

## in focus

October 2011

**Employee or Independent Contractor?**

*The IRS has announced a new voluntary correction program that would allow eligible employers to reclassify independent contractors as employees*

The Internal Revenue Service (IRS) and Department of Labor (DOL) have continued to increase their employer audits for misclassified employees. This issue typically arises where the employer erroneously classifies a worker as an independent contractor instead of a W-2 employee. This misclassification can result in (among other things), employer liability for additional unemployment, Social Security, and Medicare taxes, applicable wage and hour laws, claims for benefit plan coverage, and tax penalties and interest.

The IRS recently announced a new program that allows eligible employers to voluntarily reclassify workers as employees for federal employment tax purposes. Under the Voluntary Classification Settlement Program (VCSP), employers can request from the IRS reclassification of non-employees or independent contractors as employees. To be eligible, an employer must have consistently treated the workers as non-employees and must have filed all required Forms 1099 for the workers for the previous three years. The employer cannot currently be under audit by the IRS. In addition, the employer cannot be currently under audit concerning the classification of the workers by the DOL or by a state government agency. An employer who was previously audited by the IRS or DOL concerning the classification of the workers will only be eligible if the employer has complied with the results of that audit.

To participate in the VCSP, an employer must:

- Agree to prospectively treat the workers as employees for federal employment tax purposes;
- Pay a fee equal to 10 percent of the employment tax liability (calculated under the reduced rates of Section 3509(a) of the Internal Revenue Code) that may have been due on compensation paid to the workers for the most recent tax year; and
- Agree to extend the period of limitations on the assessment of employment taxes (*i.e.* the statute of limitations for an IRS audit) by three years for the first, second and third calendar years beginning after the date the employer has agreed under the VCSP closing agreement to begin treating the class or classes of workers as employees. (This effectively increases the limitations period to six years, instead of the usual three years.)

A participating employer will not be liable for any interest and penalties on the payment under the VCSP, and will not be audited for employment tax purposes for prior years with respect to the reclassified workers.

The VSCP provides limited relief only with respect to the issue of federal employment taxes. Employers who participate in the program may still face liability for wage and hour law violations, benefit plan coverage, etc.

**ACTION ITEMS:**

- Employers should periodically review and assess the status of the independent contractor agreements that are in place, and be prepared to prove that the worker has been properly classified as a non-employee. As working conditions change, a worker who was originally engaged as an independent contractor may transition over time to employee status, so ongoing review of existing agreements and arrangements is recommended.
- If a misclassification has occurred, employers should work with counsel to carefully consider all the potential issues, approaches, and ramifications, as a misclassification has the potential to involve liability under labor laws, tax laws, benefit plan coverage, and more.

More information about the VCSP is available here:

[Announcement 2011-64](#)

[FAQs about the VCSP](#)

[Form 8952, Application for Voluntary Classification Settlement Program](#)

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