



New Voluntary Settlement Program for Worker Classification

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The IRS considers the misclassification of workers as independent contractor instead of employees as a major contributing factor to the "tax gap." Accordingly, the IRS has instituted new initiatives relative to the examination of taxpayers on the worker classification issue and has recently entered into agreements with the Department of Labor and 11 states to share information if misclassification is determined in any of their respective audits. As a part of these initiatives, the IRS recently unveiled a new program to enable many employers to efficiently resolve past worker classification issues and achieve certainty under the law by voluntarily reclassifying their workers. The Voluntary Classification Settlement Program ("VCSP") allows eligible employers to obtain substantial relief from federal payroll taxes they may have owed in the past, if they agree to treat the workers as employees going forward. This program is particularly relevant as the IRS, coupled with the Department of Labor, began a major audit initiative in 2010, involving over 6,000 planned audits with respect to employment taxes and worker classification. The VCSP allows employers to obtain relief similar to the current Classification Settlement Program, which is available for employers already under examination.

Eligibility

Participation in this program is limited based on certain eligibility requirements. An eligible applicant must have consistently treated the workers in the past as nonemployees, and have filed all required Forms 1099 for the previous three years for the same workers. Further, an eligible applicant cannot be currently under audit by the IRS, Department of Labor, or a state agency concerning the status of these workers. The VCSP requirements could present a substantial benefit when compared to the section 530 relief requirements also available to employers. Section 530 of the Revenue Act of 1978 provides a safe harbor which allows employers to continue to treat workers as independent contractors even if the workers would be treated as employees under other tests. Under section 530, in order to qualify for relief from potential IRS reclassification, an employer must have filed all required Forms 1099 with respect to the workers, must not have treated the worker or similarly situated workers as employees (the "substantive consistency requirement"), and must have a reasonable basis to have characterized the worker as an independent contractor (the "reasonable basis requirement"). In contrast to the substantive consistency requirement under section 530, which essentially requires all workers of a given type to be classified in the same manner, the VCSP only requires that each worker who will be reclassified



as an employee has been consistently treated as an independent contractor in the past. This relaxed consistency requirement, and the lack of a reasonable basis requirement, presents an attractive opportunity for employers to seek worker classification relief.

Effect

Participation in the VCSP could offer substantial savings to an employer when compared to the uncertainty of an audit and the costs associated with resolving an audit. In exchange for an employer's commitment to prospectively treat the class of workers as employees in future tax years, and a limitations extension for the first three years following acceptance into the program, the employer will pay 10 percent of the employment tax liability that may have been due on compensation paid to the reclassified workers from the prior year. The tax liability under this program will effectively only amount to just over 1 percent of the compensation paid to the reclassified workers for the past year, with all compensation paid to such reclassified workers for all earlier tax years relieved of any tax liability. Additionally, the employer will not be liable for any interest or penalties on the liability and cannot be subject to an employment tax audit with respect to worker classification for the reclassified group of workers for any prior year.

Interested taxpayers must submit an application to the IRS, which retains the discretion whether to accept the taxpayer's application into the program. Accepted taxpayers will enter into a closing agreement with the IRS. It is important to note that application to the program will require a calculation of the liability potentially owed, and can possibly function as a disclosure to the IRS of potential employment tax liability. Additionally, employers should be aware that filing for relief under the VCSP would essentially require employers to forgo protections offered under section 530. Employers with strong positions under section 530 should be aware of this risk. Employers should consider the risks and rewards for their businesses before entering into the Voluntary Classification Settlement Program.

Attorneys in Locke Lord's Tax Practice counsel and assist clients with all of their employment tax matters and issues.

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