

Recent Developments Regarding the Proper Classification of Workers

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AGENDA

- Proper Classification of Workers
- Potential Ramification of Improper Classification
- IRS Voluntary Classification Settlement Program (VCSP)
- IRS Classification Settlement Program (CSP)
- Questions



PROPER CLASSIFICATION OF WORKERS



Terminology

- **Employee** – Individual who performs services for a person or entity that controls what will be done and how it will be done. Employee is default classification.
- **Independent contractor** – Individual who performs services for a person or entity that does not control the means and methods of how work will be performed.
- **Worker** – Employee or Independent Contractor.
- **Firm** – Person for whom services are provided by the Worker.

Employee or Independent Contractor?



According to the IRS, whether a Worker is performing services as an Employee or as an Independent Contractor depends upon the facts and circumstances and is generally determined under the common law test of whether the service recipient has the right to direct and control the Worker as to how to perform the services.



Form SS-8



Three Factors Cited by IRS

- Behavioral Control
- Financial Control
- Relationship



Behavioral Control

- Oversight and Instruction
- Training
- Schedule
- Tools and Equipment
- Ongoing Obligations



Behavioral Control

SS-8

- What specific training and/or instruction is the Worker given by the Firm?
- How does the Worker receive work assignments?
- Who determines the methods by which the assignments are performed?
- Who is the Worker required to contact if problems or complaints arise and who is responsible for their resolution?
- What types of reports are required from the Worker?

Behavioral Control

SS-8 (Continued)

- What is the Worker's daily routine, such as his or her schedule or hours?
- At what location(s) does the Worker perform services?
- What meetings are the Worker required to attend?
- Is the Worker required to perform services personally?
- If substitutes or helpers are needed, who hires them?
- If the Worker hires substitutes or helpers, is approval required?
- Who pays the substitutes or helpers?

Financial Control

- Investment
- Expenses
- Services
- Results/Time
- Wages/Compensation



Financial Control

SS-8

- What supplies, equipment, materials, and property are provided by the Worker?
- Does the Worker lease equipment, space, or a facility?
- What expenses are incurred by the Worker in the performance of services for the Firm?
- What expenses are reimbursed to the Worker by the Firm or other parties?
- How is the Worker paid (*i.e.*, salary, hourly, commission, lump sum, etc.).

Financial Control

SS-8 (Con't)

- Is the Worker allowed a drawing account for advances?
- Does the customer pay the Worker or the Firm?
- Does the Firm carry workers' compensation insurance?
- What economic loss or financial risk, if any, can the Worker incur beyond the normal loss of salary?
- Does the Worker establish the level of payment for the services provided or the products sold?

Relationship

- Sole Client
- Source of Income
- Sustainability
- Contract
- Benefits



Relationship

SS-8

- Is the Worker provided paid vacations, sick pay, paid holidays, personal days, insurance benefits, or other similar privileges or benefits?
- Can the relationship be terminated by either party without incurring liability or penalty?
- Does the Worker provide similar services for others?
- Is the Worker prohibited from competing with the Firm?
- Is the Worker a member of a union?
- Does the Worker advertise his or her services?

Relationship

SS-8 (Con't)

- Who provides the Worker with materials and/or instructions?
- What does the Worker do with finished products?
- How does the Firm represent the Worker to its customers, and under whose business name does the Worker perform services?
- How will the relationship likely be terminated?

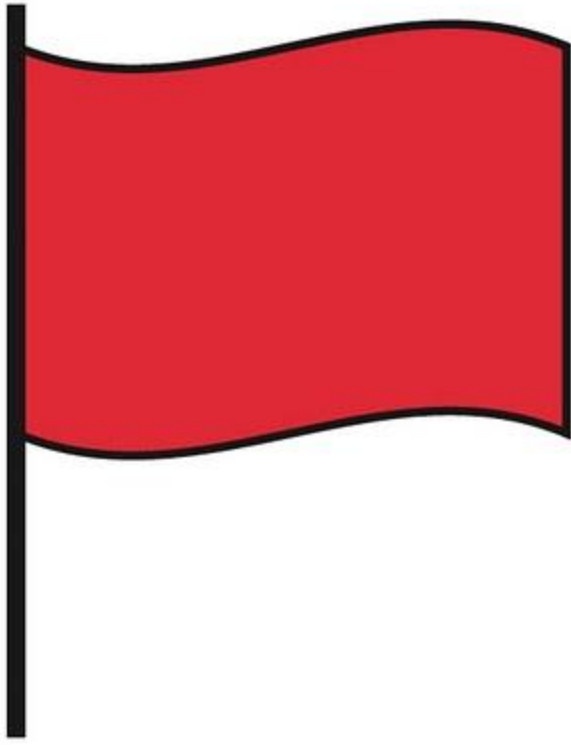
No Single Factor is Determinative



Best Practices

- Document, Document, Document
- Be Consistent
- Avoid “Red Flag Mistakes”





Red Flag Mistakes



Reclassifying Employee as Independent Contractor



Employee and Independent Contractor Doing the Same Thing



Including Independent Contractor in Benefit Plans



POTENTIAL RAMIFICATIONS OF MISCLASSIFYING WORKERS



Taxes

- Failure to withhold tax (1.5 – 3% of Worker's wages)
- Liability for FICA taxes that should have been paid by Worker
- Liability for FICA and FUTA taxes that Firm should have withheld

Federal Penalties

- 6651 – Failure to File (25% of underpayment)
- 6656 – Failure to Deposit (15% of underpayment)
- 6662 – Accuracy (20% of underpayment)
- 6663 – Civil Fraud (75% of underpayment)
- 6672 – Willful (100% of underpayment)
- 6721 – Incorrect Form (\$50)
- 7202 – Willful Violation (\$10,000 plus 5 years)

State Penalties

- Ala. Code § 40-18-40 via 40-2A-11:
 - Failure to timely pay: **Tax owed + 25% penalty.**
 - Negligent failure or intentional disregard: **tax owed + 5% penalty.**
 - Fraudulent underpayment: **tax owed + 50% penalty.**
- § 40-29-73:
 - Failure to collect and pay over: **tax owed + 100% penalty.**
- § 40-29-111:
 - Willful failure to collect or pay over tax: **\$10,000, 5 years, or both.**

Other Risks

- Interest
- Federal and State Unemployment Tax
- Potential for Unemployment Benefits
- Workers' Compensation Liability
- Fair Labor Standards Act Violations
 - Minimum Wage Requirements
 - Overtime Requirements

Legal Risks

- Tort Liability
- Back Benefits
- Jeopardize Benefit Programs
- Criminal Charges



Mitigating Factors

- Section 530 Relief
 - Establish reasonable basis for classification (judicial precedence, ruling for Firm, industry standard, or reliance on audit)
 - Consistently treat similar Workers in the same manner
 - Consistently report amounts paid to Workers

IRS VOLUNTARY CLASSIFICATION SETTLEMENT PROGRAM



Overview

- VCSP announced by IRS on September 21, 2011.
- Permits Firm to voluntarily reclassify Workers as Employees prospectively in advance of audit.
- Ensures that the IRS will not audit previous classification of Workers covered by VCSP.
- Minimizes economic impact of improper classification (10% of tax due for the preceding year with no penalties or interest).

Requirements



Consistent Treatment

- Only applies to Workers and class of Workers being prospectively reclassified, not to all Workers of the Firm.
- Firm is responsible to describe the class or classes of Workers to be reclassified.
- All Workers included in such class in the future must be consistently classified.

Filing Requirements

- Firm must have consistently filed Forms 1099 for all Workers covered under the VCSP for the previous 3 years.
- All similarly situated Workers must have been consistently reported on Form 1099 or Form W-2.

Audit/Examination

- According to IRS Announcement 2011-64 and the Internal Revenue Manual, the Firm cannot be under **audit** by the IRS, the US DOL, or any state government agency regarding the classification of Workers.
- According to IRS Form 8952, the Firm cannot be under **examination** by the IRS, the US DOL, or any state government agency.
- Firm cannot have previously been under audit/examination for the Workers in question.

Application

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IRS Form 8952



**Application for Voluntary
 Classification Settlement Program (VCSP)**

▶ Do not send payment with Form 8952. ▶ See www.irs.gov/form8952.
 ▶ See separate instructions.

Caution. Taxpayer must make certain representations in order to be eligible to participate in the VCSP. These representations can be found in Part V, below.

Part I Taxpayer Information

1 Employer Identification Number (EIN)		2 Taxpayer Name	
3 Number and street (If a P.O. box, see instructions)			Room/Suite
4 City, town, state, and ZIP code			
5 Telephone Number		6 Taxpayer's website address (optional)	
7 Fax Number (optional)		8 Email address (optional)	
9 Type of Entity. Check the applicable box <input type="checkbox"/> Sole proprietorship <input type="checkbox"/> Joint venture <input type="checkbox"/> Partnership <input type="checkbox"/> C corporation <input type="checkbox"/> S corporation <input type="checkbox"/> Cooperative organization described in section 1381 of the Internal Revenue Code <input type="checkbox"/> Tax exempt organization <input type="checkbox"/> State or local government (for worker class or position not covered under a section 218 agreement) <input type="checkbox"/> Other (specify here)			
10 Are you a member of an affiliated group filing consolidated returns for income tax purposes? <input type="checkbox"/> Yes <input type="checkbox"/> No If "Yes," complete the common parent information on lines 11-14. If "No," skip to Part II.			
11 Name of common parent of the affiliated group		12 Employer Identification Number (EIN) of common parent	
13 Number and Street (or P.O. box no. if mail is not delivered to a street address) of common parent			
14 City, town, state, and ZIP code of common parent			

Part II Contact Person

Attach a properly completed Form 2848, Power of Attorney and Declaration of Representative, if applicable.

a Name and title of contact person _____

b Contact person address: Number and street (or P.O. box no. if mail is not delivered to a street address) _____

c Contact person address: City, town, or P.O. box, state, and ZIP code _____

d Contact person telephone number _____

e Contact person fax number (optional) _____

f Contact person email address (optional) _____

Part III General Information About Workers to be Reclassified

15 Enter the number of workers from all classes to be reclassified _____	16 Description of the class or classes of workers to be reclassified. If more space is needed, attach separate sheets (see instructions). _____
17 Enter the beginning date of the tax period (year or quarter) for which you want to begin treating the class or classes of workers as employees. This date should be at least 60 days from the date you file Form 8952 (see instructions). / /	



Taxpayer's Employer Identification Number (EIN)	Taxpayer's Name
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Part IV Payment Calculation using Section 3509(a) rates (see instructions)

		Column A <small>Compensation paid to all classes of workers at or below the social security wage base (see instructions)</small>	Column B <small>Compensation paid to all classes of workers above the social security wage base (see instructions)</small>	Column C Totals
18	Compensation paid to all classes of workers to be reclassified for the most recently completed tax year			
19	Multiply line 18, Column A by the percentage (10.68% for compensation paid in 2010 or 10.28% for compensation paid in 2011) (see instructions)			
20	Multiply line 18, Column B by the percentage (3.24% for 2010 and for 2011)			
21	Total of line 19, Column A and line 20, Column B			
22	Multiply the amount on line 21, Column C by 10%. This will be your VCSP payment			

Caution. Do not send payment with Form 8952. You will submit payment later with your signed closing agreement. If you submit payment with Form 8952, it may cause processing delay.

Part V Taxpayer's Representations

(Note: Since the representations include the penalty of perjury statement, the representations under Part V must be signed by the Taxpayer, not the Taxpayer's representative.)

A Treatment of Workers

- 1** Taxpayer wants to voluntarily reclassify certain workers as employees for federal income tax withholding, Federal Insurance Contributions Act, and Federal Unemployment Tax Act taxes (collectively, federal employment taxes) for future tax periods.
- 2** Taxpayer is presently treating the workers as nonemployees.
- 3** Taxpayer has satisfied any Form 1099 requirements for each of the workers for the 3 preceding calendar years ending before the date of this application.
- 4** Taxpayer has consistently treated the workers as nonemployees.
- 5** There is no dispute between Taxpayer and the Internal Revenue Service as to whether the workers are nonemployees or employees for federal employment tax purposes.

B Examination

- 1** Taxpayer is not under examination by the Internal Revenue Service.
- 2** Taxpayer is not under examination by the Department of Labor or any state agency for the proper classification of the workers.
- 3a** Taxpayer has not been examined previously by the Internal Revenue Service or the Department of Labor concerning the classification of the workers; or,
- b** Taxpayer has been examined previously by the Internal Revenue Service or the Department of Labor concerning the classification of workers and Taxpayer has complied with the results of the prior examination.

C Extension of Period of Limitations

The Taxpayer understands that by participating in the VCSP, Taxpayer agrees to extend the period of limitations on assessment of employment taxes for 3 years for the first, second, and third calendar years beginning after the date Taxpayer elects to begin treating the workers as employees under the VCSP closing agreement. Taxpayer has the right to refuse to extend the period of limitations on assessment or to limit the extension to particular issues or to a particular period of time. However, if Taxpayer refuses to extend the period of limitations on assessment or provides only a limited extension, the IRS will not execute the VCSP closing agreement.

Sign Here	Under penalties of perjury, I declare that I have examined this submission, including any accompanying documents, and to the best of my knowledge and belief, all of the facts contained herein are true, correct, and complete.		
Your signature		Date	

Paid Preparer Use Only	Print/Type preparer's name	Preparer's signature	Date	Check <input type="checkbox"/> if self-employed	PTIN
	Firm's name ▶	Firm's EIN ▶			
	Firm's address ▶	Phone no.			



Benefits / Considerations



- **Certainty** – the IRS will not audit prior classification of Workers covered by VCSP.
- **Liability** – the total liability of the Firm from the IRS is capped at 10% of the taxes that would have been due for the immediately preceding year. No interest or penalties will be due with respect to the Workers in question.
- **Extension** – Statute of Limitations will be extended by 3 years.
- **Relief** – the applicability of Section 530 is limited.
- **Jurisdiction** – the VCSP settlement only binds the IRS.
- **Information.** According to IRM 4.23.6.19(4), the IRS will not share information with others.

IRS CLASSIFICATION SETTLEMENT PROGRAM



Overview

- Predates VCSP.
- Provides mechanism to expeditiously settle audits/examinations with the IRS regarding the proper classification of Workers.
- CSP closely follows VCSP, except with respect to audit/examination requirements and economic matters.
- In many circumstances, the IRS examiner must present a CSP offer to the Firm.

Section 530 Relief

- Application of CSP often depends on whether Section 530 Relief is available. If Section 530 relief is available, no taxes, penalties, or interest will be assessed.
- If Section 530 relief is not available, CSP may still be available if certain requirements are satisfied.

Settlement Offers

- If the Firm meets the 530 reporting requirements but does not meet the other 530 requirements, the CSP offer will be the full employment tax assessment for the taxable year in question using 3509 rates.
- If the Firm meets the 530 reporting requirements and has a “colorable” argument for the other 530 requirements, the CSP offer will be 25% of the employment tax for the taxable year in question using 3509 rates.

Conclusions



Questions?

