



New IRS Program for Resolving Worker Misclassification Problems

Businesses often struggle with the issue of whether an individual providing services is properly classified as an employee or independent contractor. If the business has been classifying a worker incorrectly and wants to correct the error, it faces potential back taxes, interest, and penalties and possible collateral issues. In the interest of encouraging businesses to come forward to correct misclassifications, the Internal Revenue Service ("IRS") on September 21 announced its new program to allow employers to voluntarily reclassify workers as employees without risking additional taxes, interest, and penalties, provided certain payments are made (as discussed below).

General Requirements

The new program is called the Voluntary Classification Settlement Program ("VCSP"). It is part of the larger "Fresh Start" initiative the IRS has introduced to assist taxpayers. VCSP allows taxpayers to obtain relief on a voluntary basis similar to the relief provided under the current Classification Settlement Program. Under VCSP, taxpayers who comply will not be liable for any interest or penalties attributable to worker reclassification and will not be audited on worker classification issues for prior years. To be eligible, an applicant must:

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

Participating employers must also agree to be subject to a special six-year statute of limitations for the first three years under the program (instead of the usual three-year statute of limitations).

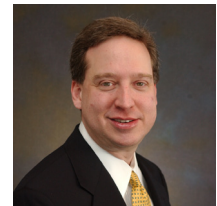
Required Payment

In Announcement 2011-64, the IRS notes that employers who prospectively treat their workers as employees can make "minimal payments" covering past payroll tax obligations and establish compliance. According to Announcement 2011-64, the required payment is "10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year" (determined under the reduced tax rates in Internal Revenue Code Section 3509), which the IRS indicates in a separate news release (IR-2011-95) is an amount effectively equaling "just over 1% of the wages paid to the reclassified workers for the past year."

According to the new IRS Form 8952 Application for Voluntary Classification Settlement Program, which is to be used to apply for VCSP, each payment is determined as a percentage of compensation at or below the Social Security taxable wage base (10.68% for 2010 or 10.28% for 2011) and a percentage of compensation above the Social Security taxable wage base (3.24% for 2010 and 2011). The total, based on these percentages, is

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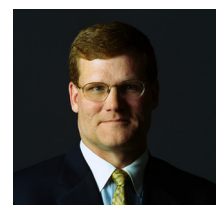


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then multiplied by 10% to arrive at the payment amount. For 2010 and 2011, the Social Security taxable wage base is \$106,800. The following is an example of the calculation:

ABC Company ("ABC") decides in October 2011 to file a Form 8952 with regard to the classification of one of its workers. In 2010, ABC paid the worker \$125,000, which was reflected on a Form 1099-MISC. Since the taxable wage base was \$106,800 in 2010, ABC would first multiply \$106,800 by 10.68%, which equals \$11,406.24. Then, ABC would take the amount over the taxable wage base, which is \$18,200, and multiply that amount by 3.24%, which equals \$589.68. Then, ABC would add the two amounts together, which total \$11,995.92, and multiply that amount by 10%. In this case, 10% would be \$1,199.59. Therefore, ABC would pay \$1,199.59 to resolve the misclassification issue with respect to this worker.

The Form 8952 uses a chart that aids in the calculation. Additional information is provided on the IRS website's Frequently Asked Questions ("FAQs").

Application and Procedure

According to the news release, employers can apply for the program by filing Form 8952 at least 60 days before they begin treating the workers as employees. Along with the application, a Form 2848 Power of Attorney should be included if an authorized representative assists with the submission. The IRS will contact the taxpayer or authorized representative to complete the process once it has reviewed the Form 8952 and has verified the applicant's eligibility. If the application is accepted, the taxpayer must enter into a closing agreement with the IRS to finalize the terms of the VCSP and make the payment. Once the closing agreement is executed, the taxpayer must treat all workers in the same classification as employees for employment tax purposes.

The IRS has the discretion to reject the application, although the IRS has not indicated the circumstances under which it may do so. Therefore, employers need to consider carefully whether they will make the application, particularly if the circumstances surrounding the misclassification are egregious. It is also not clear what collateral consequences may result from a rejection of the application but presumably an employment tax audit could follow. In addition, according to the FAQs, if a VCSP application is rejected because the taxpayer is ineligible, the taxpayer may reapply.

Related Considerations

As a related matter, the IRS has increased its enforcement efforts by entering into a Memorandum of Understanding with the Department of Labor ("DOL") to share information regarding worker misclassification in an effort to "reduce the incidence of misclassification of employees as independent contractors, help reduce the tax gap, and improve compliance with federal labor laws." As a part of this agreement, the IRS may also share employment tax referrals provided by the DOL with the state and municipal taxing agencies that are authorized to receive tax return information under approved agreements with the IRS. Moreover, the IRS may provide the DOL with information (other than taxpayer return information) that may constitute evidence of a violation of any Federal criminal law (not involving tax administration) that the DOL enforces.

This coordination among agencies and levels of government has the potential to raise a broad spectrum of issues for employers in a number of different areas: tax (federal and state), employee benefits, labor, employment (including wage and hour, leave, and nondiscrimination requirements), immigration, unemployment compensation, and workers' compensation. The IRS has not yet provided guidance regarding the extent to which specific information obtained through the VCSP may be shared among these groups.

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In light of the enhanced focus on proper worker classification, employers should consult with their qualified advisors to determine whether their organization is in compliance with all relevant worker classification laws and whether the VCSP may be appropriate. Employers need to be prepared to support the classification of workers under all relevant laws.

If you have any questions about the new voluntary compliance program or other issues related to worker classification, please contact [David Joffe](#) in the [Employee Benefits & Executive Compensation Group](#) or [Stuart Frenz](#) or [Bruce Ely](#) in the [Tax Practice Group](#) of Bradley Arant Boulton Cummings LLP.

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