THE IRS IS RAMPING UP EMPLOYMENT TAX AUDITS – WHAT'S IN YOUR FILES?

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Beginning early in 2010 and continuing for the next three years, the IRS will conduct random employment tax audits of approximately 6,000 employers as part of its National Research Program (NRP). The NRP is intended to provide the IRS with a more accurate measure of the effectiveness of existing IRS compliance programs and procedures and a more accurate measure of the "tax gap," i.e., the difference between the amount of tax money the government believes should be collected and the amount taxpayers report they owe.

The U.S. Treasury Department estimates that approximately $14 billion of a total $290 billion tax gap is attributable to underreporting of Social Security and Medicare taxes (i.e., FICA) by employers. Failures by employers to deposit withheld income and employment taxes account for roughly 10% of the total $290 billion tax gap – approximately $23 billion in income taxes and $5 billion in employment taxes. The IRS believes that a large part of the employment tax gap stems from the misclassification of workers as independent contractors rather than as employees[1].

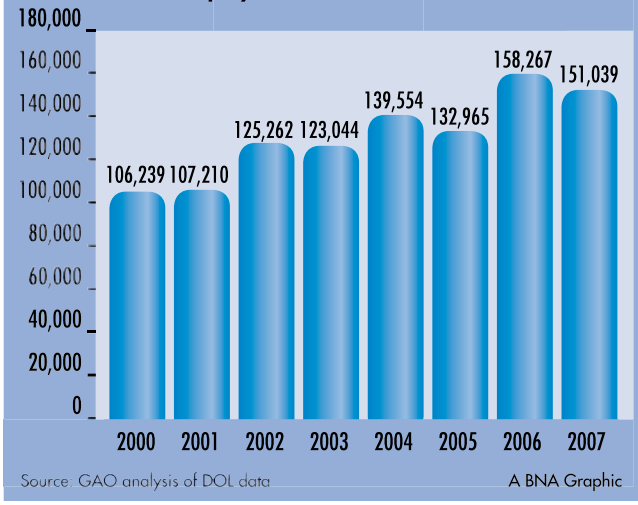
IRS NRP Employment Tax Audits.

The IRS's NRP employment tax audits will focus on four primary areas: (1) classification of workers as employees or independent contractors; (2) fringe benefits; (3) employee business expense reimbursements; and (4) compensation of owner-employees. The IRS has trained nearly 200 auditors for this effort.

Employee Versus Independent Contractor Status

Worker misclassification is a growing issue[2]. Although the true extent of employee misclassification nationally is unknown[3], a 2000 U.S. Department of Labor study estimated that even a 1% misclassification of employees nationally translated into a loss of approximately $200 million annually just in unemployment insurance revenue[4].

Figure 1: Number of Misclassified Employees Identified by State Audits of Employers, 2000–2007



Under common law, a worker is an employee when the person for whom the services are performed has the right to control and direct the individual who performs the services. This control reaches not only the result to be accomplished, but also the details and means by which that result is to be accomplished[5].

Historically, the IRS used a "20-factor test" as a guide to determine whether a worker should be classified as an employee or an independent contractor[6]. The test is based on the usual common law rules applicable in determining an employer-employee relationship. The factors, which still are used, are:

- Instructions. A worker who must comply with other persons' instructions about when, where and how he or she is to work ordinarily is an employee.
- Training. Training a worker indicates that the person(s) for whom the services are performed wants the services performed in a particular method or manner.
- Integration. Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control.
- Services Rendered Personally. If the services must be rendered personally, presumably the person(s) for whom the services are performed are interested in the methods used to accomplish the work as well as in the results.
- Hiring, supervising and paying assistants. If the person(s) for whom the services are performed hire, supervise and pay assistants, this generally shows control over the workers on the job.
- Continuing Relationship. A continuing relationship between the worker and the person(s) for whom the services are performed indicates that an employer-employee relationship exists.
- Set Hours of Work. The establishment of set work hours is a factor indicating control.
- Full-Time Work Required. If the worker must devote substantially full time to the business of the person(s) for whom the services are performed, such person(s) have control over the amount of time the worker spends working and impliedly restricts the worker from doing other gainful work.
- Doing Work on Employer's Premises. If the work is performed on the premises of the person(s) for whom the services are performed, this suggests control over the worker, especially if the work could be done elsewhere.
- Order or Sequence Set. If a worker must perform services in the order or sequence set by the person(s) for whom the services are performed, the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person(s) for whom the services are performed.
- Oral or Written Reports. A requirement that the worker submit regular or written reports to the person(s) for whom the services are performed indicates a degree of control.
- Payment by Hour, Week, Month. Payment by the hour, week or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job.
- Payment of Business and/or Travel Expenses. If the person(s) for whom the services are performed ordinarily pays the worker's business and/or traveling expenses, the worker generally is an employee.
- Providing Tools and Materials. The fact that the person(s) for whom the services are performed provides significant tools, materials and other equipment tends to show the existence of an employer-employee relationship.
- Significant Investment. A lack of investment in facilities indicates dependence on the person(s) for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship.

- Realization of Profit or Loss. A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) generally is an independent contractor, but the worker who cannot is an employee.
- Working for More Than One Firm at a Time. A worker that performs more than de minimis services for a multiple of unrelated persons or firms at the same time generally indicates that he or she is an independent contractor. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.
- Making Services Available to General Public. The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship.
- Right to Discharge. The right to discharge a worker is a factor indicating that the worker is an employee. In contrast, an independent contractor cannot be fired so long as he or she produces a result that meets the contract specifications.
- Right to Terminate. An employer-employee relationship is indicated if the worker has the right to end his or her relationship with the person(s) for whom the services are performed at any time he or she wishes without incurring liability.

The IRS came to find that the 20 common law factors listed above were not the only ones that might be important and thus now trains its auditors to look at categories of evidence that are divided into three areas: (1) behavioral control, (2) financial control and (3) the relationship of the parties. Within these evidence categories, the 20 factors are placed, with certain factors being listed as being of "lesser importance."[7]

The IRS cautions that there is no "magic number" of relevant factors, and, whatever the number of factors used, they merely point to facts to be used in evaluating the extent of the right to direct and control. For example, the fact that a delivery driver was required to wear a uniform bearing the name of the retail business demonstrated control indicating an employee relationship. Today, these requirements may be established to provide customers with some assurance that the worker can be safely allowed entry to the home or business, i.e., wearing a uniform now may have less to do with the degree of control exercised by the employer over the worker than it had in the past.[8]

If an employer has not yet been selected for an audit and is uncertain as to how a worker or group of workers will be treated for employment tax purposes, it should consider submitting IRS Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding. The IRS will officially rule on the workers' status, which will protect the employer should an audit ever occur.[9]

Table 1: SB/SE Misclassification Examination Results by Examination Source, Fiscal Year 2008

Examination Source	SS-8	ETEP	General Exams	QETP	All Programs
Number of closed examinations	38	221	690	232	1181
Percentage of all closed examinations by referral source	3	19	58	20	100
Number of closed examinations with assessments	30	127	522	165	844
Percentage of all closed examinations with assessments	79	57	76	71	71
Total assessments (dollars in millions)	$1.1	$11.8	$40.9	$9.8	$63.5
Average assessment per examination	$28,191	$53,378	$59,225	$42,314	$53,810

Source: GAO analysis of IRS data

A BNA Graphic

Fringe Benefits

The IRS also is likely to focus on fringe benefits in connection with its audit of the employer's classification of workers as employees or independent contractors. Fringe benefits are benefits provided by an employer to an employee other than salary or wages for work performed by the employee. Fringe benefits cannot be/should not be provided to independent contractors.

Fringe benefits can take many forms, including:

- Cash payments (e.g., a parking subsidy).
- Providing privileges, goods, services or facilities to the employee at a discount or for free.
- Allowing an employee to use property owned by the employer.

Generally, any fringe benefit provided to an employee is taxable and must be included in the employee's pay, unless the tax law specifically allows for the benefit to be excluded.[10]

Although it is clear that fringe benefits are taxable, employers may not treat them as wages for income and employment tax purposes. Employers may instead classify a taxable fringe benefit under expense accounts other than compensation.

To identify fringe benefits, the IRS is likely to examine the following documents and records: the employee benefits handbook; union agreements; employment contracts (particularly those for executives); annual financial reports; SEC reports such as Form 10-K and proxy statements; the employer's web-site; corporate minutes; the chart of accounts; written policies and procedures regarding fringe benefits; the accounts-payable journal; work papers that support IRS Schedule M-1 or M-3 (which are filed as part of an income tax return); general ledger accounts that include employee benefits; and payroll journals.[11]

Employee Business Expense Reimbursements

The IRS is most likely to examine whether an employer maintains a written expense-reimbursement policy that meets the requirements of the Internal Revenue Code (the Tax Code). The IRS has been concerned in recent years with a variety of arrangements that it believes are abusive. In 2008, for example, the IRS found that amounts paid to employees under specialized tool and equipment plans marketed to employers in the aviation, agriculture and construction industries did not meet the requirements for accountable plans and thus were includible in employees' incomes and subject to employment taxes.[12]

For expense reimbursements to be excludable from an employee's income, the Tax Code requires that the employer maintain an accountable expense-reimbursement plan. To be an "accountable" plan, the employer's reimbursement or allowance arrangement must be a written plan that incorporates all of the following rules:

- The expenses must have a business connection, i.e., the employee must have paid or incurred deductible expenses while performing services as an employee for the employer.
- The employee must adequately account to the employer for these expenses within a reasonable period of time.
- The employee must return any excess reimbursement or allowance within a reasonable period of time.

A plan that does not meet the above requirements is considered to be a "nonaccountable plan," which means that the money paid to the employee is taxable compensation that must be included on the employee's W-2, and the employer must withhold and deposit income and employment taxes.[13]

Compensation of Owner-Employees and Executives

The IRS has identified the reasonableness of compensation paid to an officer or owner (especially when such person also receives dividends) as another area of scrutiny under the NRP audit. This issue is more likely to affect closely held and one-person corporations. The IRS's concern generally involves whether too little compensation has been paid in comparison to dividends received by the owner-employee as the former is subject to employment taxes and withholding while the latter generally is not.[14]

The IRS is very likely to examine potential issues regarding fringe benefits commonly provided to executives such as athletic skyboxes/cultural entertainment suites; awards and bonuses; club memberships; corporate credit cards; executive dining rooms; no-cost and low-cost loans; outplacement services; qualified employee discounts; security-related transportation; spousal and dependent life insurance; company cars and chauffeurs; transfers of property; use of listed property such as cell phones; relocation expenses; use of employer aircraft; employer-paid vacations and spousal and dependent travel; and wealth-management and qualified retirement-planning services.[15]

Potential issues may include (1) whether the expense is deductible by the corporation; (2) whether the amount is excludible from the executive's gross income; (3) whether the executive is receiving personal benefit from the employer and (4) whether the benefit exceeds the Tax Code §162(m) limitation on deductible compensation.[16]

The IRS also is likely to focus on Tax Code §409A nonqualified deferred compensation plans. Tax Code §409A, provides that, unless certain requirements are met, amounts deferred under a nonqualified deferred compensation plan for all taxable years are currently includable in income to the extent not subject to a substantial risk of forfeiture and not previously included in income. Running afoul of the complex rules under Tax Code §409A may result in the recipient being subject to immediate taxation, a 20% additional tax, and an interest payment at one percentage point above the Tax Code's tax-underpayment rate.

Preparing for an NRP Audit/Best Practices

Benson Goldstein, a senior technical manager of taxation for the American Institute of Certified Public Accountants (AICPA), responding to a BNA interview question regarding what businesses could do to prepare for an NRP audit, observed that the "short answer" was that businesses "could not really prepare" and that, although only a small percentage of businesses would be audited, "they will probably be very intensive, very painful audits."[17]

Joseph Bender, a partner in the Business Transactions department of Chicago law firm Wildman, Harrold, Allen & Dixon LLP, added that his "gut reaction" was that the audits would target employers with 100 or more employees and gross revenues over $20 million on the theory that "the IRS is going to want a certain amount of bang for its buck."[18]

Don't Wait for an Audit That May Not Happen

Although an employer cannot avoid being audited, legal, accounting and payroll professionals universally agree that there are many steps an employer can take now to better protect itself if it's selected under the NRP.

GJ Stillson MacDonnell, chair of law firm Littler Mendlson's Employment Tax Practice Group, recommends that employers who are selected take the following steps:

- Initiate an internal review of current employment tax compliance (including a review of how employees are classified), fringe benefit policies, and owner compensation practices.
- Identify an internal point person to manage the audit preparation process and review company procedures to ensure that all tax-related notices and correspondence are properly routed, and that such person provides information to in-house and outside counsel, accountants, payroll and human resources personnel.
- Consider engaging experienced employment tax and IRS audit experts before meeting with the IRS.[19]

Fix Problems Now to Save Time and Money

An employer also should consider reviewing all its employee-related plans and arrangements to identify discrepancies or problems. Making corrections before an audit may result in smaller penalties and other costs. The IRS's Employee Plans Compliance Resolution System (EPCRS) allows employers to correct plan defects while preserving the tax benefits of the plan. The Self-Correction Program (SCP) is available for correction of operational failures only, and the employer may not need to contact the IRS or pay any penalty. And although the Voluntary Correction Program (VCP) requires the employer to submit the proposed correction to the IRS for approval, potential fees are set forth within the program and are significantly less than any penalty that might be imposed if the defect is discovered during the audit.[20]

To the extent that an employer discovers certain errors before an NRP audit occurs, a tool available to mitigate the impact of undercollection or underpayment of employment taxes may be to use Tax Code §6205, which allows for interest-free adjustments when certain conditions are met.[21] This provision does not apply to FUTA or penalties.

An employer can minimize the cost and complexities relating to employment, payroll, human resources, and retirement and benefits programs by using a Professional Employer Organization (PEO). A PEO provides integrated services that allow an employer to cost-effectively outsource the management of human resources, employee benefits, payroll and compensation through a co-employment model. ADP's PEO – ADP TotalSource – provides a comprehensive outsourcing solution. For more information, contact your ADP TotalSource representative and visit www.adptotalsource.com.

After the Audit – Potential Penalties and Problems Facing Employers

The potential cost to an employer that has workers reclassified as employees rather than independent contractors should not be taken lightly. Delivery giant FedEx came uncomfortably close in recent months to having to pay nearly $300 million in connection with an IRS employment tax audit of drivers' worker status for tax years 2002 to 2006, suggesting that the IRS will be aggressive in its NRP audits.[22]

In addition to potential liability for unpaid FICA, FUTA and income tax-withholding, employers also face liability for unpaid state unemployment taxes and worker's compensation insurance. Employers also face penalties for failing to file employment tax returns (e.g., IRS Forms 941, 944, 945), W-2s and other information returns (e.g., Forms 1099); failure to deposit penalties; and interest on the underpaid taxes.[23]

Equally serious, an employer's qualified retirement-related plans and arrangements could face disqualification or prove very costly to correct.

Misclassification of employees can have long-term financial costs to an employer as reclassified workers, now may have to be provided with coverage under the employer's health and pension plans, which also may require additional plan contributions.

Employees may face unexpected income tax consequences if, for example, fringe-benefits are found to be taxable compensation, or expense reimbursements are found to have been made pursuant to a nonaccountable plan. Problems with executive compensation also may result in significant adverse income-tax consequences to the employee.

Resolving Audit Issues and Employer Defenses

The mere fact that the IRS may determine during the audit that workers were misclassified does not automatically translate into maximum financial exposure for the employer, as there are several mitigation provisions that may help.

1978 Revenue Act §530 Relief

Section 530 of the Revenue Act of 1978 (§530), a non-tax provision, grants employers relief from federal employment tax obligations if certain requirements are met. Importantly, it terminates the employer's (but not the worker's) employment tax liability and any interest or penalties attributable to the liability.[24]

Section 530 is a relief provision that must be considered by the IRS as the first step in any case involving worker classification. Relief is available to taxpayers or employers that are under examination or involved in administrative (including IRS Appeals) or judicial proceedings with respect to assessments based on employment status reclassification.[25]

For §530 to apply, an employer must meet two consistency requirements:

- All Forms 1099-MISC that must be filed by the employer with respect to the workers for that period, are filed in a timely manner and on a basis consistent with the employer's treatment of the workers as independent contractors.
- The treatment of the workers as independent contractors is consistent with the employer's (or predecessor's) treatment of all workers holding substantially similar positions for any period beginning after December 31, 1977.[26]

In addition to the consistency requirements, the employer must have had some reasonable basis (including the safe havens of a prior audit, a judicial precedent or an industry practice) for its treatment. If the employer cooperates with the audit and initially establishes that it was reasonable not to treat an individual as an employee, the IRS then must prove that the employer's treatment of the worker was incorrect.

IRS Classification Settlement Program

The IRS's Classification Settlement Program (CSP) allows employers to resolve worker-classification cases as early in the IRS's administrative process as possible. CSP agreements help the IRS and employers save time and resources as opposed to going to the IRS Office of Appeals following the audit, or to court. CSP procedures also ensure that the relief provisions under Revenue Act §530 discussed above are properly applied. The CSP may apply only when a business is not eligible for Revenue Act §530 relief.

Under the CSP, IRS auditors can offer an employer a settlement that generally results in a lower tax assessment so long as the business agrees to prospectively treat all the subject workers as employees for employment tax purposes.[27]

Reduced Liability for Employment Taxes under Tax Code §3509

Tax Code §3509 provides for a reduction in an employer's employment tax liability if the employee misclassification was unintentional. Tax Code §3509 applies where Revenue Act §530 relief is not available and gives reduced rates for income tax withholding and the employee's share of FICA where an employer failed to withhold employment taxes by reason of treating such employee(s) as a non-employee. A "non-employee" includes, but is not limited to, independent contractors. The procedure does not relieve the employer of the employer's share of FICA and FUTA taxes. Application of IRC Tax Code §3509 is mandatory if the criteria are satisfied, i.e., neither the IRS nor the employer has a choice regarding its application.[28]

Under Tax Code §3509, an employer must pay income-tax withholding equal to 1.5% of the wages paid to the reclassified employee and 20% of the FICA taxes that should have been withheld from the employee's wages (in addition to the full amount of the employer's share).[29] To obtain relief, the employer must meet certain information return requirements with respect to the reclassified employees.[30]

Tax Court Review of Employment Tax Determinations

The Tax Court has jurisdiction under Tax Code §7436 to hear certain cases involving the question of whether a worker is an employee or independent contractor. When the IRS has issued a Notice of Determination of Worker Classification as part of the audit – determining that one or more individuals performing services are employees or that the taxpayer is not entitled to §530 relief – the employer can petition the Tax Court for an independent review and to determine the proper amount of employment tax.

Conclusion

The random nature of the NRP selection process means that a large majority of employers will not be selected for audit. However, the fact that classification of workers and executive compensation are issues receiving increased scrutiny by the IRS and Congress means that employers would be well served to undertake a comprehensive and thorough review of worker classification policies, executive compensation packages and fringe benefit practices, and all employee-related retirement plans and practices as soon as possible.

Footnotes

[1]According to a 2007 Government Accountability Office (GAO) report, it was estimated in 2005 that there were 10.3 million independent contractors, and the number likely is higher currently as employers seek to save on labor costs. See U.S. Dept. of the Treasury, Office of Tax Policy Report, "A Comprehensive Strategy for Reducing the Tax Gap," September 26, 2006, and "Update on Reducing the Federal Tax Gap and Improving Voluntary Compliance," July 8, 2009, reprinted in 129 BNA Daily Tax Rpt. G-8, July 9, 2009.

[2]Generally, if an employer-employee relationship exists, the employer is liable for Federal Insurance Contribution Act (FICA) tax, Federal Unemployment Tax Act (FUTA) tax, and income tax withholding under Internal Revenue Code (Tax Code) §§3101, 3102, 3301, and 3403, respectively. Certain workers are subject to FICA taxes even though they are independent contractors under the common law test, i.e., "statutory employees." See Internal Revenue Manual (IRM) Exhibit 4.23.5–2, "Employment Tax Treatment for Various Categories of Workers." The IRM is the single official source for IRS policies, directives, guidelines, procedures and delegations of authority, and contains the procedures and guidelines that tell IRS employees how to serve taxpayers in administering the tax laws.

[3]GAO report, "Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention," GAO 09-717 (August 2009) at p. 10. The last comprehensive estimate of misclassification was for tax year 1984. Id.

[4]Id. at p. 11-2, referencing Planmatics, Inc., "Independent Contractors: Prevalence and Implications for Unemployment Insurance Program (Rockville, Md; U.S. Dept. of Labor, February 2000).

[5]Tax Code Regs. §31.3121(d)-1(c); IRM 4.23.5.6 (2-1-03). Although control must be present, it does not need to be exercised. Id.

[6]See Rev. Rul. 87-41, 1987-1 C.B. 296. The twenty factors were developed based on cases and rulings considering whether an individual was an employee. See also Regs. §§31.3121(d)-1(c); 31.3306(j)-1(c); and 31.3401(c)-1; IRM 4.23.5.3 (2-1-03).

[7]IRM 4.23.5.6.1 (11-3-09).

[8]Id.

[9]It can take at least six months for the IRS to issue a determination. However, a business that continually hires the same types of workers to perform particular services may want to consider filing the form.

[10]Table 2-1 of IRS Pub. 15-B, Employer's Tax Guide to Fringe Benefits, provides a chart of the exclusion rules for the most common types of fringe benefits provided to employees.

[11]See IRM 4.23.5.11.5 (11-3-09). The IRS also will look at expense categories that are less obvious but may include fringe benefits such as miscellaneous expenses, meetings, automobile expense, insurance, and travel expense reimbursements. Id.

[12]See "Tool Plans Subject to Employment Taxes, IRS Says", 19 BNA Payroll Administration Guide Newsletter 106 (July 9, 2008). See also the IRS Coordinated Issue Paper, "Employee Tool & Equipment Plans," LMSB-04-0608-037 (7/2/08), available on the IRS's website at http://www.irs.gov/businesses/article/0,,id=97388,00.html.

[13]See Tax Code §62(c) and Regs. §1.62-2. Amounts included in income may be deductible by the employee as a miscellaneous itemized deduction subject to the 2% of Adjusted Gross Income (AGI) floor.

[14]For guidelines used by the IRS when examining officer's salaries, see IRM 4.35.2.5.2.2 (5-5-06).

[15]See IRS Executive Compensation-Fringe Benefits Audit Techniques Guide (02-05), available on the IRS's website at http://www.irs.gov/businesses/corporations/article/0,,id=134943,00.html.

[16]Id.

[17]See "Employment Tax Research Program Expected to Spur Autumn Audits by IRS," 169 BNA Daily Rpt. for Executives G-1, Sept. 3, 2009.

[18]Id.

[19]See Littler Mendelson ASAP article by GJ Stillson MacDonnell, "IRS Delays Launching Employment Taxes Audit until February 2010. IRS Plans to Target 6,000 Employers Over 3-Year Period – Is Your Company Ready?" (December 2009).

[20]See Rev. Proc. 2008-50, 2008-35 I.R.B. 464, which outlines the EPCRS program.

[21]See also IRM 4.23.8.3 (8-11-09). IRC §6413 provides that an employer who has paid more than the correct amount of employment taxes (FICA, RRTA, or income tax withholding) may make interest-free adjustments of the amount overpaid when certain conditions are met. This provision does not apply to FUTA. IRC §6402 allows the IRS to refund any overpayments, and IRC §6414 allows the IRS to refund an overpayment of income tax withholding to the extent such tax was not deducted and withheld by the employer.

[22]See, "IRS Relieves Delivery Company Of Further Taxes, Penalties," 20 BNA Payroll Admin. Guide Newsletter 189, November 24, 2009.

[23]Misclassifying employees also may lead an employer to run afoul of laws that restrict employers' hiring, retention, and other labor practices such as the Fair Labor Standards Act, the Americans with Disabilities Act of 1990, the Age Discrimination in Employment Act of 1967, the Family and Medical Leave Act of 1993, and the National Labor Relations Act.

[24]See IRM 4.23.5.2 (11-3-09); Rev. Proc. 85-18, 1985–1 C.B. 518.

[25]IRM 4.23.5.2.1 (11-03-09). It is not necessary for the taxpayer to claim Revenue Act §530 relief for the provision to apply. To correctly determine tax liability, the auditor must first explore the applicability of Revenue Act §530 even if the taxpayer does not raise the issue. Id.

[26]IRM 4.23.5.2.2 (11-3-09).

[27]See IRM 4.23.6 (10-30-09). The CSP is not available for issues other than worker classification. In addition, the program is only available to business that timely file Forms 1099. Thus, if the taxpayer did not timely file required Form 1099s, the CSP is not available even if other forms were timely filed. The methodology for determining a CSP offer is set forth in IRM 4.23.6.13 (10-30-09).

[28]See Tax Code §3509(c) and (d) for exclusion criteria. If IRC §3509 applies, the offset provisions of Tax Code §3402(d) and Tax Code §6521 do not apply. See also IRM 4.23.8.5.1 (8-11-09).

[29]Under Tax Code §3509, an employee's liability for income or Social Security tax is not affected by the employer's payment of taxes, and the employer is not entitled to recover from the employee any tax determined under this provision or to credit any tax paid by the employee.

[30]Unless an employer has "reasonable cause", if Form 1099s for independent contractors have not been filed, the special 1.5% withholding rate increases to 3% and the special 20% FICA rate increases to 40%.

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