

**ALERTS**

## IRS Broadens Program for Re-Classification of Independent Contractors as Employees

**January 14, 2013**

Employer misclassification of employees as independent contractors can be a costly mistake with many ramifications, including, but not limited to, the possibility of having to pay retroactive employment taxes with interest and penalties. In an *Alert* dated Nov. 23, 2011, we advised you of the Voluntary Classification Settlement Program (the “VCSP” or the “Program”), a program announced by the Internal Revenue Service (the “IRS”) which provides employers with the opportunity to voluntarily reclassify workers as employees with limited federal employment tax liability for past non-employee treatment. On Dec. 17, 2012, the IRS announced the expansion of the VCSP.

Pursuant to Announcement 2012-45, the VCSP was modified to: (i) permit an employer under IRS audit, other than an employment tax audit, to be eligible to participate in the Program (note, however, an employer remains ineligible to participate if it is currently under audit by the Department of Labor (the “DOL”) or by a state government agency concerning the classification of workers); (ii) clarify the current eligibility requirement that an employer that is a member of an “affiliated group” within the meaning of Section 1504(a) of the Internal Revenue Code (the “IRC”) is not eligible to participate in the Program if any member of the affiliated group is under employment tax audit; (iii) clarify that an employer is not eligible to participate in the Program if the taxpayer is contesting in court the classification of the class or classes of workers from a previous audit by the IRS or the DOL;<sup>[1]</sup> and (iv) eliminate the requirement that an employer

agree to extend the period of limitations on assessment of employment taxes as part of the VCSP closing agreement with the IRS.

In a second announcement published on Dec. 17, 2012, the IRS explained that it is also temporarily expanding eligibility for the VCSP for employers that failed to file Forms 1099 for workers they erroneously considered to be independent contractors. Generally, to participate in the Program, an employer must have filed all required Forms 1099 for its workers for the previous three years. According to Announcement 2012-46, however, an employer that has not filed Forms 1099 for the workers for the past three years is eligible to participate in a modified VCSP through June 30, 2013. Participants in the VCSP Temporary Eligibility Expansion: (i) pay 25 percent of the employment tax liability that would have been due on compensation paid to the workers being reclassified for the most recent tax year if those workers were classified as employees for such year, determined under the reduced rates provided by Section 3509(b) of the IRC; (ii) pay a reduced penalty for unfilled Forms 1099 for the past three years for the workers being reclassified; (iii) are not liable for any interest and/or penalties on the liability; and (iv) are not subject to an employment tax audit with respect to the worker classification of the workers for prior years. The penalty for unfilled Forms 1099 is graduated and based on the number of required Forms 1099 that were not filed up to a maximum amount. A computation worksheet is attached to the IRS Announcement to facilitate the calculation of this penalty. Employers wishing to participate in the VCSP Temporary Eligibility Expansion must agree to treat prospectively the reclassified workers as employees for future tax periods and they must affirm as part of the closing agreement with the IRS that they have provided to the reclassified workers and electronically filed all required Forms 1099 for the past three years.

The IRS has received a large number of applications to the VCSP from employers. Given the Obama Administration's attention to worker misclassification over the past four years, it is likely that the heightened focus on this issue by both federal and state agencies will continue. Employers should evaluate their workers' classifications and, if workers have been misclassified, consider the benefits of participation in the VCSP and the VCSP Temporary Eligibility Expansion.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] However, if an employer was previously audited by the DOL or the IRS concerning the classification of employees, and the employer complied with the results of that audit and is not currently contesting the results of that audit in court, the employer is eligible to participate in the VCSP.

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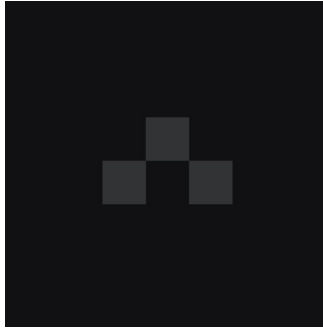
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