

Dear Client,

In late June, 2015 Congress dramatically increased the penalties for late filed, mistaken and unfiled Forms W-2 and 1099's. In most cases the penalty is now \$250 for *each* problem with maximum penalties of up to \$1.5 million! If you combine this penalty per form with payroll tax penalties exceeding 100% for misclassified employees you can clearly see that Congress is serious about addressing misclassified employees, and the IRS is stepping up its enforcement actions. We are seeing many employers incorrectly classifying employees as independent contractors, and as a result of this dramatic penalty increase we wanted to remind you of the rules, and also provide a potential solution to past problems.

The IRS uses a 3-factor system to determine if an individual is an employee or an independent contractor: behavioral control, financial control, and a relationship test. If the employer misclassifies an individual as an independent contractor when they are actually a W-2 employee, all of the previously mentioned penalties may apply for both the current and previous years.

The behavioral test focuses on whether the company controls or has the right to control what the worker does and how to do the job, such as when to come to and leave work, how to do the job, break periods and more. If so, the worker is an employee. This includes instructions about competing, performing the work, evaluation criteria and training.

The financial test looks at who controls the economics of the worker's job. Factors favoring employee status include payment on a regular timely basis (such as weekly), eligibility for reimbursement of travel costs and payment based on hours worked. Providing your own tools needed for the job is indicative of independent contractor status, as is being able to work for more than one firm.

The type-of-relationship test looks at evidence of an employer-employee situation including giving paid time off, fringe and retirement benefits, as well as hiring the worker to render services indefinitely rather than for a specific project. ***A written contract stating that the worker will be treated as an independent contractor is not the key factor!***

Because the penalties are so severe, we strongly recommend that you examine your relationship with any individual receiving a 1099. If they have been incorrectly classified you will have a major financial problem when the IRS comes calling. Fortunately there is a program that can solve the problem for the past and the future, known as the Voluntary Classification Settlement Program or VCSP.

Under this program the employer identifies those people that have been mistakenly classified as independent contractors in the past, promises to treat them as W-2 employees in the future, and pays a small 10% penalty on the employment taxes that should have been paid in the prior year. This program then provides protection and peace of mind for the employer for the future, but it needs to be submitted before the IRS letter comes. If you believe you need to complete these forms, please let us know.

Joann