LEGAL UPDATES

PUBLISHED: SEPTEMBER 28, 2011

Missouri Joins with the Internal Revenue Service and Department of Labor to Attack Misclassification of Employees as Independent Contractors

Service

Labor & Employment

On September 20, 2011, the United States Department of Labor (DOL) and the Internal Revenue Service (IRS) signed a memorandum of understanding with Missouri and six other states (Connecticut, Maryland, Massachusetts, Minnesota, Utah and Washington) that will enable the DOL to share information and coordinate enforcement activities with the IRS and participating states. It is expected that the states of Hawaii, Illinois, Montana and New York will follow suit in the near future. The focus of this agreement is the identification of employers who have misclassified employees as independent contractors and therefore a move to recover lost tax revenues. In some cases, the DOL's Employee Benefits Security Administration, Occupational Safety and Health Administration, Office of Federal Contract Compliance Programs and Office of the Solicitor will be involved.

This memorandum of understanding is a byproduct of the DOL's Misclassification Initiative that has its genesis in Vice President Biden's Middle Class Task Force and culminates an increasing effort by the federal government and many state governments to recover income tax revenues, Social Security taxes, workers' compensation premiums, and unemployment taxes. Under these agreements, when an individual files a complaint with the DOL or one of its agencies, this information will be shared with the IRS and with the states that have signed the agreements.

This initiative will result in closer scrutiny in those industries where misclassification is frequently found: hospitality, construction, building

maintenance/janitorial services, home healthcare and food services, as well as those companies that Secretary Solis referenced in a September 19, 2011, teleconference as "using business models that obscure or eliminate the employment relationship" and listed subcontractors, independent contractors, franchises, third-party management agreements, labor contractors and staffing companies as examples.

What This Means to You

Wage and Hour litigation has grown exponentially over the last decade. Misclassification cases look to be the next growth area for plaintiffs' counsel seeking to assert class or collective actions for those individuals claiming additional compensation and benefits as well as the taxes due. We strongly recommend that employers undertake a careful examination of their utilization of independent contractors and evaluate the liability, if any, which may exist. Because the standards for determining independent contractor status vary somewhat from federal agency to federal agency and from state to state, it is important to apply all applicable standards in your evaluations.

IRS VCSP Program

Two days after the memorandum of understanding was signed, the IRS announced its program for companies to volunteer to reclassify workers as employees. The carrot for participating in the program is a significant reduction in federal tax liability to 10 percent of the payroll taxes for the prior year, had the affected workers been classified as employees. Additionally, the company would not owe any interest or penalties for the non-payment. The IRS would also agree not to audit payroll taxes for these reclassified employees for prior years.

Taxpayers seeking to take advantage of the program must meet three eligibility criteria:

Must have consistently treated the workers as nonemployees and filed all required Forms 1099 for those workers for the previous three years;

Must not currently be under audit by the IRS concerning the classification of the workers; and

Must not currently be under audit by the Department of Labor or by a state government agency concerning the classification of the workers.

A taxpayer who was previously audited by the IRS or the DOL concerning the classification of the workers will only be eligible if the taxpayer has complied with the results of that audit.

Taxpayers seeking to participate must submit IRS Form 8952 at least 60 days before they intend to begin treating the workers as non-exempt employees. For the first three years of the program, the taxpayer will be subject to a special six-year statute of limitations applicable to payroll taxes.

What This Means to You

Although there is clearly some benefit for taxpayers who have determined they have misclassified employees, this benefit applies only to federal taxes. Claims for back taxes, interest and penalties by state and local governments, or claims by workers reclassified under the program for wage and hours violations would not be precluded. Accordingly, we recommend that you, your counsel and tax advisors carefully evaluate the costs and benefits of participation.

Contact Info

Should you have questions regarding these initiatives, please contact your Husch Blackwell attorney.

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