

Dealing with Non-Filers
2016 NEW ENGLAND IRS REPRESENTATION
CONFERENCE

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So what happened...?

- Whether due to greed (usually) or stupidity (often), clients can commit all sorts of civil and criminal tax offenses.
- The issue for practitioners is what to do about poor choices made by the client.
- Conducting your due diligence.
 - Taxpayer may come to you with one issue, but what other issues are lurking beneath the surface?
 - Foreign and/or domestic
 - Employment taxes
 - Sales and/or Franchise Tax issues

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How the Past Comes Up?

- Why does the client want to correct the issue now? This can be an important fact.
- Is it simply because the client can't sleep at night?
- Will correcting the problem have other potentially adverse consequences?
- Selling business/divorce
 - Do we have partners or spouses that were lied to or misled?
 - Will correcting the problems in a formal manner expose the client to additional criminal or civil liability in another forum?
- DOL audit based on employee tip
 - Will a state audit regarding classification issues have consequences on income or employment taxes?
 - Will a DOL audit raise issues pertaining to immigration concerns for the employer?

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How the Past Comes Up?

- Civil lawsuit
 - If prior non-compliance is raised in a civil suit, a fifth amendment assertion may result in an adverse inference.
 - Business records that may be discoverable could also lead to the past coming up in the present day.
- IRS/state taxation audit
 - If the taxpayer is already under audit, how does that impact the ability to correct the problem?
- Other indicted criminal action
 - Non-tax criminal investigations will often touch on tax issues that may have to be remedied.
 - Depending on the facts, the taxpayer who is under non-tax criminal investigation may still be able to participate in an IRS voluntary disclosure under IRM 9.5.11.9.
 - Generally, the disclosure must be related to legal source income and timely. The taxpayer must also be willing to cooperate in determining the tax and make good faith arrangements to pay.

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General Options/Issues to Consider

- General Options Depending on the Facts?
 - Correcting the problems prospectively only
 - Quiet voluntary disclosures
 - Formal voluntary disclosures
 - Domestic
 - International
 - If international issues exist, there are several options available – depending on the facts.
 - OVDP
 - Streamlined Filing Compliance Procedures
 - Delinquent FBAR or Information Return Submission Procedures

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General Options/Issues to Consider

- Worker classification issues
 - Section 530 Relief
 - Classification Settlement Program
 - Voluntary Classification Settlement Program
- State tax issues and disclosure issues
- Criminal exposure
 - Federal and/or State?

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Considerations – what type of tax?

- Income tax – personal
 - Joint return issues?
 - Conflicts?
 - Innocent spouse arguments?
- Income tax – business
 - Who or what is the client?
 - Entity or individual?
 - Are the other owners/partners who will be impacted by remedial efforts?
- 941 Tax
 - Who are the responsible persons?
 - Are all of the potential responsible persons adequately represented?
 - Form 9180 issues?
- Other types of taxes
 - These may sound like easy issues to determine at the outset of a client engagement, but practitioners must peel back the layers of the onion to determine the full extent of exposure in prior years.
 - Many clients will come to you and describe what they believe is their main issue, such as unreported gross receipts and income, but as you conduct your due diligence, you will find they have additional issues that may require different avenues of remediation.

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Due Diligence

- What questions should we be asking to determine how best to correct the situation?
- What did the client do (or not do)?
 - Altered books or a second set of books?
 - May be important for intent purposes.
 - Miscoded bookkeeping entries?
 - Who did it or ordered it? Was it merely negligence?
 - If the facts tilt more towards negligence, we may be considering simple amendments or quiet disclosure.
 - If the facts tend to support that the taxpayer willfully underreported his income, that may weigh in favor of the formal voluntary disclosure route.
- How material is the issue?
 - What are the amounts at issue?
 - What are the tax consequences?
 - Example: A recent IRS audit included a taxpayer who overstated significant business expenses. However, the ultimate tax consequence was minimal and the case remained in the civil process.

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Due Diligence (2)

- Was it willful?
 - "Intentional violation of a known legal duty"
- Has the IRS or another agency contacted the client?
 - If yes, what was the exact nature of the contact?
 - If a taxpayer simply receives a letter from the IRS asking about a missing tax return, the taxpayer might still be able to complete a formal IRS voluntary disclosure even though he has already been contacted.
 - See IRM 9.5.11.9(6)(D).
- Where is the issue?
 - Corporate return, partnership return?
 - Who is the individual that gets to decide the strategy?

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How likely is it to be discovered?

- Oftentimes taxpayers will want to do the minimal amount to correct an issue, but before deciding how many years to correct or how to correct it, one must consider the likelihood of discovery.
 - Whistleblowers
 - Generally, 26 U.S.C. § 7623 provides potentially handsome financial awards between 15% - 30% for information that leads to the collection of taxes.
 - In 2013, \$53M in awards were paid out and led to the collection of \$367M in taxes, penalties and interest.
 - In 2014, \$52M in awards were paid out and led to the collection of \$309M in taxes, penalties and interest.
 - Angry ex-spouses, disgruntled business partners or employees?

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Assume the Taxpayer Has Not Been Contacted by the Government

- What are the options?
- Do nothing.
 - Must be compliant moving forward
 - Is it possible to file correct current returns that will not conflict with incorrect prior returns?
 - Inventory issues?
- Amend Returns/File returns (Quiet disclosure)
 - How many years will you complete?
 - Potentially gives no criminal protection.
 - May limit years and penalties at issue.
 - Will this trigger a review of other years?
- Voluntary Disclosure
 - Legal source, timely, and cooperate in the determination of the tax and make a good faith effort to pay. IRM 9.5.11.9

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Formal Voluntary Disclosure

- IRS Voluntary Disclosure
 - Legal source, timely, and cooperate in the determination of the tax and make a good faith effort to pay. IRM 9.5.11.9
- When determining how many years to correct in a multi year problem, one should consider that there is a six (6) year criminal statute of limitations for tax offenses and there is no civil statute of limitations for fraud or failure to file.
- Although a formal voluntary disclosure does not provide for statutory criminal protections, it provides administrative protections that indicate a taxpayer who successfully completes a VD will not be prosecuted.
- If a taxpayer cannot fully pay, the VD program only requires a good faith effort to make arrangements to pay.
 - If a taxpayer cannot pay, he may consider an OIC even though he is completing a voluntary disclosure.

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OICs & Unfiled Returns

- Assume a client has 10 or more years of unfiled returns, most voluntary disclosure participants will only file the last six years to give them criminal protections.
- If the client cannot make full payment for the six years, he might consider an OIC.
- Section 7 of the OIC requires a certification attesting that all required tax returns have been filed.
- If the taxpayer has only completed six years as part of the VD process, can he certify that all required returns have been filed?
- IRM 5.8.7.2.2.1 states that an OIC will only cover six years unless a manager approves otherwise.

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The Benefits of Not Being Contacted by the Government

- The taxpayer will have more options.
- The taxpayer may get a better deal by correcting himself before contact.
- The potential to avoid criminal prosecution.
- The potential to limit the scope of the years at issue.
- Potential Negatives of Correcting the Prior Mistakes?
 - Paying the bill
 - Even if a taxpayer utilizes the formal voluntary disclosure process, he may be subjected to civil penalties and interest.
 - Collateral impact to other taxpayers may have far reaching consequences.
 - What if two business partners each had tax liabilities and only one self-reports?

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Assume the IRS has Contacted the Taxpayer

- Potentially no formal voluntary disclosure option.
- Conflict between being honest and open versus making criminal admissions or admissions that will result in a fraud finding.
- Were there any prior misstatements to auditor by the taxpayer before your representation?
- Who is the client?
 - Innocent spouse issues often come up in unreported income cases and require separate representation.
- Can you get a revenue agent report without getting a criminal referral?

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IRS Has Contacted Taxpayer First

- Is it an eggshell audit?
 - Are there sensitive issues that we know will have to be addressed?
 - What is the best way to address those issues with the agent?
- Is the IRS Special Enforcement Program (SEP) handling the audit?
 - See IRM 4.16.1
 - SEP Agents specialize in fraud cases.
 - They work closely with IRS-CI.
 - If SEP is on the case, the agent likely believes there is a significant issue on day one.
 - In Dallas, SEP agents are also handling foreign account/entity audits of people who did not come forward under OVDP or streamlined disclosures.
- Are we going to allow the taxpayer to interview with the IRS?
- CSP (if its worker classification)
 - If the taxpayer has been contacted by the government and we know there is classification issue, consider Section 530 relief and classification settlement program option.

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Foreign Account and/or Foreign Entity Non-Compliance Issues

- Offshore Voluntary Disclosure Program
- Streamlined Compliance Procedures
- Delinquent FBAR Procedures

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Worker Classification Issues: Options to Correct

- If the taxpayer is under audit:
 - Section 530 Relief:
 - IRS Pub. 1976
 - (1) Reasonable basis for not treating workers as employees?
 - Court case
 - Prior IRS audit
 - Significant segment of the industry treated similar workers as independent contractors?
 - Other reasonable basis?
 - Advice of attorney or accountant who knew the facts of the business?
 - (2) Substantial consistency
 - Treated workers and any similar workers as independent contractors.
 - (3) Reporting consistency
 - Filed 1099s
 - If we can satisfy the three requirements, the taxpayer may be able to avoid past due employment taxes.

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If Under Audit: Classification Settlement Program (CSP)

- IRM 4.23.6
- 100% CSP Offer
 - If you cannot satisfy the reasonable basis or substantive consistency requirement, the taxpayer may be able to resolve the issue by paying 100% of the employment tax for the most recent year.
- 25% CSP offer
 - If the taxpayer filed 1099s and has a colorable argument that it meets the reasonable basis or substantive consistency requirement, he may be able to resolve the case by paying 25% of the employment tax for the most recent year.

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If Not Under Audit: IRS Voluntary Classification Settlement Program (VCSP)

- The VCSP is available for taxpayers who want to voluntarily change the prospective classification of their workers.
- Currently treating their workers as independent contractors or other nonemployees and want to prospectively treat the workers as employees.
- To be eligible, a taxpayer must have consistently treated the workers as nonemployees, and must have filed all required Forms 1099, consistent with the nonemployee treatment, for the previous three years with respect to the workers to be reclassified.
- The taxpayer cannot currently be under employment tax audit by the IRS.
 - A taxpayer that is a member of an affiliated group within the meaning of section 1564(a) is considered to be under employment tax audit for purposes of the VCSP if any member of the affiliated group is under employment tax audit.
- The taxpayer cannot be currently under audit concerning the classification of the class or classes of workers by the Department of Labor or by a state government agency.
 - IRS Announcement 2012-45; IRB 2012-51
- Avoid penalties and interest.
- Pay 10% of the employment tax liability for the most recent year.
- See Form 8952.

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Hypo 1

- Client comes into see us because he found he couldn't pay his taxes 4 years ago and has not filed since.
- He and his wife are unhappy with this
- Wants to clean this up
- IRS has not contacted him

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Hypo 2

- Client owns a small business
- Has been paying kickbacks to vendor sales reps by paying each reps credit card
- EA found out and fired him, so has not filed his tax returns in 3 years
- Has received a summons to appear at the local IRS office with his books and records

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Hypo 3

- Taxpayer arrives in our office because he has a former employee who is demanding \$50,000 in cash to not go to the IRS and whistleblow
- Taxpayer runs a diner and has been paying his undocumented workers cash under the table
- Does not know what to do

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Questions



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