



Robert W. Wood

THE TAX LAWYER

Jul. 16 2011 — 8:33 am

Careful: You Can't Renege On Settlement With IRS

Have you ever struck a deal you later wished you could undo? Most of us have, and often you can do it. With the IRS, though, it's sometimes impossible.

That's especially true if you've signed an IRS closing agreement to treat your "[independent contractors](#)" as employees. It's no secret the IRS has a real problem with workers labeled as independent contractors it thinks are really employees. The [payroll taxes](#) at stake are huge. An IRS audit can be daunting and may trigger other state or local audits too. See [Can Franchisees Be Recast as Employees?](#)

In [Tree-Tech Inc. v. Commissioner](#), the employer claimed it was coerced into signing an IRS closing agreement. The audit started with the company failing to report the sole officer's compensation as wages, but then expanded to include worker classification. Were the workers really independent contractors or employees whose pay should be subject to withholding and employment taxes?

The latter, said the IRS. In fact, at the conclusion of the audit, the IRS auditor explained two numbers: The first was the taxes due if the taxpayer agreed to settle and start treating workers as employees prospectively. The second was the much bigger number the IRS would assess if the taxpayer disagreed and pursued its administrative rights.

The taxpayer took the deal but when the IRS tried to collect went to court to undo it, arguing that this amounted to IRS coercion. Because there was an incorrect [Employer ID Number](#) listed on the settlement documents the taxpayer also argued that error voided the deal. He even argued the company was entitled to [Section 530 relief](#). See [Publication 1976, Section 530 Employment Tax Relief Requirements](#). That's a get-out-of-jail-free card for worker status controversies noted [here](#).

Was this settlement deal coerced? Nope, said the Tax Court. This settlement offer was precisely the kind of arrangement contemplated under the [IRS Classification Settlement Program](#). The very nature of a settlement offer is that one party offers the other a concession to induce that party to agree to the deal, said the court. The agreement was signed and that was that, ruled the court.

The Tax Court also rejected the argument based on the scrivener's error point. Concerning Section 530 relief—which the taxpayer should have brought up before signing the deal—the Tax Court said that it lacked jurisdiction. However, the court noted that the company might *still* be eligible for Section 530 relief if it had not completely paid the employment tax liability in the closing agreement. See [Revenue Procedure 85-18](#).

For more, see:

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

[Do You Qualify For Relief Under Section 530?](#)

[1099 or W-2?](#)

[IRS: Independent Contractor \(Self-Employed\) or Employee?](#)

[Employee v. Independent Contractor—Seven Tips For Business Owners](#)

[IRS Internal Training: Employee/Independent Contractor](#)

*Robert W. Wood practices law with [Wood LLP](#), in San Francisco. The author of more than 30 books, including *Taxation of Damage Awards & Settlement Payments* (4th Ed. 2009, [Tax Institute](#)), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*