

IRS Scrutinizes Payroll Practices, Challenges for Companies

bout 6,000 companies nationwide are being selected at random for a payroll tax audit. The audits will focus on whether companies are paying all of their required employment taxes that fund Social Security and Medicare. The Internal Revenue Service wants to know how many companies are misclassifying employees as independent contractors and failing to pay taxes on fringe benefits. The initiative is expected to last for three years.

It is likely that the IRS will find many companies in violation of regulations concerning how workers are to be classified for payroll tax purposes, as there is a clear incentive to classify employees as independent contractors.

Companies are required to pay half of their employees' 12.4 percent Social Security and 2.9 percent Medicare tax. However, if the employee is misclassified as an independent contractor, the company does not pay these taxes.

The IRS estimates that companies underpay approximately \$14 billion annually by misclassifying employees as independent contractors. The recent economic recession will most likely increase the pressure on companies to avoid these payroll taxes.

A failure to pay penalty is commonly assessed in these situations, which can be costly — at up to 25 percent of the

Form W-4 (20

Purpose. Complete Form W-4 so your employer can withhold the correct amount of federal income tax from your pay. Your withholding may change, and you may be eligible for an exemption from withholding.

tions may be fined up to \$500,000.

The rules relating to whether a particular individual is an employee or an independent contractor are complex and confusing. If there is any doubt as to the status of a particular independent contractor, an experienced professional should be consulted.

Companies that find themselves under civil or criminal investigation by the IRS should promptly obtain experienced counsel as these are extremely serious investigations. Companies are also advised to review all payroll practices and tax withholding and consult with experienced counsel to resolve uncertainties or potential problems before they are contacted by the IRS.

— Bernard Bailor, member of Caplin & Drysdale in Washington, D.C.

STRATEGY

Decisions to Fight Recession May Cause Long-Term Damage

Many recession-fighting actions taken by companies in the past few years, while helpful in the short term, may cause long-term damage within companies. Of the many actions taken, the one that has had the greatest negative impact on employees was cutting services to internal and external customers, finds a study conducted by Metrus Group and *Quality Progress*, the publication of the American Society of Quality.

The study of 2,100 United States companies found that such cuts had a serious impact on the three core "people equity" factors of employee alignment, engagement and capabilities to meet customer expectations.

William A. Schiemann, coauthor of the study and chief executive of Metrus Group, says of the results, "It's a signifi-

cant finding, given the empirical evidence from this and other studies that alignment, engagement and capabilities link directly to bottom-line performance." To move beyond the recession, he says, senior executives must rethink their tactics, and especially those that impact internal and external customer service.

Analysis of the findings revealed several surprises:

- The most damaging strategy was not layoffs. While traumatic, respondents said they had only moderate negative impact on the three core factors.
- Pay cuts, pay freezes and reductions in benefits also had a moderate negative impact on employee engagement, but these cuts had no significant impact on alignment or capabilities.
- Mandatory furloughs also had no impact

on alignment and capabilities, but unlike other methods of reducing compensation, they had no effect on engagement.

■ Reduced service to customers had the greatest negative impact on employees.

A single tactic boosted all three elements of people equity: When companies focused on identifying process changes that would reduce costs, they reaped more than just financial benefits. Looking within the organization to collaboratively make improvements and reduce costs increased alignment.

"For employees, this approach represents the company choosing surgery over amputation," says lead author Jerry Seibert of Metrus Group. He says this approach, not surprisingly, led to higher levels of engagement and preserved capabilities.