



*Better Worker Identification Data
Are Needed for the Voluntary
Classification Settlement Program*

August 27, 2014

Reference Number: 2014-40-065

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

Redaction Legend:

2 = Risk Circumvention of Agency Regulation or Statute

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HIGHLIGHTS

BETTER WORKER IDENTIFICATION DATA ARE NEEDED FOR THE VOLUNTARY CLASSIFICATION SETTLEMENT PROGRAM

Highlights

Final Report issued on August 27, 2014

Highlights of Reference Number: 2014-40-065 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed and the Tax Exempt and Government Entities Divisions.

IMPACT ON TAXPAYERS

The IRS estimates that employers misclassify millions of workers as independent contractors instead of employees. In September 2011, the IRS implemented the Voluntary Classification Settlement Program (VCSP) to allow employers to voluntarily reclassify workers as employees for Federal employment tax purposes. Employers that are accepted into the VCSP enter into a signed agreement with the IRS to treat workers as employees for future tax periods.

WHY TIGTA DID THE AUDIT

This audit was initiated because the classification of whether a worker is an employee or an independent contractor has significant tax implications for the worker, the employer, and the IRS. The overall objective of this review was to assess the IRS's VCSP.

WHAT TIGTA FOUND

The IRS does not obtain the information that it needs to verify the accuracy of applications and payments. The IRS does not require employers to provide information on the VCSP application that identifies the specific workers who are being reclassified, such as the workers' names and Social Security Numbers. Without the specific worker identification information, the IRS cannot determine if the applicant met VCSP eligibility requirements. In addition, the IRS is unable to verify the accuracy of the compensation amount

reported on the application and ultimately the applicant's computation of the VCSP payment amount owed. Without identifying information for the workers being reclassified, the IRS is also unable to establish an effective process to monitor VCSP agreements to ensure employer compliance. Finally, processes to track and monitor program applications are ineffective and not always accurate, and the follow-up review control logs do not always reflect accepted agreements.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS require employers applying for the VCSP to provide the names and Social Security Numbers for the workers being reclassified, revise internal procedures for processing VCSP applications to evaluate employer eligibility, and ensure that worker compensation and the VCSP payment is accurate; develop follow-up review processes to ensure compliance with the terms of agreements; develop reporting capabilities to allow for a single system for both tracking inventory and monitoring program performance; and revise processes to ensure that accepted agreements are successfully sent to and received by the IRS business units responsible for monitoring compliance.

IRS management agreed with the recommendations. The IRS plans to revise the VCSP application to instruct employers to provide worker identification information and to revise internal procedures to use this information to evaluate eligibility for the program and compliance with VCSP agreements. The IRS also plans to implement reporting capabilities for the Reporting Compliance Case Management System to allow for a single inventory system for inventory tracking and monitoring program performance. Finally, the IRS indicated that it has developed and implemented internal procedures to ensure that inventory is accurately input and agreements are transferred to the appropriate business units for compliance monitoring.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 27, 2014

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Better Worker Identification Data Are Needed for
the Voluntary Classification Settlement Program (Audit # 201340025)

This report presents the results of our review to assess the Internal Revenue Service's Voluntary Classification Settlement Program. This audit is included in the Treasury Inspector General for Tax Administration's Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Taxpayer Protection and Rights.

Management's complete response to the draft report is included in Appendix IV.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services).



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Table of Contents

BackgroundPage 1

Results of ReviewPage 5

 Worker Identification Information Is Needed to Verify
 the Accuracy of Applications and Associated Payments.....Page 5

Recommendation 1:.....Page 6

 Processes for Monitoring Compliance With Terms of
 Agreements Need ImprovementPage 6

Recommendations 2 and 3:Page 7

 Processes to Track and Monitor Applications Are
 Ineffective and Not Always Accurate.....Page 8

Recommendations 4 and 5:Page 9

Appendices

 Appendix I – Detailed Objective, Scope, and MethodologyPage 11

 Appendix II – Major Contributors to This ReportPage 14

 Appendix III – Report Distribution ListPage 15

 Appendix IV – Management’s Response to the Draft Report....Page 16



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Abbreviations

GECU	Government Entities Compliance Unit
IRS	Internal Revenue Service
RCCMS	Reporting Compliance Case Management System
SB/SE	Small Business/Self-Employed
TE/GE	Tax Exempt and Government Entities
VCSP	Voluntary Classification Settlement Program



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Background

The determination of whether a worker is an employee or an independent contractor has significant tax implications for the worker, the employer, and the Internal Revenue Service (IRS). How a worker is classified affects the tax obligations for both the worker and the employer. For example, the classification will affect who is responsible for paying the Social Security tax, Medicare tax, and Federal unemployment taxes as well as whether or not Federal income tax withholding is needed. The IRS estimates that employers misclassify millions of workers as independent contractors instead of employees. The misclassification of employees as independent contractors is a nationwide problem.

The misclassification of employees can also create an unfair competitive business advantage when one employer classifies a class of workers as employees, while a competitor misclassifies the same class of workers as independent contractors. For example, using an annual average income of \$44,322 per employee¹ during Calendar Year 2012, an employer that misclassifies a worker as an independent contractor reduces the amount of employment taxes² it pays by \$3,811. This occurs because as an independent contractor, the worker and not the employer is responsible for paying the entire amount of his or her Social Security and Medicare taxes as well as any estimated Federal income taxes. In comparison, when an employer treats a worker as an employee, the employer pays the employer's share of the Social Security tax (6.2 percent), the employer's share of the Medicare tax (1.45 percent), and the Federal unemployment taxes.³

The Voluntary Classification Settlement Program (VCSP) enables employers to voluntarily reclassify workers

In September 2011, the IRS introduced the VCSP to encourage employers with worker classification issues to voluntarily come forward to reclassify workers from independent contractors to employees. The focus of the VCSP is on future compliance and providing employers that are currently not in compliance with worker classification an avenue to become compliant. Employers that are accepted into the VCSP enter into a signed agreement with the

¹ This is the estimated national average wage index for Calendar Year 2012 that the Social Security Administration uses to compute retirement benefits.

² The \$3,811 in employment tax benefit is calculated based upon the Social Security tax rate of 6.2 percent of wages (\$2,748), the Medicare tax rate of 1.45 percent of wages (\$643), and the Federal unemployment tax rate of 6 percent on the first \$7,000 of wages (\$420).

³ For Tax Year 2014, the Federal unemployment tax rate is 6 percent on the first \$7,000 paid to an employee; however, employers can qualify for a 5.4 percent tax deduction for their portion of the State unemployment tax, making it an effective rate of 0.6 percent.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

IRS to treat workers as employees for future tax periods. The VCSP provides significant benefits to an employer that may have misclassified workers, including:

- Avoiding worker classification audits of prior tax periods⁴ for which the workers were misclassified.
- Receiving substantial relief from Federal employment taxes owed for the prior tax periods along with relief from any interest and penalties on these liabilities.
- Obtaining a fresh start with the IRS to properly classify workers as employees for future tax periods.

To participate in the program, an employer must file an application using Form 8952, *Application for Voluntary Classification Settlement Program (VCSP)*. The employer self-declares on Form 8952 the number of workers being reclassified as well as the compensation paid to those workers for the most recent calendar year. Employers accepted into the VCSP are required to pay only 10 percent of the employers' tax liability⁵ on compensation paid to the workers being reclassified for the most recent calendar year. This equates to approximately 1 percent of the compensation paid to the reclassified workers. Figure 1 shows a hypothetical example of how an employer would calculate the VCSP payment on Form 8952 using the estimated national average wage index for Calendar Year 2012 of \$44,322.

Figure 1: Hypothetical Example of VCSP Payment Calculation

Part IV Payment Calculation Using Section 3509(a) Rates (see instructions)			
18	Enter total compensation paid in the most recently completed calendar year to all workers to be reclassified (see instructions)	18	\$ 44,322
19	Multiply line 18 by 3.24% (.0324)	19	\$ 1,436.03
20	Enter any compensation included on line 18 that exceeded the social security wage base for any worker or workers for the most recently completed calendar year (see instructions)	20	\$ 0
21	Subtract line 20 from line 18	21	\$ 44,322
22	Multiply line 21 by 7.04% (.0704)	22	\$ 3,120.27
23	Add lines 19 and 22	23	\$ 4,556.30
24	Multiply line 23 by 10% (.10). This is the VCSP payment you will pay when you submit your signed closing agreement (see instructions)	24	\$ 455.63

Source: Form 8952.

⁴ A tax period refers to each tax return filed by the taxpayer for a specific period (year or quarter) during a calendar year for each type of tax.

⁵ The employer's tax liability is calculated based on Internal Revenue Code Section 3509(a) rates. These rates apply to employers that are under worker reclassification reviews and include the employer's share of Social Security tax and Medicare tax and a portion of the employee's share of Social Security tax, Medicare tax, and Federal income tax withholding.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

To be eligible for the VCSP, the employer:

- Must have previously treated the workers to be reclassified as independent contractors.
- Must have filed Forms 1099-MISC, *Miscellaneous Income*, (referred to as Forms 1099) as required⁶ for the previous three years with respect to the workers to be reclassified.⁷
- Cannot be under an employment tax audit by the IRS or an audit of worker classification with either the Department of Labor or a State government agency.

The Small Business/Self-Employed (SB/SE) Division is responsible for the overall policy and administration of the VCSP. The Tax Exempt and Government Entities (TE/GE) Division Government Entities Compliance Unit (GECU) is responsible for evaluating and approving employer VCSP applications. As of April 25, 2014, the IRS has completed reviews of 1,508 applications and accepted 1,303 (86 percent) applicants into the program. Figure 2 provides details of the applications processed since the inception of the VCSP through April 25, 2014.

Figure 2: Summary of VCSP Applications Through April 25, 2014

Fiscal Year⁸	Applications Reviewed	Workers Requested to be Reclassified	Agreements Accepted	Workers Reclassified	VCSP Payments Received
2012	638	12,437	565	11,749	\$1,498,850
2013	629	11,083	532	10,071	\$1,728,318
2014 ⁹	241	4,323	206	3,623	\$681,545
Total	1,508	27,843	1,303	25,443	\$3,908,713

Source: VCSP monthly briefing as of April 25, 2014.

This review was performed at the SB/SE Division Specialty Tax Programs function in Florence, Kentucky, and the TE/GE Division GECU in Ogden, Utah, during the period August 2013 through May 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and

⁶ Employers are required to file Forms 1099 for workers who provide services of \$600 or more per calendar year.

⁷ During December 2012 through June 2013, the IRS temporarily allowed employers that had not filed Forms 1099 to enter into VCSP agreements provided that the employers had electronically filed the Forms 1099 for the three years prior to executing the VCSP agreement.

⁸ A fiscal year is any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

⁹ Information for Fiscal Year 2014 is for approximately seven months (a partial fiscal year).



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Results of Review

Worker Identification Information Is Needed to Verify the Accuracy of Applications and Associated Payments

The IRS does not obtain the information that it needs to verify the accuracy of VCSP applications and VCSP payments. For example, the IRS does not require employers to provide information on the VCSP application that identifies the specific workers who are being reclassified, such as the workers' names and Social Security Numbers. Without the specific worker identification information, the IRS cannot determine if the applicant met VCSP eligibility requirements. In addition, the IRS is unable to verify the accuracy of the compensation amount reported on the Form 8952 and ultimately the applicant's computation of the VCSP payment amount owed.

VCSP eligibility requirements state that employers must have filed all *required* Forms 1099 for the previous three years for the workers to be reclassified and the employer is required to pay 10 percent of the employer's tax liability on compensation paid to the workers being reclassified for the most recent calendar year. However, IRS internal procedures instruct tax compliance officers¹⁰ reviewing applications to ensure that the employer filed Forms 1099 for each of the three previous years. The verification detailed in IRS procedures is not the same as the requirement that must be met for an employer to participate in the VCSP, which is that the employer filed all Forms 1099 for the previous three years ***for the workers to be reclassified***. A sufficient verification cannot be performed without worker identification information. In addition, procedures indicate that the tax compliance officer reviewing the application is not expected to validate the taxpayer's computations.

According to IRS management, the IRS does not require employers to include information on the Form 8952 identifying specific workers to be reclassified because they intended for the VCSP application process to be easy, quick, and inclusive for employers to encourage them to voluntarily enter into the program. In addition, IRS management indicated that they rely on the information provided by the employer as being true, correct, and complete because the employer is voluntarily coming forward and signing the application under penalties of perjury.

The IRS implemented the VCSP to encourage employers with worker classification issues to voluntarily come forward to reclassify workers from independent contractors to employees. The benefits of the VCSP to the Federal Government include greater certainty for the receipt of employment tax payments and reduced cost for tax administration by reducing the number of

¹⁰ A tax compliance officer is the GECU employee who is responsible for processing VCSP applications.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

employment tax audits. For the employers accepted into this program, they receive a significant reduction in taxes owed due to their previous misclassification of workers. As such, the IRS should request specific identifying information for the workers being reclassified to ensure that employers are accurately requesting participation in the program and making the correct VCSP payment.

Recommendation

Recommendation 1: The Commissioner, Small Business/Self-Employed Division, should revise Form 8952 to require employers applying for the VCSP to provide the names and Social Security Numbers for the workers requested for reclassification. In addition, revise internal procedures for processing VCSP applications to use the names and Social Security Numbers of the workers to be reclassified to evaluate employer eligibility for the VCSP and ensure that worker compensation reported and the VCSP payment are accurate.

Management's Response: IRS management agreed with this recommendation. The SB/SE Division will work with the Wage and Investment Division to revise Form 8952 to instruct VCSP applicants to provide the names and Social Security Numbers for all workers who are being reclassified. In addition, the IRS will revise internal procedures for processing Form 8952 to utilize the names and Social Security Numbers of the workers being reclassified to evaluate eligibility for the VCSP and assure the compensation reported is reasonably accurate.

Processes for Monitoring Compliance With Terms of Agreements Need Improvement

Without identifying information on the specific workers whom employers agreed to reclassify, the IRS is unable to establish an effective process to monitor VCSP agreements to ensure employer compliance. Both the SB/SE and the TE/GE Divisions are responsible for conducting follow-up reviews of employers with accepted VCSP agreements to determine if the employer complies with the terms of the VCSP agreement. The SB/SE Division is responsible for employers classified as SB/SE or Large Business and International Division taxpayers, and the TE/GE Division is responsible for employers classified as TE/GE Division taxpayers. The VCSP closing agreement requires the employer to remain in compliance with its VCSP agreement for future tax years. If noncompliance is discovered, the employer forfeits all benefits provided through the VCSP. The reclassification of workers requires employers to change the workers from independent contractors to employees; thus, the workers will start receiving a Form W-2, *Wage and Tax Statement*, instead of a Form 1099.

The process the SB/SE Division established evaluates compliance with the VCSP agreements by performing a trend analysis. The trend analysis looks at whether the number of Forms 1099 or the amount of compensation reported on Forms 1099 for this specific employer has decreased



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Management's Response: IRS management agreed with this recommendation.

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Processes to Track and Monitor Applications Are Ineffective and Not Always Accurate

IRS procedures require GECU employees to update both the Reporting Compliance Case Management System (RCCMS)¹¹ and the GECU log¹² simultaneously when working VCSP applications. Although these systems are to be updated simultaneously, our comparison of VCSP application inventory as of March 18, 2014, identified 83 VCSP applications that had different statuses¹³ reported on the GECU log versus the RCCMS. For example, the RCCMS showed applications in the status of application received, yet the GECU log showed the application as being accepted. The GECU is in the process of creating an action plan to improve the accounting for and control of VCSP applications. For example, one of the actions is a monthly review, *i.e.*, reconciliation, of the RCCMS inventory and the GECU manual log. In April 2014, the IRS completed the review on five VCSP applications and identified 11 errors, such as the number of employees entered into the RCCMS did not match the GECU log. All of the errors identified were the result of not updating both the RCCMS inventory and the GECU log to reflect changes, updates, or corrections.

The IRS maintains duplicate inventory information as the RCCMS improves IRS control of VCSP applications but does not provide the needed management information reporting capabilities of the GECU log. Initially, the IRS maintained only the GECU log to track and monitor VCSP application inventory. In November 2013, the GECU began using the RCCMS to track VCSP applications. While the RCCMS offers improvements in the control of VCSP application inventory, our discussions with the IRS found that the RCCMS does not have the ability to generate management information reports to monitor program performance, including the number of applications received and accepted.

Errors on the GECU log and the RCCMS can result in inaccurate information in the monthly status reports for monitoring program performance and can result in applications not being worked in a timely manner.

¹¹ The RCCMS provides TE/GE Division personnel with the capabilities to perform operating division-wide inventory control, compliance testing, tax computing, education and outreach, and team examination monitoring. The GECU uses the RCCMS to log and control VCSP applications.

¹² The GECU log is an inventory list of VCSP applications in progress, accepted, and/or rejected. The GECU log is the source used to create monthly VCSP performance summary data.

¹³ The IRS uses various status codes to indicate the progress of the work on the VCSP application from receipt to approved agreement.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

The process is not adequate to control transfer of VCSP agreements between IRS functions

As of November 26, 2013, the GECU log showed that the IRS accepted 983 applications from employers for which the SB/SE Division is responsible for monitoring compliance with the terms of the accepted agreement. We identified 73 accepted agreements for which the SB/SE Division's follow-up review control log did not reflect the receipt of these accepted agreements. The GECU had no record of sending the cases to the SB/SE Division. As a result, these employers would not be subjected to a SB/SE Division follow-up review.

On a monthly basis, the GECU mails to the SB/SE Division all accepted VCSP agreements for the employers the SB/SE Division is required to monitor for compliance with the agreements. The GECU maintains documentation confirming the VCSP agreements were sent to the SB/SE Division; however, no process has been established to confirm the SB/SE Division's receipt of the VCSP agreements. After we advised management of the discrepancies in the inventories, IRS management located and routed the accepted VCSP agreements to the SB/SE Division, allowing the SB/SE Division to control these cases for subsequent compliance monitoring checks.

Recommendations

The Commissioner, Tax Exempt and Government Entities Division, should:

Recommendation 4: Develop reporting capabilities for the RCCMS to allow for a single system for both tracking inventory and monitoring program performance of the VCSP. Meanwhile, the IRS should revise processes to ensure that information is accurately and completely logged into the GECU log and the RCCMS. This process should include a periodic inventory validation.

Management's Response: IRS management agreed with this recommendation. The IRS will implement RCCMS reporting capabilities to allow for a single inventory tracking system. In addition, the IRS developed and implemented internal procedures to ensure that information is accurately recorded in both the RCCMS and the GECU log.

Recommendation 5: Revise processes to ensure that accepted agreements are successfully sent to and received by the IRS business units responsible for monitoring compliance with the terms of those agreements.

Management's Response: IRS management agreed with this recommendation. The IRS indicated that internal procedures were revised to ensure that the appropriate



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

accepted VCSP agreements are forwarded to and received by the IRS business unit that will monitor them for compliance.¹⁴

¹⁴ IRS management indicated that they implemented the corrective action to this recommendation. However, the IRS implemented the corrective action after the completion of our field work, and as such, we did not test these corrective actions.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to assess the IRS's VCSP. To accomplish this objective, we:

- I. Determined if the IRS accurately processes VCSP applications.
 - A. Reviewed the Internal Revenue Manuals and desk procedures, and interviewed IRS management and staff to determine how the IRS processes the VCSP application.
 - B. Identified a population of 554 VCSP agreements that were accepted between October 1, 2012, and November 26, 2013. There were 73 VCSP agreements that were accepted into the program from December 2012 through June 2013 as part of the eligibility expansion¹ that were excluded from our population because the eligibility expansion was discontinued. We selected a random sample of 50 VCSP agreements out of the 554 accepted agreements. A random sample was used to ensure that each VCSP agreement had an equal chance of being selected, which enabled us to obtain sufficient evidence to support our results. Because the program has only been established since September 2011, we decided to review more recently completed VCSP agreements to allow the IRS time to correct initial processing issues.
 - C. For the sample of 50 accepted VCSP agreements selected in Step I.B, determined if the applications were filled out correctly, case files contained the correct research, and the IRS could verify the workers being reclassified. We evaluated whether information available in the VCSP application and/or IRS systems was sufficient to determine the eligibility of the employers and to assess the accuracy of the compensation amount reported. We also evaluated the accuracy of the calculation of the VCSP payment using the compensation reported by employers on the VCSP application. We used the results of this sample as a basis for our conclusions that worker identification information is needed to verify the accuracy of the applications and associated payments.

¹ During December 2012 through June 2013, the IRS temporarily allowed employers that had not filed Forms 1099 to enter into VCSP agreements provided that the employers electronically filed the Forms 1099 for the three years prior to executing the VCSP agreement.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

- II. Determined if the IRS accurately accounts for all VCSP applications and maintains accurate information on these applications.
- A. Obtained copies of the GECU log² from the GECU for Fiscal Years³ 2012, 2013, and 2014 (through May 8, 2014).
 - B. Evaluated the accuracy of the GECU logs obtained in Step II.A.
 - 1. Identified fields from the GECU log that needed or required information to be filled out to evaluate the performance of the VCSP.
 - 2. Obtained a list of the GECU electronic case file directory and compared the first 435 VCSP applications listed to the 1,443 applications on the GECU log as of November 26, 2013, to ensure that the GECU log reconciled with the electronic case files. We researched all discrepancies involved and received IRS agreement on errors identified. We selected the first 435 VCSP applications listed because this provided a reasonable basis to ensure completeness of the GECU log.
 - C. Obtained a copy of the VCSP monthly summary report as of November 22, 2013. We compared the monthly summary report to the GECU logs for Fiscal Years 2012, 2013, and 2014 as of November 21, 2013. We determined whether the monthly report is an accurate portrayal of the information maintained in the GECU logs.
 - D. Assessed the effectiveness of the IRS process for converting the manually maintained GECU log to the RCCMS.⁴
- III. Determined the effectiveness and efficiency of follow-up reviews on VCSP agreements.
- A. Reviewed the Internal Revenue Manual and desk procedures, and interviewed management and staff on follow-up reviews on the VCSP agreements.
 - B. Obtained a copy of the SB/SE Division's follow-up review control log as of November 26, 2013. We evaluated the IRS process for transferring VCSP agreements between the GECU and the SB/SE Division by comparing the SB/SE Division's follow-up review control log with the GECU log as of November 26, 2013.

² The GECU log is an inventory list of the VCSP applications in progress, accepted, and/or rejected. The GECU log is the source used to create monthly VCSP performance summary data.

³ The fiscal year is any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.

⁴ The RCCMS provides TE/GE Division personnel with the capabilities to perform operating division-wide inventory control, compliance testing, tax computing, education and outreach, and team examination monitoring. The GECU uses the RCCMS to log and control VCSP applications.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

- C. Identified 109 accepted agreements from the SB/SE Division's follow-up review control log obtained in Step III.B that had an effective reclassification date of January 1, 2012, and prior. These agreements met the SB/SE Division's selection criteria for conducting follow-up reviews, *i.e.*, a minimum of one fully completed calendar year after the execution of the VCSP agreement.
- D. Determined that the SB/SE Division reviewed 39 of the 109 accepted agreements for compliance identified in in Step III.C as of November 26, 2013.
- E. Evaluated the employer's compliance with the terms of the VCSP agreement on all 39 accepted agreements identified in Step III.D.
- F. Obtained a copy of the SB/SE Division's follow-up review control log as of May 5, 2014, and determined that the SB/SE Division reviewed 86 of 144 accepted agreements for compliance. We used the results of this analysis and Step III.E as a basis for our conclusions on IRS processes for monitoring compliance with the terms of the agreements.
- G. Determined whether TE/GE Division VCSP agreements are subjected to VCSP follow-up reviews.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the SB/SE Division Employment Tax function policies and guidance on the VCSP and the TE/GE Division GECU procedures on the VCSP application. We evaluated these controls by interviewing management, conducting walkthroughs of the processes, and reviewing case files.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Appendix II

Major Contributors to This Report

Russell P. Martin, Acting Assistant Inspector General for Audit (Returns Processing and Account Services)

Diana M. Tengesdal, Acting Director

Darryl Roth, Audit Manager

Jonathan Lloyd, Lead Auditor

Johnathan Elder, Auditor

Nathan Smith, Auditor



*Better Worker Identification Data Are Needed
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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Tax Exempt and Government Entities Division SE:T
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP
Director, Government Entities, Tax Exempt and Government Entities Division SE:T:GE
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 Commissioner, Tax Exempt and Government Entities Division SE:T



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Appendix IV

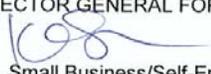
Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

AUG 11 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Better Worker Identification Data Are
Needed for the Voluntary Classification Settlement Program
(Audit # 201340025)

Thank you for the opportunity to review your draft report titled: "Better Worker Identification Data Are Needed for the Voluntary Classification Settlement Program." We agree with your recommendations and appreciate your acknowledgement that the Voluntary Classification Settlement Program (VCSP) provides significant benefits to an employer who may have misclassified their workers.

We developed the VCSP to encourage employers with worker classification issues to voluntarily come forward to reclassify workers from independent contractors to employees. The focus of the VCSP is on future compliance and providing employers an avenue to ensure that they are compliant. The simplicity of the process encouraged employers to voluntarily enter into the program with limited burden. As a result, we rely on the information provided by the employer as being true, correct and complete because the employer is voluntarily filing and signing the VCSP application under penalties of perjury.

We agree that requiring the names and Social Security numbers of the workers the business wants to reclassify will help determine that the application is reasonably accurate and will be useful in evaluating compliance after the agreement is signed. However, it must be noted that during certain times of the calendar year the most recent Form 1099 information filed by taxpayer/employer is not available. This makes "complete accuracy" in certain aspects of this program unattainable. We also agree to revise the follow up review process for monitoring compliance with the VCSP agreements and to develop reporting capabilities for a single system to track inventory and monitor program performance. Attached is a detailed response outlining our corrective actions to address your recommendations.

If you have any questions, please contact me, or a member of your staff may contact John H. Imhoff, Jr., Director, Specialty Programs at (215) 861-1176.

Attachment



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

Attachment

RECOMMENDATION 1:

The Commissioner, Small Business/Self-Employed Division, should revise Form 8952 to require employers applying for the VCSP to provide the name and Social Security Number for the workers requested for reclassification. In addition, revise internal procedures for processing VCSP applications to use the name and Social Security Number of the workers to be reclassified to evaluate employer eligibility for the VCSP and ensure that worker compensation reported and the VCSP payment are accurate.

CORRECTIVE ACTION:

Small Business/Self-Employment (SB/SE) Employment Tax will work with the Wage & Investment Division to revise Form 8952 instructions. VCSP applicants will be instructed to provide names and Social Security Numbers for all workers who are being reclassified. Internal procedures for processing Form 8952 will be revised to utilize the name and Social Security Number of the workers to be reclassified to evaluate the employer's eligibility for the VCSP and assure the dollar value entry on Line 18 of the Form 8952 application is reasonably accurate.

IMPLEMENTATION DATE:

March 15, 2015

RESPONSIBLE OFFICIAL(S):

Director, Specialty Programs, Small Business/Self-Employed Division

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:

The Commissioner, Small Business/Self-Employed Division, should revise the follow-up review process for monitoring compliance with VCSP agreements to use identifying information for the workers the employers agreed to reclassify.

CORRECTIVE ACTION:

SB/SE Employment Tax will revise the follow up review process for monitoring compliance with the VCSP agreements to use identifying information for the workers the business has agreed to reclassify.

IMPLEMENTATION DATE:

March 15, 2015

RESPONSIBLE OFFICIAL(S):

Director, Specialty Programs, Small Business/Self-Employed Division



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:

The Commissioner, Tax Exempt/Government Entities Division, *****2*****
*****2*****
*****2*****.

CORRECTIVE ACTION:

*****2*****
*****2*****
*****2*****.

IMPLEMENTATION DATE:

March 15, 2015

RESPONSIBLE OFFICIAL(S):

Director, Government Entities Compliance Services, Tax Exempt/Government Entities

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:

The Commissioner, Tax Exempt/Government Entities Division, should develop reporting capabilities for the RCCMS to allow for a single system for both tracking inventory and monitoring program performance of the VCSP. Meanwhile, the IRS should revise processes to ensure that information is accurately and completely logged into the GECU log and the RCCMS. This process should include a periodic inventory validation.

CORRECTIVE ACTIONS:

1. Reporting Compliance Case Management System (RCCMS) reporting will be implemented to allow for a single system for inventory tracking and monitoring program performance.
2. Internal procedures were developed and implemented to ensure information is accurately entered into both RCCMS and the Government Entities Compliance Unit (GECU) log, which includes additional review of and validation of inventory.



*Better Worker Identification Data Are Needed
for the Voluntary Classification Settlement Program*

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IMPLEMENTATION DATE:

1. March 15, 2015
2. Completed

RESPONSIBLE OFFICIAL:

Director, Government Entities Compliance Services, Tax Exempt/Government Entities

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 5:

The Commissioner, Tax Exempt/Government Entities Division, should revise processes to ensure that accepted agreements are successfully sent to and received by the IRS business units responsible for monitoring compliance with the terms of those agreements.

CORRECTIVE ACTION:

Internal procedures were revised to ensure the appropriate accepted VCSP agreements are forwarded to and received by the IRS business unit that will monitor them for compliance. These procedures were implemented May 30, 2014.

IMPLEMENTATION DATE:

Completed

RESPONSIBLE OFFICIAL:

N/A

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.