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to specific facts and situations.*

IRS Releases New Voluntary Worker Classification Settlement Program

As noted in a prior Client Alert (see http://www.hf-law.com/article/the_internal_revenue_service_steps_up_employment_tax_compliance_and_enforcement_efforts_be_sure_workers_are_properly_classified.html), the Internal Revenue Service continues to actively target all sizes of companies for employment tax and related audits, with a primary objective to determine whether companies are properly classifying their workers as either employees or independent contractors. Audit activity by the IRS (as well as states) is also targeting deferred compensation and 409A issues, executive compensation, taxable fringe benefits and business expense reimbursements. Whether an individual is an employee or an independent contractor is fact-driven inquiry with many areas open to interpretation. Companies with workers in the construction, ground delivery, car service, trucking and consulting fields, and leased employees, may be more closely examined than other fields.

For companies already under IRS examination, a classification settlement program is currently available to resolve federal employment tax issues related to worker misclassification, if certain criteria are met. That program permits the prospective reclassification of workers as employees, with reduced federal employment tax liabilities for past misclassification.

On September 21, 2011, the IRS released Announcement 2011-64 regarding a new Voluntary Classification Settlement Program (VCSP) for companies that are not currently under IRS examination, which can provide partial relief from federal employment taxes to companies that agree to prospectively treat workers as employees. To participate in the program, the company must meet certain eligibility requirements, apply to participate in the VCSP, and enter into a closing agreement with the IRS.

The VCSP applies to companies 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. To be eligible, the company must have consistently treated the workers as non-employees, and must have filed all required Forms 1099 for the workers for the previous three years. The company

cannot be under audit by the IRS for any tax item, and also cannot be under audit by the Department of Labor or by a state government agency concerning the classification of those workers. A company that was previously audited by the IRS or the Department of Labor concerning the classification of the workers will only be eligible if the company has complied with the results of that audit.

A company participating in the VCSP must agree to prospectively treat the class of workers as employees for future tax periods. Additionally, the company must agree to extend the period of limitations on assessment of employment taxes for an additional three years for the first, second and third calendar years beginning after the date on which the company has agreed to begin treating the workers as employees. In exchange, the company will pay only 10 percent 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 section 3509 of the Internal Revenue Code. The company will not be liable for any interest and penalties on the liability, and importantly will not be subject to an employment tax audit with respect to the worker classification of the workers for prior years.

Eligible companies who wish to participate in the VCSP must submit an application for participation in the program, along with the name of a contact or an authorized representative with a valid Power of Attorney (Form 2848). The IRS will verify the applicant company's eligibility, and the IRS retains discretion whether to accept a company's application for the VCSP. Companies that are accepted into the VCSP will enter into a closing agreement with the IRS to finalize the terms of the VCSP and must be prepared to simultaneously make full and complete payment of any amount due under the closing agreement.

A company should carefully consider whether to participate in the VCSP and the risks of disclosure to the IRS, but the benefits of participating in the VCSP are significant. In considering whether to submit an application to participate in the VCSP, a company should review its past and current worker classifications, compensation arrangements and benefit programs with its counsel to identify any potentially deficient documentation or classifications in order to better understand the scope of the risks and potential benefits of participating in the VCSP.

This Client Alert highlights some of the important issues raised by increased employment tax compliance efforts and the VCSP program but is not an exhaustive discussion of these matters. Please contact any of our tax or employment attorneys for additional details regarding the VCSP, the classification of your workers, employment taxes, or related questions.