

Update: April 2011

Tax Intelligence

Employment Tax Audit and Assessment Management

Situation

The economic recession has significantly reduced revenues collected by taxing authorities at all levels. As one measure to replenish depleted funds, federal, state and local governments have initiated tax compliance initiatives to reduce the "tax gap" (i.e. the difference between taxes due and taxes due but unpaid). Many of these initiatives focus on employment taxes and employers' noncompliance resulting in increased audits and assessments.

Government Initiatives

The Questionable Employment Tax Practice ("QETP") initiative is a collaborative, nationwide program that seeks to identify employment tax schemes and illegal practices to increase voluntary compliance with employment tax rules and regulations. QETP is a coordinated effort between the Internal Revenue Service ("IRS"), the National Association of State Workforce Agencies, and many State Departments of Revenue as well. This partnership was accomplished with Memorandums of Understanding ("MOUs"), which:

- Permit the sharing of information between the agencies, including exchanging audit reports and plans.
- Increase compliance with federal and state employment tax filings and payments.
- Enhance efforts to reduce the tax gap at the federal and state levels.

In addition, the IRS recently announced that it will begin annual random audits of approximately 2,000 employers specifically related to employment tax practices, policies and procedures. This effort began in 2010 and will be in effect through 2012 as part of an Employment Tax National Research Project.

Potential Risk Areas

Employers must be aware of potential tax practices that can lead to audits and assessments. Potential areas of exposure may include payroll, SUTA dumping, worker misclassification, items not included in taxable income, sourcing of local withholding obligations, and failure to recognize multistate non-resident withholding requirements.

Some questions to consider include:

- Does your organization have independent contractors that perform the same service as employees?
- Does your company have stated policies on non-resident state income tax withholdings?
- Does your organization report transfers of employment among legal entities for state unemployment (SUI) purposes?

With respect to **mergers, acquisitions, or reorganizations** where employees have been transferred among legal entities, there are specific compliance requirements for SUI tax purposes that are mandatory. SUI taxing agencies have developed software to detect movements of employees, and as Q1 returns are filed employers may expect to receive notices and assessments for "unreported" transactions as they may affect an employer's state unemployment tax rate.

Solution

A taxpayer advocate may act as an intermediary between a taxing jurisdiction and taxpayer to help mitigate employment tax risk, which may include one of two possible approaches, depending on the type of issue identified:

Audit Management and Notice Resolution (Reactive Approach)

Once an audit has been initiated or an assessment has been made, a taxpayer advocate may assist by developing a position based on facts and circumstances, limiting the scope of the audit or inquiry to a particular time period and issue, responding to information request and questionnaires appropriate, and/or negotiate a settlement where applicable.

Voluntary Disclosures (Proactive Approach)

When an organization has self identified an employment tax issue, entering into a Voluntary Disclosure Agreement (VDA) may be the best alternative to mitigate the risk prior to discovery and assessment. The taxpayer advocate can approach the agency on an anonymous basis and disclose the exposure item; often coming to a resolution that is agreeable to the taxpayer and taxing jurisdiction (typically including abatement of penalties) prior to revealing the taxpayer's identity.

Value

TALX can assist employers with notice resolution, audit defense, and voluntary disclosure of liabilities. Our government relations team has relationships that allow us to partner with employers through the audit and assessment process. For more information, please contact Pete Krieshok at (314) 214-7325 or pkrieshok@talx.com or visit our corporate blog at <http://blog.talx.com>.