

IRS Announces Voluntary Settlement Program to Reclassify Workers as Employees

September 26, 2011

A new IRS voluntary settlement program offers significant relief from liability for unpaid federal employment tax, penalties and interest for eligible taxpayers that agree to voluntarily treat their misclassified workers as employees.

On Wednesday, September 21, 2011, the Internal Revenue Service (IRS) issued Announcement 2011-64, which details a new program that allows eligible taxpayers that agree to voluntarily treat their misclassified workers as employees going forward can get significant relief from liability for unpaid federal employment tax, penalties and interest.

Background

The classification of a worker as an employee or an independent contractor is a complex factual problem involving many factors under the common law definition of “employment.” The issue of worker classification has been a significant area of IRS enforcement for decades. In response to a flood of litigation and complaints of overly aggressive enforcement by the IRS, Congress enacted Section 530 of the Revenue Act of 1978, which generally provides a safe harbor from liability for employment taxes and allows the taxpayer to choose to continue to treat its workers as independent contractors. An IRS examiner is generally required to first determine whether a taxpayer is entitled to relief under Section 530. (I.R.M. 4.23.6.2(1).)

For those employment tax cases that did not qualify for relief under Section 530, the IRS introduced the Classification Settlement Program (CSP) in order “... to allow businesses and tax examiners to resolve worker classification cases as early in the administrative process as possible, thereby reducing taxpayer burden.” (I.R.M. 4.23.6.1(2).) The IRS agent will typically offer a settlement under CSP based upon a single-year assessment of employment taxes using reduced rates under IRC Section 3509. (I.R.M. 4.23.6.5(3).) As a condition to the settlement, the taxpayer must agree to treat the workers as its employees prospectively.

If the taxpayer has timely filed Forms 1099, and has a “colorable argument” that it also met both the reasonable basis and substantive consistency requirements under Section 530, then the CSP offer will be based upon a single-year assessment of employment taxes at 25 percent of IRC Section 3509 rates. As above, the taxpayer must agree to treat the workers as its employees prospectively.

Despite its stated purpose to essentially reduce taxpayer burden by resolving worker classification cases as early in the administrative process as possible, settlements under the current CSP are generally limited to the context of an IRS examination.

The IRS Voluntary Classification Settlement Program

The IRS Voluntary Classification Settlement Program (VCSP) provides taxpayers with the opportunity to negotiate closing agreements borrowing settlement terms from the current CSP in the context of a voluntary disclosure. Under VCSP, eligible taxpayers will generally be entitled to settle their employment tax liability under a single-year assessment of employment taxes at 10 percent of IRC Section 3509 rates. The taxpayer will not be liable for any additional penalties or interest and VCSP promises the IRS will not subject any prior years to an employment tax audit with respect to worker classification issues.

Similar to the current CSP, the taxpayer must agree to treat the workers as its employees prospectively. Most significantly, the taxpayer must also agree to extend the statute of limitations for the assessment of employment taxes by an additional three years, for each of the three years beginning after the date that the VCSP closing agreement is executed.

To be Eligible to Participate in VCSP:

1. The taxpayer must have consistently treated the workers as nonemployees.
2. The taxpayer must have filed all required Forms 1099 reporting compensation paid to these workers for the three prior calendar years preceding. *Note:* This does *not* require the *timely* filing of all Forms 1099, as under a conventional CSP.
3. The taxpayer must not currently be under examination by the IRS, or under examination by either the Department of Labor (DOL) or any state agency on worker classification issues. If the taxpayer has *previously* been examined by the IRS or DOL on worker classification issues, it must currently be in compliance with the results of that prior examination(s).

How to Participate in VCSP

To participate in VCSP, eligible taxpayers must submit new IRS Form 8952, "Application for Voluntary Classification Settlement Program (VCSP)." The Form 8952 must be signed by the appropriate representative of the taxpayer, as enumerated in the instructions. If applicable, the taxpayer should include a completed IRS Form 2848, "Power of

Attorney," identifying its authorized representative, as part of this submission. Applications to participate in VCSP will be coordinated by the Government Entities Compliance Unit based in the IRS Service Center in Ogden, Utah.

Note: Taxpayers filing consolidated returns for income tax purposes as members of an affiliated group should consider the potential risk of drawing attention to worker classification issues for its affiliates. The Form 8952 requires taxpayers to identify the common parent of the affiliated group. At this point, there is only speculation how the IRS will use this additional information.

Click [here](#) to view a list of frequently asked questions on the IRS website.

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