

IRS Initiative for Reclassification of Contractors

By James Hammerschmidt

As part of the IRS Fresh Start initiative to help employers obtain a “fresh start” with their tax obligations, the agency has outlined a new program for employers to create a “low cost” resolution to prior worker classification issues by voluntarily reclassifying their employees.

In September of 2011, the IRS announced its Voluntary Classification Settlement Program (VCSP), which affords employers the opportunity to achieve compliance by making a “minimal” payment to cover past payroll tax obligations instead of waiting for an IRS audit. The complete announcement can be found at Announcement 2011-64 and you can also read the IRS news release (IR-2011-95).

The VCSP has the potential to save employers up to 90% of their employment tax liability that may have been due on compensation paid to workers for the most recent tax year, as well as interest and penalties. The IRS also will agree not to subject the employer to an employment tax audit for prior years.

“This settlement program provides certainty and relief to employers in an important area,” IRS Commissioner Douglas Shulman said in the news release. “This is part of a wider effort to help give taxpayers and businesses a fresh start with their tax obligations.”

The IRS already offers something similar called the Classification Settlement Program, which is available to employers in the midst of an IRS examination. The benefit of the VCSP is that it allows an employer to deal with the issue before an examination occurs.

As you might expect, there are several eligibility requirements. An employer must have filed all required Form 1099s for prior years and must not currently be the subject of an audit by the IRS, the Labor Department or a state agency for worker classification issues. If an employer was subject to a prior audit, it must have complied with all the directives from the audit. More details and an application can be found at www.irs.gov.

Beware, however, that the IRS is only one of a number of agencies that may come knocking if the employer has misclassified workers or elected to voluntarily reclassify some of its work force. State labor agencies that deal with unemployment insurance and workers’ compensation will also want to be made whole, retroactively, for the prior years of misclassification. The workers themselves may have claims for benefits and wages under local, state and federal benefit and wage and hour laws. Because IRS taxes are only one of many factors to consider, an employer should seek competent counsel to navigate these treacherous waters before jumping on the VCSP bandwagon