WORKIN’ ON IT: UNDERSTANDING EMPLOYMENT TAX CONTROVERSIES

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ABA Midyear Tax Meeting

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I. **Overview: Types of Employment Taxes**

a. **FICA (§§3101-3128)**
   
i. Social Security: 6.2% for the employer and 6.2% for the employee (12.4% total). 2019 Wage base limit is $132,900.
   
   ii. Medicare: 1.45% for the employer and 1.45% for the employee (2.9% total)
   
   iii. Employer must withhold .9% additional Medicare tax on employee’s wages above $200,000.

b. **FUTA (§§3301-3311)**
   
i. Federal Unemployment Tax: 6% on the first $7,000 of employee wages in 2020.

c. **Income Tax Withholding (§§3401-3406)**

d. **RRTA (§§3201-3232)**

II. **Employment Tax Returns**

a. Form 940 (Employers Annual Federal Unemployment Tax Return)

b. Form 941 (Employer's Quarterly Federal Tax Return)

c. Form 943 (Employer’s Annual Federal Tax Return for Agricultural Employees)

d. Form 944 (Employer’s Annual Federal Tax Return)

e. Form 945 (Annual Return of Withheld Federal Income Tax)

f. Form CT-1 (Employer’s Annual Railroad Retirement Tax Return)

g. **Other Relevant Employment Forms**
   
a. W-4 (Employee’s Withholding Certificate)
   
b. W-2 (Wage & Tax Statement)
   
c. W-9 (Request for Taxpayer Identification Number & Certification)
d. 1099-Misc (Miscellaneous Income)

III. Common Areas of Noncompliance

a. Employee Misclassification

i. Classifying employees as independent contractors or statutory employees.

b. Employee Leasing

i. If a third party, such as a professional employer organization ("PEO"), is a statutory employer, it will be the person responsible for the employment taxes on the wage payments that it had exclusive control of.

ii. If the third party is merely a conduit for the funds used to pay wages, it is not a Section 3401(d)(1) employer.

iii. It is important to remember that the Section 3401(d)(1) employer is only liable for employment taxes on wage payments over which it had control.

c. Failing to Pay Employment Taxes

i. I.R.C. 6672(a): Trust Fund Recovery Penalty ("TFRP")

1. The TFRP may be asserted against any person "responsible" for collecting, accounting for, and paying over trust fund tax who:

   a. willfully fails to collect such tax, or
   
   b. fails to truthfully account for and pay over such tax, or
   
   c. willfully attempts in any manner to evade or defeat any such tax or the payment thereof.

ii. TFRP is a civil penalty, personally assessed, equal to 100% of unpaid employee’s portion of employment tax, namely the withheld income tax and employee’s portion of FICA (7.65%). I.R.M. 8.25.1.1.2 (09-11-2018).
d. Pyramiding

i. Pyramiding is when a business withholds taxes from its employees, but intentionally fails to forward them to the IRS. After a liability accrues, the individual starts a new business and begins to accrue a new liability.

ii. Businesses involved in pyramiding frequently file for bankruptcy to discharge the liabilities accrued and then start a new business under a different name and begin a new scheme.

e. Paying Employees in Cash

i. Paying employees, whole or partially, in cash is a common method of evading income and employment taxes resulting in lost tax revenue to the government and the loss or reduction of future social security or Medicare benefits for the employee.

ii. Example from the 2019 IRS Criminal Investigation Division Annual Report (“CI Annual Report”):

1. On July 31, 2019, James Brantley was sentenced to 18 months in prison and ordered to pay $1,296,183 in restitution to the IRS relating to his employment of unauthorized aliens at Southeastern Provision Slaughterhouse in Bean Station, Tennessee.

2. On September 12, 2018, Brantley pleaded guilty to two counts of willful failure to collect or pay over tax, one count of wire fraud, and one count of unlawful employment of unauthorized aliens. Brantley employed at least 150 unauthorized aliens at Southeastern Provision, to reduce the company's expenses, including its taxes, unemployment insurance premiums, and workers' compensation premiums. (Source: IRS Criminal Investigation 2019 Annual Report available at https://www.irs.gov/pub/irs-utl/2019_irs_criminal_investigation_annual_report.pdf)
f. Filing False Employment Tax Returns (or not filing them at all)

i. Preparing false payroll tax returns, understating the amount of wages on which taxes are owed, or failing to file employment tax returns are methods commonly used to evade employment taxes.

Example from the CI Annual Report:

ii. On May 23, 2019, Clarence Michel, Jr. was sentenced to almost 6 years in prison, with 3 years of supervised release and was ordered to pay more than $19 million in restitution to the IRS. In February 2019, Michel pleaded guilty to one count of conspiracy to defraud the IRS with a $15 million employment tax fraud scheme, and to four counts of aiding and abetting the preparation and filing of fraudulent income tax returns.

iii. Michel was required to pay employment taxes for six staffing companies. From 2012 through 2016, Michel instructed one of his employees not to file Forms 941 for these companies as required, and not to pay over the employment taxes withheld from employees’ paychecks. In total, the companies failed to pay $14,671,184 they collectively owed in employment taxes.

iv. Michel later instructed another employee to pay him money from the company’s bank accounts and alter the company’s books to make it look like income taxes were withheld from the money he took from the company’s accounts.

v. This false information from the company’s books was used to create false W-2’s that made it seem that Michel had met his personal tax obligations, when in reality he underpaid his personal taxes by $2,410,827 for the 2012 through 2015 income tax years. Michel was ordered to pay an additional $2,145,365 in restitution as relevant conduct for employment taxes he withheld but failed to deposit with the IRS between August 2017 and July 2018.
IV. **Employee v. Independent Contractor: Common Law Test**


   i. The Supreme Court recognized that independent contractors existed under the Social Security Act.

   ii. Congress did not intend to change normal business practices.

   iii. The Supreme Court blessed the development of a definition of employee for tax purposes based upon all the facts and circumstances as developed by the common law. See § 3121(d).

b. IRS Chief Counsel has reminded IRS employees that the definition of employee for tax purposes is not governed by what another agency may determine. *See Field Service Advice 2001 27004 (July 6, 2001).*

   i. State laws, or determinations of state or federal agencies, may characterize a worker as an employee for purposes of various rules and regulations. Characterizations based on these laws or determinations should be disregarded, because the laws or regulations involved may use different definitions of “employee” for these purposes, including definitions that often are broader than under the common law rules.

c. **Common Law Test**

   i. Regulations provide that an individual is an employee if the relationship between him and the service recipient would be one of employer and employee under the usual common law rules. Treas. Reg. § 31.3121(d)-1(c).

   ii. Key is the “right to control and direct the individual who performs services, not only as to the result to be accomplished by the work but also as to the details and means by which it is accomplished.”

   iii. Right to direct and control does not need to be exercised to exist

   iv. If individual is subject to control by another merely as to result to be accomplished but not the means and methods used, the individual is an independent contractor.
v. Corporate officers are employees by statute. IRC § 3121(d)(1).

vi. Regulations and the IRS website provide that contractors and subcontractors are generally independent contractors. Treas. Reg. § 31.3401(c)-1(c).

vii. Other common independent contractors listed in the regulation include:

1. Physicians, lawyers, dentists, veterinarians, public stenographers, auctioneers, and others who follow an independent trade, business, or profession, in which they offer their services to the public, are not employees. See www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Independent-Contractor-Defined.

d. Common Law 20-Factor Test

i. Three Main Categories:

1. **Behavioral**: Does the company control or have the right to control what the worker does and how the worker does his or her job?

2. **Financial**: Are the business aspects of the worker’s job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)

3. **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?

ii. No litmus test on how many factors must be satisfied.

iii. Factors not uniformly applied.

e. Twenty Factor Test

1. **INSTRUCTIONS.** A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. This control factor is
present if the person or persons for whom the services are performed have the right to require compliance with instructions. See, e.g., Rev. Rul. 68-598, 1968-2 C.B. 464, and Rev. Rul. 66-381, 1966-2 C.B. 449.

2. TRAINING. Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner. See Rev. Rul. 70-630, 1970-2 C.B. 229.

3. INTEGRATION. Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business. See United States v. Silk, 331 U.S. 704 (1947), 1947-2 C.B. 167.

4. SERVICES RENDERED PERSONALLY. If the Services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results. See Rev. Rul. 55-695, 1955-2 C.B. 410.

5. HIRING, SUPERVISING, AND PAYING ASSISTANTS. If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, if one worker hires, supervises, and pays the other assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status. Compare Rev. Rul. 63-115, 1963-1 C.B. 178, with Rev. Rul. 55-593 1955-2 C.B. 610.

6. CONTINUING RELATIONSHIP. A continuing relationship between the worker and the person or persons for whom the
services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals. See United States v. Silk. 7. SET HOURS OF WORK. The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control. See Rev. Rul. 73-591, 1973-2 C.B. 337.

8. FULL TIME REQUIRED. If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor on the other hand, is free to work when and for whom he or she chooses. See Rev. Rul. 56-694, 1956-2 C.B. 694.

9. DOING WORK ON EMPLOYER'S PREMISES. If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Rev. Rul. 56-660, 1956-2 C.B. 693. Work done off the premises of the person or persons receiving the services, such as at the office of the worker, indicates some freedom from control. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer's premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required. See Rev. Rul. 56-694.

10. ORDER OR SEQUENCE SET. If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom
the services are performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so. See Rev. Rul. 56-694.

11. ORAL OR WRITTEN REPORTS. A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control. See Rev. Rul. 70-309, 1970-1 C.B. 199, and Rev. Rul. 68-248, 1968-1 C.B. 431.

12. PAYMENT BY HOUR, WEEK, MONTH. Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on straight commission generally indicates that the worker is an independent contractor. See Rev. Rul. 74-389, 1974-2 C.B. 330. 13. PAYMENT OF BUSINESS AND/OR TRAVELING EXPENSES. If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities. See Rev. Rul. 55-144, 1955-1 C.B. 483.

14. FURNISHING OF TOOLS AND MATERIALS. The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship. See Rev. Rul. 71-524, 1971-2 C.B. 346.

15. SIGNIFICANT INVESTMENT. If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and,
accordingly, the existence of an employer-employee relationship. See Rev. Rul. 71-524. Special scrutiny is required with respect to certain types of facilities, such as home offices.

16. REALIZATION OF PROFIT OR LOSS. A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee. See Rev. Rul. 70-309. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor.

17. WORKING FOR MORE THAN ONE FIRM AT A TIME. If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. See Rev. Rul. 70-572, 1970-2 C.B. 221. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement.

18. MAKING SERVICE AVAILABLE TO GENERAL PUBLIC. The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship. See Rev. Rul. 56-660.

19. RIGHT TO DISCHARGE. The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications. Rev. Rul. 75-41, 1975-1 C.B. 323.
20. **RIGHT TO TERMINATE.** If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship. *See Rev. Rul. 70-309.*

V. **Statutory Employees**

a. TCJA eliminated deduction for unreimbursed employee business expenses.

b. What about making the employees statutory employees under I.R.C. § 3121?

i. Statutory employees: If someone who works for you isn't an employee under the common law rules discussed earlier, don't withhold federal income tax from his or her pay, unless backup withholding applies.

ii. Although the following persons may not be common law employees, they’re considered employees by statute for social security, Medicare, and FUTA tax purposes under certain conditions.

c. Types of Statutory Employees

i. An agent (or commission) driver who delivers food, beverages (other than milk), laundry, or dry cleaning for someone else.

ii. A full-time life insurance salesperson who sells primarily for one company.

iii. A homeworker who works by guidelines of the person for whom the work is done, with materials furnished by and returned to that person or to someone that person designates.

iv. A traveling or city salesperson (other than an agent-driver or commission-driver) who works full time (except for sideline sales activities) for one firm or person getting orders from customers. The orders must be for merchandise for resale or supplies for use in the customer's business. The customers must be retailers, wholesalers, contractors, or operators of hotels,
restaurants, or other businesses dealing with food or lodging. I.R.C. § 3121(d)(3).

d. An individual cannot qualify as a statutory employee if they are a common law employee. *Rosemann v. Commissioner, T.C. Memo. 2009-185* (“To be included in this occupational group, the individual's entire or principal activity must be devoted to soliciting orders on behalf of a single principal. These individuals generally are exempt from income tax withholding unless they also qualify as common law employees.”)

i. The Tax Court laid out Eight Factors in *Rosemann*:

1. Degree of Control

2. Which party invests in work facilities used by the individual

3. Opportunity of the individual for profit or loss

4. Whether employer can discharge the individual (i.e. employee at-will)

5. Whether the work is part of Employer’s regular business

6. The Permanency of the relationship

7. The relationship the parties believed they were creating

8. The provision of employee benefits

b. Reporting payments to statutory employees.

i. Furnish Form W-2 to a statutory employee, and check "Statutory employee" in box 13.

ii. Show your payments to the employee as "other compensation" in box 1.

iii. Also, show social security wages in box 3, social security tax withheld in box 4, Medicare wages in box 5, and Medicare tax withheld in box 6.

iv. The statutory employee can deduct his or her trade or business expenses from the payments shown on Form W-2.
v. He or she reports earnings as a statutory employee on line 1 of Schedule C (Form 1040), Profit or Loss From Business. A statutory employee's business expenses are deductible on Schedule C. See IRS Publication 15-A (2018), p. 6.

VI. Consequences for Misclassifying Employee

a. If workers are found to be employees during an examination, employers are liable for the employment taxes on the wages paid for those periods under examination.

i. These amounts can be quite large because they include income tax withholding that employer may not have withheld in addition to the employee and employer shares of FICA.

b. Employers can also face penalties

i. Failure to file and furnish information returns. IRC §§ 6721 and 6722.

ii. Failure to deposit taxes. IRC § 6656.

iii. Failure to file and failure to pay. IRC §§6651(a)(1) and 6651(a)(2).

c. Not to mention trouble with the Department of Labor (both state and Federal).

VII. Relief is Available to Employers

a. IRC § 3509 provides for reduced rates of withholding and FICA taxes if the misclassification was unintentional

i. § 3509(a) rates are lowest if information returns filed

ii. § 3509(b) increased rates if no information returns filed (i.e. Forms 1099)

iii. § 3509(c) full rates imposed if the misclassification was due to intentional disregard

b. IRC § 3402(d) provides for that if an employer fails to deduct and withhold employment taxes, but the corresponding taxes are paid by the employees, the tax will not be collected from the employer

i. Employer should collect Forms 4669 from each employee and submit to Service with Form 4670
ii. IRC § 3402(d) does not relieve employer of responsibility for employer’s share of employment taxes
iii. If reduced rates under IRC § 3509 are used, IRC § 3402(d) is not applicable. IRC § 3509(d)(1).

c. IRC § 6205 provides for interest free adjustments of employment tax when certain conditions are met. (Does not apply to FUTA).

d. Employees may be able to seek refund of portion of SECA despite expiration of statute of limitations. IRC § 6521(a).

e. IRC § 3509 provides for reduced rates of withholding and FICA taxes if the misclassification was unintentional
   i. § 3509(a) rates are lowest if information returns filed
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   iii. § 3509(c) full rates imposed if the misclassification was due to intentional disregard

f. IRC § 3402(d) provides for that if an employer fails to deduct and withhold employment taxes, but the corresponding taxes are paid by the employees, the tax will not be collected from the employer
   i. Employer should collect Forms 4669 from each employee and submit to Service with Form 4670
   ii. IRC § 3402(d) does not relieve employer of responsibility for employer’s share of employment taxes
   iii. If reduced rates under IRC § 3509 are used, IRC § 3402(d) is not applicable. IRC § 3509(d)(1).

g. IRC § 6205 provides for interest free adjustments of employment tax when certain conditions are met. (Does not apply to FUTA).

h. Employees may be able to seek refund of portion of SECA despite expiration of statute of limitations. IRC § 6521(a).

VIII. Section 530 Relief

a. In 1978 – Section 530 of the 1978 Revenue Act, Section 530 (a)(1) PL 95-600, 11-6-78 was enacted by Congress.

b. Section 530 is not contained in Title 26 (the Internal Revenue Code) yet, but the IRS administers that provision. Such statutory mandates are often called “off-code” provisions.
c. Section 530 grants relief to an employer from the harsh consequences of reclassification of workers from independent contractors to employees if certain requirements are met.

d. Section 530(e) was added by Section 1122 of the Small Business Job Protection Act of 1996 (H.R. 3448).

e. The 1996 amendment requires the IRS to advise the taxpayer of their Section 530 rights at the beginning of a worker classification audit, and if Section 530 applies, the IRS must grant the taxpayer relief from reclassification.

f. Publication 1976 was created to advise taxpayers of their rights.

g. IRS agents required to provide notice at the start of a worker classification audit.

h. I.R.M. 4.23.5.2.1(5)(11-3-2009), “Publication 1976, Do You Qualify for Relief Under Section 530? Must be provided before initiating any worker classification examination.”

i. To be entitled to Section 530 Relief the employer must show:

   i. Treated the worker as an independent contractor for all periods;

   ii. Did not treat any other similar workers as an employee;

   iii. All Forms 1099 have been filed for the worker; and

   iv. Employer had a reasonable basis for treating the worker as an independent contractor.

j. Section 530 relief is available even if the 1099’s are not timely filed. See Medical Emergency Care Associates v. Commissioner, 120 TC. 436 (1996).

k. Legislative history shows:

ii. Employer may show a reasonable basis based on industry standards, a prior audit, judicial precedent, or an IRS ruling. **(statutory safe harbors)**

iii. Employer may also show “other” reasonable basis, ie reliance on an attorney or CPA advice.

1. Taxpayer establishes a reasonable basis under a statutory safer harbor for treating the worker as an independent contractor, the burden of proof shifts to the IRS to prove that Section 530 does not apply, provided the taxpayer has cooperated with all reasonable requests by the IRS. **See Sec. 530(e)(4)(A), PL 95-600, 11/6/78 as added by Sec. 1122(a), PL 104-188, 8/20/96.**

   i. If Section 530 does not apply then the IRS is required to determine the workers’ status according to the common law test.

IX. **The Classification Settlement Program**

   a. Employer and IRS may elect to apply the provisions of the Classification Settlement Program (“CSP”), IRM 4.23.6.1.

   b. The program is designed to reduce the burden of examination by allowing for resolution early on in the process.

   c. First the agent must determine if the taxpayer is eligible for section 530 relief; eligibility for CSP program should follow from that analysis.

   d. It is mandatory that the examination division offer to settle under the CSP if the taxpayer qualifies. **See I.R.M. 4.23.6.1.1(3) (12-21-2017).**

   e. CSP provides for a closing agreement between the TP and the Service whereby the TP agrees to treat workers as employees going forward and the Service reduces the employment tax liability or limits the liability to one year.

   f. If CSP is rejected, Service will typically open additional years for examination.

   g. CSP is only available where TP has filed Forms 1099 for workers.
h. IRM 4.23.6.8 provides a list of types of cases excluded from CSP including wage issues, prior closing agreements, 3-party arrangements, TP no longer in business.

i. There is also a voluntary Classification Settlement Program that TPs can take advantage of without being under examination. IRM 4.23.20.
CSP Analysis Chart

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<td>4. Yes</td>
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X. Employment Tax Crimes

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<td>Average Months to Serve</td>
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XI. Employment Tax Crimes: Willful Failure to Collect or Pay Over Tax

a. I.R.C. § 7202: Willful Failure to Collect or Pay Over Tax

   i. Any person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

   1. This section mirrors I.R.C. § 6672.

b. Three Elements:

   i. Duty to collect and/or truthfully account for and pay over

   ii. Failure to collect or truthfully account for and pay over

   iii. Willfulness

XII. Employment Tax Crimes: Evasion

a. I.R.C. § 7201: Attempt to Evade or Defeat Tax

   i. Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $100,000 ($500,000 in the case of a corporation), or imprisoned not more than 5 years, or both, together with the costs of prosecution.

b. Two Types:

   i. Evasion of Assessment: Willful attempt to evade or defeat assessment of tax.

Mal, 942 F. 2d 682, 687-88 (9th Cir. 1991) (if a defendant transfers assets to prevent the I.R.S. from determining his true tax liability, he has attempted to evade assessment; if he does so after a tax liability has become due and owing, he has attempted to evade payment).

XIII. Employment Tax Crimes

a. I.R.C. § 7206: Fraud and False Statements

   i. I.R.C. § 7206(1): Declaration under the Penalties of Perjury

      1. Making and subscribing a return, statement, or other document which was false as to a material matter;

      2. The return, statement, or other document contained a written declaration that it was made under the penalties of perjury;

      3. The maker did not believe the return, statement, or other document to be true and correct as to every material matter; and,

      4. The maker falsely subscribed to the return, statement, or other document willfully, with the specific intent to violate the law.

b. I.R.C. § 7206(2): Aiding or Assisting the Preparation of a False or Fraudulent Document

      1. The defendant aided or assisted in, or procured, counseled, or advised the preparation or presentation of a return, affidavit, claim, or other document which involved a matter arising under the Internal Revenue laws.

      2. The return, affidavit, claim, or other document was fraudulent or false as to a material matter.

      3. Willfulness.
XIV. **Egg Shell Audit: When Does Civil Turn Criminal**

a. There is limited administrative guidance regarding the circumstances when the IRS will refer an employment tax case for criminal prosecution.


c. Fraud requires both an underpayment of tax and affirmative acts by the taxpayer that demonstrates gross disregard of employment tax laws. To sustain a charge of fraud in a tax case successfully, it is necessary to:

   i. Establish an understatement of tax,
   
   ii. Establish that all or part of the employment tax liability is due to a false, material representation of facts by the taxpayer,
   
   iii. Show that the taxpayer had knowledge of the false representations made, and
   
   iv. Show that the taxpayer intended those false representations to be acted upon or accepted as the truth. I.R.M. 4.23.9.6 (03-27-2017).

d. Eggshell Audit: Aggravating Factors

   i. Multiple Acts of Wrongdoing

      1. Making false statement or creating false document to compound initial mistake.

      2. Pyramiding with new entities.

   ii. Bankruptcy to evade payment.

   iii. Concealing income.

   iv. Funding Lifestyle Instead of Paying Employment Taxes.

      1. Purchasing homes, cars, etc. instead of paying employment taxes.

   v. Inconsistent Treatment.
1. Signing documents stating that workers are “employees” then sending them 1099’s as “independent contractors.”

vi. Tax Professionals.


e. Handling the Eggshell Audit

i. The line from civil to criminal can be blurry for unpaid employment taxes.

1. Revenue officer will request financial information, bank records, signature cards, and copies of checks during the civil examination.

2. Revenue officer also interviews the potentially responsible individuals (the “4180 Interview”). I.R.M. 5.7.4.2.4 (06-29-2017).

3. Do you advise the client to cooperate and sit for the 4180 Interview?

   a. Noncooperation – Requires the IRS to issue a summons to require potentially responsible party to sit for the interview. I.R.M. 5.7.4.2.4(3) (06-29-2017).

      i. Does it increase the likelihood of criminal referral?

   b. Cooperation – Client is required to review the Form 4180 and sign for accuracy. Could be used as evidence against the client in a criminal proceeding.

      i. If the 4180 admits to all of the factors required for a TFRP assessment, it also admits the elements for criminal liability under I.R.C. § 7202.
XV. Employment Tax Crimes: “Willfulness”

a. Willfulness in § 7202 cases can be proved by circumstantial evidence:

i. United States v. Boccone, 556 Fed. Appx. 215, 238-39 (4th Cir. 2014) (affirming § 7202 convictions, the court stated that “[t]he intentional preference of other creditors over the United States is sufficient to establish the element of willfulness”) (citation omitted);

ii. United States v. Farr, 701 F.3d 1274, 1286 (10th Cir. 2012) (Defendant was the general manager of a medical clinic run by her husband until his death. She avoided detection by changing entity names and EIN’s and continued to fail to pay withheld employment taxes);

iii. United States v. Lord, 404 Fed. Appx. 773, 2010 WL 5129152 (4th Cir. 2010) (“paying wages and of satisfying debts to creditors in lieu of remitting employment taxes to the IRS, constitute circumstantial evidence of a voluntary and deliberate violation of § 7202”);

iv. United States v. Blanchard, 2008 WL 3915007 (E.D. Mich. 2008) (“Although such evidence is admittedly circumstantial evidence of Defendant’s willfulness, circumstantial evidence alone, if substantial and competent, may support a verdict and need not remove every reasonable hypothesis except that of guilt.”) (internal quotation marks omitted), aff’d, 618 F.3d 562 (6th Cir. 2010) (affirming § 7202 convictions).

b. Department of Justice (“DOJ”) 2012 Criminal Tax Manual:

i. A defendant may argue that she was using the withheld tax to pay current expenses so she could keep the company operating and eventually pay the delinquent tax in the future. Although such facts may affect jury appeal and perhaps how the judge views sentencing, if the government proves the defendant voluntarily and intentionally used unencumbered funds to pay creditors other than the United States, the jury may properly convict even if the intentional non-payment of the known trust
fund tax liability was motivated by a desire to keep the business afloat.

1. Cf., Collins v. United States, 848 F.2d 740, 741–42 (6th Cir. 1988) (in a § 6672 case, the court held that “[i]t is no excuse that, as a matter of sound business judgment, the money was paid to suppliers and for wages in order to keep the corporation operating as a going concern—the government cannot be made an unwilling partner in a floundering business.”);

2. Blanchard, supra (evidence at trial showed that in spite of the corporation’s persistent cash shortages and precarious financial condition, the defendant continued to pay net wages to the employees for five years without paying the concomitant payroll taxes)

XVI. **Examples from Recent Cases: Tax Professionals**


i. Lynch authorized payments in excess of $25 million from the Iceoplex entities' accounts between 2008 and 2014 while accruing more than $2 million in unpaid employment taxes during the same time period.

ii. Convicted of 16 counts of willful failure to pay over withheld employment taxes in violation of § 7202.

iii. For a period of more than ten years, Lynch kept the IRS at bay, with promises to pay the withheld employment taxes owed, and with partial payments, some made involuntarily on the rare occasion when the IRS was able to successfully levy a bank account or by applying refunds due to Defendant from his personal tax returns.

iv. He structured the Iceoplex entities to keep employees in companies with minimal assets which resulted in the IRS being
unable to collect unpaid liabilities; and, he kept Iceoplex assets in other companies that were then able to receive large loans from banks that were unaware the other Iceoplex entities owed millions of dollars in unpaid employment taxes.

v. Trial testimony established that Lynch told IRS agents that he would make more payments toward the unpaid tax liabilities when he was able to secure funds, but instead, Lynch used funds from the loans obtained to pay other creditors and to make capital improvements to his businesses.


i. Company failed to pay over employment taxes from 4Q 2001 through 2Q 2004. Celina Lord was the CFO and acting president during those periods.

ii. Lord controlled the day-to-day operations and finances of ASSC throughout the time periods at issue. Lord had signature authority over the bank account used by ASSC to pay all bills, including payroll taxes. Lord had permission to file ASSC's tax returns and to pay over the employment taxes.

iii. Prior to accepting the position of chief financial officer for ASSC, Lord had been an accountant for almost twenty years. In at least two of her previous jobs, Lord was involved with, or was in charge of, ensuring that her employer's payroll taxes were properly filed and paid. Further, Lord conceded in her trial testimony that one of her "higher priorities" at ASSC was to "file and to pay all outstanding taxes."

iv. Lord repeatedly testified that she was too busy with other responsibilities, and had to satisfy other debts and pay employee wages, before she made ASSC's employment tax payments.

v. Such acts - paying wages and satisfying debts to creditors in lieu of remitting employment taxes to the IRS - constitute circumstantial evidence of a voluntary and deliberate violation of § 7202.
vi. Lord's willfulness also can be inferred from her pattern of failing to pay over the taxes for an extended period of time. See United States v. Ostendorff, 371 F.2d 729, 731 (4th Cir. 1967); United States v. Greenlee, 517 F.2d 899, 903 (3d Cir. 1975).

c. Criminal Defense Attorney Sentenced: On April 19, 2017, in Baton Rouge, Louisiana, Michael Thiel was sentenced to 30 months in prison, two years of supervised release and ordered to pay restitution to the IRS of $998,352. Thiel pleaded guilty in December 2016 to evading the payment of federal income and employment taxes. Thiel operated a criminal defense practice in Hammond and from 2003 through 2013 but did not timely file income or employment tax returns and did not make timely payments of the taxes he owed. Thiel concealed his income and assets creating three trust and nominees. Thiel used these three trusts to evade the payment of federal income and employment taxes. In January 2007, Thiel used nominees to purchase his primary residence for $435,000 and entered into a phony lease agreement with the nominees to conceal his ownership of the property and shield it from IRS collection efforts. Between January 2007 and January 2014, Thiel deposited $416,283 into the nominee account that was used to secure and pay the mortgage on the property. These funds came from the nominee trusts and other accounts not held in his name.