

March 10, 2009

*Make no mistake, tax cheaters cheat us all and the IRS should enforce our laws to the letter.*

*Sen. Tom Daschle – Congressional Record, May 7, 1998, p. S4507*

### Special Tax LINC

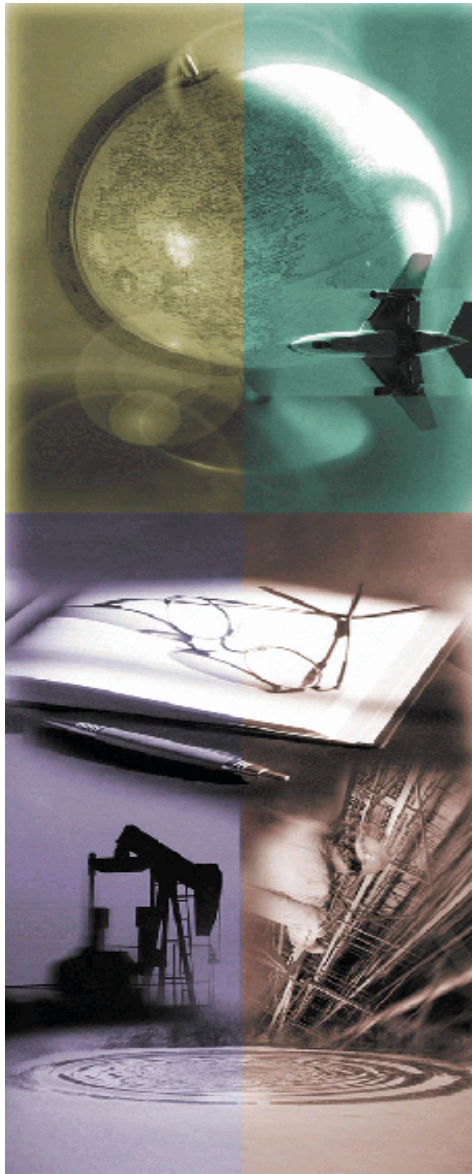
*Irony, or maybe just plain politics, made quite a show in the past few weeks. Oklahoma papers reported that three employees of an Oklahoma City company were sentenced to federal prison for submitting a false income tax return. About the same time, Tim Geithner was confirmed as Secretary of the Treasury in spite of his failure to pay taxes, and Tom Daschle was almost made Secretary of Health and Human Services in spite of a nearly \$150,000 tax bill based on unreported income. Geithner and Daschle, one successfully and one trying to save his nomination, both paid their back taxes when they got caught. Most of educated America outside of the Beltway was disgusted with the Geithner and Daschle situations, further eroding trust in Washington.*

*Some commentators found a silver lining. One comment on the Internet suggested that President Obama's greatest success in his first few weeks in office was collecting several hundred thousand dollars in back taxes from his Cabinet nominees.*

*With our commentary on taxes given, here are a few tax issues that folks need to look out for as the IRS is tasked to find money to pay for the growing national debt.*

### Independent Contractor or Employee?

We expect to see significant activity regarding the issues related to classification of workers as employees versus



independent contractors. Independent contractors do not get company-paid benefits or unemployment compensation if they are let go. Battles have been waged over the years, in many cases with so called contract workers successfully claiming that they were in fact employees who worked under the direction and control of employers and did not have the latitude in their work necessary to actually meet the definition of an independent contractor. The February 16, 2009, edition of *Forbes* magazine indicates that the government, and particularly the IRS, will likely get increasingly involved in this battle. Per *Forbes*, “Employees have taxes withheld from their paychecks, and the IRS collects 99% of the taxes owed on wages. Self-employed folks don’t have anything withheld and pay just 43% of what they owe, the IRS estimates. (The corner-cutting Treasury Secretary would seem to be in the majority).” While there has always been an element of the tax issues involved in this classification dispute (the other major issue being benefits), it seems now that tax concerns will become a major driver for aggressive enforcement and perhaps stricter interpretations.

### Untaxed Fringe Benefits

Employees, or persons otherwise in positions to receive favorable treatment, often receive benefits which should by all standards be considered taxable. Many of these issues have already been addressed, so, for example, most honest taxpayers will scrupulously keep a distinct record of personal versus business mileage on business vehicles, report the personal mileage, and, accordingly, be subject to taxes for such personal mileage. Remarkably, Mr. Daschle did not seem to understand that “free” use of a limo would be taxable to him.

Other fringe benefits are more difficult to quantify. For example, if someone takes their spouse on a business trip and the spouse receives the benefit of using a paid-for hotel room, should part of this cost be taxable? Some would argue that it essentially provides for a free vacation (depending on where the meeting is), while others would argue that it is often necessary to have spouses on business trips, if not to attend business-related social activities, then to make up for the separation caused by travel.

Another example involves educational assistance provided to persons in certain categories. Most persons understand that scholarship moneys that are paid in excess of books, fees, and tuition are in fact taxable, and some higher education institutions are now providing forms 1098-T to students so that the taxable proportion of the scholarship income can more readily be identified, reported, and paid. Other schools do not provide these documents, and, depending on the reason the “scholarship” is provided to the student, this may be a case where an untaxed benefit will be found by the IRS. Schools, as well as individuals, should be prepared for inquiries regarding this issue from the IRS beginning this year.

### Documentation

Another *Forbes* article dated March 2, 2009, highlights that the IRS is increasingly using “by-mail” audits wherein they will declare deductions denied unless taxpayers provide acceptable documentation of the deductions back to the IRS. This should not be a surprise, as the rules regarding charitable deductions were significantly tightened beginning last year so that, for example, receipts are required for any cash gifts, and for donations in excess of \$250, acknowledgments must be obtained in writing from the charity before the tax return is filed.

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