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IRS Announces New Voluntary Worker Classification Settlement Program

On September 21, 2011, the Internal Revenue Service (IRS) published Announcement 2011-64, which for the first time provides a voluntary worker classification program for employers who want to prospectively treat all or some of their workers as common law employees. Specifically, the program – The Voluntary Classification Settlement Program (VCSP) – allows eligible taxpayers to voluntarily reclassify their workers for federal employment tax purposes and obtain tax relief similar to that obtained in the current Classification Settlement Program (CSP), which is only available upon IRS examination. See <http://www.irs.gov/pub/irs-drop/a-11-64.pdf>.

In light of the legislative proposals over the last few years that threaten to severely restrict the existing 530 relief and the existing CSP relief programs available upon audit, this is a welcome step in the right direction for these historically difficult, facts and circumstances issues. The key components of VCSP are described below:

- Who is Eligible? To be eligible, an employer must:
 1. Currently treat workers (or a class or group of workers) as independent contractors or other nonemployees.
 2. Want to voluntarily (and prospectively) treat the workers as employees for employment taxes for future tax periods.
 3. Consistently have treated the workers in the past as nonemployees.
 4. Filed all required Forms 1099-MISC for each of the workers for the previous three years.
 5. Not currently under audit by the IRS, and not currently under audit concerning the classification of these workers with the Department of Labor or a state agency. Further, if the employer was previously under audit by the IRS or the DOL concerning the classification of the workers, it must have complied with the results of that audit.

Notably, eligible employers include sole proprietorship, joint venture, partnership, C corporation, S corporation, cooperative, governmental entities and tax-exempt organizations; however, workers covered by a Section 218 agreement with a state or local government are not eligible.

- What is the Application Process? Form 8952 is filed with the IRS at least 60 days before you want to begin treating the workers as employees. See <http://www.irs.gov/pub/irs-pdf/f8952.pdf>. The application requires disclosure of the following information: (1) employer contact information, (2) control group/consolidated return data, (3) contact person (and Form 2848, if applicable), (4) number of workers to be reclassified, (5) selected beginning date of "employee" status (at least 60 days from filing the application), and (6) description of the workers to be reclassified.

Once the application is accepted, which the IRS retains discretion whether or not to accept the application, the employer will enter into a closing agreement with the IRS to finalize the terms of the VCSP and will simultaneously make full and complete payment of the amount due under the closing agreement.

- What is the Cost of the Program? Employers will pay an amount effectively equal to just over one percent of the wages paid to the reclassified workers for the past year. Specifically, the employer will pay 10 percent of the employment tax liability for such workers for the most recent closed tax year at the time the application is filed, determined under the reduced rates of Code section 3509. No interest or penalties will be due, and the employer will not be audited on payroll taxes related to these workers for prior years. However, the employer will, for the first three years following the signing of the closing agreement, be subject to a special six-year statute of limitations, rather than the usual three years that generally applies to payroll taxes.

The Section 3509 rates are set forth below:

Description	2011 Rates – Up to the SSWB (e.g., if file in 2012)	2010 Rates – Up to the SSWB (e.g., if file in 2011)	2010-2012 Rates – Above the SSWB
Federal Income Tax Withholding	1.5%	1.5%	1.5%
Employee FICA	1.13%	1.53%	.29%
Employer FICA	7.65%	7.65%	1.45%
Total	10.28%	10.68%	3.24%

For example, if you have a group of workers that you want to reclassify, and you file the Form 8952 on November 1, 2011 for change effective January 1, 2012, and you paid \$500,000 of compensation to the group for 2010 (all of which earned less than the Social Security Wage Base (SSWB) (e.g., for 2010, \$106,800)). If accepted, you will pay 10% of \$500,000 times 10.68%, which is \$5,340.

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- What is the Impact on the Benefit Plans? Notably, VCSP is limited to employment taxes and does not address the impact of this filing on the employer's welfare and pension plans. Presumably, there is no special relief for the benefit plans, which means that prior to make such a filing, the employer should review the impact of this change on the pension and welfare benefits. For qualified pension plans (e.g., 401(k) Plan, Profit-Sharing Plan, etc.), this may well involve corrective contributions for improperly excluded workers, or minimum coverage violations.
- What About Labor and Employment Law Implications? Notably, VCSP is limited to federal employment taxes, and does not provide protection for other laws, such as labor and employment law requirements raised by the states or Department of Labor. Therefore, while this program is very attractive for the federal employment tax relief, careful consideration should be made regarding other legal exposures prior to filing an application.

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