Taxing Times: Haven't Filed?

Simple Steps You Can Take To Avoid A Tax Audit Even If You Haven't Filed Your Taxes

By Lance E. Rothenberg

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You did it. You gathered the courage and started your business. You set up your home office and purchased advertising. You worked your contacts and negotiated a healthy roster of accounts. Your hard work has paid off, and the revenue is coming in; so much so that you hired staff. You made it as an entrepreneur, and you should be congratulated!

Now imagine this scenario: It's late May and you haven't filed your individual income tax returns. Maybe you haven't filed for a year or two (or more!). Your business is turning a profit, but you don't understand the tax rules. Maybe you filed your federal income tax returns, but you forgot about state income taxes. Or, maybe you complied with your income tax obligations, but you haven't been keeping up with your state sales and use tax reporting requirements. Or, regarding the staff that you were so happy to have hired, maybe you haven't been keeping up with your payroll tax commitments.

Sound familiar? It likely does to some of you. There are solutions to these problems — problems that if left unaddressed will not somehow just go away on their own.

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Every for-profit business has a myriad of tax and accounting obligations placed upon it by various levels of government: local, state, and federal. It is essential that businesses and business owners take the time and effort to develop a basic understanding of these requirements (or hire competent and trustworthy advisors to act for them). Taxes are a cost of doing business, and though there are lawful ways to minimize them, there is simply no way to avoid them. If you are a "non-filer," then you owe it to yourself and to your business to address these issues sooner than later.

In my practice, I routinely represent clients confronted with ongoing tax audits. An audit can be a grueling, expensive, and truly nerve wracking experience. In the worst case, an audit can lead to a criminal investigation and can bankrupt your business. While pages can be written about the audit process, this article will focus on those business owners who have failed to file and pay their taxes.

There is a safety valve, a "panic button" that you can press, provided you are eligible, to solve this problem in a reasonable and structured manner: a voluntary disclosure. The voluntary disclosure process varies depending upon the tax and taxing authority involved. However, let's start with the basics:

DO YOU OWE TAXES?

If a business, regardless of how that business is organized as a legal matter (e.g., sole proprietor, LLC, or corporation), is subject to tax (again, income, sales and use, payroll, etc.), and it did not timely file a return and did not timely remit the tax due, then that business, and its owners, have substantial exposure. So, the first question that needs to be addressed is whether taxes are, in fact, due. In some instances, this is an easy one to answer. If you have income, then, in most cases, you surely have an income tax obligation. Other times, it can be a bit more complicated. For example, with respect to sales and use taxes, are you selling a product or service that is subject to tax? A tax professional can help you sort out these issues.

WHO DO YOU OWE TAX TO?

Are you delinquent with respect to federal or state taxes? If state taxes, is it just your home state or is more than one state at issue? Many taxpayers may incorrectly assume their obligations begin and end with the IRS, but state taxes are just as important. Indeed, in today's fragile economic climate, delinquent state taxes can be even more likely to land you in hot water, because state departments of revenue are aggressively stepping up audits to raise revenue. And, if you are doing business in more than one state, then you may have "nexus" with and owe tax to more than one state. Again, a tax professional can help you answer these questions.

YOU OWE TAX! WHAT CAN YOU DO?

Now that we have determined that you owe tax and haven't filed and haven't paid, what can you do? In a nutshell, under a voluntary disclosure, provided you are eligible, you disclose your identity, file the back tax returns, and pay the back tax and interest. However, as with most things in life, it is more complicated.

Voluntary disclosures are sensitive and must be handled carefully. Non-filing can be treated as a serious offense — it can be treated as a crime. By its very nature, a taxpayer that makes a voluntary disclosure is essentially raising her hand and admitting to the tax collector that she has failed to file.

Voluntary disclosures are also formal. The goal of a voluntary disclosure is to come clean about your noncompliance and to formalize the terms of payment in a binding agreement in order to minimize the otherwise many, negative consequences of failing to file.

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WHY WOULD YOU WANT TO TURN YOURSELF IN?

There can be substantial benefits to correcting past mistakes through a voluntary disclosure. Tax collectors want to encourage voluntary tax compliance. So, in exchange for stepping forward, reporting, and paying the back tax, tax collectors are willing to limit the havoc that they can otherwise inflict upon you.

Taxpayers have a legal obligation to file. Non-filing, then, can be treated as a criminal offense. Typically, under a voluntary disclosure, the tax collector agrees to waive criminal prosecution.

Even if a case does not become criminal, there are substantial and onerous penalties that can apply. Typically, under a voluntary disclosure, the tax collector agrees to waive the imposition of penalties.

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Furthermore, the act of filing a tax return (provided that return is not fraudulent) starts the running of the statute of limitations. Under normal circumstances, taxing authorities only have a limited number of years (i.e., the limitations period) to examine and audit a previously filed tax return. After a statute of limitations has expired, a tax that was due can no longer be assessed and collected. However, if a taxpayer has failed to file a tax return, then that statute of limitations has never begun to run — and the time to assess and collect that tax has no expiration date. For example, if your business never filed sales and use tax returns or always had an income tax filing obligation in another state but never filed in that state, you could find yourself under audit back to "the beginning." Where the limitations period may have been three years, you could find yourself under audit for, let's say, the past ten years — all the while accruing interest and penalties for ten years worth of unpaid taxes. You can see how this can quickly become an expensive mistake.

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Typically, another benefit of a voluntary disclosure, though, is the ability to limit the number of years for which you will be liable for back taxes. Taxpayers that voluntarily come forward may have the ability to negotiate with the tax collector to reduce that period to just a few years.

ARE YOU ELIGIBLE?

This is sounding a little better, isn't it? Taxpayers, though, must be eligible to

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avail themselves of a voluntary disclosure. Generally, this means you must not already be under audit or criminal investigation. The purpose behind a voluntary disclosure is to encourage taxpayers to come forward before the government has expended its resources to find you or is otherwise on to you. If you have already been contacted by the tax collector, then it's likely too late. Although, questions can arise as to what constitutes a preclusive “contact.” Depending upon which taxing authority you are dealing with, other conditions may apply.

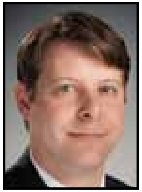
WHAT TO EXPECT?

Once an eligible taxpayer submits a voluntary disclosure application, typically some degree of negotiation ensues with respect to the ins and outs of those disclosures. Once a taxpayer is accepted into the program, she will be required to file the necessary tax returns, pay the applicable back tax and interest, and sign a contractual agreement specifying the terms of the voluntary disclosure. If you cannot pay the liability in full, you can negotiate an installment payment plan. Under the voluntary disclosure agreement, though, you will be required both to comply strictly with the terms of that payment plan and to remain compliant with future tax obligations. If you fail to stick to the terms, the tax collector reserves the right to void the agreement in its entirety and fully impose any and all sanctions that it had waived during the negotiations (including criminal prosecution and penalties).

In conclusion, if you or your business owe tax and haven't filed, then there may be a light at the end of this tunnel, and that light doesn't have to be an auditor's flashlight. Tax obligations are no laughing matter, and if you are a non-filer, these problems are, unfortunately, not going to go away. Contact a tax professional and consider whether a voluntary disclosure is an appropriate path to take. If you haven't filed, you'll be glad you did. HBM

Typical Benefits of a Voluntary Disclosure:

1. Waiver of criminal exposure;
2. Waiver of penalties;
3. Ability to limit the number of years at issue;
4. Clean conscience and no more headache! HBM



Lance E. Rothenberg is a tax attorney with the law firm of Hodgson Russ LLP located in New York City. He concentrates his practice in state and local tax controversy and planning. He has represented both Fortune 100 companies and small businesses with their tax needs, including the preparation and negotiation of voluntary disclosures. He is a frequent author and lecturer on various tax topics. For more information, he can be reached at lrothenberg@hodgsonruss.com or 646.218.7639. www.hodgsonruss.com.