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Welcome to Edition 8 of The Newsletter from Scott H. Novak, Attorney at Law. The Newsletter is designed to bring timely and interesting topics to accountants and attorneys. Comments and suggestions are always welcome. Feel free to call or write at any time.

Chalk One Up for the Swiss Banker

Over the last several years, the IRS has been diligently going after taxpayers with hidden foreign accounts and the people that helped facilitate the hiding of money and assets overseas from the IRS. They have forced countries and financial institutions to sign agreements, forced banks to pay steep fines (and in at least one instance, close) and have sent people to jail. How has the IRS managed to get the information needed to go as far as having successful prosecutions? Every time a taxpayer enters the Offshore Voluntary Disclosure Program (OVDP), with its high penalties, they are required to disclose every person that they worked with in connection with the foreign account. This has proven to be a treasure trove of information for the IRS.

In a recent case in Manhattan federal court, Stefan Buck, who was once head of the private banking desk at Bank Frey & Co. in Zurich, was acquitted after a 3-week trial that included testimony from former clients describing how Buck helped them hide assets in Switzerland when other banks would not. He had been charged with one count of conspiracy. It should be noted that the Swiss do not have an extradition treaty with the U.S., so many of the Swiss bankers under indictment avoid prosecution simply by staying out of the United States. But Buck wanted to come here to face the charges and hopefully clear his name.

This case had all of the trappings of a great international mystery novel - bank accounts in names of fictitious entities located in Panama and Lichtenstein, money being converted from cash to jewels to move out of the country undetected and various individuals counseling taxpayers how to hide money from the IRS. But when the trial concluded, the jury took just one day to acquit him of the conspiracy charge - the Department of Justice simply couldn't prove their case beyond a reasonable doubt.

New Jersey and Independent Contractors

Considering the high cost of characterizing workers as employees (workman's compensation, company benefits such as health and pension, employer's portion of employment taxes, etc.), some employers are motivated to characterize their workers as independent contractors and report their income on a 1099 at the end of the year. And in many instances, the worker is happy to go along, because it means larger deductions on a Form 1040, Schedule C. But what if one of these workers is injured on the job. The first thing they do is apply for workman's compensation benefits. The employer fires back and says, "that worker wasn't my employee. He was an independent contractor not covered by my workman's compensation policy." But in most cases, the State of New Jersey will have a different idea. The State may come in, audit your books and give you a large bill for worker's compensation coverage for all of your 1099 workers. And there may be a penalty also. This issue also comes up in the context of unemployment claims. You let a 1099 worker go for poor performance. That worker goes directly to the unemployment office and files an application. What happens next is a similar scenario to the workman's compensation situation.

While the IRS has tests to determine whether a worker should be classified as an employee or independent contractor, and they can be aggressive about it, their interest in the topic is somewhat limited, as it primarily applies to the withholding of employment taxes. But it cuts deep at the state level. It impacts not only employment taxes, but things like workman's compensation, unemployment, rules under the Fair Labor Standards Act and much more. Read the case law in New Jersey and you will see that the state has a deep bias towards workers being employees. For most purposes, the New Jersey Department of Labor and Workforce Development uses a deceptively simple 3-part test called the ABC test to determine independent contractor status. Under this test, an employer must establish that each worker: (a) is free from direction and control; (b) provides a service outside the employer's usual course of business or places of business; and (c) is engaged in an independently established trade, occupation or business.

The plumber that you call to your firm to fix a sink? Definitely an independent contractor. But if you look at the test, you can see how, except in the most obvious of circumstances, many of the employers with independent contractors might have a hard time arguing that status. Many factors go into the determination - I could spend the next few Newsletters on them. If you would like to read what is probably the premier case in New Jersey on this topic, take a look at Carpet Remnant Warehouse v. Department of Labor, 125 NJ 567 (1991). For a newer case, try Hargrove v. Sleepy's, LLC, NJ Sup Ct (A-70-12) 2015.

New Tax Law

As of this writing, Republicans have agreed on a tax bill that now must go through the Conference Committee process. As per today's agreement, the corporate tax rate would be 21% starting in 2018. In addition to corporations, this rate is supposed to apply to several pass-through businesses that many of us work in, like partnerships and LLCs. This would put mom and pop businesses on a level playing field with corporations from a tax perspective. This also means that, depending on what the final version of the bill looks like, many employees will be clamoring to become independent entities, rather than to continue on as employees. Doing so could mean up to a 17% savings in income taxes according to today's bill. As exciting a prospect as this is for both workers and those of us in the tax advising business, it is important to remember that, as described above, there are very specific rules to determine who is an employee and who is an independent contractor. No doubt, the state and federal governments will get busier going after employers misclassifying workers if there is perceived abuse of this provision. Watch for the final provisions of the tax bill. We will be here to help as soon as the bill becomes law.

Whether you like the provisions of the coming new tax law or not, it will be an exciting new year for those of us in the tax business. Until then, happy holidays and have a prosperous and healthy new year!

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