

ABA Tax Section Webinar
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CIVIL AND CRIMINAL EMPLOYMENT TAX ENFORCEMENT EFFORTS — EMPLOYERS BEWARE



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Buckle Your Seatbelts: Employment Taxes are Back in Vogue and It Will Be a Bumpy Ride—The IRS and Department of Justice Tax Division are on the Hunt



Employment Tax Matrix

- Joe tax evader who never intended to file return or pay tax
- Bill's bad business troubles
 - Government cut off money
 - Unexpected events
 - Lack of business skills
- Bill's actions after non-payment of employment taxes.
 - Claimed withholding on 1040
 - » Never thought about it
 - » Thought about it and claimed withholding nonetheless
 - Received direct business benefits (salary)
 - Received Indirect business benefits (expenses)
 - Never enjoyed 1 cent of benefit from the day the employment taxes stopped being paid

BUCKLE YOUR SEATBELTS

– Knowledge shown by:

- IRS Revenue Officer interviews with your client, explains what a responsible person is, warns against paying other creditors before paying employment taxes, and specifically informs the client of the duty to file and pay employment taxes
- Beware of IRS Form 4180 signed by taxpayer
- Letter 903 (with Notice 931) will be sent out each quarter
 - » Multiple trial exhibits and counts
- Responsible person fails to pay employment taxes and claims withholding on their own personal tax return anyway
- Inability to pay the bills does not negate knowledge or willfulness
- Prior TFRP violation (serial employment tax abuser)
- Payment of TFRP does not negate knowledge or willfulness on continuing liability

WHY ARE EMPLOYMENT TAXES IN VOGUE ONCE AGAIN?

- Why? Follow the money
 - In looking at tax enforcement, DOJ Tax and the IRS are on track with their attacks on offshore noncompliance and tax shelters while they are stemming the flow of improper refunds due to ID theft
 - So where is the next hot area of noncompliance? The answer is old-fashioned employment tax violators
 - As of September 2015, the cumulative amounts of unpaid Forms 941 was \$59 billion

WHY ARE EMPLOYMENT TAXES IN VOGUE ONCE AGAIN?

- While a business owner who fails to pay the IRS employment taxes may consider it a simple paper-free loan from the government, the government considers it to be theft



IRS EARLY INTERACTION INITIATIVE

- Targeted at employers who appear to be falling behind on employment tax payments through a sophisticated algorithm
- Even before an Employment Tax Return is filed
- Expect letters (903 Letters), automated phone messages, “other communications,” and, in some cases, a visit from an IRS Revenue Officer
- The Letter 903, “You Haven’t Deposited Federal Employment Taxes” will be useful in employment tax prosecutions as it is sent to the employer every time a payment is missed
- The 903 Letter can be used to demonstrate to a jury that the employer had notice

IRS Newswire IR-2015-136, December 8, 2015.

See Caryn D. Finley, attorney (criminal enforcement section, Southern Region) DOJ Tax Division December 11, 2015 Remarks 2015 TNT 240-4 (December 14, 2015) Civil Employment Tax Enforcement Aids Criminal Enforcement.

IRS EARLY INTERACTION INITIATIVE



Date:
Person to contact:
Employee ID number:
Contact telephone number:
Contact fax number:
Taxpayer ID number:

Dear

Our records show that you haven't deposited federal employment taxes as required by law (Treasury Regulation Section 31.6302). **If you do not bring your account current with the required deposits within 30 days of the date of this letter, we will consider stricter civil or criminal enforcement procedures.**

We may:

- **File a Notice of Federal Tax Lien (NFTL) to protect the government's interest**

By filing this notice, we are making a legal claim to your property as security for the payment of your tax debt. An NFTL is a public notice to your creditors that we have a claim against all your property, including property you acquire after we file the lien. An NFTL can have a negative effect on your credit rating. We may also seize (levy) your property. A levy is a legal seizure of property to satisfy a tax debt.

- **Assess a trust fund recovery penalty under Internal Revenue Code Section 6672 for the unpaid trust fund taxes**

We can assess a trust fund recovery penalty against anyone who is responsible for, and willfully fails to, collect, account for, or pay to the IRS income and employment taxes the law requires to be withheld. Willfulness exists if a person allows payment of net wages when the employer has insufficient funds to pay the taxes or uses withheld taxes for other purposes. Willfulness also exists if a person who knows of a previous failure to pay taxes allows payments to others (including payment of additional wages) rather than using available funds to pay the tax delinquency.

- **Refer the matter to the Department of Justice (DOJ) to institute a civil suit or to seek criminal prosecution**

In a civil suit, the DOJ can seek an injunction that requires the employer to comply with the federal employment tax laws and prohibits the employer from paying any amounts until the employer pays the correct amounts to the IRS. The DOJ may also ask the court to appoint a receiver to take control of the business to ensure tax compliance.

Letter 903 (Rev. 8-2013)
Catalog Number 10737Q

IRS EARLY INTERACTION INITIATIVE

The DOJ can also pursue criminal charges based on the willful failure to report and pay over withheld taxes (Section 7202 of the Internal Revenue Code). Willfulness is evident if an employer paid net wages and didn't leave enough funds to make the required tax payments or used withheld trust fund taxes for other purposes. **Convictions may result in imprisonment and other penalties. Other criminal statutes may also apply.**

I encourage you to comply with the federal employment tax deposit rules and to file your returns on time. I am enclosing Notice 931, *Deposit Requirements for Employment Taxes*, which explains the deposit rules.

Thank you for your cooperation.

Sincerely,

[Name]
[Title]

Enclosure:
Notice 931

METHODS TO EXPONENTIALLY INCREASE THE AMOUNT OF UNPAID EMPLOYMENT TAXES AND PEOs

- A single company is limited to the amount of employment taxes it can accumulate based on the number of employees and the amount of payroll
 - It is not uncommon to see a company incur a large employment tax debt and then simply abandon the business and set up a new one
 - There are employers who serially fail to pay employment taxes (many times accompanied by a failure to file as well) and continually open new companies known as “pyramiding”

METHODS TO EXPONENTIALLY INCREASE THE AMOUNT OF UNPAID EMPLOYMENT TAXES AND PEOs

- Another way employers may substantially increase amounts of unpaid employment taxes is to establish a business that leases employees to a number of other businesses, such as a professional employer organization or PEO
 - There is a big danger when PEO fails to pay the employment taxes that have been withheld from the leased employees. The PEO failure will not necessarily relieve the owner from potential trust fund recovery penalty exposure or the business from the taxes already paid to the PEO
 - Popular with businesses that lease employees because they can avoid all the administrative burdens of having employees that far exceed the federal tax withholding, payment and reporting obligations for the employees

CERTIFIED PEOs

- The Tax Increase Prevention Act of 2014 requires the IRS to establish a voluntary certification program for professional employer organizations (PEOs)
- Certified Professional Employer Organization means “a person who applies to be treated as a certified professional employer organization and meets the following requirements:
 - Meets requirements as the Secretary may establish with respect to tax status, background, experience, business location, and annual financial audits
 - Satisfies bond and independent financial review requirements on an ongoing basis
 - Computes its taxable income using the accrual method unless the Secretary approves another method
 - Agrees to verify on a periodic basis that it continues to meet these requirements
 - Agrees to notify the Secretary of any change that materially affects the continuing accuracy of any agreement or information that was previously made or provided

CERTIFIED PEOs

- The IRS plans to begin accepting applications for PEO certification beginning July 1, 2016
- As part of the certification program, the act requires the IRS to:
 - complete background, credit and tax compliance checks of PEOs
 - verify the PEO has an active and approved surety bond
 - verify the PEO satisfies the service agreement and financial review requirements
 - collect a user fee
 - provide public disclosure of certified PEOs and any whose certification has been suspended or revoked

THE TRUST FUND RECOVERY PENALTY

Department of the Treasury - Internal Revenue Service

Form **4180**
(August 2012)

Report of Interview with Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Taxes

Instructions: The interviewer *must* prepare this form either in person or via telephone. Do not leave any information blank. Enter "N/A" if an item is not applicable.

Section I - Person Interviewed

1. Name _____ 2. Social Security Number (SSN) _____

3. Address (street, city, state, ZIP code) _____ 4. Home telephone number () _____

5. Work telephone number () _____

6. Name of Business and Employer Identification Number (EIN) _____ 7. Did you use a third-party payer, such as a payroll service?
 Yes (if yes complete Section VI A)
 No

8. What was your job title and how were you associated with the business? (Describe your duties and responsibilities and dates of employment.) If person being interviewed is a payroll service provider or a professional employer organization, complete Section VI B

Section II - Responsibilities

1. State whether you performed any of the duties / functions listed below for the business and the time periods during which you performed these duties.

Did you...	Yes	No	Dates	
			From	To
a. Determine financial policy for the business?	<input type="checkbox"/>	<input type="checkbox"/>		
b. Direct or authorize payments of bills/creditors?	<input type="checkbox"/>	<input type="checkbox"/>		
c. Prepare, review, sign, or authorize transmit payroll tax returns?	<input type="checkbox"/>	<input type="checkbox"/>		
d. Have knowledge withheld taxes were not paid?	<input type="checkbox"/>	<input type="checkbox"/>		
e. Authorize payroll?	<input type="checkbox"/>	<input type="checkbox"/>		
f. Authorize or make Federal Tax Deposits?	<input type="checkbox"/>	<input type="checkbox"/>		
g. Authorize the assignment of any EFTPS or electronic banking PINS/passwords?	<input type="checkbox"/>	<input type="checkbox"/>		
h. Could other individuals do any of the above? (Complete Section IV and V)				
Name _____ Contact Number _____	<input type="checkbox"/>	<input type="checkbox"/>		
i. Have signature authority or PIN assignment on business bank accounts?				
Bank Name(s) _____ Account Number(s) _____				

Section III - Signatures

I declare that I have examined the information given in this interview and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of person interviewed _____ Date _____

Signature of interviewer _____ Date _____

Date copy of completed interview form given to person interviewed _____ ▶

Taxpayer Statement on Page 4: Yes No Interview Continued on subsequent pages? Yes No

Interview Handouts ("X" if given or explain why not in case history)

Notice 609, Privacy Act Notice Notice 784, Could You be Personally Liable for Certain Unpaid Federal Taxes?

Catalog Number 22710P www.irs.gov Form **4180** (Rev. 8-2012)

THE TRUST FUND RECOVERY PENALTY

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Section IV - Business Information

1. List corporate positions below, identifying the persons who occupied them and their dates of service.

Position (e.g. president, director)	Name	Address	Dates

2. Did/does the business use the Electronic Federal Tax Payment System (EFTPS) to make Federal Tax Deposits (FTDs) or payments?
 No
 Yes If yes, to whom are the PINS or passwords assigned _____

3. Other than the EFTPS, does the business do any other banking electronically?
 No
 Yes Where _____
 To whom are the PINs/passwords assigned _____

4. Does the business file Form 941 electronically?
 No Who is authorized to sign Form 941 _____
 Yes Who files the returns electronically _____

Section V - Knowledge / Willfulness

1. During the time the delinquent taxes were increasing, or at any time thereafter, were any financial obligations of the business paid? (such as rent, mortgage, utilities, vehicle or equipment loans, or payments to vendors)
 No
 Yes Which obligations were paid? _____
 Who authorized them to be paid? _____

2. Were all or a portion of the payrolls met?
 No
 Yes
 Who authorized _____

3. Did any person or organization provide funds to pay net corporate payroll?
 No
 Yes (explain in detail and provide name) _____

4. When and how did you first become aware of the unpaid taxes?

5. What actions did you attempt to see that the taxes were paid?

6. Were discussions ever held by stockholders, officers, or other interested parties regarding nonpayment of the taxes?
 No
 Yes
 Identify who attended, dates, any decisions reached, and whether any documentation is available.

7. Who handled IRS contacts such as phone calls, correspondence, or visits by IRS personnel?

 When did these contacts take place, and what were the results of these contacts?

Catalog Number 22710P www.irs.gov Form **4180** (Rev. 8-2012)

THE TRUST FUND RECOVERY PENALTY

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Section VI - Payroll Service Provider (PSP) or Professional Employer Organization (PEO)

A - Third-Party Payer Arrangements
(Complete this section only if you are a provider of a third-party payer arrangement.)

1. Who signed the service contract or entered into the agreement for services with the third-party payer?	2. Who in the business handled the contacts with the third-party payer?
3. Who was your contact at the third-party payer?	4. How were funds to be made available for the third-party payer to pay the taxes? Name of Bank(s) and Account number(s) from which funds were to be transferred.
5. What actions did you take to verify the third-party payer was filing returns, or making required payments?	6. Were funds available for the third-party payer to use for payment of the taxes? <input type="checkbox"/> Yes <input type="checkbox"/> No If yes, explain in detail how and when the money was transferred to the third-party.
7. Were you aware that the third-party payer was not making the required payments? <input type="checkbox"/> Yes <input type="checkbox"/> No	8. Did you receive IRS notices indicating that the employment tax returns were not filed, or that the employment taxes were not paid? <input type="checkbox"/> Yes <input type="checkbox"/> No

B - Third-Party Payer Companies
(Complete this section only if you are reviewing a Third-Party Payroll Service Provider.)

1. Who in your organization handled the contacts with the client?	2. Who was your contact at the client business?
3. Who at the client business signed the service contract or entered into the agreement for services?	4. Who had control over the payments of the client's employment taxes?
5. How were funds to be made available from the client business to pay the taxes? Bank Name(s) Account Number(s)	
6. Were there funds actually available for you to make the tax payments? <input type="checkbox"/> Yes <input type="checkbox"/> No If yes, explain in detail how and when the money was transferred to the third-party. If no, what actions did you take to attempt to collect the funds from the client?	

Section VII - Personal Liability for Excise Tax Cases
(Complete this section only if Business is required to file Excise Tax Returns.)

1. Are you aware of any required excise tax returns which have not been filed? <input type="checkbox"/> No <input type="checkbox"/> Yes (list periods)	2. With respect to excise taxes, were the patrons or customers informed that the tax was included in the sales price? <input type="checkbox"/> No <input type="checkbox"/> Yes
3. If the liability is one of the "collected" taxes (transportation of persons or property and communications), was the tax collected? <input type="checkbox"/> No <input type="checkbox"/> Yes	4. Were you aware, during the period tax accrued, that the law required collection of the tax? <input type="checkbox"/> No <input type="checkbox"/> Yes

Catalog Number 22710P www.irs.gov Form **4180** (Rev. 8-2012)

INJUNCTIVE RELIEF UNDER SECTION 7402(a)

- 7402(a): The district courts of the United States at the instance of the United States shall have such jurisdiction to make and issue in civil actions, writs and **orders of injunction**, and of *ne exeat republica*, orders appointing receivers, and such other orders and processes, and to render such judgments and decrees **as may be necessary or appropriate for the enforcement of the internal revenue laws**. The remedies hereby provided are in addition to and not exclusive of any and all other remedies of the United States in such courts or otherwise to enforce such laws
- IRM 5.17.4.17.1: Before seeking an injunction the Service should: (A) exhaust all administrative remedies, (B) Consult with Counsel where the taxpayer has previously abandoned other business ventures, leaving unpaid and uncollectible tax liabilities; and (C) Refer to IRM 5.7.2, Trust Fund Compliance, Letter 903 Process and IRS 25.1.8.2. Trust Fund Violations

INJUNCTIVE RELIEF UNDER SECTION 7402(a)

- IRM 5.17.4.17, *Civil Injunctions under IRC 7402(a) to Restrain Pyramiding*: Federal district courts have jurisdiction to issue injunctions under IRC § 7402(a). Injunctions can be obtained to restrain the future conduct of any person when necessary or appropriate to enforce the internal revenue laws....Suits for injunctions may be appropriate against employers and their responsible officers who have a history of pyramiding federal trust fund taxes and who continue to do so
- IRM 5.7.2.2 (5): If the taxpayer has previously abandoned other business ventures, leaving unpaid and uncollectible tax liabilities, consider seeking a civil injunction to stop further pyramiding
- IRM 25.1.8.2, *Trust Fund Violations*: When initial indicators of fraud are identified and warrant potential fraud development, ROs should consider the potential for...Civil Injunction

INJUNCTIONS - PROHIBITIONS

- Injunction Prohibitions
 - Failure to timely file employment tax returns
 - Failure to timely pay employment tax deposits
 - Transfers or assignment of property
 - Obtaining a new EIN or operating a new business
 - Operation of business by the owner without a receiver

INJUNCTIONS - CONTEMPT

– Civil Contempt

- Coercive in nature
- Avoid additional adverse actions by confirming behavior to a court order
- Carries the keys of his prison in his own pocket

– Criminal Contempt

- Punitive in nature
- Cannot avoid the consequences through subsequent compliance
- Is furnished no key and cannot shorten the term by promising not to repeat the offense

PROSECUTION OF CRIMINAL EMPLOYMENT TAX MATTERS

- In fiscal year 2015, there were 102 employment tax evasion investigations opened, with 80 prosecution recommendations and 62 sentencings, with a 77.4 percent incarceration rate
 - The average sentence to serve was 24 months

AVAILABLE CRIMINAL STATUTES

- Willful Failure to Collect, Account For or Pay Over Tax (26 U.S.C. § 7202)
- Tax Evasion (26 U.S.C. § 7201)
- False Return (26 U.S.C. § 7206(1))
- Obstruction (26 U.S.C. § 7212(a))
- Conspiracy to Defraud (18 U.S.C. § 371)

WILLFUL FAILURE TO COLLECT,
ACCOUNT FOR OR PAY OVER TAX
28 U.S.C. § 7202

Elements:

1. Duty to Collect, Account for, and Pay Over a Tax (a/k/a responsible party);
2. Failure to Collect, Truthfully Account for, or Pay Over the Tax; and
3. Willfulness

Penalties:

- Felony
- 5 years imprisonment
- \$250,000 fine

PROSECUTION OF CRIMINAL EMPLOYMENT TAX MATTERS

- IRC Section 6672 is strikingly similar to IRC Section 7202
- A large majority of criminal investigations come out of the IRS Collection Division

TAX EVASION

26 U.S.C. § 7201

Elements:

1. Affirmative Act of Evasion
2. Tax Due and Owing
3. Willfulness

Penalties:

- Felony
- 5 years imprisonment
- \$250,000 fine

FALSE RETURNS

26 U.S.C. § 7206(1)

Elements:

1. Made and Subscribed a Return that was false as to a material matter
2. Signed under penalty of perjury
3. Defendant did not believe the return was true and correct as to every material matter
4. Willfulness

Penalties:

- Felony
- 3 years imprisonment
- \$250,000 fine

OBSTRUCTION

26 U.S.C. § 7212(A)

Elements:

1. Corrupt
2. Endeavor
3. To obstruct or impede the due administration of the Internal Revenue Code

Penalties:

- Felony
- Three years imprisonment
- \$250,000 fine

CONSPIRACY TO DEFRAUD

18 U.S.C. § 371

Elements:

1. Agreement by two or more people to commit an offense against the United States or defraud the United States
2. Defendant knowingly and voluntarily participated in the conspiracy
3. Overt act in furtherance of the conspiracy

Penalties:

- Felony (assuming the underlying offense which is the object of the conspiracy is a felony)
- Five years imprisonment
- \$250,000 fine