

A Voluntary Reclassification of Workers can Give Businesses a Fresh Start

By: Nicole Destache



The IRS has generally used audits to insure that employers were properly classifying their workers as employees or independent contractors. This expensive and highly punitive method is giving way to a more gentle approach to seek compliance voluntarily. The IRS has announced a new program which will allow employers to reclassify some or all of their workers from independent contractors to employees. The program is called the Voluntary Classification Settlement Program (VCSP), and can allow employers to reclassify workers at a relatively low cost. According to the IRS, VCSP was designed to “increase tax compliance and reduce burden for employers by providing greater certainty for employers, workers, and the government.”

How Does the Program Work?

If accepted into the VCSP, you will identify workers who have been treated as independent contractors but who should have been treated as employees. You will pay only 10 percent of the employment taxes that would have been paid for the most recent tax year on the reclassified workers. This amount is generally approximately 1 percent of payments made, which is attractive to most employers. You will not be subject to any interest or penalties. Moreover, you will not be subject to an audit of payroll taxes relating to these reclassified workers for past years. However, you must pay the full amount due under the VCSP when the closing agreement with the IRS is submitted. The closing agreement will require you to treat the class of workers as employees in the future. The agreement also includes language that you agree to extend the statute of limitations for federal employment taxes from three to six years for the first three years under the program.

Despite all of the benefits of the program, there are issues of concern that have not been addressed, and must be factored into the decision of applying for the program. If rejected from this program, you are under no protection from an IRS audit on the classification of workers. By acknowledging that contractors should have been treated as employees, it may be difficult to argue upon audit that they were (or are) contractors. Additionally, the settlement program is a federal program and does not apply on the state level. Acceptance into the program may allow you to pay a portion of federal payroll taxes without penalty, but you may be responsible for state employment taxes for all open tax years. Finally, entering into this IRS program could potentially open you up to investigation by the Department of Labor of your business or the newly classified employees.

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Who is Eligible?

All business organizations, including tax-exempt and government entities, are eligible to correct their misclassification of workers from non-employees or independent contractors. However, you must meet certain participation guidelines:

- You have consistently treated workers as non-employees in the past,
- You have filed all of the required Forms 1099 for the workers for the past three years,
- You are not currently under any type of audit concerning the classification of workers,
- If you have been audited concerning worker classification in the past, you have complied with the results of the audit.

How to Apply

Application for participation in VCSP is done by filing Form 8952, *Application for Voluntary Classification Settlement Program*. Filing should be done at least 60 days before the date you would like to begin treating workers as employees. If you intend to begin treating workers as employees for the fourth quarter of 2011, you need to file as soon as possible. If you would like the IRS to discuss your application with your lawyer, accountant, or other advisor, you should submit Form 2848, *Power of Attorney*, with your application so that the IRS can contact you or the power of attorney about the application and eligibility.

If you are considering participation in this program or would like to know more, please contact us at (414) 271-3966.