Correcting Employment Tax Noncompliance

By Lawrence A. Sannicandro and Daniela Calabro

I. Introduction

Employment taxes, including federal income tax withheld and voluntarily paid over to the United States, typically account for around 70% of all tax collected by the Internal Revenue Service (the "IRS" or "Service").[1] This makes employment taxes an obvious focus for the increased enforcement efforts by the IRS, expected to come about as a result of the Inflation Reduction Act of 2022 (the "Act").[2] The Act provides for roughly $80 billion in additional IRS funding over approximately ten years, including more than $45 billion for civil and criminal tax enforcement.[3] Among other things, the funding targets the "tax gap"—the difference between taxes owed to the government and actually paid. The U.S. Department of the Treasury recently estimated a "net tax gap" of $554 billion in 2019, of which approximately 18% is attributable to employment tax noncompliance.[4] As a major contributor to the tax gap, employment tax noncompliance is a likely enforcement priority for a reinvigorated IRS as well as the Tax Division of the U.S. Department of Justice ("DOJ-Tax"). To stay out of the IRS's and DOJ-Tax's cross-hairs, all employers should be exceedingly mindful of their employment tax filing and payment obligations. And, noncompliant employers should act before a potential civil audit or criminal investigation by adopting a strategy from among the many options available to correct historical noncompliance.

This article provides an overview of federal payroll taxes, summarizes typical areas of noncompliance with employment taxes, surveys the civil penalties and criminal sanctions that can apply to employment tax violations, explains how the IRS detects such violations, and details the options available to noncompliant employers. These options include, but are not necessarily limited to: the voluntary disclosure practice; the Voluntary Closing Agreement Process—Employment Tax Issues (the "VCAP-ET"); the filing of amended tax returns and, as appropriate, requesting that penalties be abated; the Classification Settlement Program

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("CSP"); the Voluntary Classification Settlement Program (the "VCSP"); relief under Section 530 of the Revenue Act of 1978;[5] and an early referral program.

II. Overview of Federal Employment Taxes

Employers have a legal duty to collect and pay over to the United States taxes withheld from their employees' wages.[6] The taxes required to be withheld and paid over to the United States include, but are not limited to, federal income tax and various employment taxes, such as the Federal Insurance Contributions Act ("FICA") tax, which includes Social Security (Old-Age, Survivors, and Disability Insurance), Medicare, and, where applicable, the additional Medicare tax.[7] Employers also have an independent responsibility to pay the employer's share of employment taxes, including a matching amount of FICA[8] and annual Federal Unemployment Tax Act ("FUTA") tax.[9]

A. Tax Reporting and Payment Requirements

Employers are subject to both tax reporting and tax payment requirements with respect to the employment taxes withheld from employees, each of which is discussed in turn.

1. Tax Reporting Requirements Generally

Employers must report wages, tips, and other compensation paid to an employee by filing the required Form 941, *Employer's Quarterly Federal Tax Return*, for each quarter of the year.[10] Most employers must also file Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*, to report the wages paid subject to FUTA and to compute the tax.[11] At the end of the year, the employer must file Form W-2, *Wage and Tax Statement*, to report wages, tips, and other compensation paid to an employee with the Social Security Administration and furnish a timely copy to the employee so that they can properly file their income tax returns.[12] Employers that are required to file Form W-2 must also file Form W-3, *Transmittal of Wage and Tax Statements*, to report the total wages, taxable wages, and tax withheld for all its employees.[13] Moreover, everyone who is engaged in a trade or business that makes certain types of reportable payments must report the payment to the IRS. Form 1099-NEC, *Nonemployee Compensation*, is used for reporting payments for non-employee compensation of $600 or more to a payee (including independent contractors).[14] Form 1099-MISC, *Miscellaneous Income*, is used for reporting payments other than non-employee compensation.[15]

Employers must file the required forms by the required due date. Form 941 must be filed quarterly by the last day of the month that follows the end of the quarter (*i.e.*, due dates of April 30, July 31, October 31, and January 31 (for the fourth quarter of the previous calendar year)). Each of the following forms must be filed annually with a due date of January 31: Form W-2, Form W-3, Form 940, Form 944, Form 1099-NEC, and Form 945. Form 1099-MISC must be filed annually with a due date of February 28, or March 31 if filed electronically. Generally, Form 1099-MISC must be furnished to payees by January 31.

2. Tax Payment Requirements Generally

In addition to tax reporting requirements, all employment taxes must be deposited timely and by the required method. Employers must use the Electronic Federal Tax Payment System ("EFTPS") to make all federal tax deposits. The due dates for the deposit of taxes vary depending on the return the taxes are reported on, past filing history, and additional factors. These deposit due dates often are different from the filing due dates of the tax returns. For taxes reported on Forms 941, 943, 944, or 945, there are two deposit schedules: monthly and semiweekly.[16] Before the beginning of each calendar year, employers must determine which of the two deposit schedules they are required to use. The deposit schedule employers must use is based on the total tax liability that the employer previously reported on forms during the specified lookback period. The lookback period is different based on the form type. For example, for filers of Form 941, an employer's deposit schedule for a calendar year is determined from the total taxes reported on Form 941, in a four-quarter lookback period. The lookback period begins July 1 and ends June 30.[17] If the employer reported $50,000 or less of taxes for the lookback period, they would be a monthly schedule depositor; if they reported more than $50,000, they would be a semiweekly schedule depositor.[18] Under the monthly deposit schedule, employers must deposit employment taxes on payments made during a month by the 15th day of the following month.[19] Under the semiweekly deposit schedule, employers must deposit employment taxes for payments made on Wednesday, Thursday, and/or Friday by the following Wednesday, and deposit taxes for payments made on Saturday, Sunday, Monday, and/or Tuesday by the following Friday.[20] Under the next-day

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deposit rule, if an employer accumulates $100,000 or more in taxes on any day during a monthly or semiweekly deposit period, then they must deposit the tax by the next business day.[21]

Regarding FUTA deposits specifically, employers must determine when to deposit their FUTA tax based on the amount of their tax liability as determined on a quarterly basis. If their FUTA tax liability is $500 or less in a quarter, then they must carry it over to the next quarter. For any quarter where an employer's FUTA tax liability for that quarter (plus any undeposited amount from any earlier quarter) is $500 or more, they must deposit the entire amount of their FUTA tax liability as of the end of the quarter by the last day of the first month that follows the end of the quarter. If the FUTA tax liability is $500 or less for the fourth quarter, then they can make a deposit or pay the tax with their Form 940 by January 31.[22]

B. What Are Wages?

FICA taxes, FUTA taxes, and federal income taxes are all due with respect to "wages." The Internal Revenue Code (the "Code") defines "wages" for purposes of income tax withholding as "all remuneration … for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash."[23] Similar definitions apply for FICA tax and FUTA tax purposes.[24] Thus, absent the applicability of one of the statutory exceptions,[25] an employer that pays an employee remuneration for services performed should consider the payment to be wages for federal employment tax purposes.

Generally, it does not make any difference how the wages are designated.[26] Neither the reason for which the remuneration is paid nor the medium in which it is paid will change its classification as wages.[27] For FICA and FUTA purposes, however, facilities or privileges furnished to employees will not ordinarily be considered wages if their value is relatively small and they are offered merely as a means of promoting the health, good will, contentment, or efficiency of the employees.[28] While vacation allowances constitute wages for federal employment tax purposes, advances and reimbursements for traveling and other *bona fide* business expenses do not.[29] In addition, for income tax withholding purposes, the term wages generally includes pensions, retirement pay, severance pay, deductions from pay such as a State income tax, payments by an employer of an employee's tax, supplemental unemployment compensation benefits to the extent not excludible from the employee's gross income, and the value of meals and lodging to the extent not excludible from the employee's gross income.[30]

III. Typical Areas of Noncompliance with Employment Taxes

Employment tax avoidance can occur in many ways, but certain forms of noncompliance occur with regularity. The most common areas of noncompliance with employment taxes include the following:

- Misclassification of workers, which generally refers to classifying a service provider as an independent contractor, as opposed to an employee, to avoid paying employment tax and other indirect costs of labor for that worker;
- Pyramiding, which typically occurs when an employer (1) accumulates more than one quarter of unpaid employment taxes, and (2) withholds payroll taxes from its employees but intentionally does not remit those withholdings to the tax authority. This usually occurs when an employer is experiencing a cash shortfall and chooses to pay other creditors before the IRS. In addition to "pyramiders," the IRS scrutinizes so-called "repeaters," which refers to business taxpayers who repeatedly accrue employment tax liabilities and/or do not file their employment tax returns timely[31];
- Cash-intensive businesses where independent contractors are usually paid in cash and the employer does not include the cash wages on the proper Form 1099. This is a prevalent issue with employers that employ undocumented workers to avoid tax withholding obligations. The IRS has developed a Cash Intensive Businesses Audit Techniques Guide to provide guidance to its agents on how to examine income in a cash-intensive business and make sure that the required employment tax has been withheld and remitted to the IRS;
- Misclassification of compensatory items as non-compensatory, when the items paid fall within the broad definition of wages for FICA, FUTA, and federal income withholding taxes. This misclassification issue usually arises with the payment of fringe benefits (*i.e.*, a benefit other than salary, wages, and similar direct compensation, provided in connection with the performance of services)[32] or the payment of supplemental wages (*i.e.*, wages paid by an employer that are not regular wages including bonuses, overtime, sick pay paid by a third party as an agent of the employer);

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- Improper treatment of certain forms of compensation typically paid to executives, such as nonqualified deferred compensation, equity-based compensation, golden parachutes, and split-dollar life insurance. Some forms of executive compensation are excluded from the definition of wages for FICA, FUTA, and federal income tax withholding purposes, but some are not. For example, many forms of deferred compensation benefits are excluded, such as contributions to a qualified pension plan, contributions to a simplified employee pension plan forming part of a retirement plan to which an employer contributes, and contributions to a tax-sheltered annuity plan established by certain government agencies and tax-exempt entities. [33] However, salary reduction contributions made by an employee to a deferred arrangement under Code Sec. 457 are includible in the definition of wages for purposes of FICA and FUTA taxes.[34] With respect to nonqualified deferred compensation arrangements, deferred compensation is generally treated as wages for FICA and FUTA withholding purposes upon performance of the services for which such compensation is received, or, if later, when there is no substantial risk of forfeiture of the right to receive these amounts;[35]
- Although intended to be a relief provision, the deferral of employer employment taxes under the Coronavirus Aid, Relief, and Economic Security ("CARES") Act has spurned additional compliance issues.[36] By way of background, the employer employment tax deferral allowed employers to postpone paying the employer's portion of Social Security taxes due in 2020 by paying half of those taxes at the end of 2021 and the other half at the end of 2022.[37] Persons subject to self-employment tax were allowed to defer 50% of the Social Security tax portion of their SECA tax payments. Failure to pay the deferred taxes by the deadlines can cause employers to face significant failure to deposit penalties that are calculated back to the original deposit due date in 2020.[38] Furthermore, employers must have correctly reported their deferral of the employer's share of tax on Form 941 for the second, third, and fourth quarters of 2020. Unfamiliarity with these requirements creates an easy trap for employers to become noncompliant with the updated employment tax laws; and
- The failure of an officer–shareholder of small business corporations (*i.e.*, an S corporation) to be paid reasonable compensation in the form of a salary to avoid employment tax on all or a portion of cash and other benefits distributed to that shareholder.

Given the prevalence of these issues, as discussed herein, Congress and the Service have adopted specific programs for noncompliant employers to come back into compliance with the internal revenue laws concerning employment tax.

IV. Penalties Relating to Employment Tax Noncompliance

The consequences to employers for violations of the employment tax laws take many forms but generally range from, on the one end, civil monetary penalties or additions to tax to, on the other end, criminal prosecution. Before discussing those penalties, however, it is important to note that where an employee is required to withhold income taxes from wages paid to an employee, but does not, the employer is liable for the payment of the income taxes, whether or not the taxes are actually withheld.[39]

A. Civil Monetary Penalties and Additions to Tax

Employers who underpay employment taxes or fail to file required employment tax returns can, at a minimum, be liable for civil monetary penalties at the federal, State, and local levels. This article focuses on the principal civil monetary penalties that can be imposed for violations of the employment tax laws including but not limited to:

- Code Sec. 6651(a)(1), which authorizes the imposition of an addition to tax, for failure to file a required employment tax return by its due date, including extensions, unless the employer demonstrates that the failure to file was due to reasonable cause and not due to willful neglect;[40]
- Code Sec. 6651(a)(2), which authorizes the imposition of an addition to tax for failure to timely pay the amount of tax shown as due on a federal tax return, unless the taxpayer demonstrates that the failure to pay was due to reasonable cause and not due to willful neglect;[41]
- Code Sec. 6651(f), which authorizes the imposition of an addition to tax of 75% of the amount required to be shown on the tax return when the failure to file a tax return is fraudulent;
- Code Sec. 6656(a), which authorizes the imposition of an addition to tax for failure to deposit employment taxes in the correct amount, within the prescribed time, and/or in the required manner, unless the

employer demonstrates that the failure to deposit was due to reasonable cause and not due to willful neglect;[42]

- Code Sec. 6662, which authorizes the imposition of an accuracy-related penalty where any part of an underpayment is due to, among other misdeeds, negligence or intentional disregard of rules and regulations, unless the employer demonstrates that the underpayment was due to reasonable cause and not due to willful neglect;[43]
- Code Sec. 6663(a), which authorizes the imposition of a penalty equal to 75% of the portion of any underpayment of tax attributable to fraud;
- Code Sec. 6672, which (as detailed more fully below) authorizes the imposition of a penalty against any person who is required to collect, truthfully account for, and pay over any tax imposed by the Code who willfully fails to collect, or truthfully account for and pay over the tax, or who willfully attempts in any manner to evade or defeat the tax;[44]
- Code Sec. 6701, which authorizes the imposition of a penalty against any person who aids and abets an understatement of tax liability;[45] and
- Code Secs. 6721 and 6722, which generally authorize the imposition of a penalty for failure to file correct information returns and the failure to furnish correct payee statements, respectively, unless the employer demonstrates that the failure was due to reasonable cause and not due to willful neglect.[46]

B. The TFRP

Under the Code, withheld taxes (including certain employment taxes) are held "in trust" by the employer and its responsible persons for the benefit of the government.[47] The employer and its responsible persons are required to turn these withheld trust fund taxes over to the government on a timely, predetermined basis. Where an employer or its responsible persons do not collect, truthfully account for, and pay over any tax imposed by the Code, but instead willfully fail to collect or truthfully account for and pay over the tax or willfully attempt in any manner to evade or defeat the tax, then the responsible persons may be liable for a civil penalty equal to the amount of tax evaded, not collected, or not accounted for and paid over. This penalty, known as the trust fund recovery penalty (the "TFRP"), is authorized by Code Sec. 6672.

In order to establish a person's liability for the TFRP, the government must prove two elements: first, that the individual was a responsible person; and second, that the individual acted willfully in failing to remit trust funds.[48] The IRS and courts have broadly interpreted the definition of a responsible person to include business owners, corporate officers, board members, bookkeepers, accountants, and accounts payable persons.[49] In the context of the TFRP, willfulness indicates intentional, deliberate, voluntary, conscious, intentional, reckless, or knowing (not accidental) conduct—no evil intent or bad motive is required.[50]

There is a split among the federal circuit courts as to whether reasonable cause is a defense to negate willfulness. The U.S. Courts of Appeals for the First, Seventh, and Eighth Circuits have determined that reasonable cause is not a defense to willfulness.[51] The U.S. Court of Appeals for the Ninth Circuit has not specifically held that the reasonable cause defense does not apply to Code Sec. 6672, but that court has observed that "conduct motivated by a reasonable cause may, nonetheless, be willful."[52] The U.S. Courts of Appeals for the Second, Fifth, Tenth, and Eleventh Circuits have determined that the reasonable cause defense could apply to willfulness determinations under Code Sec. 6672 but only under limited circumstances.[53]

C. DETLs—the Loss of CDP Rights as Non-Monetary Penalties

In addition to the TFRP, which some courts recognize is a collection device to be used against responsible persons,[54] the IRS may also collect unpaid employment taxes directly from the business by levying property or rights to property or filing a notice of federal tax lien ("NFTL").[55] Typically, a person subjected to an enforced collection action is entitled to a collection due process ("CDP") hearing before the IRS levies the person's property or after the IRS files an NFTL.[56] However, Code Secs. 6330(f) and 6330(h) permit the issuance of a Disqualified Employment Tax Levy ("DETL") for collection of certain employment taxes without first giving the person the CDP rights typically afforded to other alleged tax debts.[57] A DETL is any levy for the collection of employment taxes for a taxable period that is within the two-year period after an employment tax period for which the taxpayer or predecessor timely requested a hearing under Code Sec. 6330.[58] As such, for repeat employment tax offenders, the loss of CDP rights and the issuance of a DETL may be a non-monetary penalty.

D. Civil Injunctions

DOJ-Tax, at the request of the IRS, can pursue civil injunctions against employers and responsible persons

who willfully fail to truthfully collect, account for, and deposit employment taxes.[59] The terms of an injunction can impose various requirements and prohibitions, including but not limited to the obligation to comply with the law and provide current notice of each deposit to the IRS, as well as restrictions on opening and operating new businesses and transferring or dissipating assets.[60] When employers violate the terms of an injunction, DOJ-Tax can seek orders of civil or criminal contempt, including incarceration of the responsible person(s), to bring the business into tax compliance. Injunctive relief is an extraordinary remedy for the government that is typically reserved for taxpayers with chronic tax delinquencies for which the IRS needs an injunction against to prevent the taxpayer from accruing further employment taxes.[61]

E. Criminal Sanctions

Finally, violation of various employment tax laws can be a crime.[62] Code Sec. 7202 makes failing to meet employment tax obligations a felony, punishable by a fine of not more than $10,000, prison for up to five years, or both. Criminal liability generally requires an affirmative action and willfulness to evade or defeat tax.[63] The term "willfulness" has been defined as a voluntary and intentional violation of a known legal duty.[64] In practice, the IRS pursues criminal charges only against the most egregious cases of tax evasion, generally targeting business owners who have diverted funds for their own benefit rather than paying their employment taxes.[65] These types of cases are in contrast to those involving unpaid employment taxes where the taxpayer was under financial distress and was using funds to pay off creditors other than the IRS.[66] Numerous factors go into the government's decision on whether to pursue criminal prosecution, including the strength of the government's evidence, the amount at stake, and the existence of chronic noncompliance. Businesses should do what they can to resolve noncompliance issues at the administrative level before the government decides to pursue criminal charges.

V. How the Service Detects Employment Tax Noncompliance

The Service detects employment tax noncompliance, and develops civil employment tax audits and criminal employment tax investigations, through many sources, though case selection and program oversight generally is coordinated by Employment Tax Workload Selection and Delivery ("ET-WSD").[67] As detailed herein, the sources of employment tax audits and investigations generally include internal referrals from various divisions of the Service, such as the Service's SS-8 Unit, Whistleblower Office, or Collection Division; external referrals from other government agencies, like the U.S. Department of Labor ("DOL"); and settlement program referrals (*i.e.*, referrals within the Service where an employer attempts to obtain the benefits of a voluntary compliance initiative to which the employer is not entitled). Additionally, the Service may identify employment tax noncompliance in connection with non-employment tax audits (*e.g.*, audits conducted by other business units), compliance initiative projects, requests for audit reconsideration, the review of claims for refund, offer in compromise on the ground of doubt as to liability, requests for audit reconsideration, and penalty abatement requests.[68] And, given that civil and criminal employment tax enforcement is among the highest priorities of the Service and the DOJ-Tax, employers should be mindful of the many ways the Service can detect noncompliance when evaluating whether (and how) to correct historical noncompliance.

A. Referrals from Within the Service

The Service receives internal referrals that may prompt an audit of employment tax issues. The sources of these referrals include the following:

- *SS-8 Unit Referrals*: By way of background, an employee (or an employer) can submit to the Service's SS-8 Unit Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, to request the Service to determine the proper worker classification of any service provider as an employee or an independent contractor. Referrals are made from the SS-8 Unit to ET-WSD when the SS-8 Unit (1) determines that a service provider has been improperly treated as a non-employee, or (2) makes no determination concerning the service provider because the service provider making the request received both a Form W-2 and a Form 1099-MISC or Form 1099-NEC from the referred business in the same year for the receipt of supplemental wages (*i.e.*, bonus or commission);[69]
- *BSA Referrals*: As a necessary pretext, the Bank Records and Foreign Transactions Act,[70] better known as the "Bank Secrecy Act" ("BSA"), allows for criminal penalties, civil penalties, and the forfeiture of assets for a number of offenses related to money laundering and tax evasion. The Service is responsible for examining many financial institutions, including check cashing

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businesses and other businesses frequented by employers with significant cash transactions, for compliance with the BSA. The Service's BSA examination team provides monthly information reports to ET-WSD on employers suspected of noncompliance with the employment tax laws;[71]

- *CI Referrals*: Special agents within the Service's Criminal Investigation division ("CI") refer employment tax issues that are not accepted for criminal prosecution to ET-WSD on an *ad hoc* basis based on information learned during the investigation.[72] And, where there is a firm indication of "substantial" civil employment tax potential, CI can recommend a direct referral in the form of a "prime lead," which is a detailed summary of the relevant information learned during the investigation;[73]
- *Collection Division Referrals*: Revenue officers within the Service's Collection Division refer cases to ET-WSD on an *ad hoc* basis based on information learned while working collection cases.[74] These referrals can include any issue or situation involving employment tax noncompliance, including but not limited to those discussed *supra* Part III;
- *Referrals from CIO for Employers in Bankruptcy*: By way of background, a bankruptcy trustee may request a prompt determination of any unpaid tax liability of the bankruptcy estate under the Bankruptcy Code.[75] The prompt determination request is mailed to the Service's Centralized Insolvency Operation ("CIO") in Philadelphia, Pennsylvania. CIO, in turn, can forward the request to ET-WSD, which generally has (1) 60 days from the date of receipt of a request to advise the bankruptcy trustee of the decision to examine a tax return or accept it as filed, and (2) 180 days from the date of receipt of a request to advise the bankruptcy trustee of any tax, penalties, and interest due;[76] and
- *Whistleblower Claims and Informant Referrals*: By way of background, the Service is authorized to pay monetary awards to individuals who expose underpayments of tax, including but not limited to employment tax.[77] The amount of an award depends upon various factors, but is generally equal to between 15% and 30% of the proceeds collected and attributable to the whistleblower's information.[78] Whistleblower awards can be significant, so the incentive is high for disgruntled employees and other third parties to report an employer's employment tax noncompliance.

  Employment tax issues making up all or a portion of a whistleblower claim are closely coordinated between ET-WSD and the Service's Whistleblower Office. In this regard, employees in the Service's Whistleblower Office enter information about whistleblower submissions into the Whistleblower e-Trak system.[79] On a weekly basis, an ET-WSD employee checks the Whistleblower e-Trak system for new cases involving employment tax issues.[80] For claims of $2 million or less, the claim is reviewed and a determination is made with respect to whether to reject, deny, or select the claim within 45 days.[81] For claims of $2 million or more, the claim is reviewed and a determination is made with respect to whether to refer the matter for further review within 10 days.[82] Thus, all whistleblower claims will be reviewed by ET-WSD.
- *Data Analytics*: The IRS is increasingly relying on sophisticated algorithms and artificial intelligence in analyzing data to better predict and identify tax noncompliance. The Office of Research, Applied Analytics and Statistics ("RAAS"), is the Service's centralized research and analytic organization.[83] RAAS published a report titled, "Better Identification of Potential Employment Tax Noncompliance Using Credit Bureau Data," in which it stated that "in the coming years, the [EFTPS] will be used to analyze the past deposits to identify deviations in the deposit patterns to determine potential noncompliance. Until then, the IRS should explore other early detection methods."[84] As such, the IRS is actively seeking out the use of data analytics to identify patterns in behavior among businesses to detect when tax noncompliance is occurring.

B. Referrals from Sources Outside the Service

The Service also receives referrals from federal government agencies that may implicate employment tax issues. The sources of these referrals include the following:

- *DOL and OSHA Referrals*: The DOL, which administers the federal laws governing wage and hour standards, unemployment benefits, and occupational safety and health, is often the first arbiter of claims filed by disgruntled employees. Most disputes adjudicated by the DOL also implicate related employment tax considerations. For example, an employer who misclassified an employee as an independent contractor may be liable for back wages in addition to related employment taxes.

  Against this background, the Service and the DOL have entered into a Memorandum of Understanding (the "IRS-DOL MOU") under which the agencies

agree to share information and collaborate with each other to improve compliance with the federal labor and internal revenue laws.[85] Under the IRS-DOL MOU, the DOL agrees to refer to the Service, at the DOL's discretion, information and other data the DOL believes may raise employment tax compliance issues related to worker misclassification.[86] Referrals from the DOL under the IRS-DOL MOU most often involve worker classification issues, but can include any issue or situation involving employment tax noncompliance.[87] The Service, for its part, agrees to evaluate and classify employment tax referrals provided by the DOL and, at the Service's discretion, promises to conduct audits to determine compliance with the employment tax laws.[88] Additionally, consistent with applicable federal laws, the Service also generally agrees to share the employment tax referrals provided by the DOL with State and local tax authorities.[89]

Anecdotally, labor lawyers handling DOL investigations sometimes advise employers that the DOL will not share information with the Service, and accordingly, that an adverse result in a DOL investigation will not necessarily lead to an inquiry by the Service. This advice is incorrect and ignores professional obligations under Circular 230. As a preliminary matter, as a result of the IRS-DOL MOU, employers being investigated by the DOL should assume that information learned by the DOL in its investigation will be provided to the Service and that the Service will attempt to recover any employment taxes that may be due. Indeed, in 2018, the Treasury Inspector General for Tax Administration ("TIGTA") criticized the Service for not acting on (or prioritizing) the information it receives from the DOL.[90] The Service, for its part, agreed to work with the DOL to design a standardized form, ostensibly to make referrals from DOL to the Service easier.[91] Moreover, any practitioner who knows the employer did not comply with the federal employment tax laws must advise the employer of the fact of the noncompliance and the consequences of the noncompliance (*e.g.*, tax, penalties, interest, cost of audit, and criminal prosecution);[92] and

- *Referrals from State Tax Authorities*: By way of background, the Service initiated the Questionable Employment Tax Practices ("QETP") program in 2006. The QETP program is a partnership between various federal and State agencies to share relevant information to address questionable employment tax practices (*i.e.*, employment tax schemes or practices that have no objective other than to avoid federal and/or State employment taxes). Pursuant to a Memorandum of Understanding entered into between the Service, the DOL, and more than 20 State workforce agencies, issues concerning employment tax will be referred to ET-WSD.[93]

C. Referrals from the Service's Voluntary Compliance Initiative Units

Although technically a referral within the Service, it bears special mention that ET-WSD may also receive referrals from employers who participate in, but do not complete or are not truthful in participating in, one of the voluntary compliance initiatives discussed herein.[94]

D. Referrals from the Service to State Workforce Agencies

Just as the Service is authorized to receive information from participating State workforce agencies under the QETP MOU, the Service is also authorized to share information with certain State workforce agencies under the same agreement. For 2019, the QETP program caused States to reclassify 89,091 service providers and nearly $1.1 billion in wages through 6,344 audits, which resulted in the assessment of nearly $25 million in additional employment taxes (without regard to penalties and interest).[95] Thus, under the QETP program, it is reasonable to infer that employment tax noncompliance may also be referred to participating State workforce agencies.

VI. Methods for Correcting Noncompliance

Like the prodigal child, the Service usually treats employers who voluntarily come into compliance with the employment tax laws with a generosity far greater than the employer might expect to receive. In this regard, as detailed herein, use of one or more voluntary compliance initiatives to voluntarily come into compliance can save an employer taxes, penalties, interest, tax compliance costs, the cost of an audit, and/or the risk of criminal prosecution. The initiatives the Service offers (or is required to consider) to correct federal employment tax noncompliance include the voluntary disclosure practice; the VCAP-ET; the filing of amended tax returns and, as appropriate, requesting that penalties be abated; the CSP; the VCSP; relief under Section 530 of the Revenue Act of 1978;[96] and an early referral program.

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The availability and advisability of a particular initiative depends upon many factors, including but not necessarily limited to:

- The type(s) of noncompliance;
- The employer's (or responsible person's) mental state in failing to comply with the employment tax laws;
- The length of noncompliance;
- The amount of tax avoided (in both nominal and relative terms);
- The use of professional advisors and the advice provided to the employer;
- The amount of time remaining before the expiration of relevant periods of limitation, such as the statute of limitation on assessment and the statute of limitations on criminal prosecution;
- The risk of significant monetary penalties;
- The risk of audit; and
- The risk of criminal prosecution.

Each option, when available, has benefits, drawbacks, and risks. And, while it is possible to analyze the attributes of each program in different ways, this article generally organizes the discussion around the type of noncompliance and the employer's or responsible person's mental state in failing to comply with the employment tax laws.

A. Voluntary Compliance Initiatives for All Employment Tax Issues

Employers can resolve most general employment tax issues using the voluntary disclosure practice, the VCAP-ET, or the filing of amended tax returns. Each compliance initiative is discussed in turn.

1. Voluntary Disclosure Practice—Willful Avoidance of Employment Tax Obligations

The Service's voluntary disclosure practice is one option by which employers and responsible persons may voluntarily come into tax compliance.[97] The Service's voluntary disclosure practice is a long-standing initiative of the Service that provides taxpayers with criminal exposure relating to tax and tax-related crimes a means to come into compliance with the internal revenue laws and potentially avoid criminal prosecution. The Service significantly modified the voluntary disclosure practice generally in November 2018, so much of the practice as concerned employment taxes was not particularly well defined until February 15, 2022, when the Service updated the practice to provide a specific penalty structure for employment tax penalties.[98]

The voluntary disclosure practice is a compliance option for employers or responsible persons who have committed tax or tax-related crimes and have criminal exposure due to their willful violation of the law.[99] As it relates to tax and tax-related crimes, criminal exposure generally exists where there is a voluntary, intentional violation of a known legal duty.[100] Significantly, for an employer or responsible person to be eligible for the voluntary disclosure practice, the violation of the law must be willful. If the violation is not willful, employers are left to consider other voluntary compliance options discussed herein, such as the VCAP-ET, the CSP, the VCSP, or the filing of amended tax returns, among others. Moreover, to be eligible to make a voluntary disclosure, the taxpayer and certain related persons or entities must not be under audit or criminal investigation (*i.e.*, the disclosure must be timely).[101] Finally, the voluntary disclosure program does not apply to taxpayers whose income is derived from illegal activities.[102]

The specific features, benefits, and drawbacks of the Service's voluntary disclosure practice are discussed in turn.

a) Features of the voluntary disclosure practice as applied to employment tax violations of the law. As relevant to the question of willful employment tax noncompliance, the voluntary disclosure practice generally requires taxpayers to:

- Prepare and submit to the Service Form 14457, *Voluntary Disclosure Practice Preclearance Request and Application to Participate in the Voluntary Disclosure Practice*. Form 14457 is submitted to CI piecemeal, in two parts. Part I is submitted to request preclearance to make a voluntary disclosure (*i.e.*, for the Service to confirm that the employer or responsible person is eligible to make a voluntary disclosure by, for example, ensuring that the employer or responsible person is not under audit or criminal investigation (*i.e.*, that the disclosure is timely)).[103] Once preclearance to make a voluntary disclosure is received, then the taxpayer submits Part II, which requires a narrative, signed under the penalties of perjury, with specific facts that detail the complete narrative of the noncompliance, including both the favorable and unfavorable facts. Among the facts required to be provided for employment tax matters are: details about the employment tax issues; a schedule of gross unreported wages by quarter, which may be incorporated into Form 14457 by reference; a list of all affected employees; and an explanation concerning any withholding-related issues;
- Fully cooperate with an assigned auditor and undergo a related examination by (1) filing amended tax returns with respect to a specified lookback period, (2) responding to all information document requests,

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(3) submitting to interviews, (4) providing access to related party witnesses, and (5) paying all determined taxes, additions to tax, interest, and penalties (or entering into an arrangement, acceptable to the Service, to pay those taxes). As to the final point, the calculation of the employment tax liability is calculated without regard to the more favorable rates allowed under Code Sec. 3509;

- Pay a single civil fraud penalty or a fraudulent failure to file penalty with respect to the tax due for the quarter with the highest employment tax liability. The single civil fraud penalty is in lieu of accuracy-related penalties and additions to tax for late filing and late payment. Section 530 relief, discussed herein, is not available;
- File all required forms, including but not limited to Forms 940, 941, W-2, and, as applicable W-2c; and
- Execute a closing agreement, which is a written contract with the Service agreeing to the amounts owed during the agreed upon lookback period and other related matters.[104]

b) Benefits and drawbacks of the voluntary disclosure practice. The burden of the foregoing process must be considered in light of the benefits and drawbacks associated with availing oneself of the Service's voluntary disclosure practice. The most significant benefits of the voluntary disclosure practice are that it provides (1) a promise by the Service (but not a guarantee) that the Service will not pursue a taxpayer for criminal violations of the law (*i.e.*, using the voluntary disclosure practice is not a grant of immunity); (2) a generally limited lookback period of six years, or 24 quarters, though that lookback period may be shortened if the noncompliance did not exist for six or more years; (3) certainty as to the applicable penalty structure in the form of a single civil fraud penalty equal to 75% of the employment tax due for the quarter with the highest employment tax liability; and (4) closure or peace of mind.[105] These benefits should be considered in light of the following drawbacks:

- *Discretion to Agents*: The Service's voluntary disclosure practice gives examiners considerable discretion in determining whether the voluntary disclosure requirements have been met and in determining the applicable closing structure. In this regard, a voluntary disclosure only occurs when a taxpayer provides information that is truthful, timely, and complete.[106] These are subjective determinations that leave considerable discretion to agents;
- *Compliance Costs*: Because some employment tax returns, like Form 941, are filed on a quarterly basis, a general six-year lookback period means employers generally must file 24 quarters of amended employment tax returns, along with required State tax returns and payee statements (*e.g.*, Forms W-2, W-3, and/or W-2c). Additionally, the issuance of the payee statements typically requires service providers to amend personal federal and State income tax returns for all or a portion of the disclosure period. These compliance costs are significant and the task of preparing them onerous;[107]
- *Impact on Employees*: Recall that employers will be required to file *all* required forms, including but not limited to Forms 940, 941, W-2, and, as applicable, W-2c. Employers often fear the employees' and, where applicable, unions' responses to the receipt of amended payee statements and the related compliance costs. Employers sometimes elect to pay all or a portion of the employees' employment tax, income tax, and/or compliance costs, in which case those payments also need to be treated as wages in the quarter paid (and with respect to which the employer and employee will owe employment tax (and the employee will owe income tax) in the year of the payment). Thus, the noncompliance may impact historical and current tax reporting in a circular cashflow that can be daunting to fathom (though relatively easy for a qualified tax professional to calculate);
- *Unpredictability as to Lookback Period and Penalty Structure if the Voluntary Disclosure is Not Completed*: The voluntary disclosure procedures generally limit the disclosure window to six years, so, as a general rule, only the prior six years of noncompliance will be examined and employers will generally owe tax and interest only on the past six years of taxes owed. However, examiners have the authority to look beyond this limited lookback period and require the filing of additional tax returns and the making of additional tax payments. Indeed, if the voluntary disclosure is not resolved by agreement, the examiner has discretion to expand the scope to include the full duration of the noncompliance and may assert maximum penalties under the law. Accordingly, if an employer or responsible person is not able to negotiate an acceptable settlement, the Service would have discretion to expand the scope to include the taxpayer's full duration of noncompliance and, if fraud is found to exist, that fraud would extend the statute of limitations indefinitely; and
- *Referrals to Other Federal and State Agencies*: Although the confidentiality of taxpayer return information, including information provided through the program, is generally protected by Code Sec. 6103, the Service is permitted to share information provided by a taxpayer

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through the voluntary disclosure practice with State tax agencies and certain federal agencies for non-tax purposes, including for purposes of investigating non-tax crimes.

In sum, the risk of criminal prosecution makes the voluntary disclosure practice an option that should be strongly considered by an employer or responsible person who willfully avoided employment tax filing or payment obligations. The question of whether to pursue a voluntary disclosure to cure employment tax noncompliance is a fluid analysis that is highly dependent upon the taxpayer's specific circumstances.

2. The VCAP-ET—Nonwillful Employment Tax Errors, Other than Misclassification, That Are Not Easily Resolved by Filing Amended Tax Returns

The VCAP-ET is another administrative process established by the Service that allows for employment tax issues not involving worker classification, and not capable of easy resolution through the filing of amended employment tax returns, to be permanently and conclusively resolved through a voluntary closing agreement process. The features, benefits, and drawbacks of the VCAP-ET are discussed in turn.

a) Features of the VCAP-ET. The VCAP-ET is an administrative process that is authorized by Code Sec. 7121 and Reg. §301.7121-1(a), which collectively provide that a closing agreement may be entered into in any internal revenue matter in which (1) there appears to be an advantage in having a matter permanently and conclusively closed or if the taxpayer shows good and sufficient reason for desiring a closing agreement, and (2) the United States will not be disadvantaged by entering into the agreement. In order to be eligible for the VCAP-ET, none of the taxpayer or any of its subsidiaries, related entities, or corporate officers may be under audit or criminal investigation with respect to a federal employment tax issue.[108] Similarly, in order to be eligible for the VCAP-ET, the employer may not be under a DOL or State agency investigation.[109]

Although the VCAP-ET has potentially broad applicability, it is not intended to replace or eliminate the general requirement to use an amended tax return to correct employment tax errors or the administrative refund process to obtain a refund of employment tax.[110] Rather, the VCAP-ET is intended for exigent circumstances—that is, situations in which filing an original or amended employment tax return would not allow for prompt, permanent, and conclusive resolution of the employment tax issue(s) in question.[111] On this point, the failure to file employment tax returns is deemed not to be an exigent circumstance, which means an employer may not use the VCAP-ET to cure noncompliance relating to the failure to file required employment tax returns.[112] Moreover, the VCAP-ET does not apply to worker classification issues.[113] Rather, worker classification issues must be resolved using the VCSP, discussed herein.

Situations in which the VCAP-ET is appropriate to resolve employment tax compliance issues include but are not limited to the following:

- The employer seeks to permanently and conclusively establish its final federal employment tax liability in order to facilitate a pending or imminent transaction, such as a merger or sale of all or part (*e.g.*, a subsidiary) of the taxpayer's business;
- An employer in the process of liquidation or dissolution desires a closing agreement with respect to its federal employment tax liabilities in order to wind up its affairs;
- When the assessment of federal employment tax liabilities are time-barred but the taxpayer nevertheless desires to resolve those federal employment tax liabilities for non-tax reasons;
- When an employer is unable to attribute specific wage amounts to any employee and is, therefore, unable to properly comply with the regular amended employment tax or other corrected return procedures because it is unable to issue accurate corrected Forms W-2 to affected individuals (*e.g.*, situations in which the taxpayer provided fringe benefits (such as subsidized meals in a cafeteria) to workers but the taxpayer does not possess adequate records to determine the exact amount of the fringe benefit provided to any individual employee for the period in question);
- When the DOL or other State or federal agency has completed an audit or investigation and the taxpayer desires to pay federal employment tax liabilities in a manner similar to the determination made by the other agency; and
- To address a mass error in wage reporting that affects a high volume of employees but involves a *de minimis* amount of understated reported wages per employee (*e.g.*, issues involving taxable fringe benefits, such as group term life insurance).[114]

There is not a specific form to be used in using the VCAP-ET. However, all requests must include (potentially among other items) the following information:

- The taxpayer's name, address, and EIN;
- The tax period(s), number of affected employees, and a calculation of the amount of potential tax per tax period(s);

- A detailed statement of the issues for which a closing agreement is requested, including the reasons for the failure to include the amounts at issue as wages, and the steps taken by the taxpayer to correct the issue for prospective compliance;
- A detailed statement addressing the reasons why the taxpayer cannot use the regular corrected return procedures (*e.g.*, the filing of Form 941-X, *Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund*) to correct the employment tax liabilities at issue;
- A statement regarding whether the taxpayer is able and willing to prepare any necessary Form(s) W-2 or W-2c;
- A statement as to whether the taxpayer or any of its related or subsidiary entities are under examination by the Service, another federal agency, or any State for the taxable years at issue;
- A statement that, to the best of the taxpayer's knowledge, neither the taxpayer nor any of its related or subsidiary entities or officers are under criminal investigation;
- A statement confirming that the taxpayer has filed employment tax returns or had such tax returns filed on its behalf for the taxable periods at issue;
- A statement that neither the taxpayer nor any of its related or subsidiary entities have been audited by the Service in prior periods for the issue for which the taxpayer is requesting a closing agreement;
- A statement as to whether the taxpayer or any of its related or subsidiary entities are in collection status or involved in collection procedures with respect to the issue for which the taxpayer is requesting a closing agreement;
- A statement that the taxpayer has not requested or received a private letter ruling or determination letter with respect to the issue for which the taxpayer is requesting a closing agreement;
- A statement that the taxpayer is not (1) a petitioner in a case docketed with the Tax Court for any issue or period, or (2) a plaintiff in a case docketed in another court, including a State court with regard to tax or employment matters;
- An acknowledgement that if the Service determines that the taxpayer has intentionally misrepresented facts in its request, the Service may open an examination regarding the issues for which the request for a closing agreement was made; and
- An acknowledgement by the taxpayer, signed under penalties of perjury, that its representations of the facts are true and correct to the best of its knowledge.[115]

The letter seeking participation in the VCAP-ET must be submitted to the Employment Tax Voluntary Request Coordinator in Florence, Kentucky.[116]

b) Benefits and drawbacks of the VCAP-ET. An employer should decide whether to use the VCAP-ET only after understanding the program's benefits and drawbacks. A significant benefit of the VCAP-ET is its flexibility—a closing agreement can take essentially any form, and for that reason (among others), a closing agreement may be a desirable option because it allows flexibility not typical of the voluntary disclosure practice or the amending of tax returns. An additional benefit of the VCAP-ET is that any adjustment to the employment taxes made as part of the closing agreement will be made without interest, provided that the taxpayer pays the liability at the time the closing agreement is executed.[117] A third benefit of the VCAP-ET is that it is final and conclusive—it may not be reopened as to the matters agreed upon.[118]

The benefits of the VCAP-ET should be considered in light of the program's drawbacks and the related risk those drawbacks pose to the employer. One significant drawback is the decision of whether to enter into a closing agreement is a matter within the agent's discretion.[119] For example, an agent may decline an otherwise proper request for a closing agreement where the tax dollars at issue are considered small to the Service in comparison to the amount of time and effort the Service would expend to enter into a closing agreement.[120] Furthermore, given this discretion, an employer may voluntarily come forward to address employment tax noncompliance, but the Service agent could be unwilling to enter into a closing agreement, if at all, on terms acceptable to the employer. Thus, an employer who voluntarily comes forward to address employment tax noncompliance could alert the Service to the noncompliance without receiving any of the benefits of the VCAP-ET. An additional potential drawback is that employers using the VCAP-ET will generally be required to file all required forms, including but not limited to Forms 940, 941, W-2, and, as applicable, Form W-2c.[121] Another drawback is that penalties may apply to a submission under the VCAP-ET, and the applicability (or amount) of the penalty is not known until the closing agreement is negotiated.[122]

In sum, the VCAP-ET is an option that should be considered for non-misclassification employment tax issues where the employer or responsible person did not willfully avoid employment tax obligations and the filing of amended tax returns does not allow for prompt, permanent, and conclusive resolution of the employment tax issue(s) at hand.

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3. Amend Tax Returns and, as Appropriate, Request Penalty Abatements

The amending of tax returns is yet another option by which employers and responsible persons may voluntarily come into tax compliance. In this regard, an employer who did not willfully avoid employment tax obligations may correct historical tax noncompliance by filing amended federal and State employment tax returns and payee statements (*e.g.*, Forms W-2 and W-3). Relatedly, an employer who willfully avoided employment tax obligations and is willing to accept the risk of a criminal prosecution may address (but not correct) the historical tax noncompliance by also amending federal and State employment tax returns and payee statements. The noncompliance for a willful taxpayer is addressed, but not corrected, because fraud on an original employment tax return cannot be undone by filing an amended tax return.[123] And, therefore, an employer who willfully avoided employment tax obligations and chooses to amend employment tax returns is at risk for criminal prosecution for the duration of the applicable criminal statute of limitations (typically, six years).[124]

a) Considerations in whether to amend employment tax returns. Assuming the employer did not act willfully, or that the employer acted willfully and will accept the risk of criminal prosecution, there are two important considerations in deciding which employment tax returns to amend: whether there is an error on the original return that needs to be amended or whether the position taken is correct (or defensible); and whether the statute of limitations on assessment has expired (or will soon expire) with respect to any particular employment tax return for which there is an error.

(i) Defensible positions on historical tax returns?. Where the original tax return does not contain an error, there is no requirement to file an amended tax return for any period because there is no error to correct. Thus, it is appropriate to consider at the outset whether the original employment tax return reporting position is correct (or defensible) because the employer may elect to defend that reporting position, if audited, in lieu of amending historical tax returns.

(ii) Other considerations in amending employment tax returns—statutes of limitation on tax assessments, interest-free adjustments, and beyond. Once it is determined that an error on an employment tax return exists, multiple competing considerations arise depending upon whether an advisor is involved. One such consideration that applies regardless of whether a tax advisor is involved is whether the statute of limitations on assessment has expired (or may expire) for a particular period. By way of background, the Code provides the general rule that the Service must assess tax within three years from the date on which a tax return was filed.[125] Where a tax return for a period ending with or within a calendar year is filed before April 15 of the succeeding taxable year, as is the case for some employment tax returns, the return is deemed filed on April 15 of the succeeding calendar year.[126] Thus, for example, quarterly employment tax returns for the 2021 tax year are deemed filed April 15, 2022, and the three-year statute of limitations on assessment is calculated by reference to that date (*i.e.*, the three-year statute of limitations on assessment generally expires on April 15, 2025). There are various exceptions to the general rules above, including that the statute of limitations on assessment is indefinitely suspended "in the case of a false or fraudulent return with the intent to evade tax."[127]

The law provides that employers "should" (but are not required to) amend incorrect tax returns for which the statute of limitations on assessment has not expired.[128] If the statute of limitations on assessment has expired with respect to a particular employment tax return, then there is no requirement to amend that tax return. Moreover, if the statute of limitations on assessment has not expired, but soon will expire and no exception to the statute of limitations on assessment applies, then the employer may be more risk tolerant of not amending the tax return because, arguably, it is not likely that the Service will detect the issue before the statute of limitations on assessment expires.

Additional considerations arise where a tax advisor is involved. As noted, a practitioner who knows an employer did not comply with the federal employment tax laws must advise the employer of the fact of the noncompliance and the consequences of the noncompliance (*e.g.*, tax, penalties, interest, cost of audit and criminal prosecution, and the obligation to issue amended or corrected Forms W-2 and W-3).[129] On the subject of interest in the employment tax context, even further discussion is appropriate. Under the interest-free adjustment rules of Code Sec. 6205 and related Treasury Regulations, employers who underreported and underpaid FICA tax or income tax withholding are allowed to correct and pay the tax, without interest. If the error is discovered after the return reporting such tax has been filed, interest may be avoided by filing an amended employment tax return.[130] Specifically, to make an interest-free adjustment, the employer must report the additional amount due on an adjusted return filed by the due date for filing the employment tax return for the return period in which the error was ascertained.[131] If the

error is not reported to the Service in the period in which the error was discovered, then the interest-free adjustment provisions do not apply.[132] The employer must also pay the amount of the underpayment to the IRS by the time the adjusted return is filed.[133] It is important to note that a correction will not be eligible for interest-free adjustment treatment if the employer received notice and demand for payment from the IRS.[134] So, timely amending employment tax returns may limit the interest due with respect to any underpayment of employment tax.

b) Securing penalty abatements in connection with amended employment tax returns. Where penalties for employment tax noncompliance are asserted, whether in connection with an amended employment tax return or otherwise, employers may request an abatement on various grounds, including but not limited to reasonable cause or under the administrative waiver commonly referred to as the "First Time Abate."[135] The extent to which reasonable cause exists for the failure to comply with the employment tax laws depends on the unique facts and circumstances of the employer's situation, but generally will be found to exist where an employer used all ordinary business care and prudence to meet its tax obligations, but was nevertheless unable to do so.[136] Reasonable cause must be proven by the employer, and the Service should review all available information in making its determination including the employer's reasons for not complying with the law, how the employer handled the rest of its affairs during the time of noncompliance, what attempts the employer made to comply with its obligation, and the employer's overall record of tax compliance.[137] If there is a possibility that an employer's noncompliance with the employment tax laws was due to reasonable cause or if other relief is available and appropriate, the employer should generally request an abatement of the assessed penalties.[138]

4. Do Not Correct Historical Noncompliance, but Be Compliant Going Forward

While not a Service-sanctioned initiative, it is important to note that a noncompliant employer may decide not to address its historical tax noncompliance at all, and instead to correct the issue(s) on a going-forward basis. As explained, although an employer "should" amend an incorrect employment tax return, there is no legal duty for an employer to do so. Indeed, many employers may elect not to enter into a voluntary compliance initiative and instead correct issues on a going-forward basis. While some employers choose this approach, a practitioner who knows an employer did not comply with the federal employment tax laws must advise the employer of the fact of the noncompliance and the consequences of the noncompliance (*e.g.*, tax, penalties, interest, cost of audit and criminal prosecution, and the obligation to issue amended or corrected Forms W-2 and W-3).[139]

B. Voluntary Compliance Initiatives Concerning Worker Misclassification

1. Worker Misclassification Generally

Some employers misclassify service providers as independent contractors to avoid employment tax and other indirect costs of labor, such as workers' compensation insurance, unemployment insurance, minimum wage and overtime pay, fringe benefits, collective bargaining rights, and the protections of workplace discrimination. In Rev. Rul. 87-41,[140] the Service articulated 20 factors to be considered in determining whether an employer–employee relationship exists. An employer–employee relationship generally exists when the persons (or businesses) for whom the services are being performed "have a right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished."[141]

Misclassification is especially common in industries where the indirect cost of labor is high (*e.g.*, in the construction or trucking industries, where the cost of workers' compensation insurance premiums are high) and/or where worksites are not centralized (*e.g.*, in-home care, janitorial, housecleaning, and court reporters). Misclassification may also arise in gig economy jobs, where it is sometimes not clear whether services providers are sufficiently autonomous to fall outside of the employer–employee relationship.[142] Given the widespread issue of worker misclassification, Congress and the Service have implemented numerous programs designed to help noncompliant employers come back into compliance while potentially mitigating (or altogether avoiding) penalties and interest. The available programs include relief under Section 530 of the Revenue Act of 1978; the Service's CSP; the Service's VCSP; and an early referral program.

2. The Section 530 Statutory Safe Harbor

Section 530 of the Revenue Act of 1978 was enacted to provide relief for taxpayers who, as a result of a perceived change in the Service's enforcement of worker classification issues, were involved in employment tax controversies that typically resulted in employers becoming liable for federal income tax withholding, Social Security taxes, and unemployment taxes that had not been paid to the United States.[143] Section 530 is a safe harbor relief provision that

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generally prevents the Service from retroactively reclassifying independent contractors as employees where an employer has in good faith consistently treated service providers as independent contractors for federal employment tax purposes.[144]

Section 530 applies only to worker classification issues. In order for an employer to qualify for relief under Section 530, the employer must have: (1) consistently treated the workers and similarly situated workers as independent contractors (the "substantive consistency requirement"); (2) complied with Form 1099 reporting requirements with respect to compensation paid to the service providers for the tax years at issue (the "reporting consistency requirement"); and (3) had a reasonable basis for treating the service providers as independent contractors (the "reasonable basis test").[145] Failure to adhere to the substantive consistency requirement sometimes causes employers to be ineligible for Section 530 relief. For example, when an employer faces a DOL investigation, an SS-8 determination, a State administrative action, or any other occurrence that may cause the employer to change the worker classification of a particular service provider (or class of service providers), that decision should be made in consultation with counsel because changing a worker's classification from an independent contractor to an employee may make the employer ineligible for Section 530 relief.

There are many benefits to Section 530 relief and no obvious drawbacks. First, where an employer is relieved of liability under Section 530, the employer's (but not the employee's) liability for back employment taxes, penalties, and interest is automatically forgiven.[146] Second, if Section 530 relief is determined to be available, then the examination of the worker classification issue will be discontinued.[147] Third, the Service considers the application of Section 530 to be mandatory, not elective; therefore, in any audit involving worker classification, an auditor must consider the availability of relief under Section 530 even if the taxpayer does not raise the issue.[148] Fourth, Section 530 relief extends into perpetuity unless there is a material change in facts surrounding the employer–service provider relationship.[149] In other words, if the employer is eligible for Section 530 relief, the employer may choose to continue treating its workers as non-employees for purposes of its employment tax liability, as long as the facts remain the same and the taxpayer continues to meet the reporting requirement for that class of worker.[150] Fifth, even if an employer is determined ineligible for Section 530 relief, the employer may be entitled to relief under the CSP.

Taxpayers that disagree with the Service's position regarding the application of Section 530 may immediately request an early referral to the IRS Independent Office of Appeals (sometimes, "Appeals") under the Service's early referral program, discussed herein.[151]

3. Relief Under the CSP

For an employer under examination for one or more worker classification issues, if the employer is not eligible for relief under Section 530, then the employer may nevertheless be entitled to relief under the CSP. The CSP allows worker classification issues to be resolved early in the administrative process, often saving employers employment taxes, penalties, interest, and cost of representation.[152] Any taxpayer with an open employment tax audit is eligible for the CSP.[153] And, if the employer has timely filed all (or substantially all) required Forms 1099, then the IRS examiner *must* present a CSP settlement offer to the employer.[154]

The procedures for the CSP begin with determining whether the employer is eligible for relief under Section 530. Assuming the employer is not eligible for Section 530 relief, and further assuming the employer agrees to classify its workers as employees prospectively, then a series of graduated settlement offers is available to eligible taxpayers as follows:

- *100% CSP Settlement Offer*: If the taxpayer meets the reporting consistency requirement but either does not meet the substantive consistency requirement or cannot meet the reasonable basis test, then CSP settlement offer will be a full employment tax adjustment for the most recent tax year under examination, computed using the more favorable rates allowed under Code Sec. 3509(a), if applicable;
- *25% CSP Settlement Offer*: If the taxpayer meets the reporting consistency requirement and has a colorable argument that it meets the substantive consistency requirement and/or the reasonable basis test, then the CSP settlement will be an adjustment of 25% for the most recent tax year under examination, computed using the more favorable rates allowed under Code Sec. 3509(a), if applicable; and
- *No Assessment CSP Settlement Offer (Section 530 Relief Available)*: Even if a taxpayer meets the requirements for Section 530 relief, the taxpayer may nevertheless wish to enter into a CSP settlement agreement. A taxpayer that enters into such an agreement may begin treating the workers as employees currently or at the beginning of the next year.[155]

In sum, if the requirements for Section 530 relief are not met, a taxpayer may still be eligible to resolve worker misclassification issues through the CSP more cost-effectively than through a protracted audit and litigation.

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4. The VCSP

The VCSP is an optional program that permits employers with misclassification issues to obtain partial relief from federal employment taxes by voluntarily reclassifying workers as employees for future tax periods.[156] In exchange for an employer's voluntary treatment of a class of workers as employees for future tax periods, the employer will: (1) pay 10% of the employment taxes that may have otherwise been due on compensation paid to the workers for the most recent tax year, determined under the more favorable rates allowed under Code Sec. 3509(a); (2) not be liable for interest and penalties on the liability; and (3) not be subject to an employment tax audit with respect to the worker classification of the workers for prior years.[157] To be eligible for the VCSP, a taxpayer must have consistently treated the workers as nonemployees, and must have filed all required Forms 1099, consistent with the nonemployee treatment, for the previous three years with respect to the workers to be reclassified.[158] Also, the taxpayer cannot currently be under an employment tax audit by the Service or an investigation concerning the classification of the workers by the DOL or a State government agency.[159] Eligible taxpayers who wish to participate in the VCSP must submit Form 8952, *Application for Voluntary Classification Settlement Program (VCSP)*.

5. The Early Referral Program

The early referral program is another program the Service offers to help employers address worker misclassification and other employment tax-related issues. In this regard, if an employer disagrees with the Service's application of Section 530, or finds a CSP settlement offer unacceptable, the employer can obtain an early referral to have the issue considered by the IRS Independent Office of Appeals.[160] If an agreement is reached in the early referral process, then the examination ends.[161] And, if an agreement is not reached with Appeals, then the taxpayer has the right to petition the Tax Court to review that determination.[162]

VII. Conclusion

The laws concerning employment taxes are complex, and it is easy for employers to be noncompliant with those laws. The consequences of noncompliance can range from civil monetary penalties to liability as a withholding agent to criminal prosecution. Staying aware of the common areas of noncompliance can help employers avoid those consequences. Where noncompliance has happened, employers should consider the methods available to them to correct that noncompliance and mitigate further liability.

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ENDNOTES

1 *See* IRS Data Book, 2021, at Table 1.

2 Inflation Reduction Act of 2022, H.R. 5376, Part 3 of Title I, Subtitle A (Aug. 7, 2022).

3 *Id.* at §10301.

4 Comm. for a Responsible Federal Budget, *Primer: Understanding the Tax Gap*, *www.crfb.org/blogs/primer-understanding-tax-gap#_Which_Unpaid_Taxes* (Jun. 17, 2021) (citing U.S. Dep't of the Treasury, *The American Families Plan Tax Compliance Agenda*, available at *home.treasury.gov/system/files/136/The-American-Families-Plan-Tax-Compliance-Agenda.pdf#page=5* (May 2021)). The "net tax gap" is the difference between taxes owed and paid voluntarily, after accounting for additional revenue from the IRS's enforcement activities and late payments. Comm. for a Responsible Federal Budget, *Primer: Understanding the Tax Gap*, *www.crfb.org/blogs/primer-understanding-tax-gap#_Which_Unpaid_Taxes* (Jun. 17, 2021). In testimony before the U.S. Senate Finance Committee, IRS Commissioner Charles Rettig estimated that the "tax gap" could approach, and possibly exceed, $1 trillion on an annual basis. United States Cong. Senate Committee on Finance, "The 2021 Filing Season and 21st Century IRS," Apr. 13, 2021, 117th Cong. 1st Session (testimony of Chuck Rettig, Commissioner of the Internal Revenue Service).

5 Pub. L. No. 95-600, §530, 92 Stat. 2763, 2885 (1978), as amended.

6 Code Sec. 7501.

7 Code Sec. 3102. Other federal employment taxes include the Railroad Retirement Tax Act ("RRTA"), with operative provisions at Code Secs. 3201 through 3233; Railroad Unemployment Repayment Tax ("RURT"), with operative provisions at Code Secs. 3321 and 3322; Collection of Income Tax at Source on Wages ("ITW"), with operative provisions at Code Secs. 3401 through 3406; and Self-Employment Contributions Act ("SECA"), with operative provisions at Code Secs. 1401 through 1403. This article generally does not discuss the RRTA, RURT, or ITW taxes.

8 Code Sec. 3111(a), (b).

9 Code Secs. 3301 and 3306(b); Code Secs. 3202 and 3221.

10 Reg. §31.6011(a)-1(a)(1). Small employers (those with annual employment tax liabilities of $1,000 or less) may file Form 944, *Employer's Annual Federal Tax Return*, if approved by the IRS, and agricultural employers file Form 943, *Employer's Annual Tax Return for Agricultural Employees*. Form 945, *Annual Return of Withheld Federal Income Tax*, should be filed to report withheld federal income tax from nonpayroll payments, such as pensions, gambling winnings, and military retirement.

11 Reg. §31.6011(a)-3(a).

12 Code Sec. 6051(a); Reg. §31.6051-1(a)(1)(i).

13 Reg. §31.6051-2(a).

14 *See* Code Sec. 6071(c).

15 *See* Code Sec. 6041.

16 Under a *de minimis* rule, small employers do not have to deposit employment taxes on a monthly or semiweekly basis. An employer with less than $2,500 of accumulated employment taxes for a calendar quarter may remit its taxes with its quarterly return. Reg. §31.6302-1(f)(4)i).

17 Reg. §31.3602-1(b)(4)(i).

18 Reg. §§31.3602-1(b)(2), 31.3602-1(b)(3).

19 Reg. §31.3602-1(c)(1).

20 Reg. §31.3602-1(c)(2).

21 Reg. §31.3602-1(c)(3).

22 Reg. §31.6302(c)-3(a)(1).

23 Code Secs. 3121(a) and 3401(a).

24 Code Secs. 3121(a) (FICA taxes), 3306(b) (FUTA taxes).

25 The definition of wages does not include any benefit provided to (or on behalf of) an employee if, at the time such benefit is provided, it is reasonable to believe that the employee will be able to exclude the benefit from income under Code Sec. 117 or 132. Code Secs. 132 and 117(d) exclude from income nine categories of fringe benefits: (1) no-additional-cost services, (2) qualified employee discounts, (3) working

condition fringes, (4) *de minimis* fringes, (5) qualified tuition reductions, (6) qualified moving expense reimbursements, (7) qualified transportation fringes, (8) qualified retirement planning services, and (9) qualified military base realignment and closure fringes. These categories of fringe benefits are also excluded from employment taxes (including FICA and FUTA) and from the income tax withholding rules, and from the Social Security benefit base.

26 *See* Reg. §§31.3121(a)-1(c), 31.3306(b)-1(c), 31.3401(a)-1(a)(2).

27 *See* Reg. §§31.3121(a)-1(d), 31.3306(b)-1(d), 31.3306(b)-1(e), 31.3401(a)-1(a)(3), 31.3401(a)-1(a)(4).

28 *See* Reg. §§31.3121(a)-1(f), 31.3306(b)-1(f), 31.3401(a)-1(b)(10).

29 *See* Reg. §§31.3121(a)-1(g), 31.3121(a)-1(h), 31.3306(b)-1(g), 31.3306(b)-1(h), 31.3401(a)-1(b)(2), 31.3401(a)-1(b)(3).

30 *See* Reg. §§31.3401(a)-1(b)(1), 31.3401(a)-1(b)(4), 31.3401(a)-1(b)(6), 31.3401(a)-1(b)(9), 31.3401(a)-1(b)(14).

31 *See* Internal Revenue Manual ("IRM") pt. 5.7.8.2 (Mar. 9, 2017).

32 Reg. §1.61-21(a)(3). Examples of fringe benefits include employer-provided automobiles, employer-provided meals and lodging, and employer-provided tuition. *See* Reg. §§1.61-21(a)(1), 1.61-21(a)(2).

33 Code Secs. 3121(a)(5), 3306(b)(5), and 3401(a)(12).

34 Code Sec. 3121(v)(1) and 3306(r)(1).

35 Code Sec. 3121(v)(2)(A) and 3306(r)(2)(A).

36 *See* CARES Act, Pub. L. No. 116-136, §2302.

37 *See id.*

38 IRS, "Deferral of Employment Tax Deposits and Payments Through December 31, 2020," *www.irs.gov/newsroom/deferral-of-employment-tax-deposits-and-payments-through-december-31-2020*.

39 Code Sec. 3403.

40 The amount of the addition to tax for failure to file equals 5% of the amount required to be shown as tax on the return for each month (or fraction of a month) that the return is late, but may not exceed 25% in total. Code Sec. 6651(a)(1).

41 The amount of the addition to tax for failure to pay equals 0.5% of the amount shown as tax on the return for each month (or fraction of a month) that the payment is late, not to exceed 25% in total. Code Sec. 6651(a)(2).

42 The amount of the addition to tax for failure to deposit depends upon the number of calendar days a deposit is late from the due date for the deposit. Code Sec. 6651(b)(1). For liability amounts not properly or timely deposited, the penalty rates are: 2% for deposits that are 1 to 5 days late; 5% for deposits that are 6 to 15 days late; 10% for deposits that are more than 15 days late; and 15% for amounts still unpaid more than 10 days after the date of the first notice requesting payment of the tax due or the day on which the taxpayer received notice and demand for payment, whichever is earlier. *Id.* Additionally, there is a 10% addition to tax imposed for the failure to pay required deposits by electronic fund transfer. *See* Code Sec. 6302; *see also* Reg. §31.6302-1(h).

43 Code Sec. 6662(a), (b)(1); *see also* Code Sec. 6664(c). The amount of the accuracy-related penalty for a penalty on account of negligence or disregard of rules or regulation equals 20% of the underpayment of tax attributable to the negligence or disregard of rules or regulation. Code Sec. 6662(a), (b)(1).

44 The amount of the penalty equals the total amount of tax evaded, not collected, or not accounted for and paid over. Code Sec. 6672(a).

45 The amount of the penalty that may be imposed under Code Sec. 6701 is equal to $1,000 for each false document, except that the amount of the penalty is increased to $10,000 if the return, affidavit, claim for refund, or other document relates to a corporation. Code Sec. 6701(a), by its terms, broadly applies to "any person." Code Sec. 6701(b)(1), (2). Code Sec. 6701(a), by its terms, broadly applies to "any person." Thus, the penalty may be imposed against a person who controls the activities of subordinates and either orders the subordinates to act or does not prevent the subordinate from acting when the person knows that the subordinate's actions will cause an understatement of tax. IRM pt. 20.1.6.14.1(d) (Oct. 13, 2021).

46 *See* Code Secs. 6721(a), 6722(a).

47 Code Sec. 7501(a).

48 *B.L. Cline*, CA-6, 93-2 USTC ¶50,403, 997 F2d 191, 198 (1993).

49 *See, e.g.*, *R.A. Smith*, CA-10, 2009-1 USTC ¶50,263, 555 F3d 1158, 1163 (2009). A corporate officer or employee is a responsible person within the meaning of Code Sec. 6672 if "he or she has significant, though not necessarily exclusive, authority in the general management and fiscal decision making of the corporation." *Id.* There may be more than one responsible person, in which case all responsible persons become jointly and severally liable for any penalty imposed under Code Sec. 6672.

50 *G.G. Domanus*, CA-7, 92-2 USTC ¶50,396, 961 F2d 1323, 1326-1327 (1992).

51 *D.A. Olsen*, CA-8, 92-1 USTC ¶50,036, 952 F2d 236, 241 (1991); *H.E. Harrington*, CA-1, 74-2 USTC ¶9772, 504 F2d 1306, 1315-1316 (1974); *R.W. Monday*, CA-7, 70-1 USTC ¶9205, 421 F2d 1210, 1216 (1970), *cert. denied*, SCt, 400 US 821, 91 SCt 38 (1970).

52 *M.E. Phillips*, CA-9, 96-1 USTC ¶50,057, 73 F3d 939, 942 (1996).

53 *R.A. Smith*, CA-10, 2009-1 USTC ¶50,263, 555 F3d 1158, 1170 (2009) (reasonable cause defense must be narrowly construed with respect to Code Sec. 6672); *P. Thosteson*, CA-11, 2002-2 USTC ¶50,649, 331 F3d 1294, 1301 (2003) (court does not decide whether reasonable cause applies, but notes that the defense is exceedingly limited); *P.J. Winter*, CA-2, 99-2 USTC ¶50,955, 196 F3d 339, 354 (1999) (reasonable cause defense negated willfulness only if the responsible person reasonably believed the taxes were being paid); *M.P. Logal*, CA-5, 99-2 USTC ¶50,988, 195 F3d 229, 233 (1999) (reasonable cause defense is exceedingly limited).

54 One set of courts, including the U.S. Tax Court ("Tax Court"), recognizes the TFRP "as a collection device by assessment of unpaid employment tax against an individual as a 'responsible person'." *O.K. Robinson*, 117 TC 308, 318, Dec. 54,567 (2001); *see also Aardema v. Fitch*, 684 NE2d 884, 896 (Ill. App. Ct. 1997). Another set of courts, including the U.S. Courts of Appeals for the Second, Seventh, and Ninth Circuits, hold that the TFRP imposes a penalty and is not a mere collection device. *See, e.g.*, *Mortenson v. Nat'l Union Fire Ins. Co.*, CA-7, 249 F3d 667, 670-672 (2001); *J.R. Duncan*, CA-9, 95-2 USTC ¶50,547, 68 F3d 315, 317-319 (1995), *aff'g in part, rev'g in part, and remanding in part*, 66 TCM 420, Dec. 49,222(M), TC Memo. 1993-370; *R.J. Kalb*, CA-2, 74-2 USTC ¶9760, 505 F2d 506, 510 (1974).

55 Code Secs. 6321 (liens), 6331 (levies).

56 *See generally* Code Sec. 6330.

57 IRM pt. 5.11.1.5.1 (Nov. 24, 2021).

58 Code Sec. 6330(h)(1).

59 Code Sec. 7402(a).

60 DOJ-Tax, *Civil Employment Tax Injunctions*, *www.justice.gov/tax/civil-employment-tax-injunctions* (last updated Dec. 8, 2020).

61 *See, e.g.*, *Askins and Miller Orthopaedics, P.A.*, CA-11, 924 F3d 1348 (2019).

62 *See generally* Code Secs. 7201, 7202, 7203, 7204, 7206, and 7215.

63 *A. Burrell*, CA-5, 75-1 USTC ¶9152, 505 F2d 904, 911 (1974); *Whiteside*, 404 FSupp 261, 265 (D. Del. 1975).

64 *P. Pomponio*, SCt, 76-2 USTC ¶9695, 429 US 10, 12, 97 SCt 22 (1976).

65 Vani Murthy, *The Consequences of Willful Failure to Pay Payroll Taxes*, 2014-3 J. ACCOUNTANCY 54 (Jun. 1, 2014), available at *www.journalofaccountancy.com/issues/2014/jun/20149645.html#:~:text=to%20criminal%20charges.-,Under%20Sec.,years%20in%20prison%2C%20or%20both*.

66 *Boyajian*, Civil Action No. 04-4835 (KSH), 2006 BL 109383 (D.N.J. Oct. 17, 2006).

67 *See generally* IRM pt. 4.23.23.3 (Jun. 29, 2021) (detailing the ways in which employment tax workload selection occurs). The coordination of employment tax issues occurs by the director of Exam Case Selection and, in turn, the manager of the Employment and Estate and Gift Tax Case Selection, including ET-WSD. *See* IRM pt. 1.1.16.5.5.3.5 (Mar. 15, 2022).

68 Revenue officers, case advocates within the Taxpayer Advocate Service, and Service employees in other business units can refer penalty abatement requests to ET-WSD to coordinate the imposition of penalties and the application of the law concerning the existence of reasonable cause. *See* IRM pt. 4.23.23.3.1.1.5 (Jun. 29, 2021). The list provided is not exhaustive—employment tax noncompliance can also be reviewed in connection with tax return preparer referrals from the Service's Office of Professional Responsibility and Lead Development Center as well as Program Action Cases (*i.e.*, an investigation where clients

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of questionable tax return preparers are examined to determine whether preparer penalties and/or injunctive relief against the preparer is warranted). This article does not discuss these instances of noncompliance, which are directed at the professional and not the taxpayer or person responsible for the taxpayer.

[69] IRM pt. 4.23.23.3.1.1.8 (Jun. 29, 2021).

[70] Pub. L. No. 91-508, 84 Stat. 1114 (1970).

[71] *See* IRM pt. 4.23.23.3.1.1.2 (Jun. 29, 2021).

[72] *See* IRM pt. 4.23.23.3.1.1.4 (Jun. 29, 2021).

[73] *See id.*; *see also* IRM pt. 9.4.1.5.1.5 (Mar. 2, 2018).

[74] *See* IRM pt. 4.23.23.3.1.1.3 (Jun. 29, 2021).

[75] *See* 11 USC §505(b)(2); *see also* Rev. Proc. 2006-24, IRB 2006-22, 943.

[76] *See* IRM pt. 4.23.23.3.1.1.6 (Jun. 29, 2021).

[77] *See generally* Code Sec. 7623(a).

[78] *See id.*

[79] "The e-Trak (entellitrak) system is a web interface software application used to create whistleblower claim submissions and to manage the whistleblower claim inventory." IRM pt. 25.2.10.1.6 (Jul. 27, 2020).

[80] IRM pts. 4.23.23.3.1.1.10.1(2), 4.23.23.3.1.1.10.2(2) (Jun. 29, 2021).

[81] IRM pt. 4.23.23.3.1.1.10.1(4) (Jun. 29, 2021).

[82] IRM pt. 4.23.23.3.1.1.10.2(4) (Jun. 29, 2021).

[83] IRM pt. 1.1.18 (Sep. 25, 2020).

[84] Datta, Langetieg, and Schafer (IRS Research, Applied Analytics and Statistics), *Better Identification of Potential Employment Tax Noncompliance Using Credit Bureau Data*.

[85] *See generally* Memorandum of Understanding between the Internal Revenue Service and the U.S. Department of Labor (Sep. 19, 2011), available at *www.dol.gov/sites/dolgov/files/WHD/legacy/files/irs.pdf*.

[86] *Id.* at §7.A.

[87] IRM pt. 4.23.23.3.1.2.1 (Jun. 29, 2021).

[88] Memorandum of Understanding between the Internal Revenue Service and the U.S. Department of Labor, §8.A. (Sep. 19, 2011), available at *www.dol.gov/sites/dolgov/files/WHD/legacy/files/irs.pdf*.

[89] *Id.* at §8.B.

[90] TIGTA, *Additional Actions Are Needed to Make the Worker Misclassification Initiative With the Department of Labor a Success*, Reference No. 2018-IE-R002, p. 3 (Feb. 20, 2018).

[91] *Id.* at p. 9.

[92] *See* 31 CFR §10.21. The Occupational Safety and Health Administration ("OSHA"), which is a part of the DOL, also refers employment tax cases to ET-WDS.

[93] IRM pt. 4.23.23.3.1.2.3 (Jun. 29, 2021).

[94] *See generally* IRM pt. 4.23.23.3.1.3, *et seq.* (Jun. 29, 2021).

[95] *See* Training and Employment Notice from Suzan G. Levine, Acting Assistant Secretary of the DOL to State Workforce Agencies (Aug. 20, 2021), available at *wdr.doleta.gov/directives/attach/TEN/TEN_03-21.pdf*.

[96] Pub. L. No. 95-600, §530, 92 Stat. 2763, 2885 (1978), as amended.

[97] *See generally* IRM pt. 9.5.11.9 (Sep. 17, 2020). This discussion focuses on the Service's voluntary disclosure practice. Some States, like New Jersey, have programs similar to the Service's voluntary disclosure practice. A State-by-State analysis of these programs is outside the scope of this article.

[98] IRS, *IRS announces an update to the Form 14457, Voluntary Disclosure Practice Preclearance Request and Application*, IR-2022-33 (Feb. 15, 2022), available at *www.irs.gov/newsroom/irs-announces-an-update-to-the-form-14457-voluntary-disclosure-practice-preclearance-request-and-application*.

[99] The voluntary disclosure program does not apply to taxpayers whose income is derived from illegal activities.

[100] *J.L. Cheek*, SCt, 91-1 USTC ¶50,012, 498 US 192, 200-201, 11 SCt 604 (1991).

[101] *See generally* IRM pts. 9.5.11.9(6), (7) (Sep. 17, 2020); *see also* IRM pt. 9.5.11.9.4 (Sep. 17, 2020). In general, if the taxpayer, the taxpayer's spouse, or any related entity is under an audit or investigation by the Service or other law enforcement authorities, the taxpayer is not eligible to make a voluntary disclosure. IRM pt. 9.5.11.9.4 (Sep. 17, 2020). Taxpayers may question whether a DOL investigation precludes them from making a voluntary disclosure. The answer to this question is not entirely settled, and taxpayers should be mindful of the risk that, in disclosing the fact of the DOL investigation in preclearing to make a voluntary disclosure, their application could be denied and they could alert the Service to potential noncompliance.

[102] *See* IRM pt. 9.5.11.9.4 (Sep. 17, 2020).

[103] A taxpayer is eligible to make a voluntary disclosure only if the disclosure is timely. A disclosure is timely if it is received before the Service: (1) commenced a civil examination or criminal investigation of the taxpayer or has notified the taxpayer that it intends to commence such an examination or investigation; (2) received information from a third party (*e.g.*, a whistleblower, an informant, other governmental agency, or the media) alerting the Service to the taxpayer's noncompliance; and (3) acquired information directly related to the noncompliance of the taxpayer from an enforcement action (*e.g.*, a search warrant, an administrative tax summons, or a grand jury subpoena).

[104] *See generally* IRM pt. 9.5.11.9.1 (Sep. 17, 2020); IRS, *Instructions for Form 14457, Voluntary Disclosure Practice Preclearance Request and Application* (rev. Feb. 2022).

[105] *See* IRM pt. 9.5.11.9.1 (Sep. 17, 2020); *see also* IRS, *Instructions for Form 14457, Voluntary Disclosure Practice Preclearance Request and Application* (rev. Feb. 2022).

[106] IRM pt. 9.5.11.9.1(6) (Sep. 17, 2020).

[107] To the extent information reported on historical returns is not reliable, it may be advisable to attach to each return a "Best Efforts Statement" advising that the taxpayer used best efforts in preparing the tax return and disclosing the estimates used or assumptions made in preparing the tax return.

[108] IRM pt. 4.23.25.2(3) (Aug. 3, 2018); *see also* IRM pt. 4.23.25.3(3) (Aug. 3, 2018).

[109] IRM pt. 4.23.25.3(3) (Aug. 3, 2018).

[110] *Id.*; *see also* IRM pt. 4.23.25.2(6) (Aug. 3, 2018).

[111] IRM pt. 4.23.25.2(3), (4) (Aug. 3, 2018).

[112] IRM pt. 4.23.25.2(5) (Aug. 3, 2018).

[113] IRM pt. 4.23.25.2(6) (Aug. 3, 2018).

[114] IRM pt. 4.23.25.3(2) (Aug. 3, 2018).

[115] IRM pt. 4.23.25.4(1) (Jun. 15, 2021).

[116] IRM pt. 4.23.25.4(2) (Jun. 15, 2021).

[117] IRM pt. 4.23.25.8(6) (Aug. 3, 2018); *see also* Code Sec. 6205(a)(1); Reg. §31.6205-1(a)(1), (b), (c).

[118] *See* Code Sec. 7121(b); *see also* IRM pt. 4.23.25.8(8) (Aug. 3, 2018).

[119] IRM pt. 4.23.25.1.1 (Aug. 3, 2018).

[120] *Id.*

[121] IRM pt. 4.23.25.8 (Aug. 3, 2018).

[122] IRM pt. 4.23.25.8(7) (Aug. 3, 2018).

[123] *See Badaracco*, SCt, 464 US 386, 394, 104 SCt 756 (1984).

[124] *See generally* Code Sec. 6531.

[125] Code Sec. 6501(a).

[126] All quarterly Forms 941 filed for a calendar year are deemed filed on April 15 of the year after the year to which the form relates. *See* Code Sec. 6501(b)(2); *see also* Code Sec. 6513(c).

[127] Code Sec. 6501(c)(1).

[128] *Accord* Reg. §1.451-1(a) (providing, in the income tax setting, that a taxpayer who ascertains that an item should have been included in gross income, but was not "should, if within the period of limitation, file an amended return and pay any additional tax due.").

[129] *See* 31 CFR §10.21.

[130] *See* Reg. §31.6205-1(b) (FICA tax). Reg. §31.6205-1(c) provides similar rules for correcting underpayments of federal income tax withholding. However, an interest-free adjustment of federal income tax withholding may generally be made only if the error is ascertained within the same calendar year that the wages to the employee were paid, unless the underpayment is attributable to an administrative error. Reg. §31.6205-1(c)(2).

[131] *See* Reg. §§31.6205-1(b)(2) (FICA tax), 31.6205-1(b)(4) (additional Medicare tax), 31.6205-1(c)(2) (federal income tax withholding).

[132] *See* Reg. §§31.6205-1(b)(2) (FICA tax), 31.6205-1(b)(4) (additional Medicare tax), 31.6205-1(c)(2) (federal income tax withholding).

[133] *See id.*

[134] *See* Reg. §31.6205-1(a)(6)(i).

[135] *See, e.g.*, Code Secs. 6651(a)(1), (2), 6656(a), 6662 (failure to file, failure to pay, failure to make deposit penalties, and accuracy-related penalties, respectively). Under the First Time Abate administrative waiver procedures, the Service generally may provide administrative relief from failure-to-file and failure-to-pay penalties under Code Secs. 6651(a)(1) and (2) as well as Code Sec. 6656, provided that the employer is being subjected to the penalty for the first time. IRM pt. 20.1.1.3.3.2.1(1) (Oct. 19, 2020).

[136] *See* Reg. §§301.6651-1(c), 301.6724-1, 1.6664-4; *see also* IRM pt. 20.1.1.3.2.1(1) (Oct. 19, 2020).

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[137] *Cf.* Reg. §301.6651-1(c) (income tax); *see also* IRM pt. 20.1.1.3.2.1 (Oct. 19, 2020).

[138] On August 24, 2022, the IRS granted broad relief to taxpayers who may be assessed with late-filing penalties for 2019 and 2020. *See* IRS Notice 2022-36. As applied to employment tax returns, the IRS is provided penalty relief to banks, employers and other businesses required to file various information returns, such as those in the 1099 series. To qualify for relief, eligible 2019 returns must have been filed by August 1, 2020, and eligible 2020 returns must have been filed by August 1, 2021. *Id.* at §3.A. (last sentence).

[139] *See* 31 CFR §10.21. While employers may elect to not correct the employment tax issue(s) on a historical or going-forward basis, such an action is not advisable and should not be recommended by any professional.

[140] 1987-1 CB 296. The factors include (1) whether the worker is required to comply with other persons' instructions about when, where, or how the worker is to provide services; (2) whether the putative employer provided the training necessary for the worker to complete the job; (3) whether the worker's services are integrated into business operations; (4) whether the services must be rendered personally; (5) whether the putative employer hires, supervises, and pays assistants; (6) whether there is a continuing relationship between the worker and the putative employer; (7) whether the putative employer sets the hours for work; (8) whether the worker devotes substantially full time to performing services for this particular employer; (9) whether work is performed on the premises of the putative employer; (10) whether a worker must perform services in the order or sequence set by the putative employer; (11) whether the worker must submit oral or written reports (such as progress reports) to the putative employer; (12) whether the worker is paid by the hour, week, or month, rather than in a lump sum or on commission; (13) whether the putative employer pays for the worker's business and/or travel expenses; (14) whether the putative employer furnishes significant tools and materials to the worker; (15) whether the putative employer has a significant investment in or maintain the facilities (*e.g.*, office space) used by the worker; (16) whether the service provider is shielded from realization of profit or loss as a result of their services separate from those ordinarily realized by an employee; (17) whether the service provider performs services for only one employer at a time, other than *de minimis* services; (18) whether the service provider's services are available to the general public; (19) whether the putative employer has the right to discharge a worker; and (20) whether the service provider has the right to terminate their relationship with the putative employer at any time without incurring liability.

[141] Rev. Rul. 87-41, 1987-1 CB 296; Reg. §31.3121(d)-1(c)(2).

[142] The gig economy, which is also referred to as the "sharing economy" or the "access economy," refers to situations in which service providers earn income for providing on-demand work, services, or goods.

[143] S. Rep. No. 1263, 95th Cong., 2d Sess. 209-210.

[144] Pub. L. No. 95-600, §530(a)(1), 92 Stat. 2763, 2885 (1978), as amended.

[145] Pub. L. No. 95-600, §530(a)(2), 92 Stat. 2763, 2885 (1978), as amended. There are multiple categories of authority that may be relied upon as a reasonable basis, including federal judicial precedent, published administrative rulings, and letter rulings issued to the taxpayer; a past audit of the taxpayer; industry custom; and a catch-all for other reasonable bases. *Id.*; *see also* IRM pt. 4.23.5.3.3.7 (Nov. 22, 2017). Commonly cited other reasonable bases include the advice of a tax professional and prior State administrative decisions (*e.g.*, workers' compensation decisions).

[146] *Id.* The relief from interest and penalties applies whether those items are charged directly to the taxpayer or personally against a corporate taxpayer's officers. *See* Rev. Proc. 85-18, 1985-1 CB 518.

[147] IRM pt. 4.23.5.3.3(6) (Nov. 22, 2017).

[148] IRM pt. 4.23.5.3.1(1), (4) (Nov. 22, 2017).

[149] IRS, *Worker Reclassification—Section 530 Relief*, *www.irs.gov/government-entities/worker-reclassification-section-530-relief* (last updated Mar. 29, 2022).

[150] *Id.*

[151] Rev. Proc. 99-28, §4.01(4), IRB 1999-29, 109.

[152] IRM pt. 4.23.6.1.1(1) (Dec. 21, 2017).

[153] IRM pt. 4.23.6.6 (Dec. 21, 2017).

[154] IRM pt. 4.23.6.6(1) (Dec. 21, 2017). The Service instructs its employees that "an inadvertent *de minimis* failure to timely file Forms 1099 should not affect the taxpayer's eligibility for CSP." IRM pt. 4.23.6.6(2) (Dec. 21, 2017).

[155] IRM pt. 4.23.6.14.1 (Apr. 22, 2014).

[156] IRM pt. 4.23.20.1.1 (Jun. 22, 2020).

[157] IRS, *Voluntary Classification Settlement Program (VCSP)*, *www.irs.gov/businesses/small-businesses-self-employed/voluntary-classification-settlement-program* (last updated Jul. 14, 2021).

[158] Announcement 2012-45, §III., IRB 2012-51, 724.

[159] *Id.*

[160] *See generally* Rev. Proc. 99-28, §4, IRB 1999-29,109. The early referral program is available for other issues, such as whether certain payments are excepted from the definition of "wages" (*e.g.*, fringe benefits that would be excludible from the employee's gross income under Code Sec. 132). *Id.* at §4.03.

[161] *Id.* at §4.05.

[162] *Id.* at §4.06(1); *see also* Code Sec. 7436(a).

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