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## Independent Contractor or Employee?

*The IRS Offers Voluntary Settlement Program for Misclassified Workers*

The Internal Revenue Service recently announced a voluntary federal tax settlement program for employers with misclassified workers. Employee misclassification exists when an employer improperly treats a worker as an independent contractor instead of an employee. Misclassification is costly—typically resulting in employer liability for back taxes (including income, Medicare, Social Security, and unemployment taxes), statutory penalties, and interest.

Much to the frustration of employers, there is no bright-line test for an independent contractor. Federal and state courts and agencies use a variety of different tests to determine worker classification. However, a common theme throughout the tests is that of employer control. An independent contractor works free from the direction and control of an employer – he or she dictates the means and methods of their work, while the employer retains control over the final result.

The IRS’s program, referred to as the Voluntary Classification Settlement Program (VCSP), comes at a time when government audits of worker classifications are on the rise. Under the VCSP, employers have the opportunity to voluntarily correct worker misclassifications with minimized federal employment tax consequences. An employer who enrolls and is accepted into the program is only liable for 10% of the federal employment tax liability that may have been due on compensation paid to the worker for the most recent tax year, with no liability for interest or penalties on that amount, and will not be subject to a federal employment tax audit for the misclassification of the worker in prior years. In return, the employer must agree to (1) prospectively treat the worker as an employee, and (2) extend the period of limitations on assessment of employment taxes for the following three calendar years after entering a closing agreement under the VCSP.

To be eligible for the VCSP, an employer must have consistently treated the worker as an independent contractor and filed all required Forms 1099 for the worker for the last three years. An employer cannot avail itself of the program if it is currently under audit by the IRS, Department of Labor, or a state government agency.

Employers should note that the VCSP offers forgiveness only for federal employment tax purposes and does not relieve an employer of its full liability under state and local tax law. Furthermore, changing a worker’s classification from “independent contractor” to “employee” carries consequences beyond the tax realm and triggers numerous obligations under federal and state labor and employment laws.

Given the increase in classification audits, every employer should review its workforce to ensure it has not mistakenly treated an employee as an independent contractor. If you would like information on how to minimize your risk, please contact Kate Grado or Randy Duncan at 503.242.0000.

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