



## Robert W. Wood

THE TAX LAWYER

Nov. 28 2012 — 10:42 pm

### Fiscal Cliff? Crackdown On Using Independent Contractors Is Perfect Storm

Independent contractors are paid without tax withholding. If a plumber fixes your toilet, a driver hauls trash from your back yard, or a handyman fixes a window in your office, you pay the flat fee or hourly rate and that's it, you're done.

In contrast, paying an employee means a host of obligations including withholding taxes on wages. The IRS gets its money instantly. It's one reason the IRS wishes virtually **everyone** was an employee. The employer acts as the agent of the IRS in deducting the income tax, Social Security and Medicare taxes and remitting them with the IRS.

Diverting earmarked money even briefly is dangerous. How do non-employees fit into this mess? Even though you may **think** your worker is an independent contractor and you have a signed contract in which he **agrees** to that status, the IRS may say otherwise. That means you failed to withhold taxes.

The business is liable, as are “responsible persons,” usually anyone with signature authority. See [IRS “Responsible Person” Label Hurts](#). Even officers of nonprofits can get stuck. See [Officers Of Nonprofits Face](#)



[Personal Liabilities For Taxes](#). The IRS takes payroll taxes very seriously and these cases are tough to win.

In determining who is responsible, courts look at a person's: duties; authority to sign checks; status as an officer, director, or shareholder; authority to hire and fire; and control over financial affairs. See [Internal Revenue Manual Trust Fund Recovery Penalty Overview and Authority](#).

The IRS has to show you were “willful,” but that’s not hard. You don’t have to actually **know** taxes weren’t being paid. You are willful if you:

1. Pay other creditors after you know the IRS hasn’t been paid; or
2. Recklessly disregard a known risk taxes aren’t being paid.

Failing to investigate after being notified taxes are not being paid is willful. If you have signature authority you are at least liable for the trust fund taxes that should have been withheld from the worker’s wages. See [Beware Personal Liability For Employee Taxes](#).

Is it a defense that you **thought** your worker was really an independent contractor not an employee? Depending on the fact, not a very good one. The IRS takes that line seriously too.

You can assert it as a defense and you can litigate the question whether the worker was an independent contractor or employee. But if you have a weak case—say you make the “independent contractor” work in your office from 9 am to 5 pm five days a week for years as your assistant. You may as well try to settle.

You can try to show that your worker paid his own taxes, including income taxes and self-employment taxes. However, that’s usually tough to do. By the time these messes come to light the worker is usually gone or the situation is so litigious that you can’t prove it.

Bottom line? Worker status disputes are scary and can involve bet-the-company stakes. Given payroll tax exposure and potential personal liability, you are best advised to get some advice about your potential exposure—and ways you might reduce it—**before** you’re embroiled in a dispute.

*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 with 2012 Supplement, [Tax Institute](#)), he can be reached at [Wood@WoodLLP.com](mailto: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.*