

The Challenge of Taxation

Tax evasion accounts for a big part of underpaid federal income taxes, but some underpayment is unintentional and due to the complexity of tax laws. Even an honest mistake can bring the IRS to your business. “Nothing strikes the fear of God in people like receiving a letter from the IRS,” says Thomas Sherman, a tax partner in the Coopers & Lybrand firm. Most audits are triggered by IRS computers using a special “score” that is based on relationships of various items on the tax return. Also, certain deductions may be scrutinized in some years because of related court decisions. For example, a 1993 Supreme Court decision restricted the types of business activity that can qualify for home-office deductions. This will likely call attention to these expenses in future audit analyses. Because small firms are often accused of being major tax offenders, they need professional tax advice to ensure that all taxes are paid properly.

Many issues have arisen since the passage of the Tax Reform Act of 1986 and, more recently, the Budget Reconciliation Act of 1993. A complete presentation of tax issues involving small firms would fill several books. The federal government provides a Publication 334 each year as a tax guide for small businesses—a document that exceeds 200 pages in length!

In March 1994, the Commissioner of the Internal Revenue Service established the IRS Office of Small Business Affairs to serve as the national IRS contact with small businesses, to recommend changes to regulations and administrative practices that cause undue burden or inequity, and to address issues that are important to both small businesses and the IRS.

Several personal computer tax-preparation software packages, such as TurboTax, are available to assist entrepreneurs who choose to prepare their own tax returns. These programs can be tremendously helpful to small business owners as they make their way through the complicated IRS forms. They virtually eliminate the math errors commonly associated with tax preparation. Most of these programs also allow taxpayers to file returns electronically.

We have discussed only the tax burden on a small firm that results from federal taxation. Of course, state, county, and local governments also have taxing authority. IN many situations, these taxes are more troublesome than the federal income tax. Even when a small firm has no taxable income, it will usually have taxes to pay. For example, each of the following taxes or fees is levied by a nonfederal agency:

- Sales taxes
- School property taxes
- Motor fuel taxes
- Incorporation fees
- Business license fees
- State income taxes

Despite its laws and tax regulations, there is still no place like the United States for the entrepreneurial spirit. We expect you to be a part of that spirit. Best of luck.