

Employment Edge 125th Edition—“Golden Opportunity” or “Gotcha”? The New IRS Voluntary Classification Settlement Program Creates Some Risk

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The Internal Revenue Service (IRS)'s new Voluntary Classification Settlement Program (VCSP) is being labeled by some as a "golden opportunity" and scorned by others as a program with "a catch." The program allows eligible taxpayer employers to voluntarily reclassify workers as employees for federal employment tax purposes with limited liability for the past nonemployee treatment. The government has recently cracked down on employers who misclassify workers, and the VCSP appears to be related to this recent enforcement effort. Classifying workers as independent contractors instead of employees allows companies to avoid paying various federal and state employment law taxes and providing benefits, but it can also lead to costly litigation and administrative penalties.

Under the VCSP, an employer would pay only 10 percent of the amount of employment taxes for compensation paid for the most recent tax year to the workers being reclassified. The program also provides that participant taxpayers will not be liable for any penalties and interest, and will not be audited on payroll taxes related to these workers for prior years.

In order to qualify for the program, an employer must:

- consistently have treated these workers as independent contractors or other nonemployees;
- filed all required Forms 1099 for the workers for the past three years; and
- not currently be under audit by the IRS, the U.S. Department of Labor, or a state agency concerning the classification of these workers.

An employer that previously was audited by the IRS or the Department of Labor concerning the classification of workers will only be eligible if the taxpayer has complied with the results of that audit. Additionally, a taxpayer participating in the VCSP must agree to extend the period of limitations on assessment of employment taxes for three years for the first, second, and third calendar years beginning after the date on which the taxpayer has agreed under the VCSP closing agreement to begin treating the workers as employees.



In addition to the VCSP, the IRS has also recently announced that it entered into a memorandum of understanding with the United States Department of Labor (DOL) under which the two agencies agreed to an information sharing initiative. The agencies indicate they are doing this to help reduce the incidence of misclassifications and improve compliance with federal labor laws. According to the understanding, the DOL will—at its discretion and consistent with applicable law—refer to the IRS investigation information and other data that the DOL believes may raise tax compliance issues. The IRS, in turn, may choose to share this information with state and municipal taxing authorities.

These two recent moves by the government indicate an increasing focus on the problem of misclassification and an attempt to encourage voluntary disclosure of potential violations. The government has offered seemingly lenient terms for those who choose to "come clean," and the program could save a company significant dollars on the tax side of the equation. On the other hand, voluntary disclosure could potentially open employers up to a wide range of liability in cases that almost certainly will be brought against them by the DOL and the newly classified employees themselves. The end result? An employer may avoid costly tax penalties by disclosing a problem but simultaneously find themselves being pursued for huge sums by a class of formerly misclassified workers seeking to obtain back wages and benefits. Evaluating and managing the risks of either situation can be tricky and very fact specific, so employers would be wise to contact their local employment lawyer for guidance prior to pursuing any relief under the new VCSP.

If you need assistance with issues related to the classification of independent contractors or other employment law issues, please contact Carl Crosby Lehmann or another member of the Gray Plant Mooty Employment and Labor Law practice group.

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