PROTECT YOUR BUSINESS IF EMPLOYMENT TAXES ARE UNPAID

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Are you an owner, investor or decision maker in a business that has withheld employment taxes, but used them for operating expenses? The failure to pay employee withholding taxes raises the ire of the IRS like few other issues.

The consequences of not making employment tax deposits can result in owners, investors, and decision makers being under investigation for their part in using withholding money to pay operating expenses.

The problem arises when a business experiences cash flow problems. The business has insufficient cash on hand to pay suppliers, make payroll and deposit with the IRS the taxes withheld from employee paychecks. Management realizes that if the suppliers are not paid, the supplies stop. If employees are not paid, the workforce is lost. The business has enough money to pay the suppliers and make net payroll, but not enough to pay the IRS the employee withholding taxes.

In tight times, the IRS is viewed as being the expense that can wait, often on the assumption that cash flow will improve so the business can later catch up with the unpaid taxes. This can turn into an expensive borrowing decision to the business as the interest and penalties the IRS charges on the unpaid taxes can ultimately double the amount owed. The IRS is used as a substitute lender for working capital, all at a very high price.

The IRS is very serious about tax deposits being diverted to pay operating expenses. When the IRS learns of the problem, the case is assigned to the most experienced, aggressive Collection Officers for investigation of the business to recover the diverted funds. Extreme cases can also be turned over to the IRS Criminal Investigation Division.

The investigation is focused on stopping the problem and collecting the taxes. If the business does not voluntarily make the necessary corrections, the IRS will seek to shut down business operations to eliminate the problem.

The IRS will also investigate those who were responsible for not paying over the taxes. The targets are usually owners, investors, management and certain employees who took part in the decision to use withholding money to pay operating expenses. The IRS will seek to hold these individuals financially responsible for their actions and for the unpaid taxes. As the corporate form does not protect decision makers from unpaid withholding taxes, the government will proceed to vigorously pursue collection against the responsible individuals.

The IRS has a wide array of tools to collect the unpaid taxes. It can file a Federal Tax Lien against any assets of the business. For those individually responsible, a Tax Lien will secure the IRS' rights to personal residences.

The IRS can also seize the business assets and garnish its bank accounts. This can make continued operations impossible for a business already trying to recover. Individuals who are determined to be responsible can also find their bank accounts seized and their paychecks garnished. The IRS can proceed with these actions simultaneously against both the business and management until the tax is collected.

There are a variety of steps that can be taken to protect the business and minimize managements' personal financial exposure to the unpaid employment taxes:

Dispute Responsibility. The individuals who are targeted by the IRS for their role have the right to dispute their culpability in an administrative hearing with the IRS. If the hearing is unsuccessful, the individual can file a complaint in U.S. District Court to overturn the IRS decision. While the hearing and court case is pending, the IRS is prohibited from collecting the liability from the individual.

Watch the Timelines. The IRS must finalize their investigation of personal responsibility within three years from April 15 of the year after the employment tax returns were due or when the returns were actually filed, whichever is later. The IRS is barred from coming after decision makers after three years.

Offer in Compromise. If a business or a decision maker can prove to the IRS that they will never be able to repay the taxes, they may be eligible for an offer in compromise to settle the unpaid taxes. A condition of the settlement is a five year IRS probationary period of remaining current on all future tax obligations.

Installment Agreement. The IRS will grant installment agreements to repay the taxes, interest and penalties. An ongoing business that can demonstrate a substantial ability to repay may be able to defer investigations of personal responsibility.

Stop Collection. The IRS may temporarily cease collection of the unpaid taxes if there is no ability to repay. This is a bad debt write-off by the IRS. The money will remain due, but the IRS does not collect9.

Implement Procedures. Cut expenses so cash flow is available to pay the employment taxes going forward. Work with suppliers on payment terms. Pay the IRS first. The number of employees approving invoices and controlling financial decisions should be monitored.

It is critical to work out a solution with the IRS sooner than later. The interest keeps growing and the potential financial damage to the business, the owner and the employees only escalates.

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