

### **IRS floats new settlement offer on workers misclassified**

IRS has launched a new voluntary compliance program that allows employers to prospectively reclassify—as employees—those workers they have erroneously treated as independent contractors. The program carries generous settlement terms and provides audit relief for previous years.

Background. Whether a worker is an independent contractor or employee generally is determined by whether the enterprise he works for has the right to control and direct him regarding the job he is to do and how he is to do it. Under the common law rules (so-called because they originate from court cases rather than from the Code), multiple factors are used to determine if an individual is a common law employee.

Section 530 of the '78 Revenue Act (as amended) provides retroactive and prospective relief from employment tax liability for employers who misclassified workers as independent contractors using the common law facts and circumstances standards. Section 530 applies only if:

- (1) the taxpayer does not treat an individual as an employee for any period, and does not treat any other individual holding a substantially similar position as an employee for purposes of employment tax for any period—the substantive consistency requirement;
- (2) for post-'78 periods, “all federal returns (including information returns) required to be filed by the taxpayer” with respect to the individual for such period “are filed on a basis consistent with the taxpayer's treatment” of the individual as a nonemployee—the reporting consistency requirement; and
- (3) the taxpayer had a “reasonable basis” for not treating the worker as an employee (judicial precedent or IRS rulings, a past IRS audit, or a long-standing practice of a significant segment of the relevant industry)—the reasonable basis requirement.

Under IRS's pre-existing Worker Classification Settlement Program (CSP), which applies only for taxpayers under audit, the examiner first determines if the taxpayer is entitled to Section 530 relief (and if it is, there is no assessment). If the taxpayer is not entitled to this relief, a series of two graduated CSP settlement offers can occur.

If the service recipient has met the reporting consistency requirement of Section 530, but either can't meet the reasonable basis requirement or can't meet the reporting consistency requirement, the offer is a full employment tax assessment under [Code Sec. 3509](#) (which sets forth the employer's liability for employment tax because of its treating an employee as not being an employee) for one tax year (with the employer agreeing to reclassify the workers as employees on a prospective basis).

If the service recipient has met the reporting consistency requirement and can reasonably argue that it met the reasonable basis and substantive consistency requirements, the offer will be an assessment of 25% of the employment tax liability for the audit year under [Code Sec. 3509](#) (with the employer agreeing to reclassify the workers as employees on a prospective basis).

If workers are re-characterized under the CSP, no interest will be due on the additional liability arising as a result of the re-characterization if certain conditions are met.

New voluntary compliance initiative. IRS has determined that it would be beneficial to create a program that allows for voluntary reclassification of workers as employees outside of the examination context and without the need to go through normal administrative correction procedures applicable to employment taxes. IRS reasons that the program will facilitate voluntary resolution of worker classification issues and achieve the resulting benefits of increased tax compliance and certainty for all parties involved.

Who's eligible. The voluntary classification settlement program (VCSP) is available to taxpayers who are currently treating their workers (or a class or group of workers) as independent contractors or other non-employees and want to prospectively treat the workers as employees. Ann 2011– 64, 2011– 41IRB says the program is open to businesses, tax-exempt organizations, and government entities. To be eligible:

A taxpayer must have consistently treated the workers as non-employees;

- RIA observation: Apparently, the service recipient must have met this requirement (which is a watered down version of the Section 530 substantive consistency requirement) for the entire period that the workers provided services. A taxpayer must have filed all required Forms 1099 for the workers for the previous three years. The Instructions for Form 8952, Application for Voluntary Classification Settlement Program (VCSP), clarify that this requirement must be satisfied for each of the affected workers for the three preceding calendar years ending before the date Form 8952 is filed.

- RIA observation: This is far more liberal than the Section 530 reporting consistency requirement, which must be met for all post-'78 periods.

- RIA observation: The taxpayer need not have had a reasonable basis for treating the workers as non-employees.

The taxpayer cannot currently be under audit by IRS, or currently under audit concerning the classification of the workers by the Department of Labor (DOL) or by a state government agency. A taxpayer that was previously audited by IRS or DOL about the classification of the workers will only be eligible if it has complied with the results of that audit.

Terms of the offer. A taxpayer who applies for and is accepted into the VCSP will agree to prospectively treat the class of workers as employees for future tax periods and in exchange:

(A) Will pay 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 rates of Code Sec.3509.

(B) Will not be liable for any interest and penalties on the liability;

(C) Will not be subject to an employment tax audit for the worker classification of the workers for prior years; and

(D) Will 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.

- RIA observation: The VCSP applies to a broader audience than the Worker CSP and is more liberal to boot.

Application process. Taxpayers will have to apply on Form 8952 for participation in the VCSP, and provide the name of a contact or an authorized representative with a valid Power of Attorney (Form 2848). The Instructions to Form 8952 provide that although Form 8952 can be filed at any time, it should be filed at least 60 days before the date a service recipient wants to begin treating the class or classes of workers as employees. IRS will contact the taxpayer or authorized representative to complete the process once it has reviewed the application and verified the taxpayer's eligibility. IRS retains discretion as to whether to accept a VCSP application. Those who are accepted will enter into a closing agreement with IRS to finalize the terms of the VCSP and will simultaneously make full and complete payment of any amount due under the closing agreement.

References: For determining who is an employee, see [FTC 2d/FIN ¶ H-4250](#); United States Tax Reporter ¶ 34,014.37 ; TaxDesk ¶ 535,001 ; TG ¶ 9160 .

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