

How to Resolve Your Business' Tax Troubles

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New businesses commonly face tax problems. The IRS has entire Audit Technique Guides devoted exclusively to Architects and Landscape Architects, Art Galleries, Attorneys, Business Consultants, Child Care Providers, the Construction Industry, Farmers, Partnerships, the Retail Industry, and the Wine Industry.

Small businesses which are operated as sole proprietorships and do not generate a profit during their first year in existence might not be required to file a tax return that year. Perhaps a business begins to be profitable after its second year in business, and the owner is so focused on building his or her business that they do not take the time to prepare and file a tax return. By the third year, the business has developed a practice of not filing tax returns and may be headed for an IRS audit unless it quickly remedies this situation. Dealing with the IRS is especially important if the business now has employees.

If you, or your business, are contacted by the IRS, there are three steps you can take:

First, find out how much the IRS asserts that is owed.

Second, find out the kind(s) of taxes that are due and the tax periods at issue. If employment taxes are due, it is especially important to make sure that the business is properly classifying those who work for it as employees or independent contractors and that the business becomes current with its payroll tax liabilities.

Third, make a plan to resolve the tax liabilities with the IRS and move on with your business.

I. The first question to ask in finding out how much is owed, is whether all required tax returns have been filed.

- **Filing Requirements.** Generally, a federal income tax return must be filed every year for an individual whose gross income exceeds a certain threshold. 26 U.S.C. § 6012(a)(1). For 2014, if an individual was single and under 65 years of age, the threshold was \$10,150. If the person filed as married filing jointly and was under 65 years of age at the end of 2014, the threshold was \$20,300. A federal tax return is also required if one is self-employed with net earnings of more than \$400.00 during the year. 26 U.S.C. § 6017. A

corporation (including a subchapter S corporation) must file a tax return whether or not it has taxable income, unless it is a tax-exempt organization. 26 U.S.C. § 6012(a)(2).

- **Dealing with Unfiled Returns.** If you or your business neglected, or were unable, to file a federal income tax return for any previous year, there are a number of advantages to filing the tax return now. You can limit penalties and interest, claim a federal tax refund for a prior tax year that is not barred by the statute of limitations, and avoid delays when applying for loans by having tax returns to provide to the lender. If the IRS has filed substitute for returns on behalf of your business, you may be able to substantially reduce the amounts it owes by filing returns with the business' expenses. Filings past tax returns may also prevent IRS collection actions.

II. **The second question to ask regarding your tax situation is what kind(s) of taxes are due.**

Does your business owe income taxes, employment taxes, unemployment taxes, and/or penalties? Does your business have employees? Does your business have independent contractors? If your business had employees, it may owe employment or unemployment taxes to the IRS. If a worker was improperly treated as an independent contractor, your business may owe back taxes and penalties to the IRS.

- **Liability for Employment Taxes.** Many employers, including business, get into trouble with the IRS by failing to pay the proper employment taxes to the IRS. Employment taxes are calculated based on the total wages, tips, or other compensation paid to all employees. By law, employers must withhold payroll taxes from the amounts paid to their employees. 26 U.S.C. § 3402(a). Withholding requirements include federal income tax withholding, Social Security tax withholding, Medicare tax withholding, and Additional Medicare tax withholding for employees earning over \$200,000.00.
- **Employees vs. Independent Contractors.** To determine whether or not a worker is an employee for tax purposes, you must evaluate the degree of control exercised over the worker. An employer has the right to direct and control an employee and dictate the manner in which the work is to be performed. In contrast, an independent contractor is often hired for a specific job, and may provide services to a number of different people. The one who hires an independent contractor generally wants a certain job to get done and is not concerned with how it is done.

The IRS uses a number of factors to determine whether or not the requisite control exists to treat a worker as an employee. The IRS uses these factors to evaluate 1) behavioral control, 2) financial control, and 3) the type of relationship the parties created. The specific factors used include the opportunity for profit or loss, furnishing of equipment and facilities, the right

to discharge the worker and the right to quit, whether the worker's services were an integral part of the business, and the type of relationship the parties thought they created. If you are audited, and the IRS asserts that a worker you treated as an independent contractor was actually an employee, you need to evaluate your circumstances in light of these factors. To show that the worker was an independent contractor you need to show that you did not exercise the kind or degree of control over the worker necessary to classify the worker as an employee.

- **Paying employment taxes.** Payroll taxes that are withheld from employees' wages must be deposited with the Internal Revenue Service. This is done by making an electronic fund transfer using the IRS' Electronic Federal Tax Payment System, or EFTPS. It may be tempting to use these funds to pay your business' expenses if your business is having financial difficulties. However, if you do so, any person in your business who had the authority to pay the taxes to the IRS, and took part in the decision to pay business expenses instead, is potentially subject to personal liability for these unpaid taxes. The IRS may assert that these "responsible persons" are liable for the "trust fund recovery penalty" in an amount equal to the amount of money deducted from employees' paychecks but not paid to the U.S. Treasury. 26 U.S.C. § 6672(a).

III. The third item to address with respect to your tax situation is to make a plan to pay and/or reduce your tax liabilities.

The Internal Revenue Service has programs through which one is able to set up a payment plan, renegotiate the amount they owe based on their ability to pay, or one's account can be declared to be currently-not-collectible.

- **Installment Agreements.** If your business does owe taxes to the Internal Revenue Service, it may be eligible for an installment agreement. Installment agreements are governed by the Internal Revenue Manual, Part 5, Chapter 14. Operating businesses which owe less than \$25,000 in employment taxes may be entitled to "express" installment agreements if they fully pay the taxes within two years. Businesses which owe less than \$25,000 in income taxes may be entitled to pay within six years with "streamlined" installment agreements. A sole proprietor who has gone out of business and owes less than \$50,000 may also be entitled to a streamlined installment agreement. If a business owes more than these limits, it may pay down the liability before entering into the agreement in order to qualify. Installment agreements for tax liabilities larger than \$50,000 will need to be negotiated with an IRS revenue officer. All installment agreements require that the business be current in filing all of its tax returns and paying the taxes due. The business also must continue to file all tax returns and pay the taxes due during the agreement.

- **Offers-in-compromise.** If your business does not have substantial income and/or assets, an offer-in-compromise may be an option. Offers-in-compromise are often advertised on the radio as a way to reduce your tax debts to “pennies on the dollar.” If a business is unable to pay the taxes it owes to the Internal Revenue Service, or if doing so would cause the business to be unable to pay its other liabilities, an offer-in-compromise may allow that business to settle its tax debt for less than the amount owed. Offers-in-compromise are authorized by 26 U.S.C. section 7122. To be eligible to make an offer-in-compromise, a business must be current with all tax filings and payments and must not currently be in bankruptcy. To compromise a tax debt with the IRS, one must offer the IRS a specific amount to settle all outstanding tax liabilities. This amount is usually based on the equity in the business’ assets and its expected monthly future income during the next two years. A denial by the Internal Revenue Service may be appealed to the IRS Office of Appeals.

If you find your business in trouble with the IRS, it is a good idea to hire a tax attorney to help you. An attorney with training and experience in settling IRS disputes will know how to achieve the best possible resolution of your tax matter. You should also make sure that your attorney has an action plan which will achieve your desired outcome.

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