

CCH Practitioners' Corner: IRS's New Voluntary Worker Classification Program: Beyond The Initial Announcement

The IRS's launch of a new worker classification program—the Voluntary Classification Settlement Program (VCSP)—in late September has generated a number of questions from businesses on how to evaluate the program (see the September 29, 2011 issue of CCH Federal Tax Weekly). In contrast to the current Classification Settlement Program (CSP) for employers subject to audit for classification issues, this program is available to employers that have misclassified employees as independent contractors and wish to voluntarily rectify the situation before the IRS or Department of Labor initiate an examination.

Mary Gorman, senior manager, Ernst & Young LLP, U.S. Business Tax Services, Washington, D.C.—*former Assistant Division Counsel, Office of Chief Counsel, IRS*—sat down with CCH this past week to provide some insights into how practitioners should evaluate the pros and cons of VCSP. Excerpts from that conversation, below, indicate the extent of such evaluation beyond the initial details found in Ann. 2011-64.

CCH: *Should this program be considered a quasi-amnesty program for those in noncompliance, but not yet under audit for worker classification?*

Gorman: The Voluntary Classification Settlement Program (VCSP) is a voluntary compliance initiative. Like other voluntary programs the IRS has offered, this program allows taxpayers to voluntarily come into the Service to reclassify their workers and pay less tax than if the IRS reclassifies their workers as the result of an audit. Also, a Government Accounting Office (GAO) report on misclassified workers had recommended that the Service offer taxpayers a way to come in voluntarily to resolve worker classification issues and taxpayers had expressed an interest in being able to voluntarily resolve this issue.

The VCSP in at least one respect should not be considered entirely new. The IRS will sometimes allow taxpayers to come in voluntarily with an agreement of future compliance that saves resources, which can then be focused on other enforcement and compliance problems that require a "stronger touch." IRS has done this in other areas as well, but just a warning to those who do not come in voluntarily is that if audited, the financial costs can be much greater. The value of the VCSP program to taxpayers that have a worker classification issue is that they will be able to resolve the issue with the Service at a reduced tax rate, which will provide certainty for the taxpayer.

CCH: *Are many businesses surprised by IRS worker classification positions? That is, are the classification standards vague as to their application to specific facts so that the resulting uncertainty becomes a serious business risk?*

Gorman: Worker classification is an area with complex factual and legal issues where the case law is not uniform. It is not uncommon to find that workers have been misclassified. There can be significant potential tax liability where there is exposure on this issue. It is also an issue that is

routinely addressed in due diligence reviews. There is also a lack of guidance on this issue because Section 530 of the Revenue Act of 1978 prohibits the IRS from issuing guidance (regulations and revenue rulings) "clarifying the status of individuals for purposes of employment taxes."

CCH: Assuming that the standards for application of worker classification are unclear, does the business get the benefit of the doubt from the IRS in most close cases on worker classification?

Gorman: Again, the case law is not uniform in this area. It varies by industry and within industries. The IRS and taxpayers have each won cases in this area. The legal issue is who has the right to control and direct the worker, which is a fact intensive determination. In these cases the decisions turn on the facts and circumstances. It is not uncommon for taxpayers to get this issue wrong, which is why taxpayers who find that they have misclassified workers may want to take advantage of the new VCSP program.

CCH: Is there a difference between application of classification standards among courts?

Gorman: The IRS Guidance, Revenue Ruling 87-41, provides for 20 common law factors. Different courts have reviewed and applied these factors. For example, the Tax Court uses a seven factor analysis.

CCH: Does the audit bar from participation in VCSP mean any sort of audit or only an audit in which the IRS has raised the issue of worker classification? Does the IRS raise worker classification as a matter of course on audits?

Gorman: The new Form 8952, Application for Voluntary Classification Settlement Program (VCSP), includes a set of representations that must be answered under penalties of perjury. The first representation that a taxpayer makes is that the taxpayer is not under examination by the Internal Revenue Service. So, the audit bar, for IRS audits, is any sort of audit. For audits by state authorities and the Department of Labor, the bar is only audits where the issue was the proper classification of the workers. This could potentially eliminate a large group of taxpayers who might otherwise participate in the program. We have urged the IRS to evaluate this to open the opportunity more broadly.

All IRS income tax examinations must include consideration of a taxpayer's liability for employment tax. Also the IRS has been conducting NRP Audits for employment tax compliance in part to identify future audit coverage. As part of an NRP audit, certain employment tax issues must be addressed in every audit, one of those issues is worker classification.

CCH: Is the recent partnership between the IRS and the Labor Department on worker classification preparation for increased audits?

Gorman: I do not have the impression that the IRS-DOL program will be used in this manner. However this issue was addressed by John Tuzynski, IRS, Chief of Employment Tax Operations, on E&Y's webcast, "Understanding the new IRS Voluntary Classification Settlement Program (VCSP)" held on October 6, 2011