

# HOW I SURVIVED MY NYS DOL AUDIT

THE SCOPE AND SCOOP

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# In General

The NYS Department of Labor has increased the number and frequency of audits.

Audits have two lines of investigation:

- Are you paying your employees correctly?
  - Pay for all hours worked
  - Pay the minimum wage
  - Pay overtime when due
  - Provide benefits
- Have you paid the required contributions and maintained the types of coverage on behalf of all employees?
  - NY State Workers Compensation
  - NY State Unemployment Insurance
  - NY State Disability Insurance

# The Notification of Audit

- The call: The NYS DOL auditor called the payroll manager on July 21 to schedule an on-site audit for August 16.
- The follow-up email: The auditor requested 2 pages of 2010 information in advance.
- The on-site visit: The auditor quickly honed in on the 1099s, revealing that it was an issue of employment classification.

# The 1099 Situation

- We had contracted with individuals to provide training (in our offices), technical assistance, and program evaluation to after-school programs.
  - Many were retained year after year.
  - Some were graduate students.
  - Some were former employees.
  - Some were later hired as employees.
- In 2010, we issued 48 1099s, with payments totaling \$292,397.

# The Meeting with the Auditor: She Said-He Said

- My claim: None were employees because:
  - the contracts stated that they were independent contractors, without rights to benefits, etc.
  - they worked for other organizations—in some cases, on a full-time basis.
  - they performed their work without our oversight.
  - they had specialized expertise.
- His claim: All were employees because:
  - the contract language alone was insufficient to make them consultants.
  - it didn't matter that they worked for others—people can have two jobs.
  - they worked on our premises and we oversaw their work.
  - they did not have a website which advertised services.

# What Came Next

- In October, we received an audit report which claimed we had underreported compensation for 2008, 2009, ***and*** 2010!
  - The state may go back 3 years, so the auditor extrapolated our underreporting in 2010 to 2008 and 2009.
- With the audit report came a request to pay \$25,700 in unpaid unemployment taxes plus interest based on the auditor's findings that:
  - 50% of our 1099 consultants should have been treated as employees over the 3 years.
  - When the payments were treated as compensation, we had unreported taxable wages of \$311,449 for the 3 years.

# And Then What

- I contacted our attorney, who advised that:
  - the state had increased the frequency of its audits to raise money.
  - we should to pay the amount requested, lest we continue to accrue penalties.
  - we should request a hearing, which would take months to get, and which we probably would not win.
  
- I contacted the auditor's supervisor to:
  - explain the situation, hoping he would be more reasonable.
  - ask him to allow us to provide more information for previous years, such as the actual payments, rather than rely on extrapolated amounts.
  - advise him we were requesting a hearing.

# Control the Damage

- Based on the follow up information we provided, the auditor reduced our taxes and penalties by more than 75%, from \$25,700 to \$6,309.
- The auditor agreed to exclude certain consultants who:
  - lived outside the metropolitan area
  - were “doing business as”
  - had specialties (e.g., photography and graphic design) that were unrelated to our core business
- The actual amounts for all the 2008 and 2009 1099s totaled lower taxable wages than the auditor’s extrapolation.



# By The Numbers

	<u>1099s</u>		<u>Initial Audit Findings October 2011</u>	<u>Final Audit Report March 2012</u>
	#	\$	Under Reported Taxable Wages	Under Reported Taxable Wages
2008	78	\$391,269	\$ 143,879	\$ 43,893
2009	38	253,133	115,570	35,429
2010	48	292,397	52,000	17,912
	<u>164</u>	<u>\$936,799</u>	<u>\$ 311,449</u>	<u>\$ 97,234</u>
Unpaid Taxes			\$ 19,900	\$ 4,835
Interest Due			5,800	1,474
			<u>\$ 25,700</u>	<u>\$ 6,309</u>

# Life After the Audit: What We Did Differently

- We amended our process for hiring consultants.
  - We became more aware of language in our agreements. For example, we stopped using “reports to” and “provides weekly reports,” which suggests employer-level control.
  - We requested proposals from consultants, which substituted for our scope of work.
  - We paid individual’s organizations whenever possible.
  - Graduate students became part-time employees.
  - We avoided hiring recently terminated employees.

# Advice

- Be prepared and provide all of the information requested.
- If you do the grunt work for the auditors, they are more likely to use your data.
- Understand what you are handing over and know where your weaknesses are.
- Clearly explain your operation to the auditors; they need context for what they're looking at.
- Always cooperate with the auditors, even when you don't want to, because it increases your chances of reasoning with them.