IRS Guidance on Voluntary Closing Agreements for Employment Tax Issues

The Internal Revenue Service (IRS) has recently established a voluntary compliance program, which allows taxpayers to resolve employment tax issues through a closing agreement. The objective of the program is to enhance voluntary compliance and reduce administrative burden by saving time and resources for both taxpayers and the IRS. Taxpayers are eligible for the program if they are not currently under audit with respect to a particular federal employment tax issue and if they have filed employment tax returns for the tax periods at issue.

In our experience, this program will be useful for companies that have identified employment tax issues that may have an adverse impact on affected current or former employees and/or may have a disproportionate effect on a company's compliance obligations (e.g., federal contractors).

The IRS has provided taxpayers with guidance on the voluntary closing agreement process for employment tax issues in Internal Revenue Manual 4.23.25, Voluntary Closing Agreements for Employment Tax Cases (VCAP – ET).

Situations Where a Voluntary Closing Agreement is Appropriate

The IRS will accept requests for voluntary closing agreements arising from employment tax issues when:

1. It is advantageous to have an employment tax issue permanently and conclusively resolved;
2. The taxpayer can demonstrate that the IRS Form 94X-X or other return procedures would not allow for prompt, permanent and conclusive resolution of the particular employment tax issue; and
3. It has been determined that entering into a closing agreement would not prejudice the interests of the government.

The IRS has provided some examples of situations where it would be advantageous to enter into a closing agreement to resolve employment tax issues:

1. The taxpayer seeks to permanently and conclusively establish its final federal employment tax liability in order to facilitate a pending or imminent transaction. For example, a proposed merger or sale of the taxpayer's business or subsidiary for which a prompt and conclusive resolution of the taxpayer's employment tax liabilities is necessary.
2. A taxpayer, 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.
3. When a taxpayer is unable to attribute specific wage amounts to any employee and is, therefore, unable to properly comply with the regular Form 94X-X or other corrected return procedures because it is unable to issue accurate corrected Forms W-2 to affected individuals. This includes
situations where 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.

4. When federal employment tax liabilities are barred from assessment but the taxpayer desires to resolve such federal employment tax liabilities for other than federal tax purposes.

5. 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. This may involve taxable fringe benefits such as group term life insurance.

**Penalties and Interest**

Any adjustment to the employment taxes made as part of a closing agreement under this program will not be subject to interest as long as the taxpayer pays the liability at the time the closing agreement is executed. The determination of whether penalties related to the employment tax liability will be waived will be made on a case-by-case basis.

**Worker Classification Issues**

The VCAP – ET process does not apply to worker classification issues. The IRS directs taxpayers to the Voluntary Classification Settlement Program (VCSP) for voluntary requests to resolve prospective classification of workers. The VCSP enables taxpayers who are currently treating their workers as independent contractors to reclassify their workers as employees for employment tax purposes for future tax periods, with partial relief from incurred federal employment tax liabilities. The IRS VCSP is described in IRS Announcement 2012-45 and further guidance is provided in IRM 4.23.20, Employment Tax – Voluntary Classification Settlement Program Procedures.

**How to Request a Closing Agreement**

The IRS does not have a specific form to request consideration for a voluntary closing agreement for employment tax issues. All applications should be submitted in writing to the IRS Employment Tax/Voluntary Request Coordinator at 201 W. Rivercenter Boulevard Stop 5702A, Covington, KY 41011, containing all of the taxpayer information listed in IRM 4.23.25.

Our tax controversy team has substantial experience resolving income and employment tax disputes. In the area described in this alert, we have worked together with the IRS personnel responsible for the new voluntary compliance program to implement a number of closing agreements under an earlier informal version of this new program. We have assisted taxpayers in abating many millions of dollars of civil penalties in reasonable cause filings. We advise clients regularly on best practices on information return filings, penalty abatements and similar matters.

If you have any questions regarding the IRS voluntary closing agreement process for employment tax issues, please contact one of the authors of this post—listed below.

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