

Benefit Providers Committee

Friday, July 23, 2010

2010 National HBPA Summer Convention

Radisson Plaza Hotel, Minneapolis, MN

IRS Targets Small Business

National Research Project {“NRP”} Audits



- The IRS has begun in March, 2010 the process of randomly auditing 6,000 small businesses as an additional national initiative to its regular audit agenda.
- “Special Emphasis” for audits will be:
 - Worker Classification [Employee/Independent Contractor]
 - Fringe Benefits
 - Reimbursed Expenses
 - Compensation of officers and highly compensated, and
 - Non-Filers

- Scope of IRS audits of 6,000 businesses is not limited to any particular industry and includes tax exempt organizations. Audit initiative is to be on the basis of random selection (Lottery).
- IRS believes that there is a \$345 billion tax gap (taxes due but not collected) and that \$15 billion is due to non-compliance in the employment tax area.
- Data collected in these 6,000 new audits to be used to develop guidelines for selection of tax returns in future for audit.

- National Research Project (“NRP”)

- These audits to be conducted in manner unlike regular IRS Audits.
- 200 senior revenue agents with extensive employment tax experience designated and specially trained.
- NPR audits have priority over any other exams and will focus on every issue uncovered regardless of small dollar content.
- Most detailed audit initiative in last 20 years

- **Misclassification of Employees**

- Major area for consideration during audit.
- Is individual who is treated as independent contractor in fact an employee?
- Basic factors considered in IRS test :
 - Behavior controls
 - Relationship of the parties
 - Financial controls
 - Case Law

- Case Law Factors:

- Right to control the manner and means by which the project is to be accomplished.
- The level of skill required to complete project.
- The duration of the relationship.
- The right of hiring party to assign additional projects.
- Hiring party's discretion over when and where project to be preformed.
- The method of payment.
- The source of tool, equipment, and instruments used to complete project.
- Hired party performance of same type of work for different clients.
- Hired party's participation in employee benefits.
- 1992 Supreme Court Case of *Nationwide Mut. Ins. V. Darden* set forth 15 factors as means to determine employee vs. independent contrator.

- Effect of Reclassification of Workers

- Additional tax liability to employer for income tax withholding, FICA, and FUTA taxes.
- Penalty and interest on tax shortfall
- Potential employer liability for employee benefits
- Overtime and accrued vacation pay

Section 530 Relief

Upon petition to IRS and when specific requirements are met - liability for additional taxes can be waived.

- **Requirements for Section 530 Relief:**

- 1. Reporting Consistency.
- 2. Substantive Compliance.
- 3. Reasonable Basis:
 - Judicial precedent
 - Prior IRS Exam
 - Industry custom/practice
 - Other reasonable basis (opinion of counsel or CPA)

Unfortunately, legislation pending that will substantially limit or eliminate 530 relief.

“Breaking News”

IRS authorizes Agents to use drastic
new hands-on audit technique



- **Fringe Benefits Examination:**

- NPS audits will include Fringe Benefits review.
 - Employer provided automobile
 - Employer provided vacation
 - Employer provided discount on property or services
 - Employer provided membership to social club.
 - Employer provided free or discounted commercial flight.
 - Employer provided ticket to entertainment or sporting event.

Fringe benefits unless specifically excluded by IRS regulation are includable in employee's income.

Employee Expense Reimbursement Plan

If qualified as an “Accountable Plan” employee does not include reimbursement for expenses in income.

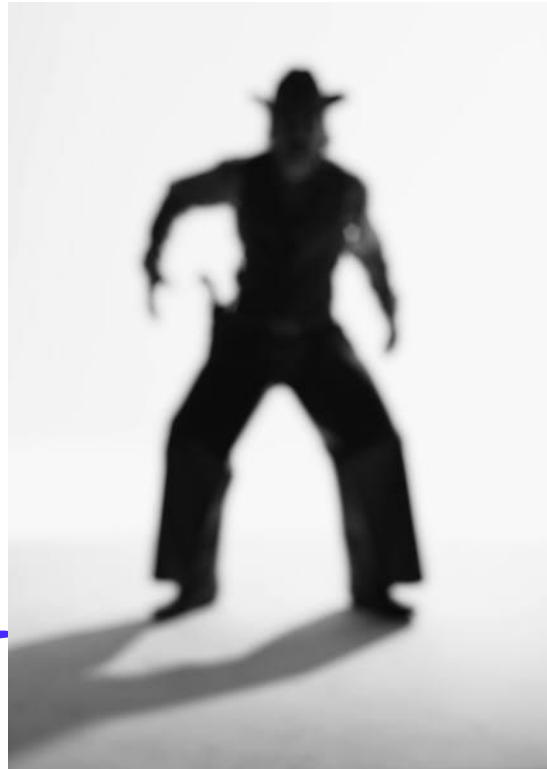
Accountable Plan:

- A business connection requirement

- A substantiation requirement

- A return of excess amount requirement

Other Option to Resolve the Audit Dispute



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