

PKF PERSPECTIVES

NEW IRS VOLUNTARY DISCLOSURE PROGRAM: RECLASSIFICATION OF INDEPENDENT CONTRACTORS TO EMPLOYEES

In its continued effort to bring taxpayers into compliance, the Internal Revenue Service (IRS) has initiated a new voluntary disclosure program that allows employers, on a prospective basis, to reclassify as employees those who have been treated as independent contractors.

The program is known as the Voluntary Classification Settlement Program (VCSP) and was launched on September 21, 2011 in IRS Announcement 2011-64. The VCSP is optional and provides taxpayers with an opportunity to voluntarily reclassify their workers as employees for future tax periods with limited federal employment tax liability for the past non-employee treatment.

The program provides generous settlement terms and should be strongly considered by all employers who are uncertain of the tax status treatment of service providers.

Background

The determination of whether a worker is classified as an employee or independent contractor is generally dependent upon whether the service recipient has the right to control and direct the person regarding his/her job and the methods he/she employs. There are a multitude of factors which are considered in this determination which have evolved over many years of court cases and, in some fact patterns, the proper worker classification status may not be clear.

If it is determined that a worker has been misclassified, certain relief is available which provides retroactive and prospective relief from employment tax liabilities for employers who misclassified

workers as independent contractors. This relief, under the current Classification Settlement Program (CSP), applies only if certain consistency and reasonable basis requirements are met and the employer is currently under audit by a taxing jurisdiction.

New IRS Initiative

The launch of the new VCSP will enable many employers to resolve past worker classification issues and achieve certainty at a low tax cost. Employers can settle their obligation by making a reasonable payment covering past payroll tax obligations rather than waiting for an IRS audit. The VCSP is open to many businesses, tax-exempt organizations and governmental entities that currently treat their workers or class of workers as non-employees or independent contractors and now want to treat them as employees.

To participate in the program, the taxpayers must meet certain eligibility requirements; apply to participate and enter into a closing agreement with the IRS.

Eligibility

- The program is available to taxpayers who currently treat workers as independent contractors or other non-employees and want to prospectively treat them as employees.
- The taxpayer must have consistently treated workers as non-employees and must have filed all required 1099 forms for the previous three years.

- The taxpayer cannot be currently under audit by the IRS or any other taxing jurisdiction for a worker classification issue. (If under audit, relief can be obtained through the current CSP initiative.)
- Taxpayers who have completed IRS audits are eligible if they are complying with the results of the audit.

It should be noted that taxpayers need not have a reasonable basis for treating the workers as non-employees to be accepted into the VCSP.

Terms of the Offer

Participants in the VCSP must agree to prospectively treat the class of workers as employees in future tax periods. In exchange, a taxpayer

- must pay 10 percent of the employment tax liability on compensation paid to the worker for the most recent tax year;
- will not be liable for any interest and penalties on the liability;
- will not be subject to an employment tax audit regarding worker classification for prior years; and,
- must agree to extend the period of limitations on assessments for three years for the first, second and third calendar years beginning after the date on which the a taxpayer agrees to begin treating workers as employees.

Application Process

To participate, eligible taxpayers must submit an application to participate in the program on Form 8952, *Application for Voluntary Classification Settlement Program* (Rev. September 2011) <http://www.irs.gov/pub/irs-pdf/f8952.pdf> which must be completed in full and signed by the taxpayer. If a representative is authorized to represent the taxpayer, a completed Power of Attorney form

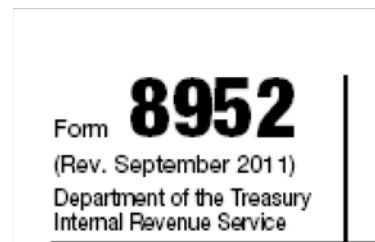
(Form 2848) should be included with the application.

The IRS will contact the taxpayer or representative to complete the process. Once accepted in the program, a closing agreement will be finalized at which time payment in full is due. IRS retains discretion as to whether to accept a VCSP application.

Effective Date

The instructions to Form 8952 indicate this form can be filed at any time; however, it must be filed at least 60 days before the date the employer wants to begin treating the worker as an employee.

Employers who wish to begin reclassification as of January 1, 2012 must file this application by November 2, 2011. Thus, urgent action is required.



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