

Good News Regarding Employee Misclassification?

10/10/2011 Paul R. Jackson, Anthony J. Kolenic, Steven A. Palazzolo

The Internal Revenue Service has announced that it will offer a break to employers who are misclassifying employees as nonemployees. Under the IRS's Voluntary Classification Settlement Program (VCSP), an employer can resolve worker classification issues for purposes of federal employment taxes and become compliant with the law in that regard by making a "minimal payment" to cover past payroll tax obligations. However, employers should be aware that the VCSP will cover only federal -- not state -- taxes, and there may be other complicating factors.

To be eligible, the employer must:

- Consistently have treated the workers as nonemployees
- Have filed all required Forms 1099 for the workers for the past three years
- Not currently be involved in an IRS audit
- Not currently be involved in a Department of Labor audit or state agency audit concerning the classification of these workers

Employers can apply for the program by filing Form 8952, which can be found [here](#), and entering into a closing agreement with the IRS. Employers must apply at least 60 days before they want to begin treating the independent contractors as employees. Additionally, employers must identify a contact person or authorized representative with power of attorney who can complete the application process.

Employers participating in the VCSP must agree to treat workers as employees for future tax periods and pay 10 percent of the employment tax liability for the most recent tax year. However, participating employers will not be liable for any interest or penalties on that amount. Nor will they be subject to an employment tax audit with respect to the worker reclassification. The participating employer must agree to extend the statute of limitations period on assessment of employment taxes for three years after reclassification occurs.

What is the difference between an employee and an independent contractor? The IRS offers three clues to determine the difference. They are

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- **Behavioral:** Do you control what the worker does and how the worker does his job?
- **Financial:** Do you determine how the worker is paid or reimbursed? Do you provide the tools necessary for the job?
- **Type of Relationship:** Do you have a contract? Do you provide benefits such as a pension, insurance or vacation?

A “yes” to any of the questions is a good indication that the workers may actually be employees. You can read more about employees versus independent contractors [here](#).

Employers who apply for VCSP should be aware that they may face other issues. For example, although many benefit plans already address this issue explicitly, workers who were misclassified as independent contractors may make claims for retroactive participation in employee benefit plans including qualified retirement plans, welfare benefit arrangements (like health insurance) and stock-based plans. In addition, the future participation of the reclassified workers in those plans should be analyzed. These issues should be reviewed as part of the VCSP process of determining whether you wish to participate in VCSP.

If you have any questions about the VCSP or whether your workers are properly classified, please contact Tony Kolenic (akolenic@wnj.com or 616.752.2412), Steve Palazzolo (spalazzolo@wnj.com or 616.752.2191), Paul Jackson (pjackson@wnj.com or 231.727.2626) or any other member of the Warner Norcross & Judd Employee Benefits, Labor and Employment or Tax Law Groups.