

**Small Business Tax Alert:**  
**IRS Begins Employment Tax Audits**  
By Lawrence N. Legg, CPA

In February, 2010, the Internal Revenue Service re-instituted National Research Program (NRP or TCMP) audits on businesses and their employment tax compliance. These examinations are being conducted to gather data that will help the IRS better understand the compliance characteristics of employment tax filers. The resulting statistics and findings will allow the IRS to focus their future audits in the problem areas where tax dollars are slipping through the cracks. This is the first comprehensive employment tax compliance study in 25 years. A total of 6,000 businesses will be selected over the next 3 years for a full examination of their employment tax practices. While this number is a very small percentage of US business, the future ramifications are what business owners and operators like you should be concerned with – i.e., more frequent and better focused audits, as well as higher potential tax liabilities to the government. Bottom line is that, after the study is complete, the IRS will have a better idea where the areas of non-compliance are; thus they will be more effective in closing the so-called “Tax Gap” – i.e., taxes the government should collect vs. what they actually collect, and thus lower the federal budget deficits.

The audits will be exhaustive in detail and will include examination of the following areas:

- *Fringe Benefits* – The focus here will be on whether your business is properly accounting for and remitting tax on fringe benefits such as retirement plans, health insurance, usage of company cars, boats and planes, club dues, and travel, meals and entertainment expenses.
- *Reimbursed Expenses* – Is your business properly reimbursing expenses to executives and employees?
- *Worker Classification* – Are you properly classifying workers as either “Independent Contractors” or “Employees”? The regulations in this area are complex, and in our experience, as CPA’s and business advisors, this is an area that IRS will find a substantial amount of non-compliance. As a business owner, if you improperly classify your workers, you could be held liable for FICA and Medicare taxes, federal and state unemployment taxes, income taxes that your workers did not, or could not pay – even if you issued them a 1099 – as well as penalties and interest. Additionally, your worker’s compensation and liability insurance carriers may disallow claims for improper classification, leaving the small business owner liable. In the upcoming years, we believe this will be a very hot area for the IRS.
- *Officer Compensation* – Are you properly accounting for officer compensation? Are you properly including in Form W-2, and paying

appropriate tax on, health, life and disability insurance paid for stockholders? In addition to these issues, the IRS will be looking at the propriety of loans to officers/stockholders/partners, dividends and distributions, stock-based compensation arrangements, non-qualified deferred compensation plans, as well as a variety of other transactions with officers, stockholders and directors.

- *Non Filers* – The IRS will also focus on companies that do not file employment tax returns.

In sum, the best advice we can give is to take a proactive business approach and conduct a comprehensive review of your employment tax compliance procedures, prior to ever being audited. Contact your CPA and solicit their advice, particularly on the areas mentioned above. It is likely that you can improve your recordkeeping and payroll tax accounting procedures so that, in the event you are audited, the risk of owing the IRS a substantial amount of tax is minimized.