

IRS Announces New Voluntary Classification Settlement Program

Recently, the Internal Revenue Service ("IRS") announced a new program that will allow employers to voluntarily reclassify workers from independent contractors to employees for federal employment tax purposes. Employers who classify workers as independent contractors, rather than employees, are not subject to the workers' employment taxes. Accordingly, employers may have an incentive to classify workers as such, and this can lead to improper classifications, either intentionally or unintentionally. In the event that the IRS chooses to audit the employer and determines that workers must be reclassified, employers may be subject to substantial tax consequences. Specifically, the employer may be required to pay many years of back taxes, interest, and penalties for the reclassified employees.

The Voluntary Classification Settlement Program ("VCSP") enables employers to avoid the potentially severe tax consequences of involuntary reclassification before an IRS audit occurs. The VCSP allows employers to voluntarily reclassify workers as employees without IRS intervention and with only minimal tax liability for prior years of misclassification. Under the VCSP, employers must prospectively agree to treat reclassified workers, and those in the same class of workers, as employees for tax purposes. In exchange for tax relief, the employer must pay the IRS ten percent (10%) of the employment tax liability that would have been due on the reclassified workers in the previous year, and will not be liable for any interest or penalties on this amount. Employers must additionally enter into an agreement with the IRS to finalize the reclassification. Pursuant to such agreement, the taxpayer must also agree to extend the period of limitations on assessment of employment taxes from three (3) to six (6) years on the first, second, and third calendar years after reclassification. Accordingly, the IRS may examine or audit an employer's payroll tax returns, and assess credits and additional taxes during such periods of limitations. Finally, employers will not be subject to an IRS audit regarding worker classification for the reclassified workers in the years prior to participation in the VCSP.

Only certain employers and classes of workers are eligible to take advantage of the VCSP. The employer must not currently be the subject of a federal Department of Labor audit, IRS examination, or state agency audit regarding worker reclassification. If an employer was previously audited for worker reclassification, the employer may still be eligible for the VCSP, provided that the employer complied with all terms of the prior audit. In order for the employer to reclassify workers, the employer must have consistently treated the workers as independent contractors or nonemployees, including having filed any required Forms 1099 for the workers in the past three years. Tax-exempt organizations and government entities are both eligible to participate in the VCSP if they meet all other eligibility requirements.

To apply for the VCSP, employers must submit a Form 8952 application, available on the IRS website. Employers may file at any time, but it is recommended that the application be filed at least 60 days in advance of the date the employer wants to begin treating the workers as employees. The IRS will contact the employer if it is accepted into the VCSP.

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If you have any questions, please contact the GW attorney with whom you regularly consult.

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