



Employee Benefits **ALERT**

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IRS to Randomly Audit Businesses for Employment Tax Compliance

Changes in the workplace, particularly those involving the way employees are compensated and classified, have evolved significantly over the past 25 years. So says the Internal Revenue Service, which is preparing to take a close look at whether any of these changes are adversely affecting employment tax compliance.

The IRS recently announced plans to audit 6,000 randomly selected businesses as part of a national study on employment tax compliance, the first of its kind since 1984. Although the scope of the audits can be expanded at any time, the IRS has indicated it will be focusing on five main areas: worker classification, fringe benefits, reimbursed expenses, executive compensation and non-filers. Of specific interest to the IRS is whether companies are misclassifying workers as independent contractors to avoid their tax obligations. The audits will also seek to identify failure to pay taxes on fringe benefits such as the personal use of company cars and improper reporting on various forms of executive compensation such as employer-provided housing, nonqualified deferred compensation, executive travel and stock-based compensation.

The IRS's National Research Program (NRP) audit initiative, which will launch in February 2010, is expected to affect a broad cross-section of companies of various sizes and types, including tax-exempt employers. While employment tax returns for the calendar years 2007 and 2008 will be the focus of the audits, the IRS has the ability to expand the scope of the audits to cover

additional employment tax years as well as other categories of business taxation.

While the random nature of the selection process means businesses can do very little to avoid being the subject of an audit, there are several steps all employers can take now to prepare for a possible audit. McAfee & Taft recommends the following:

- Conduct an internal audit of your current payroll practices, focusing your efforts on the areas identified by the IRS.
- Review all of your employee benefit programs and plans to see how they address independent contractors and contingent workers who may be reclassified as your employees.
- Carefully review your company's employment tax returns, including supporting documentation, for the last three years. If you use a third-party payroll administrator, seek their assistance with this process.
- Consult with qualified employee benefit or tax counsel prior to initiating your own internal review process. Engaging counsel ensures attorney-client privilege and protects the confidentiality of the compliance review and audit preparation process. You may also wish to consult with a qualified accountant who has specific audit experience.

For additional information, please contact any member of McAfee & Taft's Employee Benefits Practice Group.

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