



Withholding Taxes and Staying Current

Introduction

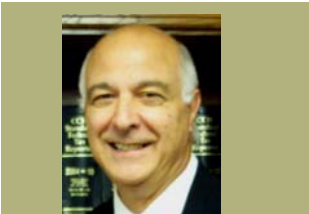
If you have employees, you have payroll taxes. Payroll taxes consist of federal withholdings, state withholdings, Medicare withholdings, Social Security withholdings, and withholdings as required in your specific jurisdiction. Unlike regular tax liabilities such as income taxes and capital gains taxes through a business, withholding taxes result from having employees. The withholdings withheld from employee payroll, results in what the IRS refers to as a "trust fund". Theoretically, when an employer withholds taxes for employees, the employer holds the money in trust to pay to the government. The money does not belong to the employer; rather it belongs to the employee. If the payments are not made to the government, the employer becomes personally responsible.

Wages Subject to Withholding

Under the Internal Revenue Code, all remuneration for services rendered to an employer is subject to withholding. This remuneration includes payments for salaries, fees, bonuses, commissions, taxable fringe benefits, pensions, and non-qualified retirement pay. Withholdings must be deducted no matter if the employee is paid in cash or equivalent value of products.

Being an "employee" must be distinguished from being an "independent contractor". In addition to common law requirements, the IRS uses a 20 factor list. The factors include control elements such as: employee compliance with instructions of the company, training, integration of worker's service into the business, services rendered

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A CASE STUDY

The Tax Court ruled that money held by a shareholder was a bona fide loan as opposed to a taxable dividend. In the case, the shareholder took a large amount of money out of the company and failed to pay taxes. The IRS protested the loan and called it a dividend. Ultimately, the taxpayer won by calling it a loan because formalities

were observed that lent to the fact that the amount was a loan intended to be paid back and not a dividend which must be taxed. The taxpayer has prepared the proper paperwork to prove the existence of a loan.

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personally, ability to hire others and supervise assistants, continuing relationship, set hours of work, whether full time is required or not, where the work is performed, services performed in set order, oral and written reports required, payment of expenses and tools and materials furnished by the company. If the worker performs services for multiple firms or makes services available to the general public, then the worker could be considered an independent contractor. If the above factors point to the worker being an "independent contractor, withholding taxes are not required to be withheld. If the worker is classified as an employee, the employer is required to withhold taxes. In most cases, the IRS finds that the worker is an employee and not an independent contractor.

Employer Responsibility

As stated above, the employer is required to withhold taxes from wages of all employees and deposit the withholdings in the proper manner. If the employer, for any reason, does not fulfill this legal requirement, not only the employer, but also any and all "responsible persons" will be held liable for the withholdings plus a personal penalty equal to 100% of the taxes that were supposed to be paid.

A person does not need to be an owner, director, or officer of a company in order to be held liable for the trust fund penalty. A two prong test has been established under section 6672 of the Internal Revenue Code. First, the person must be one of those responsible for the collection of payroll taxes. Just because a person is not connected to payroll, the lack of connection does not mean immunity! Secondly, the person must have made the decision to pay or not to pay. A willful decision not to pay will result in the withholding tax penalty being applied. If a person who is required to pay withholding taxes does not pay and is in a position to withhold taxes, generally, the person is always found personally liable for the trust fund tax and penalty.



Conclusion

This advisory should serve as a reminder that paying payroll taxes is imperative for all businesses. The taxes are not dischargeable in bankruptcy and are extremely difficult to deal with if not paid on time. If your business is responsible for withholding taxes for employees, it is the responsibility of everyone involved to make sure the taxes get paid to the proper government agency. Do not breach the responsibility, and, if necessary, divert funds from other sources to pay the taxes due on time.

Points of Interest

- **as income taxes and capital gains taxes through a business, withholding taxes result from having employees**
- **If the payments are not made to the government, the employer becomes personally responsible.**
- **remuneration includes payments for salaries, fees, bonuses, commissions, taxable fringe benefits, pensions, and non-qualified retirement pay.**
- **A person does not need to be an owner, director, or officer of a company in order to be held liable for the trust fund penalty.**

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Editor's Comment: The IRS is especially critical of loans made to shareholders. Loans made to shareholders are commonly reclassified as dividends and taxed. However, in this case, formalities to give the appearance and substance of an actual loan were followed. First, the taxpayer repaid amounts of money into the corporation. Next, the taxpayer's salary was sufficient to cover the loan. Additionally, the parties' conduct was consistent and reasonable to prove the existence of a loan and not a dividend.

When a corporation loans money to a shareholder, formalities must be observed. This is also true in any corporation regarding numerous other topics. Minutes and corporate records must be created to reflect the favorable position. There is no doubt in my mind that this taxpayer and the corporation had an updated corporate record book, which is essential to proving the existence of loans and not dividends. Records are absolutely essential. If you have questions or would like an updated corporate records book to validate various transactions, please call the Center for assistance.



When Is the Best Time To Sell My Business?

Whenever I'm asked this question, I invariably answer that you need to begin actively marketing your business a MINIMUM of 2-3 years before you're ready to walk out the door for the last time.

Also, to bring the best price, your business should ideally be on a strong growth trend, with the prospect of at least a couple more good years immediately ahead.

Unlike selling your home, which most people think should take no more than 90-120 days, selling a small- to medium-sized company can take up to 1 year, and sometimes much longer.

Finding the right buyer usually takes several months. Negotiating the definitive purchase agreement back and forth between the parties and their attorneys takes time. Completing the necessary due diligence takes time. Arranging the financing and actually closing the deal also takes time. Furthermore, once the deal closes, the seller is frequently required to spend from 1 month up to a couple of years in a training/transitioning/consulting role. While the seller will be compensated for his time, it nonetheless delays his departure.

Another factor in picking the right time to sell your business is the outlook for the US economy in general, and for your local economy and industry in particular. Buyers generally don't like to buy when they sense the economy is headed into a recession. They generally prefer to stay on the sidelines and wait for the recession to "play through."

Buyers also dislike periods of economic uncertainty, like presidential election years, because while the economy might be doing well right now, they're just not certain what the future might bring, and they'd prefer to "wait and see."

All of this suggests that the best time to begin actively selling your business might be sooner than you think.

If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free consultation with us, have them contact me, or any of the M&A professionals at www.bradwaygroup.com

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▶▶▶ Frequently Asked Questions...

Q1. Are partners considered employees of a partnership or are they self-employed?

A1. Partners are considered self employed to the extent of their distributive share in partnership profits. Limited partners are subject to self-employment tax on salary and professional fees.

Q2. As an employer, do I have any liability if my employees receive tips but don't report them to me?

A2. Employees who customarily receive tips are required to report their cash tips to their employers at least monthly, if they receive \$20 or more in the month. If the employee does not report tips to you, it places you at risk of possible assessment of the employer's share of the Social Security and Medicare taxes on the unreported tips. If you are a large food or beverage establishment (more than 10 employees on a typical day and food or beverages consumed on the premises), you are required to allocate tips if the total tips reported to you are less than 8% of gross sales.

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