# Broken Entity Issues

Jason B. Freeman
Freeman Law, PLLC
www.FreemanLaw.com

# Jason B. Freeman, J.D., CPA

Mr. Freeman is the managing member of Freeman Law, PLLC, a tax, white-collar, and litigation boutique law firm based in the Dallas-Fort Worth Metroplex. He is a trial attorney, author, adjunct professor at SMU's School of Law, and licensed CPA. Mr. Freeman handles federal and state tax controversies and white-collar matters.

Mr. Freeman has been recognized in **Chambers & Partners** as among the leading attorneys in the United States and **U.S. News and World Report's Best Lawyers in America list**. He has also been recognized by the American Bar Association, receiving its "On the Rise– **Top 40 Young Lawyers" in America award**. He was also named the "**Leading Tax Controversy Litigation Attorney of the Year**" for the State of Texas by AI in 2019 and 2020.

Jason is a **Forbes contributor** and is the former **President** of the North Texas chapter of the American Academy of Attorney-CPAs. He has been recognized multiple times by **D Magazine** as one of the Best Lawyers in Dallas for tax law, and by **Super Lawyers**. Jason is the past **Chairman of the Texas Society of CPAs (TXCPA)**.

# Is Everything Currently "Broken"?

- The Big Beautiful Bill Act and the status of Tax Cuts & Jobs Act tax provisions.
- Do entities need to prepare for their expiration?

# TCJA Provisions Set to Expire if No Action

Nearly 40 tax provisions set to expire (or are modified) after Dec. 31, 2025

**TCJA Individual Provisions:**

- Tax rates & brackets revert (39.6% comes back)
- Itemized deductions restored
- Standard deduction drops
- Increased child tax credit expires
- No SALT limitation
- Individual AMT expands
- Estate-tax exemption reverts

**TCJA Business Provisions:**

- 20% section 199A deduction expires
- R&D expenses spread over 5 years
- Narrower interest limitation
- End of bonus depreciation
- Corporate/international changes to respond to OECD global minimum tax
- Fuel tax provisions switch to Tech-Neutral

# What's in the BBB Act?

- Most of the TCJA's tax cuts
- Qualified Business Income ("QBI")
- Bonus Depreciation
- SALT
- Renewal and enhancement of Opportunity Zone incentives
- Estate Tax permanent exemption of $15,000,000
- GILTI and FDII
- General elimination or restriction of numerous energy tax credits

# Past Errors—To Amend or Not to Amend? A Recurring Issue

- Amended returns are "a creature of administrative origin and grace." *Badaracco*, 464 U.S. 386 (1984)
- Regs. Sec. 1.451-1(a) states that "if a taxpayer ascertains that an item should have been included in gross income in a prior taxable year, [the taxpayer] *should*, if within the period of limitation, file an amended return and pay any additional tax due" (emphasis added). Regs. Sec. 1.461-1(a)(3) contains similar "should" language with respect to amended returns and the discovery of erroneous deductions taken in prior years.
- "None of these provisions, however, requires the filing of [an amended return]" *Badaracco*, 464 U.S. 386 at 397; *Broadhead*, T.C. Memo. 1955-328.
- Treasury Circular 230

# The Rescission Doctrine—Unwinding a Transaction

- The "annual accounting principle" requires that one must look at a transaction on an annual basis using the facts as they exist at the end of the year. That is, each taxable year is a separate unit for tax accounting purposes.
- Under the "claim of right doctrine," amounts received under a claim of right and without restriction are generally immediately taxable, even if, in a later tax year, the taxpayer is required to return part or all of the money.
- Both the annual accounting principle and the claim-of-right doctrine stand as potential roadblocks that may prevent the ability to unwind a transaction for tax purposes.
- The IRS addressed a taxpayer's ability to rescind transactions in Revenue Ruling 80-58.
- A taxpayer must satisfy at least two requirements in order to successfully rescind a transaction under the rescission doctrine: (1) the parties to the transaction must be returned to the *status quo ante,* meaning that they are returned to the same position they would have occupied had no contract existed; and (2) the restoration must be accomplished within the same tax year as the original transaction.

# Payroll Tax Issues—Trust Fund Recovery Penalty Exposure

- **Who can be responsible for the TFRP?**
- The TFRP may be assessed against any person who:
  - Is **responsible** for collecting or paying withheld income and employment taxes, or for paying collected excise taxes, and
  - **Willfully fails** to collect or pay them.
- A **responsible** person is a person or group of people who has the duty to perform and the power to direct the collecting, accounting, and paying of trust fund taxes.

- The IRS views using available funds to pay other creditors when the business is unable to pay the employment taxes as an indication of willfulness.

# Worker Misclassification

- Section 530 Relief
- Classification Settlement Program
- Voluntary Classification Settlement Program
- Section 3509

# Worker Misclassification

- The Code does not define the term "employee." Generally, under Regs. Sec. 31.3401(c)-1, if a person has a right to control or direct the individual who performs the services, the individual will be deemed an employee. Beyond this, the term is defined by applying common law rules. The IRS uses a 20-factor test based on case law to determine whether an employer-employee relationship exists (Rev. Rul. 87-41).
- **Behavioral control** – Does the company control or have the right to control what the worker does and how the worker does the job?
- **Financial control** – Does the business direct or control the financial and business aspects of the worker's job. Are the business aspects of the worker's job controlled by the payer? How is the worker paid, are expenses reimbursed, who provides tools/supplies, etc.?
- **Relationship of the parties** – Are there written contracts or employee type benefits such as pension plan, insurance, vacation pay? Will the relationship continue and is the work performed a key aspect of the business?

# Section 530 Relief

- To qualify for section 530 relief, the taxpayer must meet three requirements:
- **Reporting Consistency:** All Federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period must have been filed by the taxpayer on a basis consistent with the taxpayer's treatment of the individual as being a non-employee. This test must be applied to each worker separately.
- **Substantive Consistency:** The taxpayer must have treated similarly situated workers consistently. That is, if the taxpayer (or a predecessor) treated a similarly situated worker as an employee, the taxpayer will not be entitled to section 530 relief. This test must be applied to the class of workers having substantially similar job responsibilities and working under substantially similar conditions (for example, supervisors vs. workers being supervised).
- **Reasonable Basis:** The taxpayer must have had some reasonable basis for treating the worker as a non-employee. This may consist of reasonable reliance on: a judicial precedent, a published ruling, a private letter ruling or technical advice memorandum issued to the taxpayer; the results of an employment tax audit of the taxpayer; or a long-standing recognized practice of a significant segment of the industry in which the worker is engaged. Any other reasonable basis may also suffice.

# Classification Settlement Program (CSP)

- Under the CSP, a series of graduated settlement offers are available:
- **100% CSP Offer:** If the taxpayer meets the section 530 reporting consistency requirement but either clearly does not meet the section 530 substantive consistency requirement or clearly cannot meet the section 530 reasonable basis test, the offer will be a full employment tax adjustment for the most recent tax year under examination computed using IRC 3509(a), if applicable.
- **25% CSP Offer:** If the taxpayer meets the reporting consistency requirement and has a colorable argument that it meets the substantive consistency requirement and/or the reasonable basis test, the offer will be an adjustment of 25% for the most recent tax year under examination, computed using IRC 3509(a), if applicable.
- **No Assessment CSP Offer (section 530 applied):** If a taxpayer clearly meets the reporting and substantive consistency requirements and satisfies the reasonable basis test, the requirements of section 530 are fully met. However, the taxpayer may wish to enter into an agreement. A taxpayer that enters into such an agreement may begin treating the workers as employees currently or at the beginning of the next year.
- In each instance, the taxpayer must agree to classify its workers as employees prospectively.

# Voluntary Classification Settlement Program (VCSP)

- A taxpayer must have consistently treated the workers to be reclassified as independent contractors or other nonemployees, including having filed all required Forms 1099 for the workers to be reclassified under the VCSP for the previous three years to participate.
- Additionally, the taxpayer cannot currently be under employment tax audit by the IRS and the taxpayer cannot be currently under audit concerning the classification of the workers by the Department of Labor or by a state government agency.
- A taxpayer participating in the VCSP must agree to prospectively treat the class or classes of workers as employees for future tax periods.
- In exchange, the taxpayer will:
  - Pay 10 percent of the employment tax liability that would have been due on compensation paid to the workers for the most recent tax year, determined under the reduced rates of section 3509(a).
  - Not be liable for any interest and penalties on the amount; and
  - Not be subject to an employment tax audit with respect to the worker classification of the workers being reclassified under the VCSP for prior years.

# Partners Treated as W-2 Employees

- The IRS's Position: For employment tax purposes, a partner may not be both a partner and an employee.
- Possible Solutions:
  - "Service Entity"
  - Tiered Partnerships
  - Disregarded Entity Beneath a Partnership
  - S Corporation Holding an Interest in a Partnership

# Improper Accounting Methods

- A taxpayer chooses a method of accounting in the first year the taxpayer reflects the item on a tax return. Once a taxpayer adopts a method of accounting for an item, it cannot change the method, even from an impermissible one, without the Commissioner's consent. See IRC 446(e).
- If a taxpayer changes a method of accounting without first obtaining consent, the Commissioner can assert section 446(e) and require the taxpayer to abandon the new method of accounting and to report taxable income using the old method of accounting. See, e.g., Lattice Semiconductor v. Commissioner, T.C. Memo. 2011-100; FPL Group, Inc. & Subs. v. Commissioner, 115 T.C. 554 (2000); ILM 201442050.
- Generally, to effect a voluntary change in accounting method, a taxpayer may file a Form 3115, Application for Change in Accounting Method.
- The voluntary method change procedures do not allow a taxpayer to file an amended return or informal claim to change an accounting method on a previously filed tax return. See Rev. Rul. 90-38; Rev. Proc. 2015-13, Section 2.03.

# Improper Tax Treatment in the Related-Party Context—a Common Scenario

- IRC Sec. 267 addresses losses, expenses, and interest with respect to transactions between related taxpayers. The purpose underlying IRC Sec. 267(a) is to prevent related persons from using different methods of accounting for federal tax purposes in order to mismatch the timing of deductions/losses and inclusions inappropriately.

- Past noncompliance may, however, constitute an accounting method.

# Missed Elections—Section 9100 Relief

- Section 9100 provides an opportunity to make a missed regulatory election.
- An election is an application for tax relief or a request to adopt, change, or retain an accounting method or accounting period.
- **Forms of Section 9100 Relief**
  - There are two general types of elections: regulatory and statutory elections. A regulatory election is governed by a regulation or a revenue ruling, procedure, notice, or announcement. A statutory election, on the other hand, is set by statute. General relief comes in two forms: Automatic Relief under Section 9100-2 and Non-Automatic Relief under Section 9100-3.

# Failure to Update Operating Agreements

- Legal Implications
- Ensure Operating/Partnership Agreements contain correct tax-sensitive provisions
- The BBA partnership rules
- Tax Elections

# Partnerships—Outdated Partnership Agreements

- Under the The Bipartisan Budget Act of 2015 ("BBA"), partnerships that file returns for tax years starting January 2018 must follow the rules under the BBA. The BBA represents a major change from the prior TEFRA regime. Yet many partnerships still have partnership agreements containing TEFRA-exclusive language that creates risks and uncertainty with respect to BBA procedures, rights, and obligations. Partnerships under the BBA must follow certain filing requirements including designating a partnership representative or, if eligible, elect out of the regime on a timely filed return. Under the BBA, the IRS generally assesses and collects any understatement of tax (called an imputed underpayment or IU) at the partnership level. Issues include:
  - How the Partnership Representative is Selected
  - Fiduciary Obligations related to BBA Partnership Representatives
  - BBA Opt-Outs
  - Notice Obligations
  - Push-Out Elections
  - Litigation Decisions

# Following the Agreement, The Importance of Maintaining Accurate Capital Accounts

- Incorrect capital accounts can lead to misallocations, phantom income, and basis errors.
- Allocations. One requirement for finding substantial economic effect with respect to an allocations is that the partnership maintain partners' capital accounts in accordance with certain rules.
- Negative capital accounts
- Out-of-Whack Capital Accounts

# Partnership Basis Issues

- Sections 754, 743
- Substantial built-in loss property

# Accidental Terminations

- Before enactment of the Tax Cuts and Jobs Act (TCJA), a partnership was considered terminated if either:
  - No part of the partnership's activities continued to be carried on by any of its partners in a partnership. For example, the partnership ceases its activities and liquidates.
  - A sale or exchange of 50 percent or more of the total interests in the partnership's capital and profits occurred within a twelve-month period. This was considered a technical termination.
- The TCJA eliminated the rule for technical terminations for partnerships or entities treated as partnerships for tax years beginning after December 31, 2017. So, a partnership may now only terminate by cessation of partnership activities and liquidation, or when the partnership's business activities no longer continue in partnership form.

# S-Corp Elections—Common Failures

- Late Elections
- Shareholder Consents
- Errors and Omissions on Election Filings
- Untimely Filings
- Single-Class-of-Stock Violations
- Disproportionate Distributions
- Other

# Late-Election Relief—Rev. Proc. 2013-30

- Rev. Proc. 2013-30 facilitates the grant of relief to late-filing entities by consolidating numerous other revenue procedures into one revenue procedure and extending relief in certain circumstances. It provides guidance for relief for late:
- S corporation elections,
- Electing Small Business Trust (ESBT) elections,
- Qualified Subchapter S Trust (QSST) elections,
- Qualified Subchapter S Subsidiary (QSub) elections, and
- Corporate classification elections which the entity intended to take effect on the same date that the S corporation election would take effect.

# Late-Election Relief

- Under Rev. Proc. 2013-30, relief from a late S election is generally obtained by filing Form 2553 within three years and 75 days of the desired effective date. In certain situations, however, a taxpayer may request relief for a late S corporation election even when more than three years and 75 days have passed since the desired effective date. This can be accomplished only when each the following requirements are met:
  - The corporation is not seeking late corporate classification election relief concurrently with a late S corporation election;
  - The corporation fails to qualify as an S corporation solely because the Form 2553 was not timely filed;
  - The corporation and all of its shareholders reported their income consistent with S corporation status for the year the S election should have been made and for every subsequent tax year (if any);
  - At least six months have elapsed since the date on which the corporation filed its tax return for the first year the corporation intended to be an S corporation; and
  - Neither the corporation nor any of its shareholders was notified by the IRS of any problem regarding the S corporation status within six months of the date on which the Form 1120-S for the first year was timely filed.

# Rev. Proc. 2022-19

- Under Revenue Procedure 2022-19, automatic relief for a failed filing or termination is available if the following three requirements are met:
  - the circumstances that resulted in the ineffective filing or termination of the election must be inadvertent;
  - within a reasonable time after discovering the error, the taxpayer must take steps to rectify the issue;
  - every shareholder who was a shareholder of the corporation at any time during the periods at issue must agree to make the necessary tax adjustments as may be required by the IRS.

- If all three requirements are met, automatic relief may be granted to address the following circumstances: (1) one class of stock requirement in governing provisions; (2) disproportionate distributions; (3) certain inadvertent errors or omissions on Form 2553 (Election by a Small Business Corporation) or Form 8869 (Qualified Subchapter S Subsidiary Election; (4) missing acceptance letters for subchapter S election or QSub election; and (5) inconsistent filings of federal income tax returns.
- In addition, Revenue Procedure 2022-19 provides a process to address non-identical governing provisions that would otherwise result in the corporation having more than one class of stock.

# “One Class of Stock”

- **“One Class of Stock” Requirement.** A corporation that has more than one class of stock does not qualify as a small business corporation. Generally, a corporation is treated as having only one class of stock if all outstanding shares of stock confer identical rights to distribution and liquidation proceeds.
- The determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable State law, and other binding agreements (buy-sell agreements among shareholders, agreements restricting the transferability of stock, and redemption agreements) relating to distribution and liquidation proceeds.
- The Income Tax Regulations identify a number of other agreements and arrangements between or among an S corporation and its shareholders that may or may not be treated as second classes of stock (e.g., buy-sell agreements among shareholders, agreements restricting the transferability of stock, redemption agreements, and other instruments and agreements)
- Revenue Procedure 2022-19 provides that such agreements will not be treated as governing agreements and will therefore not result in a second class of stock unless a principal purpose of the agreement is to circumvent the one class of stock requirement.

# "One Class of Stock"—Distribution and Liquidation Provisions

- Treas. Reg § 1.1361-1(l)(2)(i) provides that a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights.
- Under Rev. Proc. 2022-19, the IRS will not treat an S corporation as violating the one class of stock requirement of § 1361(b)(1)(D) so long as the governing provisions provide for identical distribution and liquidation rights, even if it has made disproportionate distributions.
- A "disproportionate distribution" is any distribution (including an actual distribution, a constructive distribution, or a deemed distribution) of property by a corporation with respect to shares of its stock that differs in timing or amount from the distribution with respect to any other shares of its stock

# Correction of errors

- An inadvertent error or omission on Form 2553 or Form 8869 does not invalidate an S election or a QSub election, unless the error or omission relates to shareholder consent, selection of a permitted year, or an officer's signature.

- A Form 2553 that contains an inadvertent error with regard to a permitted year may be corrected pursuant to Rev. Proc. 2013-30, which provides a simplified method for taxpayers to request relief for late S elections.
- If a taxpayer is not eligible for relief under Rev. Proc. 2013-30, a correction may be obtained through the receipt of a PLR under § 1362(f) from the Associate Chief Counsel (Passthroughs and Special Industries).

# Correction of missing officer's signature.

- A Form 2553 or Form 8869 that is missing the signature of an authorized officer of the S corporation that affects the validity of the S election or QSub election may be corrected pursuant to Rev. Proc. 2013-30 (providing a simplified method for taxpayers to request relief for late S elections and QSub elections).
- If a taxpayer is not eligible for relief under Rev. Proc. 2013-30, a correction may be obtained through the receipt of a PLR under § 1362(f) from the Associate Chief Counsel (Passthroughs and Special Industries).

# Missing Shareholder Consents

- An S election that fails to include the consent of a shareholder may be corrected pursuant to the following:
- Section 1.1362-6(b)(3)(iii) provides an extension of time for filing a shareholder consent to an S election.
- Rev. Proc. 2013-30 provides a simplified method for taxpayers to request relief for late S elections.
- Rev. Proc. 2004-35, 2004-1 C.B. 1029 provides automatic relief for certain taxpayers requesting relief for late shareholder consents for S elections in community property States.
- PLRs

# Missing Acceptance Letters

- When a Form 2553 or Form 8869 is filed, the IRS provides a letter acknowledging and accepting the election which should be retained in the taxpayer's records.
- Neither subchapter S of the Code nor the Income Tax Regulations thereunder provide that a lack of possession of a CP261 Notice, CP279 Notice, or CP279A Notice affects the validity of an S election or a QSub election, respectively. Rather, such notices are merely administrative acknowledgments of an effective election that can be reproduced upon the taxpayer's request.
- In the event the letter is missing, Revenue Procedures 2022-19 provides taxpayers with an IRS hotline to obtain a duplicate.

# Procedures for Verifying S Elections or QSub Elections.

- With regard to a missing administrative acceptance letter for an S election or an administrative acceptance letter for a QSub election, as appropriate, a replacement letter may be requested through the IRS Business and Specialty Tax Line or the IRS Practitioner Priority Service.

# Inconsistent Tax Return Filings

- Filing an incorrect federal tax return for a year that is inconsistent with the entity's S corporation or QSub status does not necessarily terminate the subchapter S election or QSub election.
- Although an inconsistent Federal income tax return filing can create several complications for the filer, nothing in the Code or Income Tax Regulations thereunder provides that such a filing affects the validity of a corporation's S election or QSub election.
- For example, filing a Form 1120 instead of a Form 1120-S will not terminate the election and the taxpayer should simply file the appropriate federal income tax return for open tax years which is consistent with its status.
- Rev. Proc. 2022-19 provides guidance to file an income tax return for open years consistent with the entity's proper status.
- Because a corporation is not treated as having terminated its S election or QSub election, as appropriate, merely due to the filing of one or more Federal income tax returns inconsistent with its S election or QSub election, the corporation's distributions and other transactions will be treated consistent with its status as an S corporation or a QSub, as appropriate.

# Non-identical Governing Provisions: Rev. Proc. 2022-19

- Section 1361(b)(1)(D) requires an S corporation to have only one class of stock. Section 1.1361-1(l) provides that a corporation is treated as having only one class of stock if all outstanding shares of the corporation's stock confer identical rights to distribution and liquidation proceeds and if the corporation has not issued any instrument or obligation, or entered into any arrangement, that is treated as a second class of stock. An S corporation in compliance with § 1.13611(l) is commonly referred to as having "identical governing provisions." The term "non-identical governing provision" means a governing provision, as defined by § 1.1361-1(l)(2)(i), on its own or as part of another governing provision, that for Federal income tax purposes results in the S corporation having more than one class of stock under § 1.1361-1(l)(1) (even if the S corporation never made a non-pro rata distribution or liquidating distribution).
- Rev. Proc. 2022–19 provides that an S corporation with nonidentical governing provisions will be treated as an S corporation from the adoption date of the first nonidentical governing provision that invalidated or terminated the corporation's S election if the following four conditions are met:
- The corporation has or had one or more nonidentical governing provisions;
- The corporation has not made and is not deemed to have made a "disproportionate distribution" to an "applicable shareholder";
- The corporation timely filed a Form 1120-S, *U.S. Income Tax Return for an S Corporation*, for each applicable tax year, beginning with the tax year in which the first nonidentical governing provision was adopted and through the tax year immediately before the tax year in which the corporation sought corrective relief; and
- The S corporation obtains the corporate governing provision statement and the shareholder statement required by Section 3.06(2)(c) of Rev. Proc. 2022-19 before the IRS discovers any nonidentical governing provisions.

# Trust Shareholders—Late Elections

- Under Rev. Proc. 2013-30, to obtain relief for a late ESBT or QSST election, the following requirements must be met:
- The trustee seeking a late ESBT election or the trust beneficiary seeking a late QSST election must have intended the trust to be an ESBT or QSST, respectively, as of the desired effective date;
- The failure to qualify as an ESBT or QSST was solely because the election was not timely filed; and
- The failure to file the timely election was inadvertent, and the person seeking relief acted diligently to correct the mistake upon discovery

# International Reporting Deficiencies

- Significant Exposure
- Voluntary Disclosure Practice
- If a taxpayer has **willfully failed to comply with tax or tax-related obligations**, submitting a voluntary disclosure may be a means to resolve such non-compliance and limit exposure to criminal prosecution.

# Streamlined Filing Compliance Procedures—For "Broken" Estates

- The streamlined filing compliance procedures ("streamlined procedures") are available to taxpayers certifying that their failure to report foreign financial assets and pay all tax due in respect of those assets did not result from willful conduct on their part. The streamlined procedures are designed to provide to taxpayers in such situations with
  - a streamlined procedure for filing amended or delinquent returns, and
  - terms for resolving their tax and penalty procedure for filing amended or delinquent returns, and
  - terms for resolving their tax and penalty obligations.
- **Eligibility criteria for the streamlined procedures**
- The modified streamlined procedures are designed only for individual taxpayers, <u>including estates of individual taxpayers</u>. The streamlined procedures are available to both U.S. individual taxpayers residing outside the United States and U.S. individual taxpayers residing in the United States.

# Form 3520 Deficiencies—A Common (And Costly) Reporting Deficiency in the Context of Trusts and Estates

- Form 3520 is an information return used by U.S. persons, and executors of estates of U.S. decedents, to report transactions with foreign trusts, ownership of foreign trusts, creation of foreign trusts, death of certain U.S. decedents who own, or whose gross estate includes, any portion of foreign trusts, and receipt of large gifts from foreign persons.
- The **penalty** for failure to timely file Form 3520 is 35% of the gross value of the property or distribution exchanged, 5% of the gross value of the foreign trust's assets, or $10,000—whichever is greatest. Failure to rectify the deficiency within 90 days of notice by the IRS will result in additional penalties of an undefined amount. If the failure to comply was the result of reasonable cause, not willful neglect, then there will be no penalty.

# “Broken” Estates and the Federal Priority Statute

- Unfiled Returns
- Unreported Sources of Income
- § 3713 states that if a debtor or estate does not have sufficient assets to cover all debts, the federal government has priority over all other creditors. This means any federal tax liability and financial claims of the U.S. government that have priority must be paid before a fiduciary pays the remaining creditors. Under the Federal Priority Statute, the fiduciary can be personally liable for unpaid federal taxes and priority claims.
- Under Section 3713(b), a personal representative or an estate that pays a creditor prior to satisfying all federal priority claims may be personally liable to the government in the amount of the payments made.

# Entities with Employee Retention Credit Exposure

- The Employee Retention Credit (ERC) – sometimes called the Employee Retention Tax Credit or ERTC – is a refundable tax credit for certain eligible businesses and tax-exempt organizations that had employees and were affected during the COVID-19 pandemic.
- Current Tax Reform Implications
- Withdrawal Program
- ERC Voluntary Disclosure Program

# Texas Comptroller – Voluntary Disclosure Agreements

- In cases where a business identifies potential state tax exposure, a viable option for addressing this may be to apply with the Texas Comptroller's office for a "voluntary disclosure agreement" ("VDA"). This involves volunteering information regarding outstanding tax liabilities to the Comptroller's office in exchange for leniency.

- The primary benefits of the VDA are (i) relief from any penalties, and possibly interest, associated with outstanding taxes, and (ii) the application of a limited four-year lookback period, which is particularly helpful in cases where a business has unfiled tax returns.

- Businesses are only eligible for the VDA if the application is submitted before they are contacted by the Comptroller's office regarding a liability, audit, or examination.

- The application may be submitted on an anonymous basis, but must include other specified information, such as the type of entity (*e.g.*, partnership, corporation), a description of the business' operations, and the type of tax for which the VDA is being requested.

- If accepted, the VDA may also be structured to allow the payment of any tax liabilities as part of an installment plan, such as a 12-month term.

# Texas Comptroller – Settlement Agreements

- Businesses with outstanding tax liabilities may also be able to negotiate a settlement agreement, or installment agreement, with the Texas Comptroller's office.

- The Comptroller is generally reluctant to engage in settlements based on ability to pay, as may be an option for federal tax obligations, but businesses may be able to negotiate a settlement if they are able to successfully establish a basis for asserting that an alleged tax may be incorrect.

- The Comptroller's office may also agree to an installment plan for the payment of any outstanding tax, penalties, or interest. This usually involves the submission of a down payment and an agreement to pay the remainder over a fixed period of time (*e.g.*, 12 to 24 months).

# Reinstatement of Corporate Privileges

- A business may have its corporate privileges forfeited for multiple reasons, including if the Comptroller determines that the business has a Texas franchise tax payment or reporting obligation that has been unmet for a sufficient period of time. *See* Tex. Tax Code § 171.251.

- This can have several negative consequences, including:
  - The business will not be able to sue or defend in Texas courts; and
  - The officers and directors of the business may be held personally liable for debts of the corporation that are incurred during the period in which privileges are forfeited.

- *See* Tex. Tax Code §§ 171.252, 171.255.

- The business can take certain steps to revive its corporate privileges. This involves resolving any outstanding Texas franchise tax compliance issues.

- The prolonged forfeiture of corporate privileges may result in the revocation of the business' corporate charter by the Texas Secretary of State. Note, also, that even after corporate privileges are revived, officers and directors may still be held personally liable for corporate debts incurred during the period of forfeiture.

# Risks Involved in Avoiding Tax Liabilities

- Businesses must also be aware of the potential risks in taking action to avoid tax liabilities, such as closing a business that is burdened with tax liabilities and starting a new replacement business.

- **Successor Liability**
  - If a business that has an outstanding tax liability with the Comptroller's office sells the business (or stock of goods) without withholding an amount of the purchase price sufficient to cover the tax liability, the purchaser ("successor") becomes liable for that amount. *See* Tex. Tax Code § 111.020.
  - Importantly, in successor liability cases, the successor business is not eligible to challenge the underlying tax assessment or liability – any challenge the business brings is limited to the determination of "successor" status under the Tax Code.

- **Fraudulent Transfer**
  - A person who acquires the business or assets of a business from a taxpayer via a "fraudulent transfer" is liable for the tax, penalty, and/or interest owed by the taxpayer. *See* Tex. Tax Code § 111.024(a).
  - A "fraudulent transfer" is one made with the intent to evade, hinder, delay, or prevent the collection of a tax, penalty, or interest owed to the Comptroller, or one where the seller does not receive "reasonably equivalent value" for the business or assets.

# Questions