

Guidelines for the Classification of Workers (Updated July 31, 2023)

During the 2020 Session, the Virginia General Assembly enacted House Bill 1407 (2020 *Acts of Assembly*, Chapter 681) and Senate Bill 744 (2020 *Acts of Assembly*, Chapter 682), which sets forth the Virginia standard for classifying workers performing services for remuneration as employees or independent contractors. In addition, this legislation imposes civil penalties and debarment on certain employers that fail to properly classify an individual as an employee. 2023 House Bill 1684 (2023 *Acts of Assembly*, Chapter 518) and Senate Bill 1354 (2023 *Acts of Assembly*, Chapter 519) clarify the procedures under which an employer may be debarred from public contracts for misclassification of workers.

These guidelines are published by the Department of Taxation (“the Department”) to provide guidance to taxpayers regarding the classification of workers, as required by the second enactment clause of 2020 House Bill 1407 and 2020 Senate Bill 744. These guidelines are not rules or regulations subject to the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 et seq.) and are being published in accordance with the requirement that the Tax Commissioner publish these guidelines pursuant to the second enactment clause of 2020 House Bill 1407 and 2020 Senate Bill 744, as well as the Tax Commissioner’s general authority to supervise the administration of the tax laws of the Commonwealth pursuant to *Va. Code* § 58.1-202. As necessary, additional information regarding these procedures will be published and posted on the Department’s website, www.tax.virginia.gov.

These guidelines represent the Department’s interpretation of the relevant laws. They do not constitute formal rulemaking and hence do not have the force and effect of law or regulation. In the event that the final determination of any court holds that any provision of these guidelines is contrary to law, taxpayers who follow these guidelines will be treated as relying on erroneous written advice for purposes of waiving penalty and interest under *Va. Code* §§ 58.1-105, 58.1-1835, and 58.1-1845.

Generally, these guidelines are effective for determinations of worker misclassification made on or after July 1, 2023. For determinations of worker misclassification prior to July 1, 2023, taxpayers should follow the Worker Misclassification Guidelines that were issued by the Department on September 30, 2021 (Public Document 21-133). However, the portion of these guidelines relating to debarment clarify existing law and, therefore, are effective as if included in Public Document 21-133.

Classification of Workers

If an individual performs services for another person or entity for remuneration, such individual is considered an employee of the party that pays such remuneration. To overcome this presumption, the individual worker or the party that pays such remuneration is required to demonstrate that such individual is an independent contractor.

Guidelines for the Classification of Workers (Updated July 31, 2023)

The applicable standard for making such a determination is Internal Revenue Service (“IRS”) guidance that is designed to help ascertain whether an individual is an employee or an independent contractor. To make a determination pursuant to such guidance, the relationship of the worker and the business must be examined. In any employee-independent contractor determination, all information that provides evidence of the degree of control the business has over the worker and the degree of independence the worker has in performing the work must be considered. Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control, and the type of relationship of the parties. For more information regarding this IRS guidance and how to apply it, see IRS Publication 15-A and IRS Topic No. 762 Independent Contractor vs. Employee. Before making any determination of worker misclassification, the Department will request information from the employer relating to its relationship to its workers, and allow reasonable time for the employer to provide such information. Such information could include business records as well as speaking to the employer or its workers about its business practices. The Department will consider all such information carefully in making any determination and will prepare an audit report that considers the application of the standard to the employer’s unique facts and circumstances. However, if requests are not responded to fully in a reasonable amount of time, the Department may make a determination without such information.

Civil Penalties for Misclassifying Employees

Any employer, or any officer or agent of the employer, that fails to properly classify an individual as an employee and fails to pay taxes required to be paid with respect to an employee will be subject to monetary penalties. Such penalties are as follows:

- Up to \$1,000 per misclassified individual for instances of misclassification that the Department finds during its first audit of an employer;
- Up to \$2,500 per misclassified individual for instances of misclassification that the Department finds during its second audit of an employer; and
- Up to \$5,000 per misclassified individual for instances of misclassification that the Department finds during its third audit of an employer and on any subsequent audits of such employer.

During each audit that finds instances of misclassification, the amount of the penalty will be determined by the employer’s total number of workers and the number of workers that were found to be misclassified. The following table provides the penalty amounts:

Guidelines for the Classification of Workers (Updated July 31, 2023)

Misclassified Offense	Penalty per Misclassified Worker for Employers with 1-50 Employees	Penalty per Misclassified Worker for Employers with 51-100 Employees	Penalty per Misclassified Worker for Employers with 101-499 Employees	Penalty per Misclassified Worker for Employers with Over 500 Employees
First Audit	\$250	\$500	\$750	\$1,000
Second Audit	\$1,750	\$2,000	\$2,250	\$2,500
Third and Subsequent Audits	\$4,250	\$4,500	\$4,750	\$5,000

However, in cases where the Department determines that an employer has misclassified an employee for tax avoidance purposes and not in good faith in the normal course of business, the Department may assess the full penalty amounts of \$1,000 for the first offense, \$2,500 for the second offense, and \$5,000 for the third and subsequent offenses.

Example:

The taxpayer treated 45 workers as employees who were issued Forms W-2 and 11 workers as independent contractors who were issued Forms 1099. Five workers who were issued Forms 1099 were found to be employees. An additional worker who did not receive a Form 1099 or Form W-2 was identified when reviewing the Casual Labor general ledger account, and that worker was determined to have been an employee. For purposes of calculating the penalty, the total number of employees would be 51, six of whom were misclassified:

W-2 Employees	45
Misclassified 1099 Workers	5
<u>Unreported Misclassified Worker</u>	<u>1</u>
Total Workers	51

The Department did not determine that the misclassifications above were done for tax avoidance purposes. As a result, if the misclassified workers were discovered on the first audit, the penalty amount would be:

$$\$500 \times 6 \text{ misclassified workers} = \$3,000$$

If the misclassified workers were discovered during the second audit, the penalty amount would be:

$$\$2,000 \times 6 \text{ misclassified workers} = \$12,000$$

Guidelines for the Classification of Workers (Updated July 31, 2023)

If the misclassified workers were discovered during the third or subsequent audits, the penalty amount would be:

$$\$4,500 \times 6 \text{ misclassified workers} = \$27,000$$

If, during any of the audits, the employer is found to have misclassified workers as employees for the purpose of tax avoidance, the penalty amount would be the full penalty amount allowed under Virginia law.

Debarment for Misclassifying Employees

If the Department determines during its first audit of an employer that such employer failed to properly classify an individual as an employee and fails to pay taxes required to be paid with respect to an employee, the Department is required to notify the employer of the determination. Such employer is entitled to administrative and judicial appeal of any such determination pursuant to *Va. Code* §§ 58.1-1821 and 58.1-1825.

If the Department finds instances of misclassification on subsequent audits and after all rights of administrative and judicial appeals have been exhausted or the time period for bringing such appeals has expired, the Department must provide notice to all public bodies and covered institutions of the name of such employer. All public bodies and covered institutions are then prohibited from awarding a contract to such employer and to any firm, corporation, or partnership in which the employer has an interest in the following manner:

- For a period of 1 year from the date of the notice for offenses found during a second audit; or
- For a period of 3 years from the date of the notice for offenses found during a third audit or any subsequent audits.

For purposes of applying such debarment provisions, “covered institution” means a public institution of higher education operating:

- Subject to a management agreement set forth in Article 4 (*Va. Code* § 23.1-1004 et seq.) of Chapter 10 of Title 23.1;
- Under a memorandum of understanding pursuant to *Va. Code* § 23.1-1004; or
- Under the pilot program authorized in the Appropriation Act.

Prohibited Actions by Employers

No employer is permitted to require or request that an individual enter into an agreement or sign documentation that results in misclassification of the individual as an independent contractor or otherwise does not accurately reflect the individual’s relationship with the employer. In addition, it is unlawful for an employer or any other party to discriminate in

Guidelines for the Classification of Workers (Updated July 31, 2023)

any manner or take adverse action against any person in retaliation for exercising rights with respect to their classification as an employee or independent contractor.

Exchange of Information with Other State Agencies

Unless an exception applies, Virginia's law provides that the Tax Commissioner, commissioner of the revenue, treasurer, and their staff may not divulge any information acquired in the performance of their duties with respect to the transactions, property, including personal property, income or business of any person, firm or corporation. It is also unlawful for any person to disseminate any confidential tax document which he knows or has reason to know is a confidential tax document. Any person who violates these provisions is guilty of a Class 1 misdemeanor. See *Va. Code* § 58.1-3.

2020 House Bill 1407 and 2020 Senate Bill 744 include an exception to this general disclosure prohibition that allows the Department to work with certain state agencies to identify employers who fail to properly classify individuals as employees and to enforce the laws regarding the classification of workers. Such agencies include the Department of Labor and Industry, the Virginia Employment Commission, the Department of Small Business and Supplier Diversity, the Department of General Services, the Workers' Compensation Commission, and the Department of Professional and Occupational Regulation. See *Va. Code* § 58.1-3.4.

In addition, if any such agency has reason to believe that an employer has failed to properly classify individuals as employees, it is required to notify the Department. Except as otherwise provided by law, such agencies are required to share any information with the Department that may assist in enforcing the provisions of the law regarding the classification of workers.

Reporting Requirement

The Department is required to report annually to the Governor and the General Assembly information regarding compliance with and enforcement of these worker classification requirements. The Department's report is required to include information regarding the following:

- Number of investigated reports of worker misclassification;
- Findings of such reports;
- Amount of combined tax, interest, and fines collected;
- Number of referrals to the Department of Labor and Industry, Virginia Employment Commission, Department of Small Business and Supplier Diversity, Virginia Workers' Compensation Commission, and Department of Professional and Occupational Regulation; and
- Number of notifications of failure to properly classify to all public bodies and institutions.

Guidelines for the Classification of Workers (Updated July 31, 2023)

The annual report is due on or before December 30.

Additional Information

These guidelines are available online on the Virginia Regulatory Town Hall website, located at <https://townhall.virginia.gov>, and on the Guidance Documents section of the Department's website, located at <http://tax.virginia.gov/guidance-documents>. For additional information, please see the Department's website at <https://tax.virginia.gov/worker-misclassification> or contact the Department at misclassificationofworkers@tax.virginia.gov.

Approved:

A handwritten signature in black ink, appearing to read "Craig M. Burns". The signature is fluid and cursive, with a long horizontal stroke at the end.

Craig M. Burns
Tax Commissioner