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New Crackdown On Using Independent Contractors

Whether to hire employees or independent contractors can seem like a no-brainer. With independent contractors you don't have to withhold taxes or pay benefits and they are easier to fire. But if your "independent contractors" are reclassified the IRS can assess crippling retroactive penalties.



See [Ten Consequences of Reclassifying Independent Contractors as Employees](#).

Classically, employees go to work at set hours while independent contractors set their own. Employees follow orders, while independent contractors don't. Employees receive regular paychecks while independent contractors are paid by the job.

Employees work year-round, while independent contractors are temporary. Employers control employee actions, while independent contractors work on their own. Of course, in real life lines blur and classifications are second-guessed.

Plus, the seamless flow of information means one investigation often triggers another. See [10 Reasons to Worry About Worker Status](#)

[Disputes](#). A small worker status dispute that doesn't seem worth fighting may trigger a large one and then another like dominoes. The contractor or employee decision involves taxes, labor and employment law, benefits, worker's compensation, unemployment insurance and more. See [Ten Things GAO Has to Say About Employee Contractor Misclassification](#).

Increasingly, the IRS, Department of Labor (DOL) and state governments are swapping information. A [GAO report](#) claims the IRS is losing billions, while a [DOL study](#) says up to 30% of employers misclassify workers. But change is on the way. The DOL announced in 2010 that it would issue regulations requiring companies to write a classification analysis for all workers, including independent contractors.

These proposed regulations are expected to require companies to explain why the worker is or is not covered by the [Fair Labor Standards Act](#). Companies may have to show each worker a copy, leading many to refer to these rules as "Right to Know." There's a similar theme in the Fair Playing Field Act of 2010 ([H.R. 6128, S. 3786](#)). Despite President Obama's support it didn't pass but the bill may return.

It would require giving each independent contractor a kind of [written Miranda warning notifying](#) the independent contractor about:

1. The federal tax obligations of an independent contractor;
2. The labor and employment law protections that ***do not apply*** to independent contractors; and
3. The right each independent contractor has to ask the IRS to determine whether he or she is an employee or independent contractor.

If you use independent contractors, consider the strength of your case and how many workers you have. Tally the cost of fighting reclassification or giving in. If your case isn't strong, you may be able to revise your contract to improve it. But you are better off considering these issues before an audit or litigation.

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