

Client Alert

Employee Benefits Group
Tax Group
Employment Practices Group

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IRS Launches Voluntary Classification Settlement Program (“VCSP”)

Eligible employers that reclassify workers as employees to receive past payroll tax relief

In September 2011, the Internal Revenue Service (“IRS”) announced a program to permit employers, on a voluntary basis, to reclassify workers as employees for federal employment tax purposes. The Voluntary Classification Settlement Program (“VCSP”) allows employers to obtain tax relief without the need to go through normal administrative correction procedures applicable to employment taxes. To participate in the VCSP, a taxpayer must meet certain eligibility requirements, apply for participation, and once accepted, enter into a closing agreement with the IRS.

The VCSP is a generous program. In exchange for an employer’s agreement to reclassify workers as employees in future tax periods, it will receive a discount of up to ninety percent (90%) of the employment tax liability that may have been due on compensation paid to these workers for the most recent tax year. The employer would not be liable for any interest or penalties on the liability, and would not be subject to an employment tax audit with respect to worker classification of the workers.

The VCSP is open to employers who currently treat all or a portion of their workforce as independent contractors or other nonemployee status, and who prospectively want to treat the workers as employees. In its Frequently Asked Questions (“FAQs”), the IRS clarified that the VCSP permits employers to reclassify some but not all of their workers. However, once an employer chooses to reclassify certain of its workers as employees, all workers in the same class must be treated as employees for employment tax purposes. To be eligible, an employer must have consistently treated the worker as a nonemployee, and must have filed all required Form 1099s for the workers for the previous three years. The IRS has also indicated that an employer will be eligible for the VCSP if it files the required Forms 1099 within six months of their due date (including extensions). However, an employer will not be eligible to participate in the VCSP if it or a member of its consolidated group is currently under audit by the IRS, or currently under audit by the DOL or a state government agency with respect to worker classification. The filing of a Form SS-8 (by employee or employer), does not constitute an audit, and does not preclude filing for relief under the VCSP. Past audits may impact eligibility so it is best to seek guidance before deciding to file under the VCSP.

Eligible employers who wish to participate in the VCSP must file an application with the IRS. If accepted, the employer enters into a closing agreement with the IRS and makes payment of the full amount of taxes that will be due under the closing agreement. (If a VCSP application is rejected because an employer is not eligible, the application may be resubmitted. The IRS also indicated in the additional FAQs that rejection of a VCSP

application will not automatically trigger initiation of a federal audit.) The IRS has not specified the duration of the VCSP.

While the program is generous, there are a number of issues to consider before applying to the VCSP. First, it does not preclude any private action by employees. Second, it does not appear to preclude enforcement action by state agencies or the Department of Labor's Wage and Hour Division, although the IRS has indicated in additional FAQs that it will not disclose VCSP applicants to state agencies or the Department of Labor. Third, depending upon the manner in which an employee benefit plan is drafted, there could be retroactive liability under the plan, although many plans, particularly those that Olshan prepares, contain language to address the contingency of worker reclassification.

Note that some employers that have misclassified workers as independent contractors are relieved from employment tax liability under Section 530 of the Revenue Act of 1978 ("Section 530 Relief"). To take advantage of Section 530 relief, an employer must file all federal returns consistent with its treatment of a worker as an independent contractor; treat all similarly situated workers as independent contractors; and have a "reasonable basis" for not treating the worker as an employee. However, the IRS does not look favorably upon claims for Section 530 relief. Thus, before seeking Section 530 relief, an employer should seek assistance to analyze the strength of its proposed 530 claim, particularly if it also wishes to avail itself of the VCSP for only certain members of its workforce.

For more information on the VCSP or to consider the advantages and disadvantages of participation in the VCSP, please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below.

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