
IRS Temporarily Expands Eligibility for Misclassified Worker Settlement Program

Gray Reed & McGraw Legal Alert

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Multiple factors are used to determine if an individual worker is an employee or an independent contractor. The determination generally is made based on whether the enterprise for which the individual works has the right to control and direct the individual regarding the job he is to do and how he is to do it.

When a company misclassifies one or more of its “employees” as “independent contractors,” the company also refrains from withholding required employment taxes from compensation payments to the misclassified worker(s). This can lead to an assessment by the Internal Revenue Service (IRS) of substantial back taxes and penalties against the company.

In 2011, the IRS announced a new program – known as the Voluntary Classification Settlement Program (VCSP) – to allow companies to voluntarily reclassify workers as employees in exchange for greatly reduced penalties and back taxes. On December 17, 2012, the IRS expanded the eligibility requirements for the VCSP, allowing many additional companies to take advantage of the voluntary correction program. However, certain changes to the eligibility requirements are only temporary (expiring on June 30, 2013), so potentially impacted companies should look into this issue soon.

To be eligible under the previous version of the VCSP, a taxpayer:

1. Must have consistently treated the workers as non-employees,
2. Must have filed all required Forms 1099 for the workers for the previous three years; and
3. Cannot be currently 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.

An employer that applies (on Form 8952) and is accepted into the VCSP must agree to prospectively treat the class of workers as employees for future tax periods, and in exchange:

1. Liability for employment taxes for the reclassified workers is limited to 10% of the compensation paid to the workers for the most recent tax year, determined under the reduced rates of Code Sec. 3509;
2. The employer will not be liable for any interest and penalties on the liability;
3. The employer will not be subject to an employment tax audit for the worker classification of the workers for prior years; and
4. The employer 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.

New Changes to VCSP Eligibility and Requirements

In Announcements 2012-45 and 2012-46, the IRS has provided the following relief to certain taxpayers who did not qualify for the 2011 version of the VCSP:

- Through June 30, 2013, a taxpayer that would have been eligible for the VCSP, except for the fact that it has not filed all required Forms 1099 for the previous three years (requirement #2, above), is eligible for a “modified” VCSP. The modified VCSP allows eligible taxpayers to prospectively treat workers as employees in exchange for partial relief from employment taxes. Payment under this temporary eligibility expansion is higher than the payment under the 2011 VCSP (the employer must pay 25%, instead of 10%, of the employment tax liability that would have been due on compensation paid to the reclassified workers), but the benefits are otherwise the same.
- Taxpayers who are under IRS audit (other than an employment tax audit) are now eligible to participate in the VCSP; and
- Taxpayers are no longer required to agree to extend the period of limitations on assessment of employment taxes as part of the VCSP closing agreement.

In addition, the IRS clarified the following two eligibility requirements for the VCSP:

- A taxpayer that is a member of an affiliated group within the meaning of Code Sec. 1504(a) is not eligible to participate if any group member is under an employment tax



audit (i.e., a group member's employment tax audit is imputed to the other group members); and

- A taxpayer is not eligible to participate if the taxpayer is challenging in court the classification of the class(es) of workers from a previous IRS or DOL audit.

For more information, please contact your attorney or contact Gray Reed attorney [Jason Luter](#) at 214.954.4135 or go to www.grayreed.com.