

## **TAX LETTER**

### **Development Regarding Misclassify Employee as Independent Contractor**

Dear Clients and Friends

There are both Federal and State actions to crack down upon “misclassify employees as independent contractors”. At the Federal level, two bills with the similar name “Employee Misclassification Prevention Act” were introduced in October 2011. Currently, both the House Bill (HR 3178) and the Senate Bill were in committee. Since both Bills have a large number of co-sponsors, they are in good position to become law. Both bills will greatly strengthen the power of enforcement against “misclassification”.

In order to focus on the “misclassification” enforcement, the Federal 2011 fiscal year budget includes about \$25 Million for new “enforcement personnel”. The IRS is getting ready to audit about 6,000 randomly selected businesses in the coming years. The soon to be passed new law will stiffen the penalties for fail to properly classify employees as employees. The civil fines will be set as high as \$1,100 each violation. For repeated offenders, the fines could be as high as \$5,000 each misclassification. Further, the Federal law will provide authority to enlist State Governments in the enforcement effort and, perhaps, to amend their State unemployment compensation law respectively.

At the State level, in October 2011, California formally joined a growing number of States, such as New York, New Jersey, Pennsylvania, Illinois, Connecticut, etc., to pass legislation to crack down on employee misclassification. Among all participating States, California SB 459 which was signed into law by Governor Jerry Brown on October 9, 2011, became the toughest State law for the enforcement and punishment of “misclassification” violators.

In California, effective 2012, the first time offender of SB 459 who willfully misclassify employee as independent contractor will be subject to a civil penalty from \$5,000 to \$15,000 for each violation ( a single misclassification). For repeated offenders, the civil penalty could be as high as \$10,000 to \$25,000 for a single misclassification. In addition to the employer, the same civil penalty may be assessed against the paid advisor and/or accountant. Therefore, for the same violation, the State could double the penalty collection. Furthermore, the new law requires the discovering State Agency to notify the appropriate State Licensing Board or Office to “initiate disciplinary action” against the Licensee (the violator) within 30 days from receiving a Notice from the reporting Agency or Court, whichever appropriate.

Why our Federal and State Governments, all in a sudden, devote so much effort in the enforcement of “Employee Misclassification” ? The answer is simple. In real term, our Federal Government and a large number of State Governments are experiencing major financial/fiscal crisis. Thus, all of them are looking for ways to increase their revenue. “Employee Misclassification” is considered as an easy “target” which happened at the right place and in the right time. The revenue in terms of taxes, for the least, could be itemized as follows:

1. Federal income taxes
2. State income taxes

3. Social Security taxes (both employer & employee portions )
4. Medicare taxes (both employer & employee portions)
5. Federal unemployment taxes
6. State unemployment taxes
7. State disability insurance taxes (if any), and
8. Many more....

Finally, we would like to point out that California licensed Contractors or Professionals should think twice before classify their hired helpers as “independent contractors” and not as their “employees”. In addition to very high Federal and State civil penalties, violators of California SB 459 will be subject to “disciplinary action”. Accordingly, their licenses may be suspended or worst revoked.

For further discussion, please give us a call at 415-381-0681

Sincerely

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An Accountancy Corporation