

September 24, 2008

A State Government “Hammer” for Non-Paying Taxpayers

With an ailing economy comes lower tax revenues – meaning that state and local governments are forced to find ways either to generate additional revenue – or cut costs, heaven forbid. In other words, the tax collectors are, once again, becoming much more aggressive in their methods to generate additional tax revenue.

The Revenue Problem

For a variety of good and bad reasons, many taxpayers do not correctly file or report their state taxes, especially when they are located and operating in multiple states. Often times, a company may have been conducting substantial business in a state without paying income or franchise taxes in that state, or it may have acquired assets or other property without paying the appropriate sales or use taxes.

To find taxpayers who have conducted business outside of their home state, states have formed entire divisions of their tax or revenue departments dedicated to searching for businesses and individuals that have operated in their state but have not paid taxes. These divisions use all available resources to uncover additional revenue, including reviewing federal agency records (e.g., FAA records related to aircraft, commerce department import/export forms, etc.), attending trade shows to identify vendors that are not collecting sales tax, reviewing newspaper articles and online stories about recent business transactions, or even talking to competitors down the street – seriously!

In the current environment, we have seen a substantial increase in the number of audits. The audit typically begins with the state sending the taxpayer a “questionnaire” to determine if it has “nexus” or minimum contacts with the state. This simple questionnaire, which may appear innocuous, is the tax equivalent of a tax “tar baby.” Touch it and you’re in for trouble. On the other hand, if you fail to respond to it, you’re also in trouble.

The Possibilities

The point here is not to worry you. In some cases, your tax exposure may be so insignificant that the expense of addressing the issue may far outweigh the exposure. However, if you are concerned that you have tax exposure in a state that needs to be addressed, you may have a few options.

So, what can you do? One option, of course, is to play the “audit lottery” and take the chance the state does not find your company and discover its unpaid taxes. The reality is, in most cases it is not a matter of *if* the state will find your company, but *when* the state will find it. As penalties and interest accrue on unpaid taxes year after year, your company’s actual tax liability could be doubled, tripled, or even more.

Another option is the voluntary disclosure agreement (VDA), which is available from many states – for example, Texas, New York, Ohio, Michigan, Illinois, and Georgia, among many others, have VDA programs. Under a VDA, a taxpayer agrees to voluntarily disclose its unpaid taxes and to continue paying its taxes and, in exchange, the state waives all penalties and interest. Here's another bonus – under these agreements, states typically only look back and require taxes to be paid for the previous four years. However, if they discover you on their own, they can look back indefinitely! Also, be aware that after a state has contacted you, it's too late to request a VDA from that state. We routinely help clients evaluate, initiate and complete this process with a state's tax department, and it is often possible to initiate or even complete the entire process on an anonymous basis, until the time you make the actual payment of taxes.

The third option, if you time it right, is to pay your taxes under an "amnesty" program. Generally, all the taxpayer must do is comply with the amnesty program – which includes sending the state your unpaid taxes. Then the state waives all penalties and interest. These programs occur infrequently, so being able to use this type of program is more a matter of luck than anything else. The State of Texas recently offered an amnesty program in the summer of 2007. When a state offers this type of program, it generally only lasts for a short period of time.

If you have any questions about your possible tax exposure in a state (income, franchise, sales and use, unclaimed property, etc.) or whether a voluntary disclosure program is appropriate in your situation, please contact one of the attorneys listed below that has expertise representing clients with state and local tax matters.

Ken Bezozo
212.659.4999
kenneth.bezozo@haynesboone.com

Jeff Slade
214.651.5899
jeff.slade@haynesboone.com

Vicki Martin-Odette
214.651.5674
vicki.martin-odette@haynesboone.com

Brandon Jones
817.347.6626
brandon.jones@haynesboone.com