



# EMPLOYERS BEWARE:

Employment tax examinations will be conducted by IRS to collect data to help it understand the compliance characteristics of employment tax filers.

## IRS TO COMMENCE INTENSIVE EMPLOYMENT TAX AUDITS

RONALD A. FEUERSTEIN

**I**n November 2009, the Internal Revenue Service announced in Headliner Volume 280 its first “Employment Tax National Research Project” (“ETNRP”) in 25 years. This past February, audits of employers under this new program commenced.

Justifying the need for this new initiative, IRS has stated that business practices regarding employment tax issues may have changed significantly since IRS’ employment tax study in the 1980s. Using rather cryptic wording in the Headliner, IRS stated that the employment tax examinations will be conducted in the order for IRS to collect data that will enable it to understand the compliance characteristics of employment tax filers. According to IRS, the results of these employment tax audits will enable it to gauge more accu-

rately the extent to which businesses properly comply with employment tax law and various related reporting requirements. IRS’ objective in this undertaking is to obtain information that will assist IRS in developing criteria for selecting and auditing employment tax returns filed in the future that have the greatest compliance risk.

IRS stated two goals for the ETNRP:

1. To secure statistically valid information for computing the so-called “Employment Tax Gap” and
2. To determine compliance characteristics in order to enable IRS to focus on the most noncompliant employment tax areas.

According to Headliner Volume 280, ETNRP will entail IRS randomly selecting 2,000 taxpayer employers each year for 2010, 2011, and 2012. IRS’ pronouncement states that the employment tax examination under the new program will be comprehensive in scope. Employers selected for these special audits will receive notices from IRS describing its National Research Project process. According to IRS, records pertaining to employment tax returns and issues that arise in the examination will be subject to

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RONALD A. FEUERSTEIN is a shareholder of Bean, Kinney & Korman, P.C., in Arlington, VA, and an experienced tax lawyer. His practice focuses on tax planning and structuring for corporate and partnership transactions, mergers and acquisitions, tax controversy work before IRS and state tax agencies, sophisticated estate planning for high net worth individuals and family wealth transfers, employee benefit matters, including Department of Labor Audits, and general business counsel and advice. For more information on the firm, please log onto <http://www.beankinney.com>.

review during these audits. IRS advises that employers who are audited should have all of their records available in order to expedite the examination.

Months prior to issuance of Headliner 280, IRS officials, in speeches to the payroll industry and the American Bar Association's Tax Section, gave some details of what these special payroll audits will focus upon. One of the most contentious areas that will receive great scrutiny by IRS agents will be "worker classification," which refers to whether a worker is properly classified as an independent contractor rather than as an employee. This issue has been a "hot button" topic with IRS for decades. Given a huge so-called "Tax Gap" for federal payroll tax and self-employment tax that has been estimated by some at \$200 billion, IRS clearly has large proposed deficiencies and collections in its sights on worker classification issues alone. If a business classifies an employee as an independent contrac-

tor, approximately 30 percent in payroll taxes can be saved, reflecting both an incentive for noncompliance and the large amount of tax, interest, and penalties that could be at stake in an audit.

The worker classification issue includes section 530 relief issues. Section 530 refers to the Revenue Act of 1978, not to the Internal Revenue Code. Section 530 itself has been a thorny issue for IRS since 1978.

Another important issue IRS will focus upon is the relatively new Internal Revenue Code section 409A, which was enacted in 2004 and created a sea-change in deferred compensation. In general, it applies a complex set of rules and traps for the unwary to stock option plans, cash bonus compensation plans, severance plans, and many other structures.

Other issues IRS plans to address in these audits include fringe benefits, executive compensation, and reimbursed expenses.

Employers should be prepared in the event they are notified of an audit by IRS. ■

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