

Client Alert.

February 2010

IRS Employment Tax Audit Initiative Begins – Morrison & Foerster Responds

By Ed Froelich and Karen Kubin

Over the last few weeks, the Internal Revenue Service has announced further details about its plan to conduct a three-year nationwide employment tax audit initiative beginning this month. The audit initiative will focus on 6,000 businesses across the country and across industries, 2,000 businesses each year. Though the majority of the businesses will be small companies, the IRS will audit larger companies as well. The initiative grows out of a continuing research effort within the IRS called the National Research Program (NRP) and is designed to address a perceived tax shortfall in the collection of employment taxes due primarily to misclassification of employees as independent contractors. Some of us will recall a similar audit effort about 25 years ago; many of these audits focused on the classification issue.

The current initiative will focus on additional areas such as fringe benefits, including section 409A deferred compensation (which is already receiving coordinated audit attention), executive compensation, backup withholding, and Forms 1099. These audits promise to be thorough and time-consuming and may run concurrently with an income tax audit or precipitate an income tax audit if the auditor should learn information suggesting that income tax items need a closer look. The first group of selected businesses should expect to receive audit appointment letters in February and March.

We understand that some states are preparing to conduct similar employment tax audits with a similar revenue-raising goal. They may find some assistance in that effort through tax information sharing agreements with the IRS whereby audit information is transmitted between the federal and state agencies. States may also keep apprised of misclassification actions being filed against employers around the country. Our firm recently successfully defended against such an action brought against a logistics company in California state court.

To help our clients meet these challenges Morrison & Foerster has assembled a group of its employment law, federal tax, and state and local tax (“SALT”) attorneys. Our team will work together to address the panoply of issues that can arise in the event the IRS or a private party contends that a business has misclassified its workers. Our employment lawyers have substantial experience defending companies in court and advising companies on best practices regarding classification issues. Our federal tax and SALT attorneys have significant experience defending businesses in audit and litigation phases on this issue and on related employment tax issues, such as 409A, executive compensation and reporting issues. It is our general experience that tax agencies are overly aggressive in classifying workers as employees, and we have been very successful in our representations of businesses on these matters.

Our team attorneys are: **Employment Law:** Daniel J. Aguilar, Lloyd W. Aubry, Jr., James E. Boddy, Jr., Marc G. Fernandez, Anna Ferrari, Karen J. Kubin, Timothy F. Ryan, Janie F. Schulman, and Daniel P. Westman; **SALT:** Eric J. Coffill, Hollis L. Hyans, and Andres Vallejo; **Federal Tax:** Linda A. Arnsbarger, Robert A. N. Cudd, Stephen L. Feldman, Joseph K. Fletcher, III, Edward L. Froelich, Yana S. Johnson, and James E. Merritt.

If you are currently undergoing an employment tax audit either at the federal or state level or receive a letter from the IRS in connection with the NRP audit program, feel free to call any of our team members. We would be happy to assist you.

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We are Morrison & Foerster—a global firm of exceptional credentials in many areas. Our clients include some of the

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largest financial institutions, Fortune 100 companies, investment banks and technology and life science companies. Our clients count on us for innovative and business-minded solutions. Our commitment to serving client needs has resulted in enduring relationships and a record of high achievement. For the last six years, we've been included on *The American Lawyer's* A-List. *Fortune* named us one of the "100 Best Companies to Work For." We are among the leaders in the profession for our longstanding commitment to pro bono work. Our lawyers share a commitment to achieving results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

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