



Tax Briefs



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Welcome to SLGG's Tax Briefs

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Certified Public Accountants & Management Consultants

In each issue, we cover various tax issues of interest to individuals and businesses.

Bill Introduced to Limit Employment Tax Relief Available in Cases of Worker Misclassifications

On September 12, Senators Obama (D-IL), Durbin (D-IL), Kennedy (D-MA), and Murray (D-WA) introduced legislation (Senate Bill 2044, the "Independent Contractor Proper Classification Act of 2007") that would revise procedures for classification of workers as either employees or independent contractors. Subsequently, Senators Boxer (D-CA) and Clinton (D-NY) joined as co-sponsors of the bill.

The bill primarily affects Section 530 of the Revenue Act of 1978. Under that provision, employers that meet the following three requirements are generally protected from potentially large employment tax assessments even though they incorrectly categorized a worker as an independent contractor:

- Reasonable basis
- Substantive consistency
- Reporting consistency

An employer can meet the "reasonable basis" requirement if judicial precedent, IRS rulings, a past IRS audit, or industry practice supports the classification of a worker as an independent contractor. An employer meets the substantive consistency requirement if it consistently treated the workers in question as independent contractors. The reporting consistency requirement is met if the employer has not classified the workers as employees on any required federal tax returns, including information returns.

The new legislation makes the following changes to procedures currently in effect:

- Prohibits employers from receiving employment tax relief for any worker who the IRS has determined should have been classified as an employee, beginning with the period after the determination.
- No longer allows employers to use industry practice as a



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"reasonable basis" for not classifying a worker as an employee.

- Allows the IRS to issue regulations or revenue rulings on employment status. The IRS has not been allowed to do so since Section 530 went into effect (in 1978).
- Allows a worker to petition for a determination of his/her status for employment tax purposes.
- Allows the IRS in any case in which it determines a taxpayer should have classified an individual as an employee to:
 - If necessary, perform an employment tax audit of the taxpayer
 - Inform the Department of Labor (DOL) about the misclassification
 - Notify the individual of possible eligibility for a self-employment tax refund
 - Apply the provisions of IRC section 3509 (relating to the determination of the employer's liability for certain employment taxes) and instruct the taxpayer to take affirmative action to abate the violation
- Requires the DOL, with respect to laws that it enforces, to identify and track complaints and enforcement actions involving misclassification of workers as independent contractors.
- Requires the DOL to investigate industries with worker misclassifications.
- Requires the DOL and IRS to exchange information on worker misclassification cases, and to provide such information to the relevant state agencies.
- Requires employers to notify individuals classified as independent contractors at the time of hire about:
 - The federal tax obligations of an independent contractor
 - The labor and employment law protections that do not apply to independent contractors
 - The right of independent contractors to seek a status determination from the IRS
- Requires employers to keep records for at least 3 years for investigation/enforcement action.

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At this stage, it's difficult to predict this bill's prospects. However, it does

serve as a reminder that the issue of worker classification (i.e., independent contractor vs. employee status) is alive and well. To discuss further, please call!

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