



September 27, 2011

TO: Clients and Friends Interested in Employment Law Issues

RE: **IRS Clemency Offer for Misclassification of Workers**

Is that worker an employee or an independent contractor?

The law is so complex and vague on this issue that many businesses and nonprofits using independent contractors operate in a perpetual state of fear. And, fear is justified: If the government determines that you misclassified someone who should be treated as an employee, you can be liable for back payroll taxes (plus penalties and interest), unpaid benefits, overtime and other costs.

The IRS announced last week a new option for businesses and nonprofits in this position. If you have consistently misclassified an employee or a class of employees as independent contractors, and have complied with 1099 requirements for at least 3 years, you may avoid retroactive taxes, penalties and interest by (i) reclassifying the workers as employees prospectively and (ii) paying 10% of the employment tax liability that would be due for the most recent tax year. (IRS Announcement 2011-64, 2011-41 IRB, 09/21/2011.)

This might prompt some companies to reconsider those “iffy” independent contractor classifications. However, as usual, there is more to the picture than meets the eye. A worker who has been improperly classified may be entitled to retroactive benefits (such as retirement, health care, vacation time and overtime), and the IRS program cannot absolve an employer of these liabilities. Also, the IRS program will not relieve an employer of misclassification liabilities arising under state laws.

We would urge our clients who may have questions about the classification of their workers to take this opportunity to consider the issue. There are some safe harbors for employers that have reasonable grounds (based on case law or regulatory precedent) for their classification decisions. We can help our clients determine whether there are reasonable grounds or not.

We would be pleased to provide more information or answer questions about this issue.

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