5. Responding to the IRS Determination

Once the Form SS-8 is submitted to the IRS, it can take up to six months to receive a response. As noted above, in more than 70% of the cases, the IRS determines that the worker is an employee.

The IRS will provide guidance on how the firm can respond. It is important to remember that the firm is not obligated to respond. The IRS is informing the firm that it believes the worker is an employee, but it is not instructing the firm to treat the worker as an employee for past or future purposes.

If the IRS determines that the worker is not an employee, the firm does not need to take any action.[35] If the IRS determines that the worker is an employee, the firm must decide among the following options:

1. Do nothing.

2. Determine whether the firm is entitled to relief under Section 530 of the Revenue Act of 1978 even if the worker is an employee under common law.

3. If the firm is not entitled to § 530 relief,

a. Treat the worker as an employee on a going forward basis, but make no changes for past taxable periods, or

b. Participate in the Voluntary Classification Settlement Program. *See* IRS website on Voluntary Classification Settlement Program (''VCSP'').

5.1. Do Nothing

As discussed in 3.2, above, the 2009 GAO Report found that only an average of two to three percent of employers the IRS identifies as having misclassified employees through Form SS-8 determinations were referred for examinations, and an even smaller percentage resulted in examinations.

If a Form SS-8 determination were to result in an examination, the firm would be able to avail itself of the IRS Classification Settlement Program. *See* IRS webpage on Classification Settlement Program (''CSP''). Under this program, a firm can settle its liability for misclassifying workers on terms more favorable than would be the case if the firm were liable for the full amount of FICA, FUTA, and income tax it failed to pay (or withhold). If the firm participates in this program, it must pay the amount due under the program and agree to treat all workers it misclassified as employees going forward. While the amount due under the CSP is less than would otherwise be due, it is more than the amount that would be due if the firm chose to participate in the VCSP.

5.2. Section 530 Relief

Section 530 of the Revenue Act of 1978 provides relief to firms that classify common law employees as independent contractors if three conditions are met. First, the firm must have a reasonable basis for treating the worker as an independent contractor. Second, the firm must have treated the worker, and any similar workers, as independent contractors. Third, the firm must have filed all required federal tax returns (including information returns) consistent with its treatment of each worker as not being an employee.

A firm will have a reasonable basis for treating a worker as an independent contractor if it can show one of the following:

1. The firm reasonably relied on a court case about federal taxes or a ruling issued by the IRS; or

2. The firm's business was examined by the IRS at a time when it treated similar workers as independent contractors and the IRS did not reclassify those workers as employees. A taxpayer may not rely on an examination commenced after December 31, 1996, unless such examination included an examination for employment tax purposes of whether the individual involved (or any other individual holding a substantially similar position) should be treated as the firm's employee; or

3. The firm treated the workers as independent contractors because it knew that was how a significant segment of its industry treated similar workers; or

4. The firm relied on some other reasonable basis. For example, it relied on the advice of a business lawyer or accountant who knew about its business.

Section 1706(a) of the 1986 Act added to § 530 a new subsection (d), which provides an exception with respect to the treatment of certain workers. Section 530(d) provides that § 530 shall not apply in the case of an individual who, pursuant to an arrangement between the firm and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work. Section 530(d) does not affect the determination of whether such workers are employees under the common law rules. Rather, it merely eliminates the employment tax relief under § 530(a) that would otherwise be available to a taxpayer with respect to those workers who are determined to be employees of the taxpayer under the usual common law rules. Section 530(d) applies to remuneration paid and services rendered after December 31, 1986.

When the IRS conducts an employment tax examination, it first determines whether § 530 relief applies. If it applies, there is no need to determine whether the worker is an employee under common law, because the firm can treat the worker as an independent contractor. If the firm is confident that § 530 applies, it may choose not to respond to the IRS Form SS-8 determination believing that, if the IRS were to examine it, it would be permitted to continue to treat the worker as an independent contractor.

5.3. No Section 530 Relief

If § 530 relief is not available, the firm can choose to treat the worker as an employee going forward without further interaction with the IRS or it can choose to participate in the Voluntary Settlement Classification Program. The advantage of participating in the VCSP is that it provides protection for past years. If the firm does not participate in the VCSP, the IRS

[35] This assumes the firm has complied with the reporting requirement by furnishing and filing Forms 1099-MISC when required.

could examine it for past years and determine that the worker should have been classified as an employee for past years. In this case, the firm could take advantage of the Classification Settlement Program to reduce it potential liability (assuming it qualifies to participate in the CSP), but the terms for settling with the IRS under the CSP are not as favorable to the firm as are the terms under the VCSP.

To be eligible for the VCSP, a firm:

- must have consistently treated the worker(s) to be reclassified as independent contractors or other nonemployees, including having filed all Forms 1099 for the worker(s) to be reclassified under the VCSP for the previous three years;
- cannot currently be under employment tax examination by the IRS;[36]
- cannot currently be under examination concerning the classification of workers by the Department of Labor or by a state government agency; and
- cannot be contesting in court the classification of the class or classes of workers from a previous examination by IRS or the Department of Labor.

A firm that was previously examined by IRS or the Department of Labor concerning the classification of the workers will be eligible only if the firm has complied with the results of the examination.

A firm will receive the following benefits from participating in the VCSP:

- It will pay 10% of the employment tax liability that may have been due on compensation paid to workers for the most recent tax year;
- The liability will be determined under the reduced rates of § 3509;
- It will not be liable for any interest or penalties on the liability; and
- It will not be subject to an employment tax examination with respect to the worker classification of the workers for prior years.

The business will be required to enter into a closing agreement with IRS and to treat the class of workers subject to the VCSP as employees for future years.

To participate in the VCSP, an eligible business must complete and submit an application, using Form 8952, Application for Voluntary Classification Settlement Program. The application should be filed at least 60 days from the date the business wants to begin treating the workers as employees. As with the CSP, the VCSP is done on the basis of each class of workers. Once a business chooses to reclassify certain of its workers as employees, however, all workers in the same class of workers must be treated as employees for employment tax purposes.

IRS has posted the following information to its website to help firms understand the VCSP:

- Voluntary Classification Settlement Program
- Announcement 2012-45, 2012-51 I.R.B. 724
- Form 8952, Application for Voluntary Classification Settlement Program (VCSP)
- Instructions for Form 8952
- Voluntary Classification Settlement (VCSP) Frequently Asked Questions

[36] If the firm is a member of an affiliated group within the meaning of § 1504(a) and any member of the affiliated group is under employment tax examination by IRS, the firm is not eligible to participate in the VCSP.