



IRS Employment Tax Audit & Executive Compensation

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May 27, 2010

Agenda

IRS Employment Tax Audits

Fringe Benefits

Worker Classification

CAWR and W-2 and 941 Year-end Reconciliation

Executive Compensation – Section 457(b) & 457(f)

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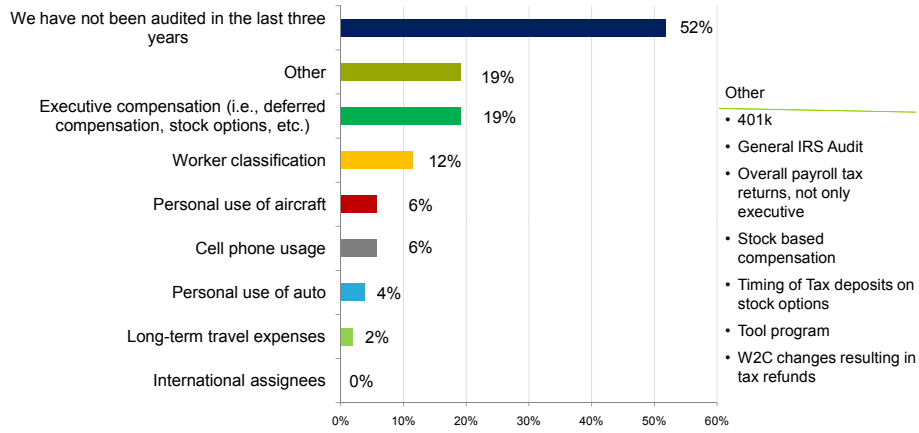
IRS Employment Tax Audits

IRS Employment Tax Audits

- Employment Tax Audit Initiative to begin February, 2010
- Purpose is to develop better audit approach and determine if \$15 billion tax gap is caused by employment tax deficiencies
 - 6,000 employer audits
 - Covering 2007 and 2008
 - Focus on:
 - Worker classification
 - Fringe benefits
 - Executive compensation
 - Expense reimbursement plans
 - Nonfilers

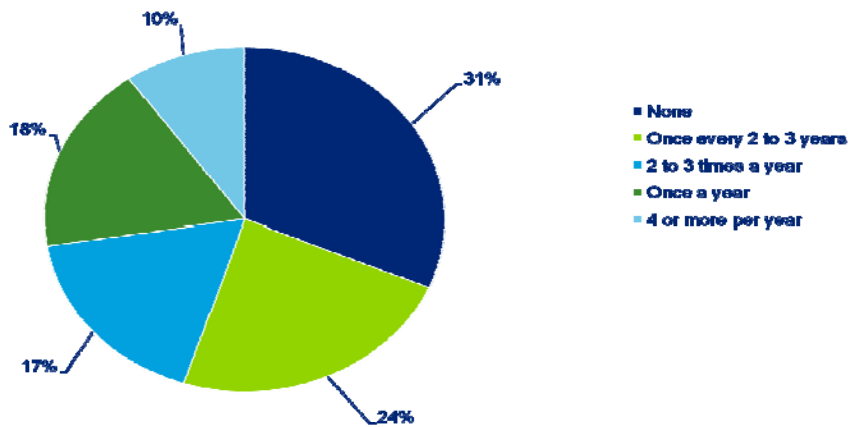
Survey Results: Audited Items

What issues has the IRS audited in the last three years?



Survey Results: Degree of Audit Activity

What degree of state/federal payroll audit activity have you seen within the last three years?



Fringe Benefits

Fringe Benefits

- Cell phones
- Awards and prizes
 - Gift cards
- Award trips
 - Spouse travel
- Company car
- Loans
- Company cafeteria
- Wellness programs

Additional Fringe Benefits and other Compensation Items Under Review

- Legal settlements with employees
- Employee discounts
- Relocation
- Tickets to sporting events, theater or concerts
- Tool reimbursement plans

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Worker Classification

Report to IRS on Worker Misclassification

August 10, 2009 GAO Report on Worker Misclassification

- Cited data from 1984 and 2000 indicating \$1.6 billion in lost IRS revenue and up to \$2 billion in lost unemployment tax revenue
- Main recommendations:
 - DOL Wage and Hour Division (WHD) focus on worker misclassification
 - OSHA and WHD coordinate efforts and refer cases outside jurisdiction
 - DOL and IRS develop efforts to team with other federal and state agencies
 - DOL train IRS and develop document for new hires about worker misclassification
 - IRS develop collaborative forum with states for sharing information
 - Extend CSP to employers willing to correct classification prospectively

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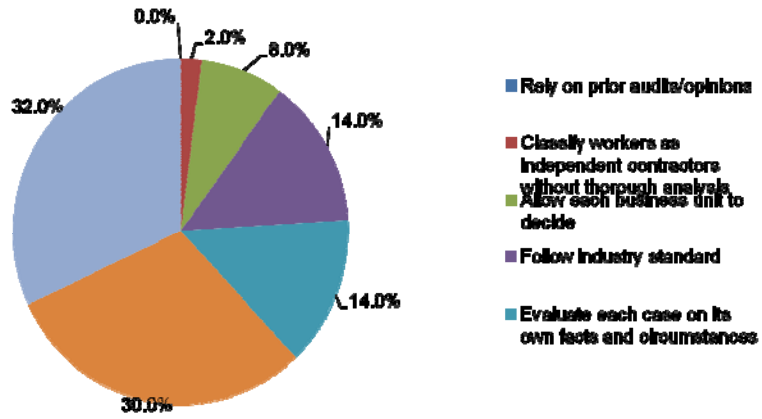
Worker Classification Defense

- Section 530 of the Revenue Act of 1978
 - Reporting consistency rule
 - Substantive consistency rule
 - Reasonable Basis
- IRC 3509
 - Employer FICA
 - 20% of employee FICA
 - 1.5% of gross

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Survey Results: Worker Classification Method

What best describes your company's processes and procedures for evaluating worker classification?



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CAWR and Year-end W2 and 941 Reconciliation

Combined Annual Wage Reporting (CAWR)

- Combined Annual Wage Reporting (CAWR) is a reconciliation process between IRS and SSA to validate reported employer tax
- IRS validates the below wages and taxes on Form 941, 943, 944, 945, and Schedule H
 - Federal Income Tax (FIT) withheld,
 - advance Earned Income Credit (EIC),
 - Medicare wages,
 - Social Security wages, and
 - Social Security Tips
- SSA extracts information from the below forms
 - Forms W-3,
 - W-2 total and the FIT from Forms W-2G and Forms 1099-R.

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The process to resolve discrepancy

- Combined Annual Wage Reporting (CAWR) is a reconciliation process between IRS and SSA to validate reported employer tax

EMPLOYER QUESTIONNAIRE DISCREPANCY BETWEEN IRS AND SSA RECORDS		
<small>IRS records show that, for the year below, you paid Social Security and/or Medicare taxes on more employer wages than SSA processed. The SSA processed wage amount is based on your Forms W-2 and W-3 reports. The total wages on your Forms W-2 and W-3 for a year should equal the sum of the amounts that you report quarterly to IRS on your Forms 941, 943, 944 or on Schedule H.</small>		
IRS SSA Data for Tax Year: 2006		EIN: 12-3456789
Employer Name: Employer Name	Soc. Security Wages	Medicare Wages/Tips
Amount Reported on W-3:	\$790,110	\$801,012
Amount Processed by IRS:	\$815,332	\$829,122
Amount Processed by SSA: (from Forms W-2)	\$790,110	\$790,110
Difference Between IRS and SSA Processed Amounts:	\$25,222	\$25,222
	Soc. Security Tip Totals	
Amount Reported on W-3:	\$0	\$0
Amount Processed by IRS: (from Forms W-2)	\$0	\$0
Difference Between IRS and SSA Processed Amounts:	\$0	\$0

- If the initial contact does not fully resolve the discrepancy, SSA follows up with Notice SSA-L-94-SM, Second Request Questionnaire SSA Has No Record of Employer Record. If, after two contacts, the imbalance is not completely resolved, SSA refers the case(s) to the IRS.

- If Social Security and/or Medicare Wages reported to SSA on Forms W-2 are lower than what is reported to IRS on Forms 94X/Schedule H, SSA contacts the employer, issuing Notice SSA-L-93-SM, Employer Questionnaire Discrepancy Between IRS and SSA Records, requesting information to help resolve the discrepancy.

SSA-L-94-SM(11-07) 123456789-04-09012007 FORM APPROVED OMB NO. 0960-0432 Date: 09/15/2007	Page 4 of 5
SECOND REQUEST EMPLOYER QUESTIONNAIRE SSA HAS NO RECORD OF EMPLOYER REPORT	
<small>IRS records show that you paid taxes on the wages that appear below. However, SSA does not have a record of processing your Forms W-2 and W-3 for these wages. IRS requires you to send Forms W-2 to SSA.</small>	
IRS Data (Forms 941, 943, 944 or Schedule H) for Tax Year: 2006 EIN: 12-3456789	
Employer Name: Bay Tech, Inc	
Employee Soc. Security Wage Totals:	\$790,110
Employee Soc. Security Tip Totals:	\$0
Employee Medicare Wage/Tip Totals:	\$801,012

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No need to wait for IRS!

We recommend you check with your Payroll and Finance departments if the 941 filings are in sync with W2.

It is time for you to check with the Payroll year end team to make sure 941s reconcile with W2 filing. If not, trace the root causes and correct.

In the below year-end process, reconciliation and adjustment are critical:



- Reconcile:
 - Reconciliation is the key in any Year End project. It includes reconciliation of tax, taxable and other reportable on various statutory forms
- Adjust:
 - Including adjustment for unrecorded reportable items, manual adjustment, as well as clearing any claims before the close of the year

Other steps to take

Below are measures you can take in response to the employment tax compliance efforts:

- The tax and payroll departments should review the company's current payroll and tax reconciliation processes
- Review three most recent years' employment tax returns, as well as all supporting documents and records.
- Establish good IRS examination management practices, including
 - Designate a clear "chain of command"
 - Retain expert outside advisors early in the process.
 - Maintain control over the IRS audit by requesting additional time to respond to information document requests, or tailoring the scope of information requested, where appropriate.

Focus of audit activity

- **Compliance with withholding rules**
 - Reconciliation of W-4's
 - Focus on “exempt” employees
 - Supplemental withholding rules
 - Amounts over \$1M
 - Expat compliance
 - Backup withholding compliance

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Government Audits are on the Rise

The Occupational Safety and Health Administration Continues to Focus on Recordkeeping: National Emphasis Program Announced

With an effective date of September 30, 2009, OSHA's one-year national emphasis program (NEP) on recordkeeping will target employers with lower than average injury and illness rates in historically high-rate industries.

ICE Sends Over 650 Employers I-9 Audit Notices in Nationwide Immigration Enforcement Initiative July 2, 2009

Six hundred fifty-two employers throughout the country are receiving I-9 Notice of Inspections (NOIs) from the Department of Homeland Security's Immigration and Customs Enforcement (ICE) unit, the Government has announced.

Legal Alert: USCIS Commences H-1B Audit Program

11/5/2009

The U.S. Citizenship and Immigration Service (USCIS) Office of Fraud Detection and National Security (FDNS) has initiated an H-1B audit program to assess employer compliance with H-1B requirements. FDNS will make unannounced Administrative Site Visits to H-1B employers and their clients, whereby the investigator will collect information regarding the legitimacy of an employer's business and the accuracy of the representations made in filed H-1B petitions.

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Section 457(b) Plans

§457(b): Who?

- Adopted by not-for-profit entities
 - Government employers
 - Non-profit employers
- What employees can participate?
 - Government– all
 - Not-for-profit–select management/highly compensated employees

§457(b): What can I defer?

- Lesser of 100% of compensation or \$16,500
 - Includes employer and employee contributions
- Catch-up contributions
 - Greater of prior unused deferrals or age 50 catch-up (governmental)
- Limit is annual, individual (aggregate plans)

§457(b): When can I get my \$?

- Similar to Qualified Plan Distribution Rules
 - Termination, Death, etc.
- Minimum Distribution requirements (70 ½)
- Rollovers?
 - Government – similar to 401(k)
 - Not-for-Profit – Not allowed

§457(b): Advantages

- Employer
 - Attract and retain employees
 - Improve morale
 - Flexibility

- Employee
 - Pretax deferral/savings mechanism
 - Tax-deferred earnings

§457(b): Disadvantages

- If fails requirements
 - Becomes ineligible plan (§457(f))
 - Subject to §409A

- Funds subject to employer creditors while deferred

Section 457(f) Plans

§457(f): Who?

- Nonqualified deferred compensation plans for:
 - State/Local government employers
 - Not-for-profit employers
- Available to key employees

§457(f): Advantages

- No discrimination rules
- Retain key employees
- Deferral of income

§457(f): Disadvantages

- Taxation at vesting
- Deferred amounts subject to creditors
- Can be subject to Section 409A

Coordination with Section 409A

- Applies in addition to 457(f) rules
- Most existing 457(f) plans would not be grandfathered, although impact is slight
- Substantial risk of forfeiture
- Deferred compensation definition broader under

409A Non-Compliance

- Does not satisfy Section 409A, the key employee is liable for:
 - Income tax on all deferred amounts not subject to a substantial risk of forfeiture
 - 20% penalty tax on amount included in income; 40% for California employees
 - Interest due for the entire deferral period.
- Plans must in be compliance with 409A currently; 2010 has some broad leniency programs for non compliant documentation

Distributions

- Under provided under Section 409A
 - Death
 - Disability
 - Change in Control
 - Separation from Service
 - Fixed Date

Roth 401(k) & 403(b)
Plans

Availability

- Can be adopted by nonprofits
 - Part of existing traditional 401(k) or 403(b)
- Same participation requirements as 401(k)/403(b)
- Available only if employer adopts Roth provisions
- Available to all employees

Deferral limits

- Choose what percentage is traditional and what is Roth portion
- Total deferral limit \$16,500 (\$22,000 if over 50)
 - Limit includes both the traditional & Roth deferral amounts
- After-tax contributions

Distributions

- Subject to Minimum Distribution requirements
- Can allow in-service withdrawals
- Qualified distributions (tax free distributions)
 - 5 tax years after first Roth contribution
 - Attained age 59½ or death or disability

Roth Plans - Considerations

- Effective January 1, 2006
- Take home pay for employees could be less
- Employers slow to offer Roth 401(k)/403(b); but catching up
 - Reduction in participation percents
 - Recordkeeping complexity

Questions & Answers

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