

## Independent Contractor/Employee: The Underground Economy and its Pitfalls

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Massachusetts Department of Revenue ("DOR") is concerned about the underground economy in which employees are improperly being treated as independent contractors or are paid surreptitiously in cash. The DOR is providing a limited opportunity until **April 30, 2009**, for employers to voluntarily come forward and indicate that they have misclassified their workers. In Technical Information Release 09-2 (02/09/2009), the DOR announced an initiative for voluntary disclosure by such employers as a means to bring them into compliance with their withholding obligations. This initiative is not an amnesty program per se, penalties are not automatically being waived, but the DOR may view more favorably on not assessing penalties or abating penalties if assessed for those employers who voluntarily came forward as opposed to the DOR identifying those employers who did not take advantage of this opportunity.

For Massachusetts income tax purposes, the DOR follows the federal definition

of an employee for worker classification purposes. If a worker qualifies as an employee under the federal standards, then Massachusetts withholding on wages is required by the employer. If a federal determination of worker status has already been established, then the DOR will accept such determination for its withholding tax purposes and will not make a separate, independent determination. An employer who has failed to classify its workers as employees has also failed to file wage and withholding information returns with respect to those employees. Since there is no statute of limitations for an employer who has failed to file these appropriate returns, there is always the risk that the DOR and/or the Internal Revenue Service ("IRS") will discover this failure and assess substantial civil and criminal penalties, along with tax, interest and other charges.

Employers should review their classification of workers for both federal income and Massachusetts state income tax purposes. If an employer believes that it may have misclassified workers as independent contractors under the DOR's definition, which is the same as the federal standards, then the employer should consider participating in the DOR disclosure program as well as voluntarily coming forward to the IRS and reclassify its workers as employees. An employer who voluntarily comes forward can relieve its burden of noncompliance and emerge with a clean

slate. Voluntary disclosure shows lack of willfulness, the critical element in assessing criminal penalties.

Employers should seek advice from tax and employment experts based on all the facts and circumstances of its particular situation. Some misclassified workers may be undocumented aliens and hard choices may be required, but these issues must be faced, since this may not be a problem that will go away if left uncorrected.

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