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Worry Over Worker Status Isn't Crying Wolf

I've often written about [independent contractor versus employee messes](#). They're scary, and I'm not the only one who thinks so. At the [American Payroll Association's](#) 29th Annual Congress, one of its workshops was on "Employee or Independent Contractor—How to Determine a Worker's Status."

If you misclassify workers you may not face a stake through the heart, but the penalties can seem just as bad. By definition, if you treat someone as an independent contractor you don't [withhold income tax](#), don't withhold and pay employment taxes, and your filing burden with the IRS, Social Security Administration, and state government is much reduced.

The IRS penalty for **unintentionally** failing to withhold federal income tax is 1.5% of the wages paid. It doubles to 3% if the employer failed to file a [Form 1099-MISC](#). The IRS penalty for failing to withhold the employee's share of Social Security and Medicare taxes is 20%, doubling to 40% if the employer failed to file a Form 1099.

If an employer **intentionally** misclassifies a worker, the employer is liable for the full federal income tax that should have been withheld, plus 100% of all Social Security and Medicare taxes! Of course, there are potential state penalties too.

Match Point. Don't discount the importance of IRS [Forms 1099](#). Each one counts and should [match](#) to something. But if a taxpayer receives

only one Form 1099-MISC, just how independent does he look? The IRS may look closely.

I'll Show You Mine... Most (40!) [state unemployment agencies](#) share the results of their employment tax examinations with the IRS. One domino often topples another. The U.S. Department of Labor also shares data with the IRS.

Don't Forget Employee Benefits. Apart from the IRS, there's potential employee benefit liability, and it can be even bigger. In a landmark case, Microsoft had to include programmers in its 401(k) plan and employee stock purchase plan, even though these "independent contractors" had signed agreement saying they were contractors and were ineligible. See [Vizcaino v. Microsoft Corp.](#)

Silver Bullet? At least with the IRS, you might be entitled to Section 530 Relief. For details, see [Do You Qualify For Relief Under Section 530?](#)

For more, see:

[IRS Nightmare: What Employment Taxes?](#)

[IRS "Responsible Person" Label Hurts](#)

[Some Control Won't Convert Independent Contractors To Employees](#)

[Independent Contractor Versus Employee Issues: Bad, Ugly, and Uglier](#)

[1099 Or W-2?](#)

[With Taxes "Responsible" Means Holding The Bag](#)

[Personal Tax Liability When A Business Goes Under](#)

[Criminal Penalties For Misclassifying Independent Contractors?](#)

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