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National Research Program Employment Tax Initiative

On June 4, 2009, the IRS announced that it will soon begin conducting employment tax audits as part of the IRS National Research Program (NRP). In addition to the traditional focus on determining whether a taxpayer is properly reporting specific taxes for specific years, audits conducted as part of the NRP focus on industry- or nationwide problem areas to help the IRS design future audit procedures. As a result, employment tax audits conducted as part of the NRP will be more time-consuming and detailed than traditional audits. The IRS will begin audits under the employment tax initiative of the NRP in November 2009 and expects the initiative to last for three years. The IRS anticipates conducting approximately 2,000 employment tax audits per year during the three-year period.

Employment tax audits conducted as part of the NRP will examine employers' record keeping and reporting procedures in the areas of worker classification (employee v. independent contractor), fringe benefits, office compensation, and expense reimbursements. This is in addition to the usual examination of annual employment tax returns. Accordingly, if you are contacted with an employment tax audit notice during the next three years, you should prepare for a much more detailed and time-consuming process than has been used in employment tax audits conducted before November 2009.

Employment Taxes and the Trust Fund Recovery Penalty

Every employer is responsible for withholding the appropriate amount of income taxes, social security taxes (Federal Insurance Contribution Act or "FICA" taxes), and Medicare taxes from each of its employees' paychecks. These withholdings, along with the employer's share of FICA taxes, are then remitted to the IRS. Until the withholdings are remitted to the IRS, they are considered to be held by the employer in trust for the benefit of the employees. This article explains what happens when an employer fails to remit its employees' withholding taxes to the IRS.

Many years ago, Congress enacted a law that if an employer fails to remit the withheld taxes to the IRS and is unable to pay these taxes over time, the IRS can collect those taxes personally from one or more persons with power over the employer's finances by assessing a "trust fund recovery penalty."

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Individuals who can be held liable for the trust fund recovery penalty are typically the officers or key persons of an employer, partners in a partnership, or members in an LLC with the duty to collect and pay over withholdings. An individual who may be liable for the trust fund recovery penalty is called a "responsible person." The penalty only includes taxes withheld from employees and does not include the employer's share of withheld taxes, interest, and penalties. However, if the employer is a sole proprietorship, the owner is liable for not only the employees' withholding tax but also the employer's share of taxes, interest, and penalties.

During economic slowdowns, when receivables are aging longer than usual and when creditors are demanding to be paid, employers are often tempted to draw on the funds withheld from employees' paychecks to pay creditors. This is effectively robbing Peter to pay Paul and the IRS will eventually show up and demand that the delinquent taxes be paid. If the employer cannot pay in full, or does not have enough funds to make monthly payments, the IRS will look to the responsible person to pay the trust fund recovery penalty.

As previously touched on, a responsible person is one who has the duty and the authority to see that taxes are paid or one who pays other creditors rather than the IRS. Generally, the responsible person must be an individual who signs the employer's checks and decides which creditors get paid. In some cases, even an officer who can only direct which creditors get paid, but cannot sign checks, has been deemed a responsible person. The reverse is not true, however. An individual who signs checks, but does not determine which creditors get paid is not a responsible person because he or she lacks the authority to direct payments.

Typically, the responsible person is an owner, director, officer, key employee, or accountant. In extreme cases, even a creditor may be a responsible person if the creditor knows that the employer is paying off its debts with withholding taxes.

In addition to having the authority to direct which creditors get paid, a responsible person must act willfully in failing to pay the IRS to be held responsible for the trust fund recovery penalty. A willful act is one that is intentional, deliberate, and voluntary.

To act willfully, an individual must know or be in a position where he or she should know of the delinquency. Payment of other creditors is a presumptively willful act.

Once the IRS determines the responsible person or persons, it will assess the trust fund recovery penalty against all responsible persons. Any payments made by the responsible person(s) will be credited against the trust fund recovery penalty and the employer's tax liability. The IRS can only assess and collect the trust fund recovery penalty to the extent the employer has unremitted withholding, such that the trust fund recovery penalty is not actually a penalty, but a mechanism to collect the unremitted withholding. If one person of several responsible persons pays the penalty, then he or she can try to recover some of that payment from the other responsible persons, but the IRS is not required to collect a pro-rata share from each responsible person. Indeed, the IRS will usually go after the person with the deepest pockets first.

The following steps can help employers or responsible persons avoid or reduce the trust fund recovery penalty:

1) Pay the IRS before other creditors, even if additional funds need to be borrowed from outside sources. By doing so, an employer will avoid the 10% late deposit penalty and the failure to pay penalty of .5% per month, as well as professional fees for dealing with the IRS.
2) If partial payments of employment taxes are sent to the IRS, include a cover letter directing that those payments be applied first to reduce employee withholdings due. The IRS will apply the taxes as requested, reducing the trust fund recovery penalty that can be assessed against responsible persons.
3) Contact the IRS and enter into an installment agreement to pay any delinquent taxes over time, preferably over a period no longer than five years. Once the IRS accepts an installment agreement, it may assess the trust fund recovery penalty against the responsible person(s) but will withhold collection activities so long as the employer makes regular monthly payments and stays current.
4) Make sure that withholding taxes (as well as federal income taxes, including estimated taxes where applicable) are paid currently in order maintain eligibility for an installment agreement.
5) If the IRS proposes a trust fund recovery penalty assessment and a deemed responsible person believes that he or she is not actually a responsible person, that individual should file a protest to appeal the IRS's decision.

If the employer cannot pay in full, or does not have enough funds to make monthly payments, the IRS will look to the responsible person to pay the trust fund recovery penalty.

EVERYBODY'S DOING IT!...

Tax Breaks for Going Green

Going green can benefit your tax return as well as the environment. The federal government, as well as many states, offer significant tax credits for engaging in certain environmentally friendly activities. This article highlights tax credits available to offset your federal, Maryland, or Virginia income taxes. Unfortunately, DC does not provide any substantive going green tax benefits.

Before you purchase a new car, make home improvements, or purchase new equipment for your business, consider what tax benefits may be available for going green.

FEDERAL

The Federal Government offers tax credits to both individuals and businesses for energy-saving improvements and investments. Many have already taken advantage of the tax credit for purchasing a hybrid car. The credit amount can be up to $3,400 (depending on the vehicle and when it is purchased), and credits are still available for certain Ford, Mazda, and Mercury hybrids. A complete list of the makes and models for which the credit remains available and the credit amount for each vehicle can be found at http://fueleconomy.gov/Feg/tax_hybrid.shtml.

There are also tax credits available for energy-efficient home improvements. If you are planning home improvements, going green could give you something in return by improving your energy bills in the long run and by providing a tax break in the meantime. The American Recovery and Reinvestment Act of 2009 (ARRA) allows a tax credit equal to 30 percent of the cost of certain home improvements, with the maximum credit being $1,500. Qualified improvements include adding insulation, energy-efficient exterior windows, and energy-efficient heating and air conditioning systems. For the installation of solar water heaters, geothermal heat pumps, and small wind turbines, there is no limit to the 30 percent tax credit.

There are two new tax credits this year for those who purchase plug-in electric vehicles, also known as neighborhood vehicles. The ARRA created a credit for those who purchase low-speed electric vehicles with two or three wheels between February 17th, 2009 and January 1st, 2012. This credit is good for 10 percent of the cost of the vehicle up to $2,500. There is a similar tax credit created by the Emergency Economic Stabilization Act of 2008 (EESA) for those who purchase plug-in electric vehicles with four wheels, such as a Tesla. The minimum tax credit is $2,500, but, depending on the weight of the vehicle and battery capacity, the credit can be as much as $15,000.

MARYLAND

Maryland also offers tax credits for individuals and businesses going green. If you own waterfront property in Maryland, consider installing an aquaculture oyster float and you will receive up to a $500 tax credit and help restore the oyster population in the Chesapeake. An oyster float can house up to 200 oysters, which can filter up to 10,000 gallons of bay water a day. Also, you can contribute directly to the Bay Fund on your Maryland tax return. If you make a contribution, Maryland will deduct the amount from your refund or add it to your tax liability.

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TAX CALENDAR

AUGUST

Monday, August 17, is the deadline for employers to deposit income, Medicare, and social security taxes withheld from their employees' salaries in July if the monthly depositor rules apply.

Monday, August 17, is the due date for calendar year exempt organizations who filed a three-month extension to file Form 990 or 990-PF. An additional final three-month extension can be requested on Form 8868.

SEPTEMBER

Tuesday, September 15, is the deadline for employers to deposit income, Medicare, and social security taxes withheld from their employees' salaries in August if the monthly depositor rules apply.

Tuesday, September 15, is the deadline for a calendar year corporation that properly obtained a filing extension to file a Form 1120 or Form 1120S income tax return.

Tuesday, September 15, is the due date for the third quarterly installment of the 2009 estimated tax for calendar year corporations. For fiscal year corporations, estimated payments fall due on the fifteenth day of the fourth, sixth, ninth, and twelfth months of the taxable year.

Tuesday, September 15, is the due date for the third quarterly installment of your estimated individual income tax (including any self-employment and alternative minimum tax).

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Tax Breaks for Going Green

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In addition, contributions to the Bay Fund qualify as itemized deductions on your federal return.

For pre-approved businesses and individuals, Maryland allows a Bio-Heating Oil tax credit equal to $0.03 for each gallon of heating oil blended with at least 5 percent biodiesel used for space or water heating, up to $500. Businesses operating in Maryland can receive a credit for expenses incurred for research and development in cellulosic ethanol technology. The credit is equal to 10 percent of a business's qualified research and development expenses, but is limited to $250,000 for all business claiming the credit. Pre-approved businesses may also receive a Clean Energy Incentive tax credit for using renewable energy sources or waste to produce energy. The credit amount ranges from $0.50 to $0.85 per kilowatt produced and businesses may be pre-approved for a credit amount up to $2.5 million. The Water Quality Improvement tax credit is available to pre-approved individuals and businesses and is equal to 50 percent of the cost of additional commercial fertilizer needed to convert agricultural production to a nutrient management plan, up to $4,500.

VIRGINIA

Virginia corporations can claim a tax credit for certified equipment purchased to produce tangible personal property items from recycled materials. These items must be produced for sale and the manufacturing facility where they are produced must be located in Virginia. This credit is for 10% of the price of the equipment and cannot exceed 60 percent of the entity's tax liability.

Virginia resident businesses or individuals with waterfront property can claim the Riparian Waterway Buffer credit for developing a certified Forest Stewardship Plan. If you harvest timber on the land, you must not harvest trees within a buffer zone that is from the water's edge to at least 35 feet from the water's edge for at least 15 years after the tax credit is taken. The credit is for 25 percent of the value of the timber in the buffer zone and cannot exceed $17,500. The buffer zone used for calculating the credit cannot exceed 300 feet from the water's edge.

Virginia offers a credit to individual and corporate farm owners for the purchase of conservation tillage equipment, such as "no-till" planters or low soil disturbance drills, which help prevent soil erosion, improve water conservation, and reduce fuel consumption. The tax credit is 25 percent of the cost of such equipment, up to a maximum of $4,000.

Virginia also offers a Land Preservation tax credit to those who convey Virginia property to a public or private agency for conservation or preservation purposes. The tax credit is equal to 40 percent of the appraised value of the donated land and can be carried forward for ten years.