ALERT
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# IRS BEGINS MAJOR INITIATIVE TO AUDIT 6,000 COMPANIES

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The Internal Revenue Service ("IRS") has determined to perform its most expansive and widespread audit initiative in recent history. Beginning in early 2010, the IRS will audit the federal tax returns of 6,000 companies to assess compliance with tax and labor regulations. This new audit initiative will be conducted in three phases, with the IRS studying the tax returns of 2,000 companies in each of 2010, 2011 and 2012. This determination was likely prompted, at least in part, by the United States Government Accountability Office advising that the IRS and the United States Department of Labor should step up efforts to reduce company misclassification of independent contractors, and to curb abuses in the areas of payroll taxes, fringe benefits and executive compensation.

While there has been little disclosure concerning the method and precise focus of these audits, it is clear that the IRS intends to target a wide spectrum of industries to assemble statistical data for future auditing purposes and develop "red flags" for future audits. Companies in industries such as transportation, financial services, and health care have historically been subject to inquiries concerning the misclassification of workers as independent contractors. However, all companies, large and small, as well as for-profit and not-for-profit, are within the potential scope of the IRS' new initiative.

It is strongly recommended that every company take certain proactive measures immediately to minimize any potential exposure that may arise if the company becomes a target of an IRS audit.

First, companies should become familiar with the basic standards for independent contractor classification, and conduct their own internal review to determine whether their current workers are properly classified based on the application of those standards to the actual day-to-day activities of the workers. Companies should also carefully examine the extent to which there has been compliance with Section 409A relating to executive compensation, and whether certain non-salary components of such compensation, as well as applicable fringe benefits, are properly treated and reported.

Second, companies should create and maintain sufficient documentation setting forth the reasons for a particular classification, or tax reporting practice, so that they can justify those decisions in the event of any audit.

Third, after review, if it is determined that certain workers are in the gray area regarding classification, companies may be able to rectify the problem by making certain adjustments to the workers' relationship with the companies via adjusting the relationship or using a third-party employee leasing company.

For more information on worker classification matters or anything discussed in this alert, please contact any of the following Cozen O'Connor attorneys:

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