

Voluntary Classification Settlement Program May Benefit Eligible Employers

By Joseph M. Donegan on August 24th, 2012

Misclassifying an employee can carry significant consequences for businesses, and the Internal Revenue Service is urging employers to take advantage of a new program to avoid these penalties.

The IRS is cracking down on companies that misclassify employees as independent contractors in an attempt to avoid paying federal FICA taxes and providing benefits to workers. Under the current tax law, employers are exempt from paying the Medicare and Social Security taxes – commonly known as FICA – that they are required to pay for regular employees. In addition, companies are not required to extend benefits, such as healthcare and retirement options, to independent contractors.

For these reasons, many companies have a financial incentive to misclassify workers, but this can lead to tax penalties, taxes, and fines from the IRS. To help curb these abuses and entice companies that have misclassified workers to come forward, the IRS unveiled its Voluntary Classification Settlement Program. The program allows companies to voluntarily reclassify workers as employees, rather than contractors, for future tax years, and avoid significant liability for previous years of misclassifications.

Companies must meet several eligibility rules in order to qualify for the program, according to the Philadelphia Business Journal. For example, employers must have consistently treated workers as independent contractors and filed 1099 forms for the previous three years. In addition, the businesses must not currently be facing an audit from the IRS or other tax agency in order to qualify. Those who have undergone previous audits related to misclassifications must also have complied with the auditors' requests to be considered eligible.

The IRS has created several program recently to encourage those who have violated tax law to come forward and pay their tax burden. While the IRS has been able to recoup millions through its use of voluntary programs, the federal tax gap remains upwards of \$385 billion.