Executive Compensation
& Benefits

January 28, 2010

IRS Employment Tax Audit Letters Are Coming!

by Scott E. Landau and Kathleen D. Bardunias

As discussed in our previous client alert (see "Employment Issues & the IRS"), the Internal Revenue Service announced its intention to conduct an employment tax National Research Program beginning in 2010. This program will result in employment tax audits of approximately 6,000 U.S. companies over the next three years. An IRS official at the American Bar Association Section of Taxation midyear meeting noted that audit appointment letters could begin going out as early as the end of February. The 2008 tax year will be targeted by these audits.

The employment tax National Research Program audits will focus on the following five key areas: worker classification, fringe benefits, executive compensation, backup withholding, and Form 1099 reporting. Any employment tax issues may be reviewed—as part of the audit. In particular, during an audit, all IRS examiners must review worker classifications even if all the applicable workers are currently classified as employees, according to the IRS official.

Also, as discussed in our client alert "IRS Announces Correction Program for Nonqualified Deferred Compensation Plan Document Failures" (January 21, 2010), the IRS has provided guidance on correcting plan document and operational failures in section 409A nonqualified deferred compensation arrangements. Note, the relief is not available if the employee or the employer is under examination by the IRS for the tax year involved. (A special transitional rule for periods ending on or prior to December 31, 2011 is available for corporate employers who are under continuing examination.) It is therefore extremely important for employers to focus on 409A document and operational failures as soon as possible.

As the IRS increases its focus on employment-related issues, all employers should review current plans and practices now and correct any problems. For a further discussion of some of these issues and the process of conducting an internal review of employment-related plans and practices, please see the previous Pillsbury client alerts referenced above.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work or any of the members of the Executive Compensation & Benefits group.

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