

- IRS Crackdown on Independent Contractor Classification
- Bankruptcy Basics

## Difficult Times Can Provide Opportunities

*Anthony K. Mallgren, Esq., LL.M.*

The difficult economic climate has affected a number of our clients in different ways. We have been able to assist some of our existing clients and a number of new clients in saving substantial amounts of money and reducing their exposure to additional liabilities. Some of the results our clients have obtained are due to the flexibility of their creditors, but other results are due to the creative options or aggressive strategies we have been able to recommend and implement. Here are some examples of the savings our clients have been able to achieve recently with our assistance:



- **IRS Audit.** Reducing a Federal income tax deficiency and tax lien from over \$1,200,000 to \$186,000.
- **Loan Discount.** Obtaining a \$300,000 discount on a \$1,200,000 loan payoff.
- **Sales Tax Audit.** Reducing multi-jurisdictional sales tax deficiency from over \$1,000,000 to less than \$400,000.
- **Reducing State Taxes.** Reducing state taxes by changing state of organization.
- **Probate Costs.** Ensuring lower probate costs by identifying proper residency in low probate-cost states.
- **Loan Restructuring.** Convincing lender to extend amortizing loan for another 6 months at 4%, interest only, with no principal pay-down.
- **Eliminate Guaranty.** Convincing lender not to require personal guaranty on restructuring of a non-performing loan.
- **Short Sale Discount and Release.** Convincing lender to accept a \$200,000 discount on a short sale, along with a full release of borrower.

We find that each difficult situation may have circumstances that can lead to a significant savings in terms of discounts or releases from liability. Sometimes it is asking the right questions of the creditor to determine if they have some compatible common ground. In some situations, there are problems with the loan documentation that can be leveraged into discounts. Occasionally, we help clients and lenders find different ways of looking at possible problems. Certainly sometimes we are not successful, but even in those situations we can ensure that our clients have examined all of the possibilities.

In any event, having been through several economic downturns, we have important experience in identifying and implementing strategies that can significantly reduce or eliminate possible costs and liabilities in these times. Please keep Mallgren & Ferrell, P.C., in mind if you know of someone who is struggling with these issues.

## Bankruptcy Basics

*Paul Chmielewski, Esq., LL.M.*

Current economic circumstances have resulted in an increase in bankruptcy filings in Colorado and throughout the rest of the country. The following article provides a general overview of the most common types of bankruptcy filings allowed by law. As a preliminary matter, each type of bankruptcy filing requires that an individual debtor receive credit counseling from an approved credit counseling agency within 180 days of filing for bankruptcy. If this requirement is not met, an individual debtor's bankruptcy petition will be denied.



**Chapter 7.** In order to file under Chapter 7, a debtor's income must not exceed the applicable State Median Income. The State Median Income varies based upon the number of persons in the debtor's family. If the debtor's income exceeds the State Median Income, a "means" test is imposed to ensure that the bankruptcy filing is not abusive. Individuals and most business entities are eligible to file a Chapter 7 petition. In Chapter 7, the bankruptcy trustee liquidates any non-exempt assets owned by the debtor and uses the proceeds to pay off creditor claims. Individual debtors receive a discharge of their debts at the end of a Chapter 7 bankruptcy proceeding. Business entities do not receive a discharge under Chapter 7. Instead, the entity is dissolved after its assets have been liquidated. The entity's debts are terminated only after the statutory period of limitations has expired.

**Chapter 13.** Chapter 13 is often referred to as a wage earner's plan. This is because it enables a debtor to develop a plan to repay all or part of their debts over three to five years. Any individual, including those operating an unincorporated business are eligible to file under Chapter 13 (corporations and partnerships are not eligible to file under Chapter 13). If the debtor's income does not exceed the applicable State Median Income, the debtor's repayment plan is generally limited to three years. If the debtor's income exceeds the applicable State Median Income, the debtor's repayment plan is generally required to be for five years. In addition to the income limitations previously discussed, Chapter 13 also limits the amount of unsecured and secured debts to which a debtor can be subject. Unlike Chapter 7, a debtor may be able to maintain ownership of their personal residence in Chapter 13 even if it exceeds the statutory homestead exemption amount. In order to keep their house, a debtor must bring all past due payments current over a reasonable period of time and make all payments due after the date the Chapter 13 petition is filed. Regardless, a lender is entitled to foreclose on the

*(Continued on page 4)*

"Business entities do not receive a discharge under Chapter 7."

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## IRS Announces Crackdown on Independent Contractor Classification

*Paul Chmielewski, Esq., LL.M.*

There are significant tax implications to a business owner when determining whether a worker is an employee or an independent contractor. If the worker is classified as an employee, the business owner must withhold income taxes, withhold and pay Social Security and Medicare taxes and pay unemployment tax on wages paid. Conversely, a business owner generally has no obligation to withhold or make any tax payments on compensation paid to independent contractors. Many business owners classify their workers as independent contractors to be free of the withholding and tax payment requirements discussed above. The IRS estimates that 15% of employers incorrectly classify their workers as independent contractors resulting in \$1.6 billion in lost taxes. To combat this problem, the IRS recently announced that it is embarking on a nationwide employment tax audit of randomly selected employers.

“Many business owners classify their workers to be free of the withholding and tax payment requirements.”

The main factor in determining the proper classification of a worker is the degree of control and independence exercised by the worker in performing their tasks. A worker’s chances of being classified as an independent contractor increase with the amount of control and discretion the worker has over the schedule and method in which an assigned task will be performed. If a worker is subject to a business owner’s strict oversight in the performance of a task, there is a good chance that the worker should be classified as an employee. The IRS evaluates the following evidence when determining the degree of control and independence over an assigned task:

**Behavioral:** Does the business owner have the right to control whatever the worker does and how the worker does their job? For example, is the worker required to perform the task at the business owner’s offices during fixed time periods (e.g., Monday through Friday, 8:00 a.m. to 5:00 p.m.).

**Financial:** Are the business aspects of the worker’s job controlled by the business owner? Some issues to be considered are how the worker is paid, whether expenses are reimbursed and who provides the tools/supplies.

**Type of Relationship:** Are there written contracts or employee type benefits (i.e., pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Business owners must weigh all of these criteria when determining how to classify their workers. Some factors may indicate an independent contractor relationship while others may indicate an employee relationship. The proper classification rests upon the totality of the relationship, not upon any particular number of criteria.

Despite the IRS announcement of a crackdown on worker classification issues, the General Accountability Office (“GAO”) issued a report that cited several factors that interfere with the IRS’ ability to ensure compliance. These factors are: (i) limited IRS resources, (ii) a failure to share information on this issue between the IRS and the Department of Labor (“DOL”) due to federal law privacy issues, and (iii) the failure of DOL agencies to internally share information on worker classification issues. Regardless of these compliance problems, you do not want to be the business owner caught with improperly classified workers by the IRS. This is especially true under recently proposed legislation that would make it harder for employers to escape the imposition of an employment tax assessment due to improperly classified workers.

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## **Bankruptcy Basics, Cont.**

*(Continued from page 2)*

residence at any time prior to the filing of a Chapter 13 petition by the debtor. Unlike Chapter 7, a discharge of debt under Chapter 13 does not occur when the bankruptcy court approves the repayment plan. Instead, a Chapter 13 debtor receives a discharge at the end of the repayment plan period (three to five years).

**Chapter 11.** Although individuals are eligible to file under Chapter 11, this bankruptcy provision is most commonly used by business entities to reorganize their affairs and enable them to continue their business activities. Under Chapter 11, a debtor may remain in possession of the assets in the bankruptcy estate. If so, the debtor in possession is considered a fiduciary and is obligated to manage the assets in a professional manner. In addition, the court often appoints a creditor's committee to monitor the activities of a debtor in possession. Alternatively, either a creditor or the U.S. Trustee can petition for the appointment of a trustee to manage the debtor's assets. This is generally used when there is a fear of mismanagement, waste or fraud involving the debtor's assets. Once a plan of reorganization is approved by the bankruptcy court, the debtor is discharged from any debt incurred before the date of plan confirmation that is not required to be repaid by the reorganization plan.

The summary set forth above is general in nature and does not attempt to address all issues involved in the bankruptcy process. Our office is available to assist persons who have specific questions or require assistance in filing for bankruptcy.