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SECTION 530 RELIEF FROM INDEPENDENT CONTRACTOR RECLASSIFICATION

By Victor Sy, CPA

The IRS conducts worker classification audits when businesses classify workers as independent contractors. If the IRS prevails, the business may incur liabilities for taxes that should have been withheld from employees as well as employer's share of such taxes. Section 530 of the Revenue Act of 1978 **prevents the IRS from reclassifying a worker as an employee** for federal payroll tax purposes **if the following requirements are met:**

1. The business has **always treated the worker as an independent contractor (IC)**. The IRS considers a worker to be treated as an employee if the business withholds income or social security and Medicare ((FICA) taxes, whether or not remitted, or files any payroll tax return (Form 940, 941, 943, or W-2) that includes amounts attributable to the worker, whether or not tax was withheld from the worker.
2. The business did **not treat any worker performing the same job or a substantially similar job as an employee**. Here, "treatment as an employee entails the same actions noted in the preceding requirement (withholding tax or filing payroll tax returns.)
3. The business **consistently filed timely Form 1099s for payments made to the worker being classified as independent contractor**. This requirement applies only to the worker being classified (eligibility requirement), and applies on a worker-by-worker and a year-by-year basis. If the business is not required to file Form 1099-MISC this requirement is met, and if the business mistakenly but in good faith files the wrong type of Form 1099, Section 530 eligibility is not lost.
4. The business has a **"reasonable basis"** for treating the worker as an independent contractor (IC). The business may rely on a court case that parallels the treatment of its similarly situated workers. It may also rely on a prior IRS audit that resulted in no assessment. A prior compliance check can also constitute a prior safe haven if the review was detailed enough to be considered an audit. A business may also rely on a long-standing recognized practice of a significant segment of the industry. Reliance on the advice of an attorney or accountant may also constitute a reasonable basis.

Section 530 is unique in that **it rewards taxpayers who consistently misclassify workers**. Consistency in treatment and information reporting is the key. Thus, a business that wants to use the Section 530 rules to classify workers must be aware of the importance of **consistent treatment across the years and throughout the ranks of workers holding substantially similar job positions**. Treating even one worker in an **inconsistent manner** (i.e., as an employee) can eliminate Section 530 treatment for all workers within the same class, and **failing to timely file a Form 1099-MISC** for a worker can prevent Section 530 treatment for that worker for that year.

The business need not concede or agree that the workers are common law employees for Section 530 relief to be available. Therefore, a business relying on Section 530 for federal payroll tax purposes should vigorously defend the position that the workers are nonetheless ICs under the common law rules. This may dispel an IRS argument that, by relying on Section 530, the business is conceding that the workers are employees for federal income tax purposes. It may also support the business's position in worker classification audits involving other federal or state agencies.

Section 530 relief is **not available** to technical service brokers or similar agencies that contract with a technical service worker and then hire the worker out to third-party clients.