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IRS Holds out the Carrot and California Holds the Stick

By Gerald A. Griffin, Esq. and Gary E. Scalabrini, Esq.

The Carrot

Recently the IRS rolled out a new, voluntary worker classification settlement program. Employers will have an opportunity to reclassify their independent contractors as employees and ***escape a good share of tax liability and penalties*** that would otherwise attach to such a reclassification.

To be eligible:

- an applicant must have consistently treated the workers in the past as nonemployees;
- must have filed all required Forms 1099 for the workers for the previous three years;
- must not currently be under audit by the IRS; and
- must not currently be under audit by the Department of Labor or a state agency concerning the classification of these workers.

Employers accepted into the program will pay an amount effectively equaling just over one percent of the wages paid to the reclassified workers for the past year. No other interest or penalties will be due, and the employers will not be audited on payroll taxes related to these workers for prior years. Participating employers should note, however, that for the first three years under the program, they will be subject to a special six-year statute of limitations, rather than the usual three years that generally applies to payroll taxes.

The Stick

SB 459: California Imposes New Penalties for Employee (Independent Contractor) Misclassification.

Effective January 1, 2012, this new law imposes greater civil penalties for employers who ***willfully misclassify*** their workers as independent contractors. Penalties include civil **penalties ranging from $5,000 to $25,000 per violation,** which could be assessed by the Labor Commissioner or, presumably, under the California Private Attorney General Act ("PAGA").

Other remedies include a "Scarlet Letter provision," requiring an employer to display on its website, or other area accessible to employees and the general public a notice that explains that the employer has been found guilty of committing a serious violation of the law by willfully misclassifying employees, along with other required information. The law also prohibits charging misclassified independent contractors fees or deductions from compensation (such as rental fees for space or equipment), if those fees and deductions would not permissible to charge an employee.

Quick Tips on How to Avoid the Stick and Get the Carrot

1) Employers should consider a timely and thorough self-audit of such classifications.

2) Identify when an independent contractor morphs into an employee or if the employer at some point overreaches and exerts a new, higher level of control over the work at issue. The employee versus independent contractor determination turns on **control**—how much control does the employer exercise over how the worker accomplishes his or her task?

3) Turn to the statutes for guidance: California and federal statutes, case law and regulations provide some guidance regarding such "control" and overlap in many respects. In particular, the IRS administrative guidelines, although not dispositive, provides some fairly straightforward "employee versus independent contractor" concepts.

4) In performing a self-audit of worker classifications, it is critical to obtain assistance from labor and employment counsel, human resources experts, or both.

IRS News Release Link

Questions or Comments? Contact Us at:
Gibbs, Giden, Locher, Turner & Senet, LLP
1880 Century Park East, Suite 1200
E-mail: info@gglts.com or call (310) 552-3400

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