

## EMPLOYERS BEWARE: THE IRS IS RAMPING UP EMPLOYMENT TAX ENFORCEMENT

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Approximately 72% of all revenue collected by the IRS is from withheld employment taxes. As a result, the IRS has increased its focus on employment tax audits, recently reporting that there are 530,000 employment tax audits pending. Employers should understand the potential consequences of an employment tax audit and take steps to ensure they are properly prepared for an audit.

### IRS LIENS AND LEVIES

Failure to withhold and pay employment taxes can have severe repercussions on the financial well-being of a business. Two methods the IRS may use to collect unpaid taxes are tax liens and levies, and the IRS is more likely to file liens and levies to collect unpaid employment taxes than unpaid income taxes.

A lien is a legal claim against property to secure payment of the tax debt. A tax lien can adversely affect a company's finances by preventing it from selling property or obtaining credit. A tax levy occurs when the IRS seizes property to satisfy a tax debt. For example, a tax levy could require banks or customers to turn over payments to the IRS rather than the taxpayer. If the debt is sizable enough or remains outstanding too long, the IRS can take possession of the business.

### TRUST FUND RECOVERY PENALTY AND CRIMINAL LIABILITY

In addition to liens and levies, the IRS can hold responsible persons personally liable for the Trust Fund Recovery Penalty ("TFRP") for the *willful* failure to collect and pay employment taxes. The TFRP is also referred to as the "responsible person penalty" or the "100% penalty." The TFRP applies only to the amounts an employer is required to withhold for federal income taxes and for the employees' share of FICA taxes. It cannot be imposed to collect an employer's share of employment taxes. The IRS is not required to attempt to collect from the employer before it pursues the TFRP (although it usually does).

The TFRP may be levied against more than one responsible person. Responsible persons are those individuals so connected with a business entity as to be deemed responsible for collecting, accounting, and paying over taxes to the government. Accordingly, a responsible person may include an officer of a company, a member of a partnership, a corporate director, a member of the board of trustees of a nonprofit corporation, or even a bookkeeper in charge of writing and distributing paychecks to employees.

In addition to civil liability, there is a criminal counterpart of the TRFP that makes it a *felony* to willfully fail to collect or pay over employment taxes and may result in a fine of up to \$10,000 and imprisonment for up to five years. There is significant overlap between the two provisions, and civil TRFP investigations are often a source for criminal referrals.

Although IRS criminal cases are less common than civil cases, there has been an uptick in criminal prosecution of employment tax cases in recent years. As part of its focus on compliance issues, the IRS recently formed a new Fraud Enforcement Office. It is expected that this will lead to increased enforcement, including coordinated criminal and civil examinations, and employment tax compliance will likely be a priority. Indeed, the Treasury Inspector General for Tax Administration—which provides IRS oversight and audits the IRS’s efficiency and effectiveness—has recommended that the IRS increase its use of the TFRP and refer more employment tax cases for criminal investigation.

## WHAT CAN YOU DO?

Because of the harsh potential consequences for failure to pay employment taxes, employers (and their officers and directors) should take the following actions:

- **Conduct an internal audit.** Employers should conduct internal audits of their employment tax compliance. This will allow an employer to correct any problem prior to an audit and can show a good faith attempt to comply with the tax laws in the event of an audit.
- **Promptly respond to IRS correspondence.** Promptly review and respond to any correspondence received from the IRS. IRS correspondence often places a relatively short timeframe for a response. Failure to respond timely can result in liens or levies or the imposition of the TFRP.
- **Contact an attorney specializing in tax controversy.** If you have any questions regarding a potential examination, we highly recommend that you consult with an attorney specializing in tax controversy (in addition to your CPA). Tax controversy attorneys focus their practice on advocating for taxpayers before the IRS and can help you navigate the enforcement efforts to minimize the impact on your business and any responsible persons.

## WE ARE AVAILABLE TO HELP

Thompson & Knight attorneys have significant experience in assisting taxpayers with employment tax audits and can counsel you on how to reach the best outcome. If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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