

Alert

IRS Launches New Voluntary Classification Settlement Program

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The Internal Revenue Service (the "IRS") recently announced the Voluntary Classification Settlement Program ("VCSP"), a new program available to businesses, tax-exempt organizations, and government entities that are erroneously treating workers as non-employees or independent contractors. The program provides employers the opportunity to voluntarily reclassify workers as employees with limited federal employment tax liability for past non-employee treatment.

Misclassifying a worker is a costly mistake that many companies make. If the IRS reclassifies a worker as an employee, the employer may owe additional employment taxes, as well as penalties and interest on the reclassified worker's compensation for the most recent three tax years (the period during which the IRS may assess employment taxes). Under the VCSP, employers will pay 10 percent of the employment tax liability that may have been due on compensation paid to the reclassified workers for the most recent tax year. Employers will not have to pay any interest or penalties on the liability, and will not be subject to an audit with respect to the reclassified workers for prior years. Employers must, however, agree to extend the period of limitations on assessment of employment taxes from the standard three years to six years beginning after the date on which the employer enters into an agreement under the VCSP to begin treating the workers as employees. Moreover, once an employer reclassifies a worker under the VCSP, all workers in the same class must also be reclassified.

The VCSP is especially timely given the United States Department of Labor's ("DOL") recent focus on employee misclassification. On Sept. 19, 2011, the Secretary of Labor, Hilda L. Solis, signed a memorandum of understanding ("MOU") with the IRS that will improve DOL efforts to end the practice of misclassifying employees. Additionally, labor commissioners and other agency leaders representing seven states signed MOUs with the DOL's Wage and Hour Division, and, in some cases, its Employee Benefits Security Administration, Occupational Safety and Health Administration, Office of Federal Contract Compliance Programs and Office of the Solicitor. The signatory states are Connecticut, Maryland, Massachusetts, Minnesota, Missouri, Utah and Washington. Secretary Solis also announced an agreement for the Wage and Hour Division to enter into an MOU with the state labor agencies of Hawaii, Illinois and Montana, and the attorney general of the state of New York. The MOUs are intended to enable the DOL to share information and coordinate law enforcement with the IRS and participating states.

To be eligible for the VCSP, an employer must: (i) consistently have treated the workers in the past as non-employees; (ii) filed all required Forms 1099 for the workers for the previous three years; and (iii) not currently be under "examination" by the IRS, the DOL, or a state agency concerning the classification of these workers. An employer who was previously audited by the IRS or the DOL concerning the classification of workers will only be eligible for the VCSP if the employer has complied with the results of that audit. Notably, even if an employer's application is approved, participation in the VCSP does not absolve it of state law liabilities. Employers that reclassify workers under the VCSP are still liable to state unemployment agencies and state

workers' compensation agencies for unpaid unemployment insurance and workers' compensation premiums, along with applicable penalties and interest.

The misclassification of workers is a common issue that employers face. Whether a worker should be classified as an employee or independent contractor can be unclear, and the standards for making such a determination can be different under different laws. Consequently, employers should familiarize themselves with the standards utilized by the IRS, DOL, and state agencies for determining employee status. To avoid misclassification, employers should periodically review their workers' status. If upon review it appears that workers have been misclassified, employers should consider applying to the VCSP if they are eligible.

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