Employment tax advisory services

Employment tax audit risk management

There has been a recent increase in employment tax audit and enforcement activity at the federal, state and local levels. This is due in part to improvements in technologies, successful initiatives that create interstate and cross-agency relationships and a national focus on improving voluntary tax compliance. What was once an area of minimal focus for taxing authorities is now significantly relevant.

The Internal Revenue Service has launched two major enforcement initiatives regarding employment tax issues: (1) inclusion of compensation and fringe benefit review in all audit examinations and (2) the Questionable Employment Tax Practice program that includes an agreement to share employment tax audit findings with more than two dozen states.

State taxing authorities have similarly increased employment tax enforcement activities using various automated systems to flag questionable transactions (e.g., employees transferring from one unemployment account to another). This gives the taxing authorities an opportunity to initiate information requests and subsequent audit assessments. For instance, the Connecticut Department of Revenue launched an electronic employment tax audit similar in breadth and scope to a highly successful and profitable New York employment tax audit program. Several states, including Ohio, Oregon and Maryland, formed interagency agreements to share information concerning misclassified workers and/or impose substantial fines on businesses for worker classification violations.
Measuring your employment tax audit risk

A business is at risk of an employment tax audit and/or employment tax assessments if:

- Employees work outside of their resident states and/or countries and tax is not withheld in the nonresident jurisdictions.
- Employees work outside their home countries and in the US for temporary stays.
- Employees who work in the US on an inpatriate assignment are paid from their home countries' payroll.
- Nonemployee compensation is provided to foreign national individuals for services performed within the US (i.e., foreign nationals are treated as US independent contractors).
- Withholding tax is not collected in all jurisdictions in which employees live or work.
- Workers are paid through accounts payable, and a Form 1099 rather than a Form W-2 is issued (i.e., workers are treated as independent contractors rather than as employees).
- Workers were transferred from one legal entity to another (e.g., as a result of a merger, acquisition or restructuring) without evaluating state successorship law and filing requirements.
- Tax deposits are not timely made for imputed income (e.g., taxable stock transactions).
- Compensation is deferred over a period of more than one year (e.g., stock awards and deferred compensation) and is not allocated to the various states and localities where services were performed as required under state and local law.
- Legal settlement (e.g., back pay) awards are made to current or former employees.
- Policies and controls are not in place to ensure that employee business expense reimbursements are adequately and timely substantiated and have a business connection.
- Fringe benefits are not appropriately recorded as compensation.
- Important tax records such as federal, state and local withholding allowance certificates and supporting documentation, have not been secured and/or retained according to jurisdictional record retention requirements.
- Tax notices, or other information requests, have already been issued by taxing authorities but not addressed appropriately and/or timely.
- An employment tax audit is already scheduled or under way.

Why businesses are turning to EY for risk management services

Whether a business is seeking an employment tax audit risk evaluation or assistance with a current employment tax audit, our professionals offer the skills and experience needed to provide assistance throughout the process. Our dedicated employment tax team works across Ernst & Young LLP tax service lines in order to provide a wide range of risk management services that include:

- Compliance and audit exposure assessment
- Adjustment return preparation
- Examination, appeals and hearings representation
- Mediation for penalty abatement and voluntary disclosure/settlement agreements
- Pre- and post-audit employee communication and individual tax consultation and return preparation
- Audit coordination
- Electronic data processing audit file preparation and consulting services
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State and Local Tax
State and local taxes can significantly impact a company’s cash flow, effective tax rate and risk profile. Our network of dedicated state and local tax professionals combines technical knowledge with industry understanding and access to technologically advanced tools and methodologies. We identify risk areas and sustainable planning opportunities for state and local taxes throughout the tax lifecycle, helping you address your state and local tax responsibilities and achieve your business goals in the US and around the world. Our network of practitioners has in-depth knowledge of both direct and indirect state and local taxes and offers a broad array of services, including: State Income Tax, Sales Tax, Property Tax, Employment Tax, Business Incentives and Tax Credits Services. Our US State and Local Tax group is effectively integrated with our Global Indirect Tax team to give you the perspective and support you need to manage your global tax burden effectively. It’s how Ernst & Young makes a difference.

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