

IRS Expands its Voluntary Worker Classification Settlement Program

03.13.13 01.07.26

Garvey Schubert Barer Legal Update, March 2013.

Introduction

According to a Bureau of Labor Statistics study conducted almost 8 years ago, approximately 10.3 million workers in the United States, or 7.4% of the workforce, are classified as independent contractors. Today that number, despite recessionary times, is likely dramatically larger.

The federal government, based upon recent case studies including federal and state income tax and unemployment tax audits, recently concluded many workers classified as independent contractors are actually employees. Consequently, worker classification is currently a hot topic for the Internal Revenue Service, the state departments of revenue, and other federal, state and local agencies.

Government focus on worker classification is not a new phenomenon. Due to current economic and political pressures, however, it has risen to the forefront of governmental attention. During the last few years, federal, state and local agencies have dramatically increased audit activity, targeting worker misclassification.

In 2011, to encourage worker classification compliance by businesses, the Internal Revenue Service ("IRS" or "Service") adopted a voluntary compliance program (commonly referred to as the "Voluntary Worker Classification Settlement Program" or "VWCSP"). The program provides businesses: (i) the opportunity to get into compliance by making a minimal payment covering some of their past payroll tax obligations (i.e., an amount equal to just over one percent of the wages paid to reclassified workers for the past year without penalties or interest); and (ii) a fresh start going forward relative to worker classification. The problem with the 2011 program is the stringent eligibility requirements prohibit many businesses from participating in the program. It requires the applicant meet the following:

- Consistently treated the workers in the past as nonemployees;
- Filed all required Forms 1099 for the workers for the previous three years;
- Not currently be under audit by the IRS; and
- Not currently be under audit by the Department of Labor or a state agency concerning the classification of the workers.

The second requirement, the filing of Forms 1099, has been the roadblock for many businesses. In order to alleviate this participation barrier, the Service recently removed the roadblock. Unfortunately, this new program is only available for a limited period of time. Businesses desiring to participate in the program must apply on or before June 30, 2013.

Benefits of the Voluntary Worker Classification Settlement Program

Participation in the VWCSPP may have significant benefits for businesses including:

- The business will not owe any interest or penalties;
- The business will not be audited on worker classification matters relative to the workers who are the subject of its application;
- The business will only be required to pay a small fraction of the potential employment tax liability to bring itself into compliance; and
- The business obtains some worker classification certainty going forward.

Temporary Expansion of the Voluntary Worker Classification Settlement Program

Qualification under the VWCSPP, as expanded, requires the business to pay a higher amount of taxes than under the original program. Participation is still subject to the eligibility requirements (except the Forms 1099 filing requirement). The business must submit an application, and if accepted, enter into a closing agreement with the IRS. Assuming the VWCSPP requirements are satisfied, the employer must treat the workers (or class of workers) subject to the VWCSPP as employees going forward.

The business must satisfy the following requirements to be eligible for this temporary expansion of the VWCSPP:

- It consistently treated the workers (or class of workers) subject to the VWCSPP as nonemployees;
- It is not under a federal employment tax audit by the IRS (including as a member of an affiliated group under Section 1504(a) of the Internal Revenue Code); and
- It is not under an audit concerning the classification of the class or classes of workers subject to the VWCSPP by the U.S. Department of Labor or any state government agency.

Note: A previous IRS or Department of Labor audit on the class or classes of workers subject to the VWCSPP will not preclude eligibility if the business has complied with the results of the audit and is not currently contesting the classification.

Application Process

- The business must submit an application (Form 8952) before June 30, 2013;
- The IRS will contact the business or its authorized representative with instructions on how to file the Forms 1099 once the IRS has reviewed the application and determined eligibility;

- The business must contact the IRS to confirm the Forms 1099 have been electronically filed and furnish the Forms 1099 to the workers subject to the VWCSPP; and
- Once the IRS accepts the application, the business must enter into a closing agreement with the IRS to finalize the VWCSPP's terms and pay all amounts due under the closing agreement.

Effect of the Voluntary Worker Classification Settlement Program

The business must treat the workers (or class of workers) who are reclassified under a VWCSPP agreement as employees for federal employment tax purposes going forward. It should expect the state(s) and local governments where these workers are located to assert these workers are also employees for state and local employment tax purposes.

The expanded VWCSPP requires the business pay the following:

- Twenty-five percent (25%) of the federal employment tax liability for the most recent tax year that would have been due on the compensation of the workers subject to the VWCSPP; and
- A reduced penalty for unfiled Forms 1099 for the previous 3 years for workers subject to the VWCSPP (the penalty for unfiled Forms 1099 is graduated, based on the number of unfiled Forms 1099, and is capped at a maximum amount of \$10,000).

Conclusion

This temporary VWCSPP may be a viable option for businesses who were previously ineligible because of the failure to file the required Forms 1099. The amnesty from federal employment tax audits based on employee classification may be an attractive option for businesses which are nervous about potential employee classification issues, including the penalties and interest associated with misclassification. However, it is not without risks, including:

- The IRS maintains discretion to deny a business' application under the program. So, if a business submits an application that the IRS denies, it will be denied the benefits of the program and will also identify itself to the IRS as having workers which it believes may be misclassified, and potentially subject itself to further investigation by the IRS. This could lead not only to increased burden and expense on behalf of the business, but also potential tax liability for those misclassified workers.
- The program only offers protection from the IRS, not the Department of Labor or state departments of revenue, and other state and local agencies. Further, the program does not preclude the IRS from sharing information with other government agencies.
- The business must agree to extend the statute of limitations on the assessment of employment taxes for the first, second and third calendar years beginning after the date on which the business has agreed under the closing agreement to begin treating the workers as employees. The extended statute of limitations under the program is not limited to employee misclassification issues, but will allow the IRS to review a participating business's entire employment tax compliance during the extended period.

- The amount of taxes due under the expanded program are much higher than under the original VWCSF.
- The expanded program added a penalty for unfiled Form 1099s, a new cost of entry.

The new VWCSF offers businesses significant advantages. Given the potential risks and added costs of entry, however, businesses are well advised to fully evaluate the risks and rewards prior to applying for the program. The assistance of tax counsel well versed in this area of the law is warranted.

For more information about the expanded VWCSF or worker classification, please contact Larry J. Brant (lbrant@gsblaw.com or (503) 553-3114) or Jonathan Cavanagh (jcavanagh@gsblaw.com or (503) 553-3133).

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