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The Employment Tax Gap

Renewed Focus From the Internal Revenue Service and U.S. Department of Justice

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Federal employment taxes amount to one-third of all revenue collected by the Internal Revenue Service (IRS) and approximately $72 billion of the tax gap.[1] Employment taxes are collected under the Federal Insurance Contribution Act (FICA), Self-Employment Contribution Act (SECA), and the Federal Unemployment Tax Act (FUTA).[2] FICA and SECA taxes fund old-age, survivor, and disability insurance benefits, as well as hospital insurance benefits, commonly referred to as Social Security and Medicare taxes.[3]

In its simplest terms, the IRS imposes FICA taxes on an employee's wages, and the tax liability is split 50–50 between the employee and the employer, but the employer is responsible for withholding the employee's share from their wages and remitting the tax payment to the U.S. Treasury.[4] The SECA tax is comparable to the FICA tax but imposed on self-employed individuals. FUTA taxes fund federal and state unemployment insurance benefits and are imposed solely on employers; employees and self-employed individuals do not pay FUTA tax.[5] Employers are also responsible for withholding an employee's individual income taxes from their wages and remitting those payments to the U.S. Treasury.[6] Under this tax regime, employers are not only required to pay more in employment taxes than a business that does not have employees, but they must spend valuable time and resources to comply with their tax responsibilities. By not complying with this tax regime, employers who have employees and disregard these responsibilities, or misclassify their workers as independent contractors, gain an unfair advantage over their compliant competitors.

The IRS addresses the employment tax gap and encourages voluntary compliance by: (1) conducting worker classification audits; (2) proposing trust fund recovery penalty (TFRP) assessments against responsible individuals who willfully fail to collect or pay the employee's portion of employment taxes; and (3) initiating criminal investigations and, where appropriate, recommending cases to the U.S. Department of Justice (DOJ) for prosecution. The IRS is working collaboratively with DOJ to increase its civil and criminal employment tax enforcement efforts, and according to the acting assistant attorney general of Justice's Tax Division, Caroline Ciraolo, these cases are one of the DOJ's top priorities this year.[7] With the government's renewed focus on employment tax noncompliance, federal practitioners should know the risk and pitfalls their clients need to be wary.

Worker Classification

For employment tax purposes, most workers are classified as either employees, where the employee and employer are subject to FICA, or independent contractors, where the self-employed individual is subject to SECA.[8] Seasonal businesses and businesses in the construction, landscaping, restaurant and hospitality, and medical-service industries frequently classify their workers as independent contractors rather than employees and are frequently subject to IRS worker classification audits. In addition to government-initiated examinations, a disgruntled worker can bring a business into the limelight by filing an unemployment insurance claim or a labor, benefits, or tax contribution complaint with the appropriate state or federal agency. The outcome of such an investigation can be costly for the business and hinges on whether the worker was properly classified as an independent contractor or an employee as defined by the applicable federal or state authority.

There is no litmus test for determining whether a worker should be classified as an employee versus an independent contractor. Each state and federal agency concerned with worker classification has developed its own, multifactor test for this inquiry, but they frequently consider three common-law elements: behavioral control, financial control, and the relationship of the parties. Behavioral controls include whether the employer has the right to direct or control how the worker performs specific tasks to complete the work for which he or she was engaged.[9] Financial controls center on whether the business aspects of the worker's activities are controlled or directed by the business/service recipient.[10] The relationship of the parties is illustrated by the intent of the worker and service recipient through the terms of the engagement, or the contract that established the relationship.[11] The IRS applies the common law rules to aid in determining whether an employer–employee relationship exists for federal tax purposes,[12] and elaborated on these criteria in Revenue Ruling 87-41, which sets forth 20 factors to consider in worker classification matters. These include: (1) instruction and (2) training provided by the service recipient; (3) integration into business operations; (4) services rendered personally; (5) hiring, supervising, and paying assistants; (6) continuing relationship; (7) set hours of work; (8) full-time requirement; (9) doing work on employer's premises; (10) order or sequence set; (11) oral or written reports; (12) payment by hour, week, or month; (13) payment of business and/or traveling expenses; (14) furnishing of tools and materials; (15) significant investment; (16) realization of profit or loss; (17) working for more than one firm at a time; (18) making service available to the general public; (19) right to discharge; and (20) right to terminate.

The VCSP, created in 2011 and recently modified in 2012, allows eligible taxpayers to voluntarily reclassify their workers as employees for federal employment tax purposes and obtain relief similar to that obtained in the CSP. Taxpayers must meet specific eligibility requirements, apply to participate in the VCSP, and, if accepted, enter a closing agreement with the IRS.

The overarching theme of these factors is whether the person contracting for services controls, or has the *right* to control, the results of the services completed by the worker and the means by which the results are accomplished. Service recipients and workers aware of these criteria often design their service arrangements to avoid triggering an employer–employee relationship. The IRS applies special scrutiny in such cases to assure that the formalistic aspects of the arrangement do not obscure the substance of the relationship.[13] The IRS weighs these factors differently depending on the occupation and the factual context in which the services are performed. Other factors not included in this list may be relevant.[14] As a result, worker classification cases are often complex, fact intensive, and frequently litigated in court or through the IRS' administrative appeals process, leaving a plethora of case law in its wake.

Section 530 Safe Harbor Relief

Since the enactment of this employment tax regime, businesses have challenged attempts by the IRS to reclassify their workers as employees and have vigorously lobbied Congress to reign in the IRS' authority to retroactively assess unpaid employment taxes, penalties, and interest in worker classification cases. In response, Congress enacted a safe harbor statute under § 530 of the Revenue Act of 1978.[15] Although originally enacted as a temporary safe harbor, § 530 became permanent in 1982 and was further amended by the Tax Reform Act of 1986, the Small Business Job Protection Act of 1996, and the Pension Protection Act of 2006.[16] Under § 530, a business (taxpayer) will qualify for the safe harbor if the taxpayer: (1) had a reasonable basis for not treating the workers as employees, (2) treated all similarly situated workers as independent contractors, and (3) filed all required federal tax returns and information returns (i.e., Forms 1099) consistent with treating the workers as independent contractors.[17] A taxpayer can demonstrate that it had a reasonable basis for not treating an individual as an employee by: (1) citing relevant judicial precedent or some other published ruling or authority, (2) relying on the taxpayer's prior employment tax audit[18] where the IRS did not reclassify its workers as employees, (3) citing reliance on a long-standing recognized practice of a significant segment of its industry, or (4) demonstrating a reasonable basis by some other manner.[19]

Congress intended that the "reasonable basis" standard be construed liberally in favor of the taxpayer,[20] but the taxpayer bears the burden to prove by a preponderance of the evidence that it qualifies for § 530 relief.[21] The burden of proof shifts to the IRS if the taxpayer establishes a prima facie case that it was reasonable not to treat an individual as an employee and fully cooperates with the reasonable requests from the IRS during the examination.[22] Another provision in § 530 favorable to the taxpayer requires the IRS to provide the taxpayer with a written notice explaining the eligibility requirements of § 530 safe harbor relief before or at the beginning of any audit inquiry relating to the employment status of one or more individuals who perform services for the taxpayer.[23] The IRS created Publication 1976 and internal tracking procedures to ensure its examiners comply with this requirement.[24]

Unintended Consequence of Section 530

The safe harbor provision of § 530 has provided many businesses with relief in worker classification audits but qualifying for the safe harbor has added another layer of complexity, and seemingly endless case law, to worker classification cases. Section 530 barred the IRS and Department of Treasury from issuing any regulations or revenue rulings pertaining to worker classification.[25] The IRS has published a significant amount of internal guidance and training material for worker classification matters, but these offer little precedential value for taxpayers, the IRS, or the judiciary.[26] As a result, the common-law standards have continued to evolve, and even diverge, over the last 38 years in the state and federal courts where these matters have been litigated.[27] The IRS acknowledges that some of its revenue

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rulings may be outdated and in conflict with judicial decisions,[28] and the National Taxpayer Advocate has raised this and other faults in the IRS' worker classification program numerous times in its annual report to Congress, recommending that Congress repeal § 530 and replace it with another safe harbor provision.[29]

Alternative Dispute Resolution Options for Worker Classification Issues

The IRS has developed three programs in an effort to streamline worker classification cases: (1) the Voluntary Classification Settlement Program (VCSP) for taxpayers not under examination by the IRS; (2) the Classification Settlement Program (CSP) for taxpayers under examination; and (3) the Early Referral Program (ER Program) for taxpayers who disagree with one or more issues at the examination level. Each program has specific eligibility requirements and terms that the taxpayer and IRS must agree to.

The VCSP, created in 2011 and recently modified in 2012, allows eligible taxpayers to voluntarily reclassify their workers as employees for federal employment tax purposes and obtain relief similar to that obtained in the CSP.[30] Taxpayers must meet specific eligibility requirements, apply to participate in the VCSP, and, if accepted, enter a closing agreement with the IRS.[31] If the taxpayer consistently treated its workers as independent contractors and filed all required Forms 1099, timing is the next most important eligibility threshold. A taxpayer cannot use the VCSP if it is currently subject to an employment tax audit by the IRS or a worker classification audit by the U.S. Department of Labor (DOL) or a state government agency.[32] A taxpayer who was previously audited by the IRS or the DOL concerning the classification of the workers will only be eligible if the taxpayer has complied with the results of that audit.[33] Taxpayers who execute a closing agreement under the VCSP: (1) pay 10 percent of the employment tax liability (using the reduced tax rates specified in IRC § 3509(a)) that would have been due on compensation paid to the workers for the most recent tax year; (2) are relieved of all penalties and interest; and (3) will not be subject to an employment tax audit for prior years with respect to those workers reclassified.[34] Another significant benefit of the VCSP program is that the IRS cannot propose a trust fund recovery penalty assessment (discussed in following section) associated with employment tax liabilities calculated under IRC § 3509 because the IRS cannot prove willfulness with respect to the liability.[35]

The CSP, piloted in 1996 and adopted indefinitely in 1998, aims to allow taxpayers and the IRS to resolve worker classification cases as early in the administrative process as possible and ensure that the § 530 relief provisions are properly applied.[36] Under the CSP, eligible taxpayers can qualify for a series of graduated settlement offers depending upon which combination of the reporting consistency, substantive consistency, and reasonable basis tests the taxpayer can satisfy, and if the taxpayer will agree to classify its workers as employees going forward.[37] The offers range from a: (1) 100 percent CSP offer, where a full employment tax adjustment, computed using IRC § 3509(a), if applicable, is made for the most recent tax year under examination; (2) 25 percent CSP offer, which is an adjustment of 25 percent, computed using IRC § 3509(a), if applicable; and (3) no assessment CSP offer, where § 530 relief applies.[38] Taxpayers are not required to accept an offer under the CSP and may disagree with the IRS' analysis under the program.[39]

The IRS created the ER Program in 1999 to allow eligible taxpayers under examination to request the transfer of a developed but unagreed issue, including but not limited to disputes over CSP offers, to Appeals while other issues remain with the examination or collection office working the case.[40] If an agreement is reached, the taxpayer can execute a closing agreement with respect to that issue, but if an agreement is not reached, the taxpayer retains its judicial appeal rights.[41]

These programs offer eligible taxpayers some relief with respect to worker classification issues, but each is narrowly tailored and

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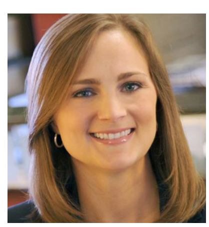

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subject to numerous exceptions. Without the proper guidance, a taxpayer can easily hurt its chances for a favorable outcome.

Trust Fund Recovery Penalty

Employment taxes are an essential component of the nation's revenue, but the "trust fund" portion is particularly important. Generally, each employer must withhold income[42] and employment taxes[43] from its employees' wages and hold the funds in "trust" before paying them over to the government. When an employer withholds the taxes on behalf of its employees but fails to pay them over to the government, the IRS may propose the assessment of a TFRP against any person "required to collect, truthfully account for, and pay over" the taxes, who "willfully fails to collect such tax, or truthfully account for and pay over such tax."[44] The penalty is equivalent to 100 percent of the taxes withheld and not paid over to the government, which can amount to truly staggering penalty assessments. The government may propose TFRP assessments against multiple responsible persons, who, in the event of an assessment, will face joint and several liability. Once assessed, the government will seek to collect the full amount of the outstanding trust fund liability from any combination of the employer or one or more of the responsible persons.[45] As most business owners, executives, and employees are understandably wary of sharing the tax liabilities of an employer (limited liability is, after all, an important feature of many business entities), the TFRP is one of the government's most powerful employment tax collection tools.

Responsible Person

An individual must satisfy the responsibility and willfulness requirements to be found personally liable for unpaid trust fund liabilities. A "responsible person" is one who has the duty to perform or the power to direct the act of collecting, accounting for, or paying over trust fund taxes.[46] In determining responsibility under IRC § 6672, the "crucial inquiry is whether the person had the effective power to pay taxes—that is, whether he had the actual authority or ability, in view of his status within the corporation, to pay taxes owed."[47] Courts have detailed a number of factors that are "indicia of the requisite authority," including "whether the employee: (1) served as an officer of the company or as a member of its board of directors, (2) controlled the company's payroll, (3) determined which creditors to pay and when to pay them, (4) participated in the day-to-day management of the corporation, (5) possessed the power to write checks; and (6) had the ability to hire and fire employees."[48] Thus, although most TFRP cases involve officers or executives, a responsible person may be any of the following:

- An officer or employee of a corporation.
- A member or employee of a partnership.
- A corporate director or shareholder.
- A related controlling corporation.
- A professional employer organization (PEO).
- A payroll service provider (PSP).
- A responsible party within a PSP.
- A responsible party within a PEO.
- A responsible party within the client (i.e. common-law employer) of a PSP/PEO.
- A lender, surety, or any other person with sufficient control over the employer's funds to direct disbursement of the funds.
- A person assuming control after accrual of the liability[49].

The classification of PSPs and PEOs as potential responsible persons is a relatively recent development, initially in interim guidance from 2011 and later incorporated into the Internal Revenue Manual in 2012. PSPs typically prepare employment tax returns for signature by the employer under the employer's employment identification number (EIN) and process the withholding and payment of associated employment taxes. PEOs, often referred to as employee leasing organizations, enter into an agreement with an employer to perform some or all of the employment tax withholding, reporting, and payment activities related to workers performing services for the employer. The PEO then pays the aggregate employment tax under its own EIN. The use of a third-party payer such as a PSP or PEO does *not* relieve the employer and officials of the employer who are responsible for collecting, accounting for, and paying over the employer's employment taxes from the responsibility of ensuring that all of the employer's federal employment tax obligations are met. Thus, in situations where an employer is using a PSP or PEO, both the employer and third-party payer must be mindful to carefully monitor the employer's compliance, because the employer's officers and executives, the PSP/PEO and the PSP/PEO's employees may be deemed responsible persons and potentially exposed to a TFRP assessment.

Although the government is typically able to prove responsibility when an official possessing check-signing authority exercises that authority during the periods at issue, there are instances where check-signing authority does not automatically amount to financial control within the meaning of IRC § 6672. Typically, these cases involve a situation where the government proposes a TFRP assessment against an individual who signs corporate checks during the periods at issue serving under a responsible person exercising true financial control over the employer.[50] In a rare case, this fact pattern has produced a summary judgment against the IRS.[51]

Willfulness

Even if the IRS identifies a responsible person, it must still establish that he or she acted *willfully* before proposing a TFRP assessment. Willfulness under IRC § 6672 does not require fraudulent intent or evil purpose; the IRS must merely show that a responsible person knowingly or intentionally disregarded the statutory provisions and acted with actual or constructive knowledge that the taxes were not paid.[52] Some factors considered in determining willfulness include whether the responsible person:

- Had knowledge of a pattern of noncompliance at the time the delinquencies were accruing.
- Received prior IRS notices indicating that employment tax returns have not been filed, are inaccurate, or employment taxes have not been paid.
- Took actions to ensure the employment tax obligations have been met after becoming aware of the tax delinquencies.
- Used fraud or deception to conceal the nonpayment of tax from detection by the responsible person.[53]

Like responsibility, a determination of willfulness depends on the particular facts and circumstances of each case. Because the degree of willfulness necessary to establish liability under IRC § 6672 is lower than criminal intent, the IRS is usually able to establish willfulness where a responsible person directs the employer to use the employee withholdings to pay general operating expenses—a common occurrence and low-hanging fruit for the IRS. An employer's payment of net wages to employees when funds are unavailable to pay withholding taxes is a willful failure under IRC § 6672; if funds are not available to pay both wages and withholding taxes, a responsible person has a duty to apportion the available funds between the government and the employees so that the taxes are fully paid on the amount of wages paid. For these purposes, the IRS views an employee who is owed wages as merely another creditor of the business, and preferences to employees over the government constitute willfulness.[54] The responsible person's obligation to pay the trust fund taxes to the government is durable. Thus, if a responsible person is aware of the employer's outstanding trust fund liabilities which accrued before his or her hiring, the payment of ordinary business expenses instead of the trust fund taxes may expose the responsible person to a TFRP assessment.[55]

Along the same lines, the IRS may establish willfulness if a responsible person was acting under a mistaken belief that the employer was required to use available funds to satisfy other creditors before paying the trust fund taxes to the government.[56] However, the IRS is required to show that the responsible person was aware of the outstanding taxes and either decided to not pay them or recklessly disregarded the risk that they would not be paid.[57] Reasonable cause is available as a defense to willfulness only in the Second, Fifth, Tenth, and Eleventh circuit courts and only under very limited circumstances. The Ninth Circuit has not definitively ruled on the possibility of reasonable cause negating willfulness in this context. The First and Eighth circuits have found that reasonable cause is not a defense.[58]

TFRP Investigation

The IRS assigns revenue officers to investigate outstanding trust fund liabilities and determine if there are any responsible persons against whom the assertion of a TFRP would be appropriate. During the investigation, a revenue officer will collect information to identify any responsible persons and evaluate if they willfully failed to pay the trust fund taxes. Information may be gathered by reviewing business documents and bank records or through interviewing potential responsible persons or third parties who may possess important information. Because multiple responsible persons may be present, it is common for them to blame one another for the outstanding employment tax accruals. Practitioners who represent more than one responsible person will thus have a conflict to resolve, typically by referring the work to other lawyers.

The IRS generally has the later of three years from the following April 15 or three years from the date the employment tax return was filed to propose the assessment of a TFRP.[59] The statute of limitations on assessment is unlimited if the return remains unfiled, is false or fraudulent, demonstrates a willful attempt to evade tax, or is prepared by the IRS under IRC § 6020 (substitute for return, or SFR).[60] Because of the limited assessment period, one might assume that the IRS would prioritize the proposal of TFRP assessments in cases involving outstanding trust fund liabilities. Interestingly, in a May 23, 2014, report, the Treasury Inspector General for Tax Administration (TIGTA) found that "TFRP actions were untimely and/or inadequate in 99 of the 265 cases reviewed in a statistically valid sample." In response, TIGTA recommended numerous ways for the IRS to improve its processes to ensure timely and appropriate TFRP assessments. Potential responsible persons and practitioners should thus be prepared for more rigorous enforcement in the future.[61]

After determining that the assertion of the TFRP is appropriate and receiving approval from the group manager, the revenue officer will send the responsible person a notice of the proposed assessment detailing the periods and liabilities at issue.[62] The responsible person will then have 60 days to file a protest and request the review by the IRS Office of Appeals. A formal protest detailing the factual and legal basis for the taxpayer's disagreement with the government is necessary only if the proposed assessment exceeds $10,000.

So taxpayers facing TFRP assessments have some options. First, any responsible person's hope is that the employer will pay the outstanding trust fund taxes before or during the TFRP investigation. Naturally, this is easier to ensure when the responsible person is able to influence the employer's decisions. If funds are available, the employer can send designated voluntary payments for application against the trust fund liabilities.[63] In some cases, taxpayers will agree with the revenue officer to voluntarily extend the statute of limitations for TFRP assessment in exchange for additional time to satisfy the trust fund liabilities before the TFRP assertion.

In the event the employer is unable to satisfy the liabilities, responsible persons with no present or future collection potential may be able to dissuade the revenue officer from asserting the TFRP.[64]

Often the employer has no funds available to pay the outstanding trust fund liabilities, and the most sensible route is for the taxpayer to file the protest. If the appeal is unsuccessful, a responsible person may make a divisible payment (i.e., the tax attributable to one employee for each period of liability) and request a refund.[65] After the IRS denies the refund claim, the taxpayer may file a refund complaint in the relevant U.S. District Court. Because TFRP litigation is so common, Appeals personnel are empowered and encouraged to consider settlement to resolve cases in appropriate situations. A settlement may be reached based on factual considerations, by agreement to allocate the assessment among the various responsible persons, or based on the Appeals employee's evaluation of litigation hazards.[66] Taxpayers may also request Appeals to facilitate a resolution through fast-track mediation while the case is still under the revenue officer's jurisdiction or elect for post-Appeals mediation to avoid litigation.[67] Finally, at any point, taxpayers pessimistic about their likelihood of success may choose to acquiesce to the TFRP, often avoiding substantial legal fees and headaches, and seek to address the liabilities through the collection process.

3. Criminal Employment Tax

The Department of Justice Tax Division is increasing its enforcement efforts against employers who willfully fail to meet their employment tax responsibilities, and recently updated a portion of its Criminal Tax Manual for IRC § 7202, the criminal charge for willful failure to collect, account for, and pay withholding and employment taxes.[68] The government can also prosecute employment tax crimes pursuant to IRC § 7201 (tax evasion), IRC § 7206(1) (making and subscribing to false returns), IRC § 7212(a) (obstruction), and 18 U.S.C. § 371 (conspiracy to defraud).[69]

A person found guilty of violating IRC § 7202 has committed a felony and is subject to penalties, fines, and imprisonment for not more than five years, plus the costs of prosecution.[70] To satisfy the willfulness requirement under IRC § 7202, the government must demonstrate that the taxpayer voluntarily and intentionally violated a known legal duty.[71] The government can point to the employer's use of withheld amounts to pay other business expenses or for personal benefit. The government may also meet this requirement by showing that the taxpayer repeatedly disregarded its employment tax responsibilities over a period of time or participated in other employment tax-evasion schemes, such as pyramiding, paying workers in cash, misclassifying workers, failing to file or filing false employment tax returns, and employment leasing with PEOs.[72] For wages paid for quarters beginning on or after March 31, 2014, the Department of Justice will pursue IRC § 7202 cases against PEOs and the common-law employer, both of whom can be liable for the common-law employer's unpaid employment taxes.[73] Given the Tax Division's recent pronouncements, its aggressive employment tax prosecutions should come as no surprise.

On Nov. 18, 2015, a federal grand jury returned an indictment charging Gary B. Bertoni, a prominent Portland, Oregon, defense attorney, with 10 counts of willfully failing to collect, truthfully account for, and pay over federal employment taxes to the government pursuant to IRC § 7202. The indictment alleges that Bertoni, the sole owner of Bertoni & Associates LLC, declined to pay over the firm's employment taxes for 10 quarters between 2009 and 2011 while failing to properly allocate employee payroll deductions to employee health insurance, retirement accounts, and other benefits. Bertoni is also alleged to have caused his firm to spend more than $300,000 on his personal expenses while his firm's outstanding employment taxes continued to accrue. If Bertoni is convicted, he faces a statutory maximum sentence of 50 years in prison, a maximum fine of $2.5 million, and restitution to the IRS.[74]

On Nov. 13, 2015, William Kristen Hathaway, CEO of Baltimore Behavioral Health (BBH), a tax-exempt organization providing treatment for substance abuse and mental disorders, was sentenced to spend 24 months in prison and pay restitution of $3,411,375 to the IRS after pleading guilty to a count of willful failure to pay over employment taxes to the IRS. BBH withheld $2,495,779 in taxes from employee wages, but Hathaway diverted the funds to pay operating expenses. Additionally, Hathaway was a fiduciary for BBH's employee pension plan and pled guilty to a count of theft from an employee benefit plan.[75]

On June 9, 2014, Eric Anderson pleaded guilty to willfully failing to collect and pay over employment taxes owed by his Dix Hills, New York, construction companies: Anderson Framing, Anderson Enterprise, and Anderson Trim Specialty. Anderson cashed checks paid to his businesses through a commercial check-cashing service and paid cash wages to his employees without withholding funds for employment tax payments, and he allocated a portion of the cash for his own personal use. The scheme resulted in a tax loss of more than $1 million for multiple quarters between 2006 and 2008.[76] On June 5, 2015, Anderson was sentenced to serve 18 months in prison and pay $1,080,222 in restitution to the IRS.[77]

On Jan. 14, 2015, a federal grand jury indicted Beverly Carden, age 53, and her husband Kevin Carden, age 54, formerly of Bel Air, Maryland, on charges arising from a scheme to steal at least $2.5 million from their clients and the IRS. The defendants owned and operated AccuPay Inc., a payroll service provider company, which was supposed to complete and file federal and state tax returns for its clients, collect the funds from the clients to pay the taxes, and then pay those taxes to the taxing authorities. The indictment alleges that in order to keep the clients unaware that their taxes were not fully paid, Kevin Carden changed the address listed for certain clients to the address for AccuPay, without the clients' consent, causing all future IRS correspondence, including notices of underpayment, to be sent to AccuPay rather than the client.[78]

On Feb. 25, 2015, Maria Townsend, owner of Townsend Controls Inc. (TCI), a Pasco, Washington, electrical contractor, was convicted of willfully failing to pay over employment taxes owed by TCI for 10 quarters between 2007 and 2009. Townsend withheld taxes from wages paid by TCI to its employees while purchasing numerous automobiles and disbursing funds from the business to her family members.[79] After her conviction on all 10 counts, Townsend was sentenced to 40 months of imprisonment and restitution of $3,327,124.49.[80]

Conclusion

The government's enhanced enforcement activity should serve as a clear warning to taxpayers and practitioners that employment tax noncompliance, especially cases involving lavish personal expenditures and diversion of funds from employee benefits, is now more likely to result in criminal charges. Now is an excellent time for businesses to take necessary steps to improve their accounting protocols to ensure strict employment tax compliance. ⊙

Endnotes

[1]IRS Office of Research, *Federal Tax Compliance Research: Tax Year 2006 Tax Gap Estimation* (March 2012).
[2]26 U.S.C. (I.R.C.) §§ 3101-3128, 1401-1403, and 3301-3311.
[3]I.R.C. §§ 3101 and 1401.
[4]I.R.C. §§ 3101, 3102, and 3111.
[5]I.R.C. § 3301.
[6]I.R.C. §§ 3401-3406.
[7]Nathan J. Richman, *Tax Division Official Gives Insight Into Enforcement Priorities*, Tax Notes Today, Oct. 13, 2015, at 7, summarizing remarks by Acting Assistant Attorney General Caroline Ciraolo from the ALI-CLE Tax Controversy conference Oct. 9, 2015; and William R. Davis, *DOJ Paying Close Attention to Employment Tax Compliance*, Tax Notes Today, Nov. 10, 2015, at 6, summarizing remarks by Acting Assistant Attorney General Caroline Ciraolo from the California Tax Bar and Tax Policy conference, Nov. 6, 2015.
[8]Two other federal worker classifications, statutory employee and nonstatutory employee, are narrowly construed categories and not the subject of this article.
[9]Internal Revenue Service, *Independent Contractor or Employee? Training Materials,* Training 3320-102 (Oct. 1996), at 2-7.
[10]*Id.*
[11]*Id.*
[12]I.R.C. §§ 3121(d)-1(c); 31.3306(i)-1; and 31.3401(c)-(1) with respect to collection of income tax from wages.
[13]Rev. Rul. 87-41, at 4.
[14]*Id.*
[15]§ 530, Revenue Act of 1978, P.L. 95-600 (11/6/78), as amended.
[16]§ 530, Revenue Act of 1978, P.L. 95-600 (11/6/78), as amended by § 9(d)(1) and (2), P.L. 96-167, (12/29/79); § 1(a) and (b), P.L. 96-541, (12/17/80); § 269(c)(1) and (2), P.L. 97-248, (9/3/82); § 170(a), P.L. 99-514, (10/22/86); § 1122(a), P.L. 104-188,

(8/20/96), and § 864, P.L. 109-280 (applicable to remuneration for services performed after Dec. 31, 2006) (Aug. 17, 2006).
[17]*Id.*, and Rev. Proc. 85-18, 1985-1 C.B. 518 (IRS RPR 1985).
[18]As amended in 1996, a taxpayer may not rely on an audit commenced after Dec. 31, 1996, unless such audit included an examination for employment tax purposes of whether the individual involved (or any individual holding a position substantially similar to the position held by the individual involved) should be treated as an employee of the taxpayer. Revenue Act of 1978, § 530(e)(2)(A), enacted by P.L. 104-188, § 1122.
[19]Rev. Proc. 85-18, 1985-1 C.B. 518 (IRS RPR 1985) § 3.01.
[20]Rev. Proc. 85-18, 1985-1 C.B. 518 (IRS RPR 1985) § 3.01, citing H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 5 (1978), 1978-3 (Vol. 1) C.B. 629, 633.
[21]*Boles Trucking Inc. v. United States*, 77 F.3d 236, 240 (8th Cir. 1996).
[22]Revenue Act of 1978, § 530(e)(3)(4), enacted by P.L. 104-188, § 1122; codifying the holding in *McClellan v. United States*, 900 F.Supp. 101 (E.D. Mich. 1995). Pursuant to § 530(e)(3)(4)(B), the burden does not shift if the taxpayer relied on some other manner to prove its reasonable basis (i.e., evidence other than judicial precedent, a prior audit, or industry standard).
[23]Revenue Act of 1978, § 530(e)(1), enacted by P.L. 104-188, § 1122.
[24]*See* IRS Publication 1976 (Rev 05-07) and IRM Section 4.23.5.2.1(4)(12-10-2013), Technical Guidelines for Employment Tax Issues, Section 530 of the Revenue Act of 1978.
[25]§ 530(b), Revenue Act of 1978, P.L. 95-600 (11/6/78), as amended.
[26]Present Law and Background Relating to Worker Classification for Federal Tax Purposes, Joint Committee on Taxation (JCX-26-07) 5/7/07), 8-9; and Department of Treasury, Internal Revenue Service, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (10-96) TPDS 842348I.
[27]Department of Treasury, Internal Revenue Service, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (10-96), 18.
[28]*Id.*
[29]*See* National Taxpayer Advocate 2013 Annual Report to Congress 199; National Taxpayer Advocate 2012 Annual Report to Congress 19-20; National Taxpayer Advocate 2010 Annual Report to Congress 371; National Taxpayer Advocate 2008 Annual Report to Congress 375-90.
[30]IRS Announcement 2011-64, 2011-41 I.R.B. 503 *and* IRS Announcement 2012-45, 2012-51 I.R.B. 724.
[31]IRS Announcement 2012-45, 2012-51 I.R.B. 724.
[32]*Id*.
[33]*Id*.
[34]*Id*.
[35]IRM 8.25.1.3.1.1 (12-07-2012).
[36]IRS Fact Sheet, FS 1996-05 (March 1996); IRS Notice 1998-21, 1998-15 I.R.B. 14; and IRM 4.23.6.1 (03-02-2012).
[37]IRM 4.23.6.14.1 (04-22-2014).
[38]*Id*.
[39]*Id*.
[40]Rev. Proc. 99-28 and IRM 8.26.4.1 (10-26-2007).
[41]IRM 8.26.4.7.1 (10-26-2007).
[42]I.R.C. §§ 3401-3406.
[43]I.R.C. § 3102.
[44]I.R.C. § 6672(a).
[45]IRM 1.2.14.1.3(2) (06-09-2003)
[46]IRM 8.25.1.4.1(1) (12-07-2012).
[47]*Plett v. United States*, 185 F.3d 216, 219 (4th Cir. 1999) (quoting *Barnett v. Internal Revenue Service*, 988 F.2d 1449, 1455 (5th Cir. 1993)).
[48]*Id.*
[49]IRM 8.25.1.4.1(2) (12-07-2012).
[50]*Tarpoff v. United States*, 109 A.F.T.R.2d 2012-1031 (S.D. Ill. 2012) (holding that the individual who signed numerous checks for employer was not responsible person because he did not exert significant control over disbursal of corporate funds).
[51]*Comeaux v. United States,* 2013 WL 786685 (W.D.La. 2013).
[52]*See Johnson v. United States*, 861 F. Supp. 2d 609 (D. Md. 2012).
[53]IRM 8.25.1.4.2(1) (12-07-2012).
[54]IRM 8.25.1.4.2(2) (12-07-2012).
[55]*See Slodov v. United States*, 436 U.S. 238 (1978).
[56]*Thomsen v. United States*, 887 F.2d 12, 17-18 (1st Cir. 1989).
[57]*See Phillips v. United States*, 73 F.3d 939, (9th Cir. 1996).
[58]IRM 8.25.1.4.2(3) (12-07-2012).
[59]IRM 5.7.3.5(2) (11-12-2010).
[60]IRM 5.19.14.1.5 (04-23-2013).
[61]Treasury Inspector General for Tax Administration, "Trust Fund Recovery Penalty Actions Were Not Always Timely or Adequate" (May 23, 2014).
[62]I.R.C. § 6672(b) (TFRP assessment notice requirements); IRM 8.25.1.5(4) (12-07-2012).
[63]IRM 5.1.2.8 (06-20-2013).
[64]IRM 5.7.5.3.1(1) (11-12-2014).
[65]IRM 8.25.1.7.4.2(2) (10-14-2014).
[66]IRM 8.25.2.6.1(4) (12-12-2012).
[67]IRM 8.25.1.7.1 (12-07-2012); 8.26.5.3 (08-27-2010).
[68]Nathan J. Richman, *Tax Division Official Gives Insight Into Enforcement Priorities*, Tax Notes Today, Oct. 13, 2015, at 7, summarizing remarks by Acting Assistant Attorney General Caroline Ciraolo from the ALI-CLE Tax Controversy conference Oct. 9, 2015.
[69]Department of Justice, Criminal Tax Manual 2012 § 9.02.
[70]I.R.C. § 7202.
[71]IRM 9.1.3.3.2.2.3 (05-15-2008).
[72]IRS, *IRS Warns Businesses, Individual to Watch for Questionable Employment Tax Practices*, IR 2004-47 (April 5, 2004).
[73]Treas. Reg. § 31.3504-2 (2014).
[74]Indictment, *United States v. Gary B. Bertoni,* No. 3:15-cr-00410-H2 (D. Or. Nov. 18, 2015).
[75]Judgment, *United States v. William Kristen Hathaway,* No. 1:15-cr-00086-RDB (D. Md. Nov. 13, 2015).
[76]Indictment, *United States v. Eric Anderson,* No. 2:13-cr-00261-ADS-SIL (E.D.N.Y. Apr. 25, 2013).
[77]Judgment, *United States v. Eric Anderson,* No. 2:13-cr-00261-ADS-SIL (E.D.N.Y. Jul. 29, 2015).
[78]Indictment, *United States v. Beverly Carden and Kevin Carden,* No. 1:15-cr-00016-MJG (D. Md. Jan. 14, 2015).
[79]Indictment, *United States v. Maria Elizabeth Townsend,* No. 2:13-cr-06068-TOR (E.D. Wash. Oct. 22, 2013).
[80]Judgment, *United States v. Maria Elizabeth Townsend,* No. 2:13-cr-06068-TOR (E.D. Wash. July 7, 2015).