



THE KULLMAN FIRM

A PROFESSIONAL LAW CORPORATION

CLIENT E-NEWSLETTER

SPECIAL BULLETIN

IRS Voluntary Compliance Program for “Misclassified” Employees . . . PROCEED WITH CAUTION!

The IRS has recently announced a new voluntary compliance program providing employers the opportunity to prospectively reclassify as employees workers erroneously treated as independent contractors. To encourage such voluntary reclassification, the program offers generous settlement terms and, according to the IRS, provides audit relief for previous years.

To obtain the benefits of the program, the employer must be “eligible,” which requires the employer to have:

- Consistently treated the workers in the past as nonemployees;
- Filed all required Forms 1099 for the workers for the previous three years; and
- Not currently be under audit by the IRS, the Department of Labor or a state agency concerning the classification of these workers.

Employers “accepted” into the program agree to prospectively treat the class of workers as employees for future tax periods and in exchange:

- Will pay 10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year, determined under the reduced rates of Code Sec. 3509;
- Will not be liable for any interest and penalties on the liability;
- Will not be subject to an employment tax audit for the worker classification of the workers for prior years; and
- Will agree to extend the period of limitations on assessment of employment taxes for three years for the first, second, and third calendar years beginning after the date on which the taxpayer has agreed under the program closing agreement to begin treating the workers as employees.

To apply, employers must submit an application, Form 8952, available at <http://www.irs.gov/pub/irs-pdf/f8952.pdf>. The IRS will contact the applicant to complete the process once it has reviewed the application and verified the employer's eligibility. Notably, the IRS retains discretion as to whether it accepts an application, but according to the IRS, an employer's application will be denied only if the employer is not "eligible" for the program.

The voluntary compliance program provides attractive tax benefits to employers BUT there are a number of POTENTIAL RISKS that should be considered prior to submitting an application to the IRS, such as, (1) the IRS's discretion to deny the application; (2) the IRS sharing information with the DOL (which could lead to unpaid overtime liability); (3) possible state tax liability; and (4) the extension of the applicable federal tax statute of limitations period to six years.

The IRS retains discretion to accept or deny the employer's application under the program. As a result, the employer's application should be carefully reviewed to ensure the employer is eligible. Otherwise, if an employer submits an application that is denied by the IRS, either in its discretion or because the employer is not eligible, the employer will not only be denied the benefits of the program but will also identify itself as having potential employee misclassifications to the IRS.

Even more troubling for employers is that the voluntary compliance program offers "protection" only from the IRS, not the DOL or other state tax or wage and hour agencies. Thus, even if the employer is accepted into the voluntary compliance program, nothing under the present law precludes the DOL or another state agency from pursuing claims based on the same employee misclassification.

Moreover, nothing under the program precludes the IRS from sharing information provided to it by the applicant with other governmental entities. In fact, five days after the announcement of the voluntary compliance program, the IRS and DOL signed a memorandum of understanding ("MOU") to share information and collaborate on the issue of employees who have been misclassified as independent contractors. According to the IRS, this MOU does not "require" it to provide the applicant's information to the DOL. Nevertheless, even if the MOU does not require disclosure to the DOL, it neither prohibits it nor offers any assurance to the employer that the information will not be shared with the DOL.

Lastly, upon acceptance into the program, the employer must agree that, for the first three years beginning after the date on which the employer agreed to begin treating the workers as employees under the program, it will be subject to a special six-year statute of limitations, rather than the usual three years that applies to payroll taxes. For example, if under the program an employer begins reclassifying workers as employees effective January 1, 2012, the employer must agree to extend the statute of limitations period for calendar year 2013 to April 15, 2020 (instead of April 15, 2017, without the extension). The limitations period for 2014 must be extended to April 15, 2021, and for 2015 it must be extended to April 15, 2022. This extended limitations period allows the IRS more time to conduct audits not only for employee misclassification issues but also for employment tax compliance generally.

If you have any questions about this new voluntary compliance program or would like to discuss it further, please contact the Kullman attorney with whom you regularly correspond.



Management Resource in Labor and Employment Law

1600 Energy Centre, 1100 Poydras Street / New Orleans, LA 70163 / 504.524.4162
Suite A, 4605 Bluebonnet Boulevard / Baton Rouge, LA 70809 / 225.906.4250
Suite 340, 600 University Park Place / Birmingham, AL 35209 / 205.871.5858
Suite 704, Court Square Towers, 200 6th Street North / Columbus, MS 39701 / 662.244.8824
Suite 120, 1640 Lelia Drive / Jackson, MS 39216 / 601.366.2990
1100 Riverview Plaza, 63 S. Royal Street / Mobile, AL 36602 / 251.432.1811

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