



From the Desk of Dean Zerbe.



Keeping a Close Eye on Independent Contractor Status

by Dean Zerbe

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I wanted to call to your attention an issue of which you should be aware - independent contractor status. I expect that we will see an early push by the new administration for significant changes to independent contractor status, although unlikely to be included in the stimulus bill. The blueprint for that effort was already provided by then-Senator Obama when he introduced legislation in 2007: the Independent Contractor Proper Classification Act of 2007.

This bill was one of the very few pieces of tax legislation of which Senator Obama was the original sponsor, and that speaks to the weight it carries for him. I have included below a brief write-up on this legislation from alliantgroup's Ben Yaker. This legislation also enjoys strong support from many other members of Congress, e.g., Senator Durbin of Illinois (Majority Whip) and leading Ways and Means Committee members Congressmen McDermott (D-Wash) and Neal (D-MASS), who introduced similar legislation in 2007 in the House and held hearings on the issue.

While the bill is widely viewed as friendly to the unions and their efforts to organize workers, the justification for it is wrapped in the context of addressing the "tax gap" (the IRS-estimated \$300 billion-plus difference between the taxes that should be collected as opposed to taxes actually collected). According to then-Senator Obama when the legislation was introduced:

"Every day, millions of Americans go to work and play by the rules, teaching our children the values of hard work and responsibility, and most employers treat their workers fairly, paying them a decent wage and providing the benefits they deserve. But we must fix the system to stop those few employers from breaking the rules and exploiting this tax loophole at the expense of taxpayers and our workers' safety and security." - Statement by Senator Obama when legislation was introduced. I expect the new Congress to consider legislation this year that reforms the laws regarding independent contractors along

the lines of Senator Obama's bill. My crystal ball is uncertain right now whether there will be sufficient opposition to stop such changes, but I suspect that they could be buried in a much bigger bill that will be difficult for members to oppose. Regardless of the outlook for changes in the law, I anticipate that the IRS will be putting more coal in the furnace to ramp up audits of independent contractor status.

Now is the time for you and/or your clients (if you are a CPA) to make certain that the belts and suspenders are on in terms of documenting and justifying independent contractor status. alliantgroup's Tax Controversy Services (TCS) team is here to assist you with any IRS examination or audits, including employment status, and you may also want to consider a "pre-audit review" that identifies and corrects problems before the IRS comes knocking.

A Present and Future View of Independent contractor Status

Current Employee Classification Standards
Presently, §530 of the Revenue Act of 1978 allows employers to use a considerable amount of discretion in determining whether workers should be classified as employees or independent contractors. Employers are not required to pay employment taxes on workers classified as independent contractors and may also be excused from other costs, such as overtime and worker's compensation.

Generally speaking, §530 gives employers discretion to classify workers as employees or contractors, as long as they have a reasonable basis for doing so. Employers have a reasonable basis for making a classification as long as they reasonably rely on judicial precedent, prior IRS audits, or long-standing practices of the industry. In addition, the IRS is prohibited from publishing ruling or regulations on the status of an employee and will bear the burden of proving a misclassification if the employer can establish a *prima facie* case.

Where Does Obama Want To Take Us?

While in the Senate, Barack Obama co-sponsored S. 2044, the Independent Contractor Proper Classification Act of 2007, with Senator Dick Durbin. S. 2044 called for a significant overhaul of §530 and would have substantially reduced an employer's ability to classify workers as employees or contractors. In addition, S. 2044 would have increased the IRS' ability to investigate worker classifications, thereby creating the potential for significant administrative burdens.

For starters, S. 2044 removes the prohibition against the promulgation of regulations or rulings pertaining to the classification of workers. S. 2044 also eliminates a safe harbor provision for employers who rely upon long-standing, recognized classification practices within their industries. Though employers may still take such practices into account, the IRS will no longer be prevented from reclassifying workers that an industry has traditionally viewed as contractors. This provision has the potential to create significant classification disparities within a given industry. S. 2044 also allows workers to petition the IRS for a determination of their status. Employees may appeal their classification and are eligible to receive expenses and attorney's fees from the employer in the event of a reclassification. Furthermore, if an employer discriminates or retaliates against a worker for seeking a petition under S. 2044, the worker may file a complaint with the Secretary of Labor.

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