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Business Law Newsletter

Tax Law:

IRS Announces New Settlement Procedure For Workers Misclassified as Independent Contractors

By Ronald A. Feuerstein, Esquire

On September 21, 2011, the Internal Revenue Service ("IRS") announced its new Voluntary Classification Settlement Program ("VCSP"). Under VCSP, eligible employers can receive relief from payroll taxes otherwise owed in exchange for agreeing ***prospectively*** to treat such workers as employees.

Background

Whether a worker is performing services as an employee or an independent contractor depends upon the facts and circumstances and is generally determined under the common law test of whether the service recipient has the right to direct and control how the worker performs the services. In many situations, the determination of the proper worker classification status under the common law can be far from clear.

For taxpayers under IRS examination, the current Classification Settlement Program ("CSP") is available to resolve Federal employment tax issues related to worker misclassification, if certain criteria are met. CSP permits the prospective reclassification of workers as employees with reduced Federal employment tax liabilities for past nonemployee treatment. The CSP allows employers and tax examiners to resolve the worker classification issues as early as possible in the administrative process, thereby reducing taxpayer burden and providing efficiencies for both the taxpayer and the Government.

IRS decided that in order to facilitate voluntary resolution of worker classification issues and achieve the resulting benefits of increased tax compliance and certainty for taxpayers, workers and the Government, it would be beneficial to provide taxpayers with a program that allows for voluntary reclassification of workers as employees outside of the

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examination context and without the need to go through normal administrative correction procedures applicable to employment taxes.

VCSP

In order to be eligible for the new settlement program, the employer must have filed Form 1099 for each worker for the past three years and not be currently under audit by IRS, the Department of Labor or any state government agency.

If the employer agrees to treat the workers as employees, the employer will be liable for only 10 percent of liability due for the most recent tax years in accordance with reduced rates under Section 3509 of the Internal Revenue Code, but will not be liable for any penalties and interest and will not be subject to audit for employment tax issues with respect to the worker classification of such workers for prior years. Employers participating in the program will also be required to extend the statute of limitations for assessment of employment taxes for three years beginning after the date the employer has agreed to begin treating the workers in issue as employees.

Employers participating in the VCSP will be required to enter into a Closing Agreement with IRS.

Significant Benefits and Advantages

Under the appropriate facts and circumstances, many business taxpayers may find it beneficial to pursue VCSP, but like so many other tax considerations and dealings with IRS, such decisions should be made on a case-by-case basis with the advice of tax counsel, who should weigh and balance various considerations, factors and risks.

One of the most important advantages of the VCSP is that it requires only three years of Forms 1099 being filed for each worker to be reclassified, rather than the rules required under so-called "Section 530" relief (referring to Section 530 of the Revenue Act of 1978, not to the Internal Revenue Code), requiring Forms 1099 to have been filed for all years after 1978. Moreover, relief under Section 530 is only available if the employer had a "reasonable basis" for treating a worker as an independent contractor. Significantly, no such "reasonable basis" is required under VCSP, representing a remarkable liberalization that will no doubt open the VCSP to a much greater number of taxpayers.

Another obvious benefit of VCSP is the waiver of all penalties and interest, which could be very substantial in many instances.

An additional advantage provided under VCSP is that the taxpayer will not be subject to an employment tax audit concerning the reclassified workers for prior years. However, it is important to note that the IRS would not be prevented from conducting a tax audit of the taxpayer on other issues.

All in all, VCSP promises to be a program well worth considering for many businesses who have misclassified workers as independent contractors.

Ron Feuerstein practices tax law and is a Shareholder with Bean, Kinney & Korman, P.C. in Arlington, Virginia. He can be reached at (703) 525-4000 and rfeuerstein@beankinney.com.

Non-Competes in Virginia Civil Settlement Agreements

By James V. Irving, Esquire

It is fundamental in Virginia that non-competition agreements arising from arm's length business transactions are afforded greater judicial deference than those between an employer and an employee, which are presumed to be the result of unequal bargaining position.

In a case of first impression, Judge Norman K. Moon of the United States District Court for the Western District of Virginia, sitting in Charlottesville, has denied a Defendants' Motion to Dismiss a claim based upon the breach of a covenant not to compete contained within a post-employment Settlement Agreement.

Mark D. Carucci, a New Jersey resident, had been employed as regional manager by McClain

& Co., Inc. ("McClain"), a Virginia corporation engaged in multi-state traffic maintenance services. In March 2010, Carucci was terminated for allegedly misappropriating approximately $285,793 in McClain funds. Thereafter, McClain's civil claim against Carucci was settled by way of an Agreement, pursuant to which McClain released its claims against Carucci in return for a payment of $250,000; return of McClain's equipment, records and confidential information; and Carucci's entry into restrictive covenants governing competition and solicitation of McClain's business by Carucci for a limited period of time. McClain alleges that thereafter, and within the restricted period, Carucci and his grandfather established MPT Rentals, Inc., a business in direct competition with McClain.

In particular, McClain alleged that within six days of signing the Agreement, Carucci and MPT began to offer "Competing Services" (as defined in the Agreement), within the restricted area. According to McClain, MPT advertised that they were the "one stop shop for traffic equipment and safety needs." McClain sued for (among other things) breach of the Agreement. Carucci responded by asking the Court to dismiss the claim because the Non-Competition provision was overbroad and unenforceable under the applicable Virginia case law. According to Judge Moon, the Virginia Supreme Court has not announced a standard governing the enforceability of covenants against competition appearing in civil settlement agreements.

Carucci's principal argument was that the non-compete should be measured against the "rigorous standard developed to review non-compete agreements incident to employment contracts." McClain argued that the provision should be reviewed according to the less restrictive test applicable to agreements such as a sale of a business; agreements between partners in a professional firm; or other transactions where the parties have relatively equal bargaining power.

Judge Moon declined to adopt Carucci's strict standard of analysis. While stating that "a requirement of reasonableness is adequate to afford fair protection to the interests of both parties to the contract and the public." He noted that the settlement was the result of arm's length negotiation between parties fully represented by counsel; that the Agreement was specifically deemed to have been drafted "jointly by the parties"; and that public policy favors the enforcement of negotiated resolutions of private disputes.

Judge Moon's ruling left it to the trial court to determine if Carucci had acted as alleged, and if he had, what damages should be awarded. He also made it clear that Carucci would have a lot of explaining to do to the jury.

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Meet Our Attorneys
Jennifer A. Brust

Ms. Brust is a shareholder of the firm representing clients in banking, bankruptcy, creditor's rights, government contracts, and commercial and civil litigation. Ms. Brust also has experience as a court appointed receiver taking over troubled and mismanaged companies. Ms. Brust has served as a Commissioner in Chancery for the Arlington County Circuit Court since 1996.

Ms. Brust actively litigates in the state, federal and bankruptcy courts in Virginia, Maryland and the District of Columbia. She has lectured extensively on various civil litigation topics including creditor's rights and discovery issues.

Ms. Brust is a Past President of the Arlington County Bar Association (1998-1999). She is a Fellow of the Honors Society, Litigation Counsel of America. Ms. Brust is a member of the Arlington County and Northern Virginia Bankruptcy Bars and the Walter P. Chandler American Inn of Court. Ms. Brust served on the Virginia State Bar Council and the Virginia State Bar's Standing Committee on Legal Ethics

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from 2001-2007. In the fall of 2010, she began teaching the course "Secured Finance" at George Mason University School of Law which explores the law and economic consequences of Secured Finance, with a focus on the Uniform Commercial Code's Article 9.

Ms. Brust is a graduate of Princeton University. She received her law degree from The George Mason University School of Law and is "AV" rated by Martindale-Hubbell, as well as earning the distinction of the Martindale-Hubbell Bar Register of Preeminent Women Lawyers. Ms. Brust is also listed in Best Lawyers of America in the specialty of Bankruptcy and Creditor-Debtor Rights Law for 2010, 2011 and 2012.

Some of Ms. Brust's notable cases include the representation of US Airways, Inc. in a multi-million dollar business interruption claim, the defense of a commercial real estate developer in an eighteen million dollar breach of contract action, the defense of a national retail pharmaceutical company in a twenty million dollar breach of contract action, the representation of a limited liability company against Cable & Wireless, Inc. in a breach of contract action, and the representation of creditors with multi-million dollar claims in the In Re: Jefferson Mills, Inc. bankruptcy, the In Re: U.S. Airways bankruptcy and the In Re: Orbital Sciences Corporation bankruptcy.

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