

NEW IRS PROGRAM PROVIDES RELIEF TO EMPLOYERS THAT HAVE MISCLASSIFIED WORKERS

On September 21, 2011, as part of the IRS's "Fresh Start" initiative, the IRS launched a new program aimed at bringing employers into compliance with their federal employment tax obligations. Specifically, this program, titled the Voluntary Worker Classification Settlement Program (VCSP), enables certain employers who have been misclassifying their workers as independent contractors rather than employees to voluntarily admit to this misclassification and begin correctly classifying their workers as employees, all while avoiding much of the substantial tax, interest, and penalties that the IRS would normally impose.

CLASSIFICATION AND MISCLASSIFICATION OF WORKERS

For federal employment tax purposes, workers are classified as either employees or independent contractors. An employer does not have the option of choosing the appropriate classification for its workers; instead, whether a worker is an employee or an independent contractor is dependent on several factors that have been developed through the Internal Revenue Code, Treasury Regulations, and Federal case law. If a worker is classified as an employee, the employer is responsible for paying its share of that worker's FICA taxes and for withholding income and FICA taxes from his or her wages and paying these amounts to the IRS. On the other hand, if a worker is an independent contractor, the employer has no employment tax obligations and the worker generally is subject to self-employment taxes on his or her earnings. For this reason, in many instances it is advantageous for employers to classify their workers as independent contractors rather than employees.

When the IRS discovers that an employer has misclassified its workers as independent contractors, that employer may be subject to substantial costs, including the payment to the IRS of any employment taxes that would have been due if the workers had been classified as employees, substantial penalties, and interest. In addition, certain individuals of the employer that were responsible for the employer's wrongdoing may be held personally liable for amounts that should have been withheld from the workers' wages and paid to the IRS but were not.

RELIEF FROM LIABILITY

Generally, if employers can meet certain requirements, they may be eligible for complete relief from past-due employment taxes or for the payment of past-due employment taxes at a reduced rate. However, to be eligible for such relief, employers must show that they had a "reasonable basis" for misclassifying their workers or did not "intentionally disregard" their employment tax liabilities, among other requirements. Therefore, employers that knowingly and intentionally misclassified their workers normally are not eligible for relief from paying their past-due taxes in full and from harsh penalties and interest.

Under the VCSP, though, there is no requirement that an employer acted reasonably or unintentionally in misclassifying its workers. Instead, all that is required is that the employer:

- 1) Must have consistently treated its workers (or a certain group of its workers) as independent contractors;
- 2) Must have issued all required forms 1099 to these workers for the past three years; and
- 3) Is not currently under audit by the IRS, the Department of Labor or a state agency concerning the classification of these workers.

If an employer meets these requirements and enters into a closing agreement with the IRS affirming that it will treat these workers as employees in the future, such employer's liability for past-due employment taxes will be limited to 10% of the liability that would have been due on compensation paid to workers in the most recent tax year only. Effectively, employers will be required to pay to the IRS an amount equal to **just over 1%** of wages paid in the previous year. Moreover, the employer will not be subject to any interest or penalties on these unpaid taxes and will not be subject to IRS employment tax audits with respect to worker classification for previous years.

APPLYING FOR RELIEF

To apply for this relief, employers must submit a completed IRS form 8952 (Application for Voluntary Classification Settlement Program) at least sixty days prior to the date on which they will begin treating their workers as employees. Upon the IRS's acceptance of an employer's application for relief, the employer must enter into the closing agreement described herein and make a full and complete payment to the IRS of the reduced balance due.

Obviously, the VCSP is a great opportunity for employers who have been misclassifying their workers (intentionally or unintentionally) to correct prior non-compliance and begin complying with their federal tax obligations with minimal cost. For more information about the VCSP, please refer to IRS Announcement 2011-64 and contact Joshua Nesser of Lavelle Law, Ltd. at 847-241-1778.