The New Voluntary Classification Settlement Program

By Robb A. Longman*

The Service has recently increased its employment tax audits by focusing on businesses to ensure they are properly classifying their workers. Many businesses classify workers as independent contractors when they are, in fact, employees. The distinction between the two is not always clear, but the primary factor used to determine if workers are employees or independent contractors focuses on the amount of control the employer exercises over its workers. The difference for the employer typically equals thousands of dollars saved as it does not have to pay employment taxes; however, many employers do this at a great risk because in many cases workers are misclassified as independent contractors.

The Service will always prefer to collect employment taxes from employers as it simplifies the collection process. In order to bring more taxpayers into compliance, the Service, in September 2011, released Announcement 2011-64. It provides a voluntary settlement program for employers that have misclassified their employees or others as independent contractors or nonemployees. The Voluntary Classification Settlement Program (VCSP) offers employers a significantly reduced penalty and audit protection for previous years, in exchange for their agreement to prospectively treat any and all misclassified workers as employees; in turn, it provides the Service an opportunity to bring many employers into compliance and make them responsible for withholding taxes.

Worker classification determines if an individual providing services for a business is an employee or independent contractor. The purpose of worker classification is to properly classify compensation for services rendered.

Worker classification has important federal and state tax consequences. For statutory employees, employers are responsible for withholding and paying income and employment taxes (FICA and FUTA, respectively) on wages paid to employees. An employer is required to withhold employment taxes from the employees' wages, and failure to do so can result in liability for unpaid withholding, FICA, and FUTA taxes, as well as interest and possibly personal assessment. If a worker is classified as an independent contractor, the worker is responsible for the payment of taxes on his or her earnings.

The VCSP allows employers currently treating workers (or a class or group of workers) as independent contractors to acknowledge the misclassification and convert their employees' status to that of statutory employees going forward. Employers who take this step suffer minimal adverse consequences from the Service. The requirements of VCSP are as follows:

1. The employer must have treated its workers as nonemployees, and filed all required information returns for its workers, such as Forms 1099, for the three preceding calendar years. An employer qualifies whether or not the misclassification was the result of a close call in judgment or an obvious misinterpretation of the law. The Service will not pursue businesses if they attempt to come into voluntary compliance.
2. The employer cannot currently be under audit by the Service or Department of Labor (DOL) for worker classification. An employer previously audited by the Service or DOL concerning worker classification may request to participate in the VCSP if the employer has complied with the results of the previous audit. If the employer has not complied with the requirements placed upon it by the prior audit, it will be excluded.
3. The employer must extend the period of limitations on assessment of employment taxes for three years to include the first, second, and third calendar years following the date on which the employer agrees to begin treating workers as employees. In most cases, this is an inconsequential concession; however, some employers may be concerned that the Service requires an extension of the statute of limitations on assessment.
4. The employer must request to participate in the VCSP by filing Form 8952, Application for Voluntary Classification Settlement Program. The Service has advised employers to file Form 8952 at least 60 days before the employer wants to begin treating its workers as employees.
5. Employers must apply to the Service for acceptance to the program. If the Service does not accept the employer based upon the initial Form 8952 filing, the employer may re-file. Employers should be aware of, and carefully follow, the filing rules to increase the likelihood that their filings will be accepted.

In exchange for employers' agreement to prospectively treat workers as employees, employers will only have to pay (i) ten percent of the employment tax liability that may have been due on compensation paid to workers in the most recent year and (ii) twenty percent of employee social security taxes for the immediate past year. Employers will *not* be assessed any interest and penalties on the liabilities, and they will not be subject to an employment tax audit regarding the worker classification for

* McMillan Metro, P.C., Rockville, MD.

prior years. When the employer is accepted into the program, it will be required to enter a closing agreement with the Service.

Because this is a new program, questions still remain about its process and whether or not states will also provide taxpayers with a discount to come into compliance. Deals such as this, however, are not generally seen from the Service. Employers should act promptly while the opportunity is still available. ■

Recent Developments Affecting Employee Benefit Plans

By David Pratt*

As usual in the ever-changing world of employee benefits, there have been far more recent events than can be covered in this column, even briefly. The following is a brief discussion of some of the more important.

Legislation

On October 21, 2011, the President signed the Trade Adjustment Assistance Extension Act of 2011, Pub. L. No. 122-40. The Act extends the health care tax credit under Code section 35 and amends ERISA section 602 and Code section 4980(f) to extend the duration of COBRA benefits for certain TAA-eligible individuals and individuals receiving payments from the Pension Benefit Guaranty Corporation (PBGC).

Agency Action

Health Care Reform. The agencies have issued voluminous guidance on various provisions of the 2010 legislation. The best single source is the Department of Labor's (DOL) Affordable Care Act page, www.dol.gov/ebsa/healthreform/. Recent guidance includes:

- A Department of Health and Human Services (HHS) final rule on Medical Loss Ratio requirements for issuers;
- A DOL proposed rule, Summary of Benefits and Coverage and the Uniform Glossary, 76 Fed. Reg. 52442 (Aug. 22, 2011);
- An IRS, DOL, and HHS amendment to the interim final rule relating to internal claims and appeals and external review processes, 76 Fed. Reg. 37208 (June 24, 2011); and
- An IRS, DOL, and HHS amendment to the interim final rule relating to coverage of preventive services, 76 Fed. Reg. 46621 (Aug. 3, 2011).

Definition of Fiduciary. In October 2010, DOL issued a controversial proposed regulation (75 Fed. Reg. 65263) that would have expanded the definition of who is a fiduciary under ERISA. In September 2011, DOL said that it will re-propose the regulation. According to DOL, "The decision to re-propose is in part a response to requests from the public, including members of Congress, that the agency allow an opportunity for more input on the rule." The full text appears at www.dol.gov/ebsa/newsroom/2011/11-1382-NAT.html.

Investment Advice. A statutory prohibited transaction exemption enacted in 2006 allows a fiduciary, who provides investment advice to plan participants, to receive compensation if (1) the investment advice is based on a computer model or (2) the adviser's fees do not vary based on the investments selected by the participant. In October 2011, DOL issued a final regulation (76 Fed. Reg. 66136), effective for transactions on or after December 27, 2011. The final regulation provides detailed guidance on compliance with these rules.

Fee Disclosures. In 2010, DOL issued (1) an interim final regulation requiring certain retirement plan service providers to disclose information about fees and potential conflicts of interest to plan sponsors (75 Fed. Reg. 41600) and (2) a final regulation requiring plan sponsors to disclose information about plan and investment costs to participants (75 Fed. Reg. 64910). Under final regulations issued on July 19, 2011 (76 Fed. Reg. 42539), the deadline for

* Professor of Law, Albany Law School, Albany, NY.