

## IRS Tightens Scrutiny of Worker Misclassification

### NBAA Publication

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In public events this summer, Internal Revenue Service (IRS) officials have indicated the agency will step up audits of companies for improperly classifying employees as independent contractors. The IRS is also promoting its Voluntary Classification Settlement Program (VCSP), launched in 2011, for taxpayers to voluntarily change the classification of their workers.



“Participation in the VCSP is essentially an admission to the IRS that you’ve misclassified workers in exchange for paying a reduced amount in back taxes,” said Gregory Ripple, a labor and aviation attorney at Michigan-based law firm Miller Johnson. Ripple said he has heard of several businesses receiving letters from the IRS, inviting them to participate in the VCSP.

The IRS website explains that if a taxpayer agrees to prospectively treat any misclassified workers as employees, then “in exchange the taxpayer will pay 10 percent of the employment tax liability that would have been due on compensation paid to the workers for the most recent tax year.”

The IRS is promoting the VCSP to recover some of the tax revenue lost from companies misclassifying workers. Because contractor wages are not subject to tax withholding, the cost to the federal government alone is estimated by the Government Accountability Office to be approximately \$4 billion. State agencies, too, are increasing enforcement of this issue.

“The VCSP is not the only avenue governments are taking to enforce this issue,” said Margaret Vernet, founder and president of Corporate Aviators Inc., a business aviation staffing firm. “The VCSP is only offered by the IRS; participation does not eliminate the threat of an audit from another federal or state agency.”

While the IRS does not share information from the VCSP with other agencies, it has worked since 2011 with the U.S. Department of Labor (DOL) and several state agencies to reduce misclassification of workers. Today the IRS, DOL and 15 state agencies share information and coordinate enforcement.

“This issue is not going away,” said Vernet. “Misclassification results in losses to the U.S. Treasury, Social Security and Medicare funds, as well as state unemployment insurance and workers’ compensation funds.”

However, companies should be cautious before applying for the VCSP, advised Vernet and Ripple. The IRS may not accept a company’s application for a variety of reasons, leaving the problem unresolved.

“There are many risks associated with misclassifying workers. This only deals with one of them,” said Ripple. “Participating in the program could expose a company to additional liability from workers denied benefits because they were classified as contractors.”

A company that has concerns it may have misclassified workers should consult with its legal and financial advisers. There are a number of steps such companies can take, as laid out in the guide NBAA Best Practices for Utilizing Independent Contractors, including formally hiring those contractors as employees or using an “employer of record” – a staffing firm that employs pilots and flight attendants and hires them out to other companies. Review NBAA Best Practices for Utilizing Independent Contractors.

“Those options may be more expensive than using independent contractors, but the potential costs of enforcement are severe, possibly in the millions of dollars,” said Ripple. “This remains a huge issue for the IRS and state agencies. You can’t just ignore it.”

**[Learn more about VCSP.](#)**

<http://www.nbaa.org/admin/personnel/independent-contractors/20140827-internal-revenue-service-tightens-scrutiny-of-worker-misclassification.php>