

IRS ANNOUNCES VOLUNTARY SETTLEMENT PROGRAM ON WORKER CLASSIFICATIONS

The Internal Revenue Service has announced a new Voluntary Classification Settlement Program (VCSP). The program provides partial relief from federal employment taxes for eligible employers that agree to prospectively treat workers (or a class of workers) as employees (as opposed to independent contractors) for employment tax purposes.

Whether an individual can be classified as an employee or independent contractor is based upon criteria established by the courts and administrative agencies. It is not simply a choice to be made by the employer and worker. Historically, the proper classification has required a facts and circumstances analysis and in certain situations, the determination of the proper worker classification status for employment tax purposes is unclear. Classification audits by the IRS and/or Department of Labor can be expensive for the employer and can possibly result in significant employment tax liabilities, including interest and penalties.

In order to facilitate voluntary resolution of worker classification issues and achieve the benefits of increased tax compliance and certainty for employers, workers and the IRS, the IRS is providing employers with a program that will allow for voluntary reclassification of workers as employees.

Eligible employers who participate in the program must agree to prospectively treat the class of workers in question as employees for future tax periods. In exchange, the employer will have to pay 10% of the employment tax liability that would have been due on compensation paid to the workers for the most recently completed tax year. However, the employment tax liability is to be determined under the reduced rates provided for in Section 3509 of the Internal Revenue Code. Importantly, the employer will not be liable for any interest and penalties and will not be subject to an employment tax audit for prior years with respect to the classification of those workers.

To be eligible to participate in the program, the employers:

- >> must currently be treating their workers (or class of workers) as independent contractors, or other non-employees, and want to prospectively treat the workers as employees;

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THE BOTTOM LINE

The VCSP presents an opportunity for any employer who treats workers as independent contractors to eliminate exposure to what could be significant tax and audit costs for prior years at the price of paying a limited employment tax liability for the most recently completed year. The benefits offered by the VCSP only apply to IRS liabilities, and participation in the program will not affect an employer's potential liability for state payments, such as unemployment contributions.

Employers should contact their legal and tax advisors to discuss whether participation in the program is right for them.

- >> must have consistently treated the workers as non-employees;
- >> must have filed Forms 1099 for the workers for the previous three years (or lesser period if the employer was not in business for three years); and
- >> cannot currently be under audit by the IRS, the Department of Labor or by a state government agency concerning the classification of workers. If the employer had previously been audited by the IRS or the Department of Labor concerning the classification of workers, the employer will only be eligible if the employer has complied with the results of the audit.

To participate in the program, the employer must file Form 8952, Application for Voluntary Classification Settlement Program, and will enter into a closing agreement with the IRS concerning the classification of such workers. Form 8952 can be filed at any time but should be filed at least 60 days before the date the employer wants to begin treating the workers as employees. As part of the VCSP, the employer must extend the statute of limitations on assessment of employment taxes for 3 years for the first, second, and third calendar years beginning after the date the employer elects to begin treating the workers as employees under the VCSP closing agreement.

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