

SURVIVING AN EMPLOYMENT TAX AUDIT - NEWS FROM THE AICPA

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The America Institute of CPA's (AICPA) Tax Advisor Magazine recently reported on the scope of activity of Internal Revenue Service (IRS) employment tax audits of recent years. The report stated that the IRS, in recent years, has closely examined the status of workers classified as independent contractors to determine whether they should instead be considered employees. The results of these examinations is that hundreds of thousands of workers have been reclassified as employees, and their employers were assessed hundreds of millions of dollars in additional payroll taxes, penalties and interests.

An IRS employment tax audit would generally be in the form of either a compliance check, or a full audit. In a compliance check, the IRS is performing minimal work and is simply looking over the association's employment tax forms, and perhaps conducting interviews to determine if problem areas exist. On the other hand, a full audit is an extensive and detailed examination of association books and records.

When an association receives the IRS notification of audit, it should immediately notify its independent CPA, most of whom have experience in conducting a response to an IRS employment tax audit. If it doesn't already have an understanding, the CPA firm must obtain a clear understanding of the facts and issues relevant to the association's situation, and the notice of the audit from the IRS.

The first step is gathering information, and the association will need to provide the CPA with the following:

1. A complete list of workers.
2. A complete list of outside vendors and other entities used as independent

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The CPA will focus his or her attention on those individuals classified as independent contractors. This is where the real exposure exists. If the IRS determines that your golf pro is an employee rather than an independent contractor, the association will likely be responsible for all unpaid payroll taxes.

3. contractors.
4. All 1099 forms issued for the year.
5. All W-2 forms issued by the Association for the year.

The CPA will want to interview the association management, and if necessary, the workers themselves to insure that the work relationships support the company's classifications. In addition, the CPA will want to review all documents and tax filings between the workers and the association to make certain that the workers are classified consistently from year-to-year. Lastly, the CPA will want to review employment contracts or contractual agreements between the association and all workers and/or contractors.

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these individuals. For instance, the IRS has ruled that an individual may not be both an employee and an independent contractor with respect to the same employer (association). Also, some associations like to pay cash Christmas bonuses outside of payroll, so they are not subject to withholding. The right way to do this is to treat it as a payroll check, but simply “gross it up” from the desired net to the proper gross pay. This will give that employee a net check for exactly \$250 (or whatever amount is desired).

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Prompt and complete response to the IRS auditor is generally beneficial to the association. It may help to avoid a full scale audit. A lack of cooperation by the association is generally not going to enhance the association’s position.

The association will be well advised to review worker classification status before any audit occurs, correcting any improper situations and rewriting contracts to solidify independent contractor status.

<p><u>TABLE 1</u></p> <p><u>SUMMARY OF IRS GUIDELINES FROM REVENUE RULING 87-41</u></p> <p>These are the key factors used to determine if an individual is an employee or an independent contractor.</p> <ol style="list-style-type: none">1. Instructions2. Training3. Integration4. Services Rendered Personally5. Hiring, Supervising, and Paying Assistants6. Continuing Relationship7. Set Hours of Work8. Full Time Required9. Doing Work on Employer's Premises10. Order or Sequence Set11. Oral or Written Reports12. Payment by Hour, Week, Month13. Payment of Business and/or Traveling Expenses14. Furnishing of Tools and Materials15. Significant Investment16. Realization of Profit or Loss17. Working for More Than One Firm at a Time18. Making Service Available to General Public19. Right to Discharge20. Right to Terminate

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