

IRS' NRP Audit Initiative

Payroll Taxes
Fringe Benefits
Worker Classification
Executive Compensation

Retirement Capital Group

November 24, 2009

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Overview

- IRS Audit Initiative of 6,000 Taxpayers (and more)
- TCMP/NRP Audit Initiative
- The Four Audit Topics
 - Worker Classification/Independent Contractors
 - Fringe Benefits
 - Executive Compensation
 - Payroll Tax Issues

Overview

- Universities and Other Tax-Exempt Organizations
- Tax Risks
- Methods to Reduce Exposure
- IRS-State Coordination
- Other Developments

IRS National Research Program

- 6,000 employers to be audited
- Every employer is a potential target—large, small, for profit/nonprofit, governmental entities.
- First 2,000 have been identified
- Payroll tax agents completing training
- Last TCMP/NRP audits occurred more than 20 years ago

IRS National Research Program

- Targeted issues:
 1. Independent contractors
 2. Payroll taxes
 3. Fringe benefits
 4. Executive compensation
- IRS and 34 states share information on misclassification audits

IRS National Research Program

- Universities
 - 36 Universities—Payroll taxes and other issues
- Governmental Entities
 - Unknown number
- Tax Exempt Organizations
 - 500 Organizations to be targeted

Tax Risks Related to the NRP Audits

Full-rate statutory liability equal to at least 40% of payment

- 25% Federal Income Tax Withholding exposure
- 7.65% Employer FICA
- 7.65% Employee FICA
- FUTA tax exposure
- Information reporting penalties—Failure to file and Failure to furnish
- Negligence
- Failure to deposit
- Interest

The Four Central Issues

- Worker Classification
 1. Independent Contractors
 2. Leased Employees
 3. Terminated/Rehired Workers
 4. Dual Status Workers
 5. Forms W-2/Forms 1099

The Four Central Issues

- Payroll Taxes:
 1. Forms 941
 2. Forms 940
 3. Forms W-4 with Exemptions in Excess of 10
 4. Forms W-2/Forms 1099
 5. Payroll Tax Deposits
 6. B Notices
 7. Backup Withholding

The Four Central Issues

- Fringe Benefits:
 1. Expense Reimbursement Arrangements
 2. Working Condition Fringes
 3. Gift Cards
 4. Athletic Facilities
 5. Cell Phones/PDAs
 6. Automobiles
 7. Spousal Travel
 8. Per Diems
 9. Many more . . .

The Four Central Issues

- Executive Compensation:
 1. Corporate Aircraft
 2. Nonqualified Deferred Compensation
 3. Retirement Contracts
 4. Reviewing Executives' Income Tax Returns
 5. Corporate Housing/Vacation Homes
 6. Stock Based Compensation
 7. Golden Parachutes
 8. 409A Compliance
 9. Compare to Executive Compensation Audit Initiative 5 Years Ago

Worker Classification Issues

1. The IRS has renewed its focus on independent contractor issues
2. The IRS replaced the 20-Factor Common Law Test with a Three-Factor Test
 - *Behavioral Control Factors*
 - *Financial Control Factors*
 - *Relationship of the Parties Factors*
3. The IRS has published its IRS Agent training materials
4. Understand the relief provisions
 - *Section 3509*
 - *Section 530 Relief—“off Code” relief*
 - *IRS Classification Settlement Program*

Worker Classification Issues

5. Seek consistency for tax, labor and benefits purposes
6. The IRS has never met a valid independent contractor relationship (OK, maybe one or two)
7. Watch out for Washington—Congress, the GAO and the new Administration may be active in IC matters, including Section 530 repeal/restructuring
8. Understand the financial exposure/consequences from a worker's reclassification

Tax Risks of Worker Reclassifications

The total exposure for 60 ICs earning \$50,000 for the four open years of 2006-2009 are as follows:

<u>Relief Provision</u>	<u>2009 Exposure*</u>	<u>Total 4-Year Exposure</u>
Full-rate assessment	\$ 1,209,000	\$ 4,836,000
Section 3509	320,400	1,281,600
100% CSP Offer	320,000	320,400
25% CSP Offer	80,100	80,100
Section 530 Applies	0	0

* Calculations do not include FUTA, SUTA and SITW liabilities

Methods to Reduce Exposure

1. Undertake Section 530/Independent Contractor/CSP reviews
2. Undertake Fringe Benefit/Executive Compensation Reviews
3. Identify reasonable basis which can extend relief for payroll tax, worker classification and fringe benefits issues

Section 530/CSP relief for worker classification issues

“Reasonable to Believe” Relief for Payroll Taxes/Fringes

Interest-free adjustments

Central Illinois Confusion Doctrine

Methods to Reduce Exposure

4. Reducing Independent Contractor Exposure

Always issue Forms 1099

Obtain services from ICs who have incorporated or are provided by third parties

Avoid issuing Forms W-2 and Forms 1099 during the same year

Neutralize employee benefits considerations by adopting “Microsoft Language”

Seek consistency

5. Adopt and implement best practices

IRS and State Coordination

- Coordinating on pre-filing and filing efforts in educational and assistance programs and filing process
 - *e.g.*, Coordinated EIN filing
- IRS and 34 states share information on misclassification-related audits
- Uniform employment tax and wage reporting law
- FUTA/SUTA coordination
- Joint initiatives focusing on abusive tax transaction
- Database sharing for transcript deliveries
- State Income Tax Levy Program

Other Developments

Taxpayer Responsibility, Accountability and Consistency Act of 2009 (H.R. 3408)

- Eliminate Section 530's prospective relief
- Replace with retroactive relief only
- Modify the industry practice
- Increase information reporting penalties
- Require annual IRS report on misclassification
- Repeal Form 1099 exemption for corporations

Also follow potential reintroduction:

- Independent Contractor Proper Classification Act
- The Employee Misclassification Prevention Act

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