

From Overdue to Overcome – 4 Strategies to Help Entrepreneurs Address Back Tax Issues

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As the April 15, 2024, tax filing deadline has come and gone, many entrepreneurs and small business owners are left grappling with back tax issues. Recent challenges have compounded these problems, making now a critical moment for business leaders to act. Delaying further can exacerbate financial stress and legal repercussions.

Recent IRS data highlights the urgency for entrepreneurs to address their tax liabilities. The IRS, leveraging funding from the Inflation Reduction Act, has significantly increased its enforcement efforts. In 2023 alone, the IRS launched a new compliance initiative targeting high-income non-filers, identifying over 125,000 cases since 2017 as part of a sweeping effort to restore fairness to the tax system. Moreover, the IRS has enhanced its audit activities, particularly on wealthy individuals and large partnerships.

Drawing from our team's extensive tax resolution experience at Advanced Tax Solutions, here are four essential strategies for entrepreneurs to effectively resolve outstanding back taxes and prepare for productive communication with the IRS.

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1. Understand the urgency and consequences

Ignoring back tax issues can lead to severe consequences. The IRS can impose hefty penalties, including a 5% monthly late filing penalty for the first five months, which quickly adds up to 25%. After that, there's an additional 0.5% per month penalty, plus interest on the owed taxes, penalties and accumulated interest. In extreme cases, the IRS may file a substitute return on your behalf, which often disregards deductions and leads to the highest possible tax liability.

The IRS's increased enforcement budget underscores the urgency. Drawing on the new IRA funding, the White House has budgeted to increase the IRS' annual enforcement budget almost fourfold over the next decade, to \$19.5 billion, and the agency has announced numerous multiyear endeavors in several key areas to increase collections.

2. Gather and organize financial records

Before contacting the IRS, ensure all financial records are meticulously organized, including income statements, expense receipts and previous tax returns. A comprehensive and organized record will make communication with the IRS smoother and demonstrate your commitment to resolving the issue.

Use digital tools and bookkeeping software such as Sage, Oracle and Xero to keep track of your financial records throughout the year. These tools can help generate detailed reports that are easy to share with your tax professional or the IRS. The accounting software market is rapidly growing, with its value rising from USD 11,071.6 million in 2018 to a projected USD 20,408.0 million by 2026, reflecting an annual growth rate of 8.02%, according to Fortune Business Insights.

This trend shows just how vital these tools have become for effective financial management.

Related: Finally, Tax Season is Over. Or Is It? Here are 5 Things You Need to Do All Year to Reduce Tax-Season Stress.

3. Seek professional help

Navigating tax regulations can be daunting, especially with complex back tax issues. Hiring a Certified Public Accountant (CPA) or a Certified Tax Resolution Specialist (CTRS) can be invaluable. These professionals have the expertise to negotiate with the IRS on your behalf, potentially reducing your tax liability and penalties. They can also provide invaluable guidance on organizing your financial records and ensuring all documentation is accurate and complete, preventing future tax issues.

I've seen many entrepreneurs significantly reduce their tax burdens by leveraging professional help. Understanding the nuances of tax law and having someone who can effectively communicate with the IRS can make all the difference. Even having a Master's Degree in Taxation and 30 years of experience, some returns show up in my office that I either have to collaborate with other professionals on or even refer to another professional who specializes in that particular client's industry. Understanding your limits is a key to empowerment. Taking on a truly difficult issue may require professional help because making a mistake can be quite costly in IRS penalties and interest.

That said, unless you have something unusual or confusing, many tax returns are within reach to prepare on their own, especially with the help of tax preparation software. I would not recommend preparing a tax return with just pen and paper, even if it's simple. Sadly, the tax system's complexity has progressively worsened over the years, and there is no end in sight.

4. Communicate effectively with the IRS

On May 2, 2024, the IRS released an update on its Strategic Operating Plan, which outlines the implementation of the Inflation Reduction Act (IRA). This update details the IRS's plan to nearly triple audit rates for large corporations with assets over \$250 million, increasing from 8.8% in 2019 to 22.6% by 2026. Additionally, audits on large, complex partnerships will increase to 1% from a tenth of a percent. With these changes on the horizon, it's never been more important to stay vigilant and ensure your financial records are meticulously maintained so you're fully prepared for heightened scrutiny.

When you're ready to approach the IRS, preparation is key. Start by requesting your tax transcript to get a clear picture of what the IRS knows about your financial situation. Be honest and forthcoming in your communication. Explain the reasons behind your back taxes, whether due to economic hardship, oversight or other factors. The IRS is more likely to work with you if they see a genuine effort to resolve the issue.

Related: 5 Small Business Tax Audit Triggers and What to Do If the IRS Comes Calling

By taking these steps, entrepreneurs can transform their overdue tax issues into a manageable process, paving the way for financial stability and peace of mind. Remember, the key is to act now and seek the right help to overcome these challenges.

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