

# *Legal Update*

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## **IRS WORKER MISCLASSIFICATION AMNESTY: IS IT RIGHT FOR YOU?**

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With the year-end fast approaching, not only is it a good time to be thinking of new resolutions for 2012, but, more importantly, it is a better time to tie-up loose ends and make good on outstanding 2011 resolutions. If conducting an employee classification audit is still on your list – or if it isn't but should be – now is the time to act.

Earlier this year, we warned about the high price tag associated with misclassifying a worker as an independent contractor rather than as an employee ([click here for our prior Legal Update](#)). To protect employees from abuse and also protect a major source of government revenue, the IRS, Department of Labor, and several state agencies have increased investigations and stepped up enforcement of employee misclassifications. Now, the IRS – through its Voluntary Classification Settlement Program (VCSP) - is offering a chance at partial relief from federal payroll tax liabilities to employers who voluntarily change the prospective classification of their workers from independent contractors to employees.

The VCSP is for employers who for the past three years have consistently treated at least one worker as an independent contractor by, among other things, filing IRS form 1099. Such employers should re-evaluate their independent contractor relationships (including consultants and freelancers), and if the underlying facts do not support the “non-employee” label for even one worker, the employer should consider applying for relief under the VCSP. If the employer is currently under an IRS, Department of Labor or state government agency audit concerning worker classification, or if the employer is not in compliance with the results of a prior audit, the employer will not qualify for VCSP relief.

Eligible employers will pay a fixed amount equal to 10% of the employment tax liability due on the compensation paid to the reclassified workers for the most recent tax year, determined under reduced rates. This means the employer will only have to pay 10% of the liability for the income tax withholding and the employer and employee portions of Social Security and Medicare taxes. Further, the employer will not have to pay any interest or penalties and will not be subject to an IRS audit with respect to the reclassified workers in question. These benefits can be significant, especially when considering that a non-participating employer who is subjected to an IRS audit may have to pay hefty interest and penalties in addition to several years-worth of full back taxes.

While the benefits of the VCSP may be great, participating in the VCSP may have a few drawbacks. First, under the VCSP, the employer will agree to extend the period in which the IRS can audit the employment tax returns for each of the three years beginning after the reclassification. Instead of a three-year limitations period, the IRS will have six years to audit the employment tax returns and assess

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additional taxes and penalties for the first three years of the reclassification. Second, the VCSP only applies between the IRS and the employer. This means that even though the employer will not be liable to the IRS for employment taxes for reclassified employees under the VCSP, the employer may still be subject to scrutiny and liability at the state level (note – the Illinois Department of Revenue has not yet implemented a similar voluntary reclassification program). Finally, other federal agencies, such as the Department of Labor, may incorporate the worker's (new) IRS tax classification for purposes of determining employee status and employee benefits under laws such as the Fair Labor Standards Act, Americans with Disabilities Act, and Title VII, to name a few. This may trigger a slew of potential new issues, including back wage and hour benefits (such as minimum wage or overtime), retirement benefits, e, and unemployment insurance and workers' compensation issues.

Since every employer's workforce is unique, it is important to assess whether the VCSP may be beneficial for any, some, or all of a particular class of workers. Together with counsel, employers should (i) review their worker classifications and determine the likelihood of success in the event of a classification audit, (ii) the employer's tax liability for prior years for non-employees, (iii) the additional future cost for newly reclassified employees, and (iv) the ramifications and obligations regarding other federal and state agencies. With this information, the employer can make an informed decision as to whether the VCSP settlement is truly a benefit.

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