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Payroll Tax Hike Adds Scrutiny On “Independent Contractors”

Whether you’re in business, self-employed or a wage earner, by now you know that 2013 brought higher payroll taxes. See [Fiscal Cliff, Dairy Cliff, What About the Payroll Tax Cliff?](#) After the hype about raising taxes only on high incomes, payroll taxes went back up for all employees, even for those earning \$20,000 a year. Climbing from 4.2% to 6.2%, that extra 2% adds up. If you make \$50,000, it’s an extra \$1,000 a year.



But do higher payroll taxes mean more pressure on independent contractors? Perhaps. There’s no tax withholding on independent contractors—the contractor pays his own taxes. Although it’s unlikely that higher taxes on the worker’s share will motivate employers to treat workers as independent contractors, there is a connection.

Employers have a duty to withhold taxes from employees. That’s one reason the IRS likes employees better than independent contractors. See [IRS, DOL And States Mount Independent Contractor Attack](#). The IRS gets its tax money sooner and more reliably by withholding. Does that mean **everyone** is an employee?

Clearly not, but be reasonable. If you use independent contractors, consider the strength of your case and how many workers you have. Tally the cost of fighting reclassification or giving in. If your case isn't strong, you may be able to revise your contract to improve it.

But you are better off considering these issues before an audit or litigation. A [GAO report](#) claims the IRS is losing billions, while a [Department of Labor \(DOL\) study](#) says up to 30% of employers misclassify workers. But change is on the way. The DOL announced in 2010 that it would issue regulations requiring companies to write a classification analysis for **all** workers, including independent contractors. Plus, the IRS, DOL and state governments are swapping information.

Personal Liability. Business owners and other “[responsible persons](#)” have personal liability and excuses are rarely accepted. The IRS can assess a [Trust Fund Recovery Assessment](#), also known as a 100% penalty, against every “responsible person.” See [Section 6672\(a\)](#). You can be liable even if have no knowledge the IRS is not being paid.

But suppose you didn't even **know** you had a payroll? You **knew** (or **thought** you knew) your workers were independent contractors so you didn't have to withhold. It turns out you did have a payroll after all. Since you failed to withhold and pay the trust fund taxes to the IRS, you're on the hook personally.

In [Colosimo v. United States](#), the court refused to take sympathy on a company owner who claimed he was duped by his bookkeeper. How about if your accountant embezzles your money and then dies? Even those facts were not enough to get business owners out from under a \$2 million IRS penalty on payroll tax failures in [Oppliger v. United States](#).

Be careful out there.

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