



# THE KULLMAN FIRM

A PROFESSIONAL LAW CORPORATION

## SPECIAL EMPLOYMENT TAX BULLETIN

### IRS Employment Tax Audit Initiative

In February 2010, the Internal Revenue Service will begin a major audit program focusing on the underpayment of employment taxes by employers. This program, which the IRS calls the "Employment Tax National Research Project," is the IRS' first such project in 25 years. The IRS wants to gather data to understand the compliance characteristics of employment tax filers. The IRS will randomly select 2,000 employers to audit each year for the next three years. Those employers will be subjected to comprehensive audits of their employment tax practices.

The audits will focus on four areas the IRS believes employers are currently reporting improperly:

- Worker classification (employee versus independent contractor);
- Fringe benefits;
- Executive compensation; and
- Reimbursed expenses.

In reviewing worker classification, the IRS disregards the employer's label and instead looks at, among other things, whether the employer has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. It is not necessary the employer actually direct or control the manner in which the services are performed. It is sufficient if he has the right to do so.

If the IRS concludes workers should properly be classified as employees rather than contractors (and if the employer cannot establish entitlement to relief under section 530 of the Revenue Act of 1978), the employer will owe additional employment taxes. Classifying workers incorrectly as independent contractors can also result in minimum wage and overtime violations.

Depending on how benefit plan documents are written, reclassified workers may be entitled to back benefits. For example, several years ago, after the IRS reclassified a group of Microsoft workers as employees, the workers successfully sued for benefits under Microsoft's stock purchase plan and 401(k) plan. Microsoft had not provided these workers benefits on the ground Microsoft did not classify them as employees. The workers had even signed contracts agreeing they were not employees and not entitled to benefits, but the plan documents, which did not clearly exclude them, were held to be controlling.

Employers who use contract labor or who classify workers as independent contractors should review whether these worker classifications will withstand scrutiny.

Please contact the attorney with whom you normally work if you have any questions or would like assistance in making this analysis.



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