

## White Collar Criminal Investigations Slowing Down? Think Again... The Increase in Employment Tax Prosecutions

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### Introduction

The Internal Revenue Service (“IRS”) is responsible for nearly 96% of the gross revenue received on behalf of the United States.<sup>2</sup> Employment taxes, including federal income tax actually withheld and paid over to the IRS, constitute over 70% of all revenue collected by the IRS.<sup>3</sup> Despite our strong system of voluntary compliance, the IRS estimates the annual gross tax gap – “the amount of true tax liability that is not paid voluntarily and timely” – to be \$441 billion.<sup>4</sup> Of this amount, \$81 billion is attributable to employment tax.<sup>5</sup>

Therefore, it comes as no surprise that civil and criminal employment tax enforcement is among the highest priorities of the IRS and the Tax Division of the U.S. Department of Justice (“DOJ”). The IRS and the DOJ have increased civil and criminal employment tax enforcement since 2015 in an effort to educate, modify the behavior of, and hold accountable those employers who intentionally fail to comply with their employment tax obligations.

### The Basics

An employer is required to deduct and withhold income tax from wages.<sup>6</sup> As set forth on Form W-4, *Employee's Withholding Certificate*, the amount of income tax required to be withheld depends on a variety of factors. Employers are liable for the

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<sup>2</sup> IRS Progress Update, Fiscal Year 2019, *Putting Taxpayers First*, IRS Pub. 5382, p. 4.

<sup>3</sup> *Id.*, p. 22.

<sup>4</sup> Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013, Executive Summary, IRS Pub. 1415, p. 1 (Rev. 9-2019).

<sup>5</sup> *Id.*, p. 2.

<sup>6</sup> 26 U.S.C. (“IRC”) § 3402(a).

payment of amounts withheld, whether or not the employer collects the tax from the employees.<sup>7</sup>

In addition to federal income tax withholding (“FITW”), employers are required to withhold Federal Insurance Contribution Act (“FICA”) tax, which includes Social Security (Old-Age, Survivors, and Disability Insurance (OASDI)), Medicare (Hospital Insurance), and, where applicable, the additional Medicare tax.<sup>8</sup> Once employment taxes are withheld, the funds “constitute a special fund held in trust for the United States.”<sup>9</sup>

Employers are also responsible for direct employment taxes, including a matching amount of FICA<sup>10</sup> and annual Federal Unemployment Tax Act (“FUTA”) tax.<sup>11</sup>

### **The Deposits**

Subject to limited exceptions,<sup>12</sup> if the employment tax liability equals or exceeds \$2,500 during the tax period for which the employment tax return is filed, employers must deposit FITW and FICA tax within several days of the payment.<sup>13</sup> All federal tax deposits must be made electronically.<sup>14</sup>

### **The Returns**

An employer who pays wages subject to FITW and FICA tax is generally required to file Form 941, *Employers Quarterly Federal Tax Return*, 30 days after the end of each quarter.<sup>15</sup> FUTA tax is paid and reported on Form 940, *Employer's Annual Federal Unemployment Tax Return*, which is filed by January 31 following the calendar year being reported.<sup>16</sup>

Each year, the employer must furnish accurate Forms W-2, *Wage and Tax Statement*, to each employee reflecting, among other things, wages paid and tax withheld. Copies of the Forms W-2, along with a Form W-3, *Transmittal of Wage and*

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<sup>7</sup> Treas. Reg. § 31.3403-1.

<sup>8</sup> IRC § 3102.

<sup>9</sup> See IRC 7501(a); *Thibodeau v. United States*, 828 F.2d 1499, 1506 (11th Cir. 1987).

<sup>10</sup> IRC § 3111(a), (b).

<sup>11</sup> IRC §§ 3301 and 3306(b). “The [Railroad Retirement Tax Act] RRTA serves as the functional equivalent of FICA for railroad employers, employees, and employee representatives (a group unique to the railroad industry).” Internal Revenue Manual (“IRM”) 5.1.24.2 (08-15-2012); IRC §§ 3202 and 3221.

<sup>12</sup> See IRM 21.7.2.3.4(1) (10-01-2019).

<sup>13</sup> IRS Pub. 15 (2020), (Circular E), Employer’s Tax Guide.

<sup>14</sup> See IRM 20.1.4.2.2.2 (02-09-2018). Payments made directly to the IRS can result in a failure to deposit penalty. *Id.*

<sup>15</sup> IRM 21.7.2.4.7 (02-27-2013). A Form 944, *Employer's Annual Federal Tax Return*, is for small employers, who file annually instead of quarterly. IRM 21.7.2.4.9 (10-01-2019).

<sup>16</sup> See IRM 21.7.3 (08-18-2020). An employer who pays compensation subject to RRTA must file Form CT-1, *Employer's Annual Railroad Retirement Tax Return*. See IRM 21.7.2.2 (3) (10-01-2019).

*Tax Statements*, are filed with the Social Security Administration.<sup>17</sup> The failure to issue these forms can result in a civil penalty generally equal to \$250 for each statement.<sup>18</sup>

### **Importance of Withholding and Reporting to the IRS**

The IRS has established that tax compliance is much greater if income is subject to third party information reporting and even higher when also subject to withholding. “[T]he net misreporting percentage (NMP) for income amounts subject to substantial information reporting and withholding is 1 percent; for income amounts subject to substantial information reporting but not withholding, the NMP is 5 percent; and for income amounts subject to little or no information reporting, such as nonfarm proprietor income, the NMP is 55 percent.”<sup>19</sup>

### **Civil Penalties**

Employers that fail to make timely deposits of employment taxes during the quarter or fail to pay via electronic transfer face substantial civil penalties, which increase with the length of the delay.<sup>20</sup> In addition to the foregoing failure to deposit penalties, the failure to timely file required employment tax returns, or to timely pay any balance due reflected on those returns, can result in additional civil penalties under IRC §§ 6651(a)(1) and (2), respectively.

These civil penalties, and statutory interest on both the unpaid tax and penalties, add up quickly and continued noncompliance exposes employers to both civil and criminal penalties and enforcement efforts.

### **Trust Fund Recovery Penalties**

When an employer fails to collect, account for, and pay over the employee’s share of employment tax, the IRS may pursue the amounts required to be withheld from any or all of those individuals determined to be responsible persons. IRC § 6672 provides:

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

In other words, the IRS can impose personal liability for unpaid trust fund taxes on any or all “responsible persons” that “willfully” fail to meet their obligations.<sup>21</sup> The

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<sup>17</sup> IRM 21.7.2.3.3.3 (02-27-2013).

<sup>18</sup> IRC § 6722(a), (e).

<sup>19</sup> Federal Tax Compliance Research: Tax Gap Estimates for Tax Years 2011-2013, Executive Summary, IRS Pub. 1415, p. 13 (Rev. 9-2019).

<sup>20</sup> See IRC § 6656; see also IRM 20.1.4 (02-09-2018); 21.7.2.3.4(3) (10-01-2019).

<sup>21</sup> See IRM 5.7.3.3 (11-12-2010).

trust fund recovery penalty (“TFRP”) is also referred to as the 100% penalty, in that the amount of the penalty equals the full amount of the trust fund liability.

An individual is considered a responsible person if he or she has “both the responsibility and authority to avoid the default.”<sup>22</sup> A person is responsible for collecting, accounting for, and paying over if he or she has “the authority required to exercise significant control over the employer’s financial affairs, regardless of whether such control was exercised.”<sup>23</sup>

Merely signing checks or preparing tax returns at the direction of supervisors does not rise to the requisite level of control. “However, a responsible person need not have the final word in the company regarding the payment of creditors. Officers and higher level employees of a company who are non-owners may still be required to sacrifice their jobs (*i.e.*, quit) to avoid being responsible for the TFRP, rather than obey the orders of an owner to pay other creditors but not to pay current federal trust fund taxes as they become due.”<sup>24</sup> Finally, it is well established that more than one person in a company may be a responsible person.<sup>25</sup>

Willfulness in the context of IRC § 6672 has been defined as “a deliberate choice voluntarily, consciously, and intentionally made to pay other creditors instead of paying the Government . . . [and it] may also include a reckless disregard of an obvious and known risk that taxes might not be remitted.”<sup>26</sup> While mere negligence will not suffice, “a responsible person cannot avoid reckless behavior through insulation and may not ‘immunize himself from the consequences of his actions by wearing blinders which will shut out all knowledge of the liability for and the nonpayment of its withholding taxes.’”<sup>27</sup> Moreover, “willfulness is shown where a responsible person fails to take action, ... or where other creditors are paid after the deficiency is known.”<sup>28</sup>

## Civil Enforcement

Despite the assessment of substantial civil penalties and interest, the filing of Notices of Federal Tax Liens, and enforced collection efforts including offsets, levies,<sup>29</sup>

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<sup>22</sup> *Salzillo v. United States*, 66 Fed. Cl. 23, 32 (2005); *see also* IRM 5.7.3.3.1 (08-06-2015).

<sup>23</sup> *United States v. Jones*, 33 F.3d 1137, 1139 (9th Cir. 1994).

<sup>24</sup> *See* IRM 5.7.3.3.1.2 (11-12-2010) (citing *Brounstein v. United States*, 979 F.2d 952, 956 (3rd Cir. 1992)).

<sup>25</sup> *Jenkins v. United States*, 101 Fed. Cl. 122, 132 (2011); *Brinskele v. United States*, 88 Fed. Cl. 334, 346 (2009) (citing *Stuart*, 337 F.3d at 36).

<sup>26</sup> *Godfrey v. United States*, 748 F.2d 1568, 1577 (Fed. Cir. 1984) (internal citations and quotation marks omitted).

<sup>27</sup> *United States v. Waterhouse*, 122 Fed. Cl. 276, 285 (2015) (quoting *Bolding v. United States*, 565 F.2d 663, 674 (Ct. Cl. 1977)).

<sup>28</sup> *Waterhouse*, 122 Fed. Cl. at 285 (internal citations omitted); *see also United States v. Kim*, 111 F.3d 1351, 1357 (7th Cir. 1997) (a responsible person has a duty to use all unencumbered funds to pay deficient taxes, once known).

<sup>29</sup> *See* IRC §§ 6331 (levy and distraint) and 6330(h)(1) (disqualified employment tax levy); *see also* IRM 8.22.6.3.3 (08-26-2020).

and seizures of assets, some employers continue to ignore their employment tax obligations and allow liabilities to pyramid quarter after quarter. When this occurs, there is a risk that the IRS will seek a civil injunction pursuant to IRC § 7402.<sup>30</sup>

Section 7402(a) “encompasses a broad range of powers necessary to compel compliance with the tax laws.”<sup>31</sup> These powers include the district court’s ability to issue “orders of injunction ... as may be necessary or appropriate for the enforcement of the internal revenue laws.”<sup>32</sup> In determining the propriety of injunctive relief under IRC § 7402(a), courts require the government to demonstrate: (1) a substantial likelihood of success on the merits; (2) irreparable injury will be suffered absent the injunction; (3) the threatened injury outweighs the potential damage of the proposed injunction; and (4) the injunction would not be adverse to the public interest.<sup>33</sup>

“Injunctive relief is appropriate if the defendant is reasonably likely to violate the federal tax laws again.”<sup>34</sup> In making this determination, courts will “consider such factors as: (1) the gravity of harm caused by the offense; (2) the extent of the defendant's participation, and his degree of scienter; (3) the isolated or recurrent nature of the infraction and the likelihood that the defendant's customary business activities might again involve him in such transaction; (4) the defendant's recognition of his own culpability; and (5) the sincerity of his assurances against future violations.”<sup>35</sup>

An injunction can include various requirements, including ongoing compliance with employment tax laws, providing notice of all future employment tax deposits to the IRS, prohibitions against opening new business or obtaining new employer identification numbers, and restrictions on paying certain liabilities or transferring assets until all pending tax liabilities are paid in full.<sup>36</sup>

If an employer violates an injunction, DOJ will seek an order of civil or criminal contempt, which can result in monetary damages, closing the business, and even incarceration of the responsible individuals.<sup>37</sup>

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<sup>30</sup> See *McComb v. Jacksonville Paper Co.*, 336 U.S. 187, 192 (1949) (“Decrees ... are often necessary to prevent further violations where a proclivity for unlawful conduct has been shown.”) (internal citations omitted).

<sup>31</sup> *United States v. Askins & Miller Orthopaedics, P.A.*, 924 F.3d 1348, 1358 (11th Cir. 2019).

<sup>32</sup> IRC § 7402(a); *United States v. Ernst & Whinney*, 735 F.2d 1296, 1300 (11th Cir. 1984).

<sup>33</sup> *Keeton v. Anderson-Wiley*, 664 F.3d 865, 868 (11th Cir. 2011).

<sup>34</sup> *United States v. Dampier Electric, Inc.*, 2020 WL 1317343, 125 A.F.T.R.2d 2020-1298, at \*4 (E.D. Cal. Aug. 31, 2020) (citations omitted).

<sup>35</sup> *Id.* (citations omitted).

<sup>36</sup> See *United States v. Dampier Electric, Inc.*, 2020 WL 5105796, 126 A.F.T.R.2d 2020-5920 (E.D. CA.) (Aug. 31, 2020); *United States v. Askins & Miller Orthopaedics, P.A., et al.*, 2020 WL 619550, 125 A.F.T.R.2d 2020-821 (M.D. Fla.) (February 10, 2020); *United States v. Bestcare Nursing and Residential Services, Inc., et al.*, 2016 WL 6998774, 118 A.F.T.R.2d 2016-6365 (D. MD) (Aug. 4, 2016).

<sup>37</sup> *United States v. Baker Funeral Home, Ltd, et al.*, 196 F. Supp. 3d 530 (E.D. PA. 2016).

## Fraud Referrals and Data Analytics

In an effort to increase employment tax compliance, the IRS increased the training of revenue officers and other compliance employees to recognize potential indicators of fraud related to payroll tax violations. If such indicators are identified, employees are instructed to consult with group managers and fraud enforcement advisors to determine if the matter should be referred to IRS Criminal Investigation.<sup>38</sup>

In March 2020, the IRS created the Fraud Enforcement Office and appointed a veteran of IRS Criminal Investigation, Damon Rowe, to serve as its director. In this role, Director Rowe is “the principal advisor and consultant to IRS Division Commissioners and Deputy Commissioners on all issues involving Fraud Enforcement strategic plans, programs, and policy.”<sup>39</sup> This sends a strong signal to all taxpayers, including employers, that the IRS is committed to holding those engaged in fraudulent conduct accountable.

The IRS is also becoming more adept in data analytics. For example, IRS Criminal Investigation established the Nationally Coordinated Investigations Unit (NCIU) in 2017 and, in late 2019, the unit was awarded a Commissioner’s award related to employment tax and their innovation and use of data analytics to identify non-compliance. The team also briefed the Secretary of the Treasury on the employment tax initiative.<sup>40</sup> It stands to reason that identifying civil and criminal non-compliance in employment tax is ripe for data analytics because the IRS has all the data it needs to connect the dots and select the best cases for civil action and criminal investigation.

## Criminal Enforcement

The difference between *civil* employment tax violations and *criminal* employment tax offenses is often in the eye of the beholder. To begin, the elements needed to impose civil liability for trust fund recovery penalties under IRC § 6672 are the same as those required to impose criminal liability under IRC § 7202, which provides:

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, be fined . . . or imprisoned not more than five years, or both, together with the costs of prosecution.

Like IRC § 6672, offenses under IRC § 7202 are focused on the portion of employment tax that is withheld or collected from the employees.<sup>41</sup> In addition, the

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<sup>38</sup> IRM 5.1.24.5.9 (03-02-2018).

<sup>40</sup> IRS: CI Annual Report 2020, p.30, <https://www.irs.gov/pub/irs-pdf/p3583.pdf> (last visited February 1, 2021).

<sup>41</sup> See DOJ Criminal Tax Manual, Ch. 9.03 (2015).

government will pursue individuals with the duty to collect, truthfully account for, and pay over, including “an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.”<sup>42</sup> Finally, willfulness is defined the same under both the civil and criminal penalties.<sup>43</sup>

In *Cheek v. United States*,<sup>44</sup> the U.S. Supreme Court set forth the standard for establishing willfulness:

Willfulness, as construed by our prior decisions in criminal tax cases, requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty.<sup>45</sup>

The government is not required to prove “bad faith or evil intent” or “evil motive and want of justification,” but certainly may introduce such evidence in a tax prosecution. In response, a defendant may attempt to establish a good faith misunderstanding of the law or a good faith belief that he did not violate the law to negate willfulness, even if his belief or misunderstanding is objectively unreasonable.<sup>46</sup> A related concept in criminal tax prosecutions is “willful blindness” or “conscious avoidance.” A defendant may not avoid criminal liability by intentionally putting himself in a position where he does not have actual knowledge of the facts.<sup>47</sup>

The government may prove willfulness through circumstantial evidence.<sup>48</sup> In *United States v. Radtke*,<sup>49</sup> Radtke was found guilty of failing to collect, account for, and pay over taxes in violation of IRC § 7202 as a result of his participation in a scheme to pay employees using “cash checks” from which no taxes or union benefit payments were withheld. On appeal, Radtke argued that the evidence was insufficient to support his conviction, since it only showed that he instigated and permitted the use of cash checks, not that he did so with criminal intent. Of the 600 cash checks introduced, Radtke only signed four, and those were to workers not subject to withholding or union benefit payments.

The court disagreed, noting that intent to defraud need not be proved by direct

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<sup>42</sup> IRC § 7343.

<sup>43</sup> *Cf. Phillips v. United States*, 73 F.3d 939 (9th Cir. 1996) (for purposes of § 6672, a responsible person acts willfully if he “knows that withholding taxes are delinquent, and uses corporate funds to pay other expenses, even to meet the payroll out of personal funds he lends the corporation.”) with *United States v. Easterday*, 564 F.3d 1004, 1005 (9th Cir. 2008) (for purposes of § 7202, “if you know that you owe taxes and you do not pay them, you have acted willfully.”).

<sup>44</sup> 498 U.S. 192 (1991).

<sup>45</sup> *Cheek*, 498 U.S. at 201.

<sup>46</sup> *See United States v. Montgomery*, 747 F.3d 303, 309 (5th Cir. 2014).

<sup>47</sup> *United States v. Hale*, 857 F.3d 158, 166 (4th Cir. 2017).

<sup>48</sup> *See United States v. Lynch*, 227 F.Supp.3d 421 (W.D. PA 2017).

<sup>49</sup> 415 F.3d 829 (8th Cir. 2005).

evidence, but can be inferred from conduct. The court referred to testimony that Radtke recognized that the use of cash checks was illegal and expressed concern about the legal consequences, including incarceration. The court also observed that Radtke was the president and chief executive officer, was involved in the daily operations, and personally profited from the use of cash checks. The court held that this evidence gave rise to a sufficiently strong inference of intent to defraud to sustain the jury’s verdict.

In *United States v. Easterday*,<sup>50</sup> the defendant appealed his conviction for violations of IRC § 7202, arguing that the district court erred in refusing to instruct the jury that the government, to prove willful failure to pay taxes, must prove that, at the time the tax was due, the defendant had the funds available and thus, the ability to pay. The Ninth Circuit rejected the notion that a defendant’s ability to pay tax due is relevant to the determination of willfulness and, in so doing, held that its prior decision in *United States v. Poll*,<sup>51</sup> was no longer binding authority. The court based its decision on *United States v. Pomponio*,<sup>52</sup> in which the Supreme Court rejected the notion that the government is required to prove more than “a voluntary, intentional violation of a known legal duty.”<sup>53</sup>

The prioritization of employment tax enforcement is producing results. The following IRS Criminal Investigation statistics demonstrate that criminal employment tax investigations initiated, charges filed, convictions obtained, and incarcerations are on the rise:

	2015	2016	2017	2018	2019	2020
<b>Investigations Initiated</b>	102	137	162	207	250	298
<b>Prosecutions Recommendations</b>	80	77	59	81	104	151
<b>Informations/Indictments</b>	87	71	60	64	73	67
<b>Sentenced</b>	62	87	77	48	50	52
<b>Incarceration Rate</b>	77.4%	70.1%	78%	77%	84%	83%
<b>Average Months to Serve</b>	24	14	21	21	23	18

<sup>50</sup> 564 F.3d 1004 (9th Cir. 2009).

<sup>51</sup> 521 F.2d 329 (9th Cir. 1975).

<sup>52</sup> 429 U.S. 10 (1976) (*per curiam*).

<sup>53</sup> *Pomponio*, 429 U.S. at 12.



It appears that this trend will continue in fiscal year 2021. For example, on October 5, 2020, Trennis Baer pleaded guilty to employment tax violations.<sup>54</sup> Baer owned and operated Baer Construction based in Great Falls, Montana. From 2010 through 2018, Baer failed to deposit employment tax withheld and failed to file Forms 941. These offenses, coupled with additional income tax liabilities, resulted in a tax loss to the IRS of more than \$1.5 million.

On October 7, 2020, Rebecca Adams was sentenced in Greensboro, North Carolina to 42 months' imprisonment for failing to pay employment tax accrued by her temporary staffing businesses, A & R Staffing Solutions Inc., Wood Executive Services Inc., and Adams Staffing Enterprises Inc.<sup>55</sup> Adams and her daughter, Elizabeth Wood, withheld tax from employee wages and failed to pay those funds over to the IRS. Wood was sentenced in June 2020 to 18 months' imprisonment, and both were ordered to pay more than \$2 million in restitution.

On October 27, 2020, a federal grand jury – also in North Carolina – returned an indictment charging James Rice and his wife, Susan Rice, with, *inter alia*, evasion of payment of employment tax and failing to pay trust fund liabilities.<sup>56</sup> The government alleges that, from 1992 through the present, Mr. Rice was an orthopedic surgeon who owned and operated an orthopedic practice, and that Mrs. Rice handled the administrative operations, including payroll and employment tax obligations. Between 2007 and 2014, the Rices allegedly withheld employment taxes from employee wages and failed to pay over approximately \$580,000 in withholdings to the IRS.

On January 13, 2021, Aleksandar Sreckovic, the manager of a San Diego restaurant chain with more than 110 employees and five locations, pleaded guilty to employment tax violations.<sup>57</sup> Mr. Sreckovic directed an outside payroll company to stop depositing employment tax withheld and failed to file employment tax returns for several years, causing an aggregate tax loss of more than \$1.5 million. Mr. Sreckovic is scheduled for sentencing in April 2021, and will pay more than \$2.2 million in restitution to the IRS.

While many recent prosecutions involve the diversion of employment tax to fund lavish lifestyles, the government has made it clear that it will pursue those employers that use employment tax to fund business operations and, in doing so, gain a competitive advantage over other businesses. These warnings are especially appropriate for employers who are willing to shirk employment tax obligations to satisfy cash shortfalls caused by the COVID-19 emergency.

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<sup>54</sup> <https://www.justice.gov/opa/pr/owner-montana-construction-company-pleads-guilty-employment-tax-fraud>.

<sup>55</sup> <https://www.justice.gov/opa/pr/owner-north-carolina-temporary-staffing-firms-sentenced-prison-employment-tax-fraud>.

<sup>56</sup> <https://www.justice.gov/opa/pr/north-carolina-couple-indicted-failing-pay-employment-taxes-and-failure-file-tax-returns>.

<sup>57</sup> <https://www.justice.gov/opa/pr/restaurant-chain-manager-pleads-guilty-employment-tax-fraud>.

In addition to violations of IRC § 7202, the government may charge employment tax offenses as tax evasion under IRC § 7201, willful failure to file under IRC § 7203, fraud or false statements under IRC § 7206, or conspiracy under 18 U.S.C. § 371.

### **My Client is Out of Compliance – What are the Options?**

An employer who is out of compliance has various options, depending on the status of IRS enforcement efforts. First and foremost, the employer must get into current compliance. Continued failure to comply with employment tax obligations will aggravate the situation and impair the ability to reach a resolution with the IRS or DOJ.

If the employer failed to file or filed willfully false employment tax returns, the statute of limitations on assessment never begins to run. To come into compliance, the employer can file delinquent or amended returns pursuant to the IRS long-time policy statement that recommends a 6-year look-back period.<sup>58</sup> However, taking advantage of the IRS's policy does not guarantee that earlier years will not be audited, and the returns that are filed will result in the automatic assessment of applicable delinquency penalties – failure to deposit, file, and pay – that can be in excess of 50% of the tax due, plus interest. This approach also does not prevent an audit of the returns filed, which could result in additional civil penalties or a criminal referral.

For taxpayers at risk for criminal investigation and prosecution, the best option may be a formal voluntary disclosure. In November 2018, the IRS updated its longstanding voluntary disclosure practice and reiterated that, to avoid a criminal referral, a taxpayer must make a timely, accurate, and complete disclosure. Since then, the IRS updated the form used to initiate a voluntary disclosure (Form 14457), issued detailed instructions, and published new administrative guidance.<sup>59</sup> The IRS makes it clear that a disclosure is timely only if received before:

- A. The IRS has commenced a civil examination or criminal investigation of the taxpayer or has notified the taxpayer that it intends to commence such an examination or investigation;
- B. The IRS has received information from a third party (*e.g.*, an informant, another governmental agency, or the media) alerting the IRS to the taxpayer's noncompliance; and
- C. The IRS has acquired information directly related to the noncompliance of the taxpayer from an enforcement action (*e.g.*, search warrant, summons, grand jury subpoena).

Practitioners expect the IRS to apply the current voluntary disclosure penalty framework to employment tax-related disclosures, but further guidance is pending.

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<sup>58</sup> IRM 4.12.1.3 (10-05-2010) (formerly Policy Statement 5-133).

<sup>59</sup> IRM 9.5.11.9 (09-17-2020).

Before initiating a voluntary disclosure, employers should consult with counsel experienced in this area.

## **Conclusion**

Our tax system is one of voluntary compliance, which works when everyone pays their fair share. However, employers often face trials and tribulations that hamper compliance. Such situations have become more prevalent in these tough economic times, and employers are often faced with difficult choices. In light of the substantial civil costs and criminal exposure associated with failure to collect, account for, and pay over employment tax, employers should seek assistance as soon as they find themselves out of compliance and choose wisely in selecting which creditors are given priority.