

NATIONAL INSTITUTES

Criminal Tax Fraud/
Tax Controversy 2023

December 7-9, 2023

Las Vegas, NV



THE PREMIER SOURCE FOR CLE

Employee Retention Credit: Civil and Criminal Enforcement

December 9, 2023

NATIONAL INSTITUTES

Criminal Tax Fraud/Tax Controversy 2023



James Creech

Senior Manager, Baker Tilly

james.creech@bakertilly.com

Daniel Mayo, JD, LLM

Partner and Lead – National Tax Services



Professional Experience

- More than 20 years of professional tax experience
- Leader of Withum's National Tax Services Group
- Oversee U.S. federal income tax policy, planning and review
- Experienced in federal income tax and financial products taxation
- Experienced in capital markets and M&A transactions
- Adjunct Tax Professor, Georgetown University Law Center
- Contributing Author, Forbes Magazine
- Frequent author and speaker on U.S. federal income tax topics

Credentials/Education

- Member of the New York and New Jersey Bars
- LLM in Tax, New York University School of Law
- JD, *cum laude*, Seton Hall University School of Law
- BS, Accounting, Rutgers College
- Approved Arbitrator for FINRA
- Attended Executive MBA program at INSEAD, Fontainebleau, France

Recently Published: [Top 10 Things To Preserve Qualified Small Business Stock Treatment](#), [IRS Stops Processing New ERC Claims](#), [Can I Replace My Tax Advisor With ChatGPT?](#)

Industries

- Financial Services
- Professional Services
- Real Estate
- Technology

Services

- Employee Retention Credit
- Qualified Small Business Stock
- Expert Witness
- IRS Audits
- Financial Products Taxation

Memberships

- American Bar Association
- Past Chair of the Banking and Savings Institutions Tax Committee
- New York Bar Association

Daniel Price, JD

Managing Member of Law Offices of Daniel N. Price, PLLC



dan@pricetaxlaw.com

- Practice focuses on federal tax and Title 31 matters including civil and criminal defense of IRS audits and investigations.
- Assists taxpayers in navigating the process of coming into compliance, especially taxpayers with international reporting obligations who have failed to comply fully with U.S. tax and Title 31 laws.
- Expertise concerning the IRS' voluntary disclosure practice, the Streamlined Filing Compliance Procedures, and international penalty regimes allows him craft strategies to mitigate civil penalties and criminal exposure.
- 19 years as an attorney for the Office of Chief Counsel of the Internal Revenue Service.
 - Work in the arena of international enforcement.
 - Completely revising the IRS's Voluntary Disclosure Practice.
 - Works in the Offshore Voluntary Disclosure Programs, the Streamlined Filing Compliance Procedures, foreign bank account reporting, Bank Secrecy Act investigations, various LB&I compliance campaigns, expatriation issues, international collection of taxes, and much more.

Kathy A. Enstrom

Director of Investigations, Moore Tax Law Group, LLC



Assists clients facing governmental investigations and civil matters involving all manner of alleged tax, financial and economic fraud.

Professional Experience

- Retired IRS Criminal Investigation Special Agent
- Executive Director of Operations, Policy and Support
- Executive Special Agent in Charge Chicago Field Office
- Executive Director of Field Operations, Northern Area

FDIC-Office of Inspector General
Special Agent in Charge, Chicago Region

Credentials/Education

- Enrolled Agent
- Certified Fraud Examiner
- MBA, Cardinal Stritch University

Kathy.Enstrom@mooretaxlawgroup.com

The Stakes

- The PPP had a finite pool of funds to be distributed; the ERC does not
- January 2021 – CBO projects \$85 billion in ERC claims
- May 2023 – IRS estimates it has paid more than \$152 billion in ERC claims
 - IRS had a backlog of more than 929,000 claims, but it increased processing from 20,000/week to 40,000/week
 - IRS is now slowing down payment on claims because it perceives recent claims as weaker than claims filed closer in time to the pandemic
- 2020 ERC claims can be submitted until April 15, 2024 – §6511 & §6513(c)
- 2021 ERC claims can be submitted until April 15, 2025
- IRS has already processed more than 3.6 million ERC claims, and paid out more than 3 times the amount budgeted for the program
- 15 taxpayers charged with fraud; 6 convictions; average prison sentence is 21 months; IRS working on hundreds of criminal cases and thousands have been referred for civil audits

Statute of Limitations

- IRS generally has 3 years to assess under §6501, and 941s are deemed filed on 4/15 of following tax year under §6501(b)(2)
- Congress extended Q3 and Q4 2021 to 5 years in §3134(l)
 - 941s for Q1, Q2, Q3 & Q4 2020 are deemed filed on April 15, 2021, which means the 3-year SOL expires on April 15, 2024;
 - 941s for Q1 & Q2 2021 are deemed filed on April 15, 2022, which means the 3-year SOL expires on April 15, 2025; and
 - 941s for Q3 2021 & Q4 2021 (for RSUBs) are deemed filed on April 15, 2022, which means the 5-year SOL expires on April 15, 2027
- SOL does not restart when an amended return is filed

- Civil Actions for Erroneous Refunds – §7405(b) & §6532(b)
 - IRS can bring civil action within 2 year of payment on an ERC claim – and 5 years in cases of fraud or misrepresentation of a material fact
 - Need DOJ involvement and unclear how widely this procedure will be used
 - Similarly, taxpayers have 6 months to bring suit after a refund claim is filed and ending 2 years from IRS disallowance of the claim – §6532(a)

Recent IRS Guidance / Warnings

- October 19, 2022 – IRS issues [press release](#) advising taxpayers to be wary of third parties that promise tax savings that are too good to be true
 - Tax credit shops are advising taxpayers to claim the ERC when they do not qualify
 - Red flag – large upfront fee or a fee that is contingent on the amount of the refund
 - Improperly claiming the ERC could result in taxpayers being required to repay the credit along with penalties and interest
 - **Likely signals increased IRS enforcement activity**
- November 7, 2022 – second IRS warning (Covid Tax Tip 2022-170)
- March 7, 2023 – another warning (IR-2023-40) – “Beware of ERC promotions”
- March 7, 2023 – IRS issues OPR Memo (2023-02) discussing tax return preparers professional responsibilities under Circular 230
- March 20, 2023 – ERC added to top of the Dirty Dozen list of tax scams (IR-2023-49)
- May 25, 2023 – IRS warning (IR-2023-105) – “The IRS has stepped up audit and criminal investigation work involving these claims”

Recent IRS Guidance / Warnings (cont'd)

- July 20, 2023 – IRS issues GLAM (AM 2023-005) limiting supply chain disruptions; 5 scenarios discussed and none of them qualify
- July 24, 2023 – Tax Tip 2023-93 – latest warning signs of ERC scams
- July 27, 2023 – IRS issues FAQs regarding various aspects of ERC, including warning about ERC scams
- September 14, 2023 – IRS issues processing moratorium, upcoming settlement/withdrawal initiatives, FAQs, Eligibility checklist
 - IRS will stop processing new ERC claims until at least 2024, and processing times likely to double as it scrutinizes existing claims
 - Could IRS have processed new claims in 2023? It has a backlog of 600,000 claims and processes about 40,000/week
 - Announced an upcoming settlement program for the repayment of improper ERC claims to allow “businesses to avoid penalties and future compliance action”
 - Announced an upcoming withdrawal option for filed but unprocessed claims to avoid repayment issues and paying contingency fees to promoters, but would not exempt taxpayers from potential criminal exposure if they file a fraudulent claim

IRS Audits

- IRS is aggressively auditing ERC claims
- It is auditing each and every issue that relates to the ERC, including aggregation, eligibility, number of 2019 FTEs, qualified wages, no double dipping with PPP and other credits, and other aspects of calculating the credit
 - For example, IRS is auditing the calculation of gross receipts to ensure there is no shifting between or among calendar quarters
- IRS is asking for governmental orders and for an explanation of the effect they had on business operations
 - When it comes to supply chain issues, remember that there must be a US governmental order relating to Covid that affected the taxpayer's supplier, the supplier could not deliver critical goods because of the governmental order, the taxpayer could not obtain the goods from alternate sources, and the inability to obtain the goods has more than a nominal effect on the taxpayer
- IRS is auditing some ERC claims BEFORE they are paid, and is committing to an audit timeline upfront
- IRS is asking for taxpayer interviews and site visits

Lessons Learned

- If you didn't prepare the eligibility analysis or the ERC calculation, do it yourself before your first response to the IRS – errors are common
- Consider amending the claim, if necessary, in your first response to the IRS
- Only submit responses that you can verify or are comfortable submitting
- Always be polite and recognize that most agents act in good faith and try to do his/her job to get to the right answer
- Agents do not always accommodate requests for extra time to deliver IDR responses, so document ERC claims in advance of an audit

Small or Large Eligible Employer

- 2019 monthly average number of full-time employees (FTEs)
 - For 2020 ERC, need 100 or fewer in 2019 to be a small eligible employer
 - For 2021 ERC, need 500 or fewer in 2019 to be a small eligible employer
 - Remember that the aggregation rules apply for this purpose

- How to calculate?
 - FTE means 30 hours/week or 130 hours/month
 - Different from PPP where there was a full-time equivalency test
 - Determine the number of FTEs each month, and then divide by 12

- IDRs request documentation on this issue, and auditors are flexible in terms of the documentation provided as long as the taxpayer is not close to one of the thresholds

Gross Receipts Test

- Gross receipts is a top-line revenue number, net of returns and allowances (§448(c), or §6033 for tax-exempt entities)
 - Don't take your client's word for it – make sure you review the general ledger, because the IRS will
 - Remember that the aggregation rules apply for this purpose
- Must use the method of tax accounting, *i.e.*, cash or accrual, that the taxpayer used for the tax year in question, even if a different method is used for book purposes
- Business combinations – remember there is a safe harbor for business combinations in 2020 and in 2021
- IDRs request either general ledger detail; tracing exercises to the tax return have not sufficed on audit so far

Full or Partial Suspension of Business Operations

- Did the taxpayer identify a U.S. governmental order that limited its commerce, travel, or group meetings due to Covid-19?
- Were the taxpayer's employees able to work comparably through telework?
- Did the full or partial suspension of business operations have more than a nominal effect on the taxpayer's business? Recall there are 10% safe harbors in Notice 2021-20, Q&As #11 & 18.
- Did the suspension of operations result from a reduction in client demand? *See* Notice 2021-20, Q&A #13.
- Did the suspension result from a supply chain disruption? *See* AM 2023-005, confirming the supply chain disruption is interpreted narrowly by the IRS

Full or Partial Suspension of Business Operations (continued)

- Audit Experience
 - IDRs request copies of actual government orders to show the restrictions and the length of time they were in effect (to ensure they cover the period of the claim)
 - Burden of proof is on taxpayers to show they were impacted by the orders
 - One agent requested that the taxpayer document the effect the governmental orders had on the services listed on its public website

Aggregation

- Aggregation applies for purposes of (i) the gross receipts test, (ii) the suspension of operations test, (iii) the calculation of the number of FTEs, and (iv) the determination of the maximum credit amount per employee. *See Notice 2021-20, Q&A #7*
 - Parent/sub aggregation, brother/sister aggregation, combined group under common control, affiliated service groups
 - Constructive ownership rules apply (*see Reg. §1.52-1(c) & (d)*)
- Aggregation with non-US entities still applicable
- Audit Experience – IDRs generally request an explanation of how the taxpayer determined aggregation, and how it allocated the ERC among the aggregated group (if there is one)



ERC Calculation

- No double dipping with wages used for the PPP, FFCRA credits, other listed credits
- Cannot include severance and other post-termination payments made to former employees
- Were the proper wages included for the type of employer, *i.e.*, small eligible employer or large eligible employer?
- Cannot include wages for self-employed individuals, greater-than-50% owners, and “related individuals”
 - Constructive ownership rules apply and the “related individual” determination can produce unexpected results
- Wage limit is \$10,000 for March 13, 2020 through December 31, 2020, and \$10,000 for each of the first three calendar quarters in 2021
- ERC percentage applied to wage limit is 50% in 2020, and 70% in each of the first three calendar quarters in 2021
- Different rules apply for recovery startup businesses (businesses started after 2/15/2020, have gross receipts under \$1M, and do not meet the partial suspension or gross receipts tests)

ERC Calculation (cont'd)

■ Audit Experience

- IDRs request the signed PPP loan forgiveness application that was submitted to the lender, and sometimes the forgiveness letter received from the SBA
- IRS generally does one of the following:
 - Tracing analysis of wages on an individual basis from the ERC calculations back to documentation filed with taxing authorities (W-2s, for example)
 - Reconciliation on the population of wages to the originally filed Forms 941
- For large eligible employers, IDRs require substantiation on how the taxpayer determined qualifying wages that were paid to employees not to provide services

Substantiation and Taxation

- Make sure your clients maintain adequate records to substantiate eligibility and the ERC calculation – Notice 2021-20, Q&As #71-71
 - Generally requires taxpayers to maintain documents on eligibility and the ERC calculation for at least 4 years
- Make sure your clients amend their 2020 and/or 2021 income tax returns to pay tax on the ERC
 - Reduce the wage/health plan expenses that were used for the ERC – Notice 2021-20, Q&A #60-61
 - Reductions must be made on the tax return for the tax year in which they were paid, not the year in which the ERC was applied for or received
 - IRS view is that amended returns must be filed when the ERC claim is filed, not when it is received

Penalties

- Underpayment of taxes
 - May be required to pay back erroneously claimed ERC amount, resulting in additional tax liabilities
- Accuracy-related penalties
- Fraud penalties
- Interest
- Note: Warnings from IRS may undermine reasonable cause defense to penalties on audit

Promoters and Criminal Investigations

■ Categories

- Individuals or Small Groups
- CPAs and Return Preparers
- Promoter Businesses

■ IRS CI has uncovered pandemic fraud totaling more than \$8 Billion

■ As of 9/30/2023

- 301 under investigation, totaling \$3 billion in estimated fraud
- 15 Charged, which 8 have been convicted and 4 sentenced
- Average sentence is 21 months

NATIONAL INSTITUTES

Thank you



THE PREMIER SOURCE FOR CLE