



To Our Clients and Friends:

October 19, 2011

**The New Voluntary Disclosure:
No, It's Not For Those Hidden Foreign Bank Accounts --
This Time It's For Employers
Who Need to Reclassify Their Workers As Employees**

Having raised millions of dollars by encouraging taxpayers to come forward and report their foreign bank accounts and come into compliance, the Internal Revenue Service ("IRS") has now focused its sights on the domestic employee classification system. In determining whether a worker is an employee or an independent contractor, an employer has to examine all of the facts and circumstances. This is often a very difficult test to evaluate. A recent IRS study showed that the government has lost over \$2.7 billion in taxes due to worker misclassification. Rather than focusing on recovering this lost revenue, however, the program is intended to help taxpayers struggling with the complexity of the outdated worker classification rules to voluntarily come forward and straighten out the classification of their workers potentially at a low cost.

This new program, titled the Voluntary Classification Settlement Program (VCSP), is intended to allow employers the chance to voluntarily come forward and become compliant by making a "minimal" payment covering past payroll obligations instead of waiting for an IRS audit that could result in significant penalties and back taxes. The Service states that this is part of its larger "Fresh Start" initiative to help taxpayers and businesses address their tax responsibilities.

Employers who are accepted into the program will pay an amount equal to ten percent of the employment tax liability that would have been due on the amount paid to the reclassified workers for the most recent year (which is effectively slightly over one percent of the wages paid to the reclassified workers for the prior year). Interest and all penalties will be waived, and no audit with respect to employment taxes for those workers will occur for any prior years.

The IRS has been very active in auditing employers in this area over the last few years and has stated that it will continue to run a robust audit program for those taxpayers who are ignoring the law. In fact, on September 19, 2011, the Secretary of Labor and the IRS Commissioner signed a Memorandum of Understanding to coordinate both agencies' law enforcement efforts aimed at businesses that misclassify employees as independent contractors. The Memorandum of Understanding allows the Labor Department and IRS to share information with each other and thus makes it easier for the IRS to locate and identify employers with misidentified employees. Seven states have also signed memoranda of understanding with the U.S. Department of Labor to address and combat employee misclassification, and four more intend to do so shortly.

To be eligible for the VCSP, the employer must have always treated the workers as nonemployees in the past, filed Forms 1099 for those workers for the previous three years, and not currently be under audit by the IRS, the Department of Labor or any state agency concerning the classification of these workers. The taxpayer may be eligible if it was previously audited by the IRS or the Department of Labor if it complied with the results of that prior audit. Unlike other relief available in this area, under the VCSP the employer does not have to establish that it had a reasonable basis for treating the workers as nonemployees.

The Service has issued a new form specific for the VCSP, Form 8952, to apply for acceptance into the program. The IRS has discretion as to whether or not to accept the taxpayer's application. The one restriction placed on participants is that they must agree to extend the statute of limitations for assessment of unpaid taxes for the first three years that they are participating in the program to six years, rather than the standard three year limitation period.

Employers who wish to participate in this program should apply at least sixty days prior to the date the worker will begin to be classified as an employee. In deciding whether or not to participate in this program, it is important that consideration be given to, among other things, (i) the possible consequences with respect to the employer's tax-qualified plans (e.g., classification as an employee may cause compliance problems with the minimum coverage rules applicable to qualified plans) and (ii) the possible state tax consequences of reclassifying workers (e.g., there is nothing to limit a state tax department's ability to audit prior years and impose penalties on any deficiencies that are found to arise for those years).

If you have any questions, please contact Norman J. Misher (212) 903-8733, Allen J. Erreich (212) 903-8769, or Ellen S. Brody (212) 903-8712.