



# Are You Too Cozy With Your Independent Contractors?

Insights

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January 1, 2015 is fast approaching, and with it, the first year the employer mandate applies to employers with 100 or more full-time employees (50 in 2016) – the “Play or Pay” rules. In preparation for this new law, employers should review the individuals they treat as independent contractors to be sure they can defend that classification if audited by the IRS. An employer with 90 full-time employees and 10 independent contractors may find itself subject to the employer mandate if those contractors are really common-law employees (as defined by the IRS).

Beginning in 2015, an employer must cover 70% of its full-time employees, 95% in 2016. It’s important that your employee count be accurate, or you risk paying a penalty tax. Besides ensuring compliance with the employer mandate, worker misclassification may cause additional tax liability if the company is audited by the IRS and the IRS decides that individuals should have been treated as employees and not independent contractors for all tax periods open to audit.

If you have some hesitation about whether some of your independent-contractor arrangements can withstand IRS scrutiny – or worse, you are pretty sure some of them can’t – treating these workers as employees on a going-forward basis can be accomplished with little pain and expense by using the IRS Voluntary Classification Settlement Program (VCSP).

Most employers are eligible to use VCSP to prospectively reclassify independent contractors as employees by filing an application with the IRS and, if that application is approved, paying a small percentage of the federal wage withholdings that would have applied had the contractors been included on the employer’s payroll.

Here’s an example of how it works: Fuzzy Bear, Inc. has 90 full-time employees and 10 individuals it treats as independent contractors. Each is paid \$40,000 a year which is reported to the IRS on a Form 1099 and each individual drives a company-owned truck. Each person works 40 or more hours a week and reports to and is supervised by a Fuzzy Bear manager who sets the work schedule. None of the drivers has another job (and they go to the Fuzzy Bear holiday party and get a turkey).

Fuzzy Bear is too cozy with its independent contractors. There are also five truck drivers doing the same job under the same manager who are treated as employees. Fuzzy Bear’s owner, Fuzzy Bob, has been audited by the IRS before and wants to avoid any potential tax liability associated with how he has classified these workers in the past. He wants to put them on the payroll, but is afraid that action will cause him to be audited.

By filing the appropriate application with the IRS under VCSP, and assuming the application is approved, Fuzzy Bear, Inc. can pay the IRS \$4,272 and begin treating the independent contractors as employees on an agreed upon future date. And the IRS states that an employer using this program will not be audited with respect to its prior treatment of workers as independent contractors, even if the application is declined.

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*For more information, contact Sandra Feingerts at [SFeingerts@fisherphillips.com](mailto:SFeingerts@fisherphillips.com) or 504.522.3303.*