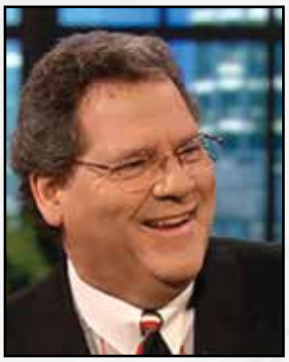


Pilla Talks Taxes

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN

September 2020
Vol. 32 Issue 8

DEFERRING SOCIAL SECURITY & MEDICARE PAYMENTS - THIS IS NOT A TAX CUT

Making Sense of the President's Executive Action

On August 8, President Trump instituted four executive actions in the ongoing battle against COVID-19. One of the four was a memorandum instituting a deferment on the collection of payroll taxes of certain employees. There is a great deal of confusion about what this means. Let's break this down to get a detailed understanding of what's going on here.

BACKGROUND

The executive action drawing the attention is that related to the payment of withholding and employment taxes. The action declares that the Treasury Secretary is directed to "defer" an employer's obligation to "withhold, deposit, and pay" Social Security and Medicare taxes from the paychecks of certain employees. See: Memorandum on Deferring Payroll Tax Obligations in Light of the Ongoing COVID-19 Disaster, Presidential Memoranda, August 8, 2020, §2.

The employees to whom this action applies are those making less than $4,000 on a bi-weekly basis, or no more than $104,000 per year. Ibid, §2(b).

The deferral applies only to payroll taxes due on wages paid from September 1 through December 31, 2020. An employee bears a Social Security and Medicare tax burden equal to 7.65% of wages. Thus, a person earning the max of $104,000 annually will see an increase in take-home pay of about $2,560 over the period during which the directive is in effect.

THIS IS NOT A TAX CUT

Let's be clear on what this is not. It is not a tax cut. Neither is it a tax rebate. It is simply a temporary "deferral." The deferred taxes become payable as of January 1, 2021. Thus, the employee still owes the employment taxes that were not withheld beginning September 1

IN THIS ISSUE

through December 31. The order is silent as to exactly when and how the deferred tax must be paid.

Under ordinary circumstances, an employee who was paid compensation on which Social Security and Medicare taxes were not withheld must report those taxes on a separate form filed with the tax return. That form is IRS Form 8919, *Uncollected Social Security and Medicare Tax on Wages* (reproduced below). Since payroll taxes subject to the President's directive are the obligation of the employee, anyone who had their taxes deferred under this program will be personally responsible for filing Form 8919 with their 2020 tax return and paying the taxes that otherwise would have been withheld.

IT IS AN INTEREST FREE LOAN

Though you get an increase in your take-home pay up to $2,560 (max), you don't get to keep the money. It must be paid back to the IRS effective January 1, 2020. However, section 2(b) of the memo states that the amounts deferred are deferred "without any penalties, interest, additional amount, or addition to the tax."

So it is clear that this is merely a penalty- and interest-free loan from the government. The loan is due and payable after December 31, 2020, and, it seems to me, must be paid no later than April 15, 2021, which is the due date of the 2020 tax return. There is no suggestion in the memo or IRS guidance issued as of this writing that the deferment goes beyond April 15, 2021.

DON'T BET ON FORGIVENESS

It is also true that the memo makes no attempt to claim that the taxes deferred either are or will be forgiven in the future. I rather doubt the President has the constitutional authority to issue such an order.

Instead, section 4 of the memo instructs the Treasury to "explore avenues" that might lead to the "eliminat[ion] of the obligation to pay the taxes deferred." What may be such avenues?

The IRS already has the statutory authority to compromise (forgive) delinquent tax debts under code section 7122. But that requires a taxpayer seeking to compromise to comply with substantial financial disclosure requirements and limitations. I believe it would require deliberate Congressional authority to bring these specific employment tax debts under the sweep of section 7122. Short of that, a person would have to meet all existing Internal Revenue regulations and guidance in order to achieve a compromise of delinquent liabilities.

WHO OWES THE TAXES?

If no plan of forgiveness is put into effect, who owes the deferred taxes? Foundationally, those taxes are owed by the employee who earned the income. That is why the employee is responsible for filing Form 8919 with his return.

But additionally, and what may come as a surprise to many unsuspecting employers, is that the employer is equally liable for the tax. Code section 3403 dictates that the employer is legally responsible and liable for the payment of all employment taxes, even if the money was paid to the employees. As it stands of course, the statute makes no exception for taxes deferred under a Presidential Memorandum. Therefore, if the employee does not pay the tax, the IRS certainly can—and I expect will—look to the employer for collection.

And for corporate entities that otherwise find themselves in trouble with the IRS, the agency can be expected to use the Trust Fund Recovery Penalty, under code section 6672, to make individual corporate officers or employees personally responsible for the unpaid taxes.

Both employees whose Social Security and Medicare taxes were not withheld, and employers who did not withhold, might wake up on April 15, 2021 to discover they owe taxes to the IRS. The joy of receiving higher take-home pay for four months might well become the misery of dealing with IRS enforced collection.

THE PRESIDENT'S AUTHORITY

One might ask what the President's authority is to issue an executive order suspending the operation of federal tax law. Well, to start with, this directive is not an executive order at all. It does not purport to be an executive order. Rather, the directive is styled as a "Presidential Memorandum." It appears to be in the nature of mere suggestions and expressed wishes—rather than orders—to a federal agency with regard to law enforcement.

An executive order is the means by which a president instructs federal agencies how to carry out their duties. The key element of an executive order is that it must be consistent with legal parameters already set by Congress and the Constitution. That is to say, executive orders cannot make law; they merely express the president's direction on how to enforce the law, per his charge under Article II of the Constitution. That article provides that the president "shall take Care that the Laws be faithfully executed."

A Presidential Memorandum, on the other hand, carries no such force. Indeed, in section 5(c) of the memo, it provides that the memo "is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the United States" or any of its officers, agencies or employees."

The bottom line is that it appears to me that the Presidential Memorandum is not worth the paper it is written on when it comes to substantive tax relief.

TO WITHHOLD OR NOT TO WITHHOLD

In light of the forgoing, the question for employers is, starting September 1, should you continue to withhold on your employees as you have in the past, or do you subscribe to the deferral period and give your employees 7.65% larger paychecks until the end of the year?

Here are some factors to consider in making the decision.

1. It is important to understand that the memo does NOT apply to federal or state income taxes. The deferral applies only to the employees' share of Social Security and Medicare taxes. Nor does the deferral apply to the matching Social Security tax imposed on the employer. So to be clear, we are talking only about the employees' share of employment taxes under code sections 3101 and 3201, per section 2 of the Memo.

2. If you elect to not withhold the taxes, make triple sure your employees know and understand that this is not a tax cut or a tax rebate. This is simply a deferral and they are responsible for paying the taxes after January 1, 2021, under terms and conditions that we don't yet fully understand. Moreover, the deferral is not permanent. It ends December 31, 2020.

3. The deferral is not mandatory; thus employees have the choice to opt out if they don't wish to incur a tax liability on the deferred withholding. Exactly how that might occur is not clear at this time but I certainly would not force my employees to accept the deferral, and thus, a guaranteed future tax debt.

4. You as the employer need to understand that if the employee fails to pay the taxes, you are liable for the tax. Nothing in the Presidential Memorandum suspends or otherwise undermines the scheme of liability established under code section 3403. Even if your business is a corporation, the IRS could use the Trust Fund Recovery Penalty to hold you personally liable for the unpaid taxes.

5. The IRS cannot force employers to stop withholding. Even if your employees wish to take part, you as the employer can choose to continue withholding and depositing just as you have always done. In this scenario, you absolutely avoid any liability for an employee's potential failure to pay. And while the employees don't get more money in their checks, they don't owe the IRS money after December 31 either.

Form **8919**

Department of the Treasury
Internal Revenue Service

Uncollected Social Security and Medicare Tax on Wages

► **Go to *www.irs.gov/Form8919* for the latest information.**
► **Attach to your tax return.**

OMB No. 1545-0074

2019

Attachment Sequence No. **61**

Name of person who must file this form. If married, complete a separate Form 8919 for each spouse who must file this form.

Social security number

Who must file. You must file Form 8919 if **all** of the following apply.

- You performed services for a firm.
- You believe your pay from the firm wasn't for services as an independent contractor.
- The firm didn't withhold your share of social security and Medicare taxes from your pay.
- One of the reasons listed below under *Reason codes* applies to you.

Reason codes: For each firm listed below, enter in column (c) the applicable reason code for filing this form. If none of the reason codes apply to you, but you believe you should have been treated as an employee, enter reason code G, and **file Form SS-8 on or before the date you file your tax return.**

A I filed Form SS-8 and received a determination letter stating that I am an employee of this firm.

C I received other correspondence from the IRS that states I am an employee.

G I filed Form SS-8 with the IRS and haven't received a reply.

H I received a Form W-2 and a Form 1099-MISC from this firm for 2019. The amount on Form 1099-MISC should have been included as wages on Form W-2. **(Don't file Form SS-8 if you select reason code H.)**

	(a) Name of firm	**(b)** Firm's federal identification number (see instructions)	**(c)** Enter reason code from above	**(d)** Date of IRS determination or correspondence (MM/DD/YYYY) (see instructions)	**(e)** Check if Form 1099-MISC was received	**(f)** Total wages received with no social security or Medicare tax withholding and not reported on Form W-2
1					☐	
2					☐	
3					☐	
4					☐	
5					☐	

6	**Total wages.** Combine lines 1 through 5 in column (f). Enter here and include on Form 1040 or 1040-SR, line 1; Form 1040-NR, line 8; or Form 1040-NR-EZ, line 3			6	
7	Maximum amount of wages subject to social security tax	7	132,900		
8	Total social security wages and social security tips (total of boxes 3 and 7 on Form(s) W-2), railroad retirement (RRTA) compensation (subject to the 6.2% rate), and unreported tips subject to social security tax from Form 4137, line 10. See instructions	8			
9	Subtract line 8 from line 7. If line 8 is more than line 7, enter -0- here and on line 10			9	
10	Wages subject to social security tax. Enter the smaller of line 6 or line 9			10	
11	Multiply line 10 by 0.062 (social security tax rate for 2019)			11	
12	Multiply line 6 by 0.0145 (Medicare tax rate)			12	
13	Add lines 11 and 12. Enter here; include as tax on your annual tax return (Schedule 2 (Form 1040 or 1040-SR), line 5; Form 1040-NR, line 56; Form 1040-NR-EZ, line 16; Form 1040-SS, line 6; or Form 1040-PR, line 6) and see the instructions there ►			13	

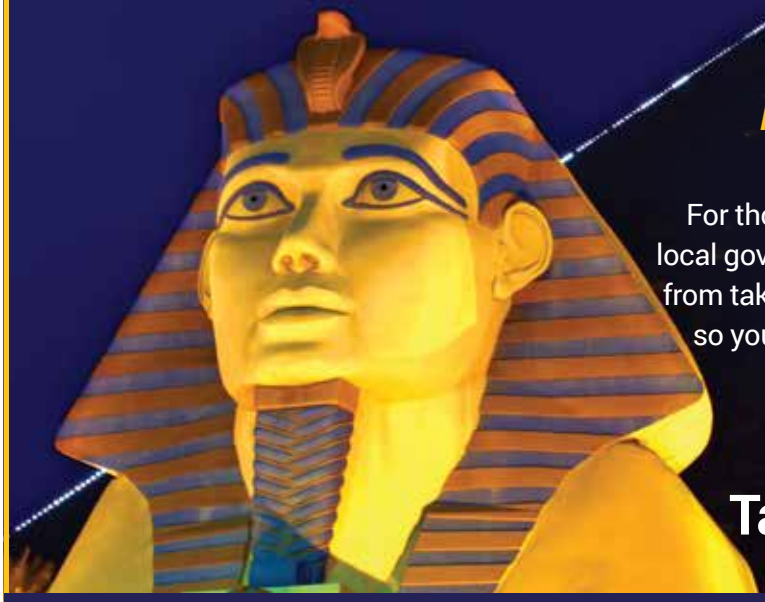
Mark Your Calendar Now!

Don't Miss the 2020 Taxpayers Defense Conference

Monday & Tuesday,
October 26-27, 2020
Luxor Hotel –
Las Vegas, NV

Continuing Education Credits Available for All Tax Pros

TFI is an IRS approved continuing education provider



Our TFI Members Only Business Meeting will be the Evening of **October 25, 2020.**

Mark your calendar now and don't miss this conference!

For those who do not wish to travel, or for some reason, local government shutdown orders prevent our live seminar from taking place, we are working to establish connections so you can participate in the conference electronically.

Check Out The Details On Our Website.

TaxFreedomInstitute.com

2020 Taxpayers Defense Conference Agenda

The Broken IRS

This session addresses the current condition of the IRS in light of COVID-19 shut downs and force reduction. Focus will be on work-arounds when dealing with the Collection and Appeals functions.

Holistic Tax Resolution Strategy

This session presents a broad, holistic "systems engineering" approach to tax resolution. Using checklists and flowcharts, we analyze all of the essential "issue spotting" considerations to review when a new client comes in.

Emergency Measures to Stop Collection

This session identifies and explains the three emergency measures to stop enforced collection, including an analysis of the statutory levy exemptions and how to assert them. This session also includes a discussion of claiming a refund for wrongfully levied property.

Understanding the Tax Court

This session reviews the fundamentals of the U.S. Tax Court. Special emphasis is on Tax Court jurisdiction so practitioners fully understand the scope of cases subject to review by the U.S.

Tax Court. This session is essential even for non-attorneys, since non-attorney practitioners regularly encounter situations in which the Tax Court is a resolution option that must be recognized. In that case, non-attorneys must be prepared to bring in counsel admitted to practice in the Tax Court.

Appealing a Notice of Deficiency

This session addresses the specific procedures for challenging a Notice of Deficiency, which is the IRS's final administrative determination that a citizen owes additional taxes. The session addresses the two specific options for judicial review of the Notice of Deficiency and builds on issues presented in the session Understanding the Tax Court.

Appealing a Notice of Determination

This session addresses the statutory procedures for challenging a Notice of Determination, which is the final determination that is issued by the IRS's Office of Appeals in a Collection Due Process Appeal. It outlines the procedures for judicial review of a Notice of Determination and builds on issues presented in the sessions Understanding the Tax Court and Appealing a Notice of Deficiency.

Live Role-playing of Appeal Scenarios

During this session the attendees are broken into separate groups and each group is presented with a set of facts regarding a hypothetical case involving the topics presented. All of the facts are derived from actual cases. The groups must develop/present arguments to defend the taxpayer and assert a potential defense based on the facts and applicable law of the case, based on all of the teachings of the previous day's sessions. Each group includes an experienced tax pro playing the part of an IRS officer.

Evaluation and Critique of Role-playing Sessions

Dan Pilla and other TFI staff review, critique and analyze each of the mock negotiation sessions. We analyze the strengths and weaknesses of each presentation, evaluate the performance of the participants, and discuss potential alternative approaches under the circumstances.

Tax Court Practice Basics

This session presents the basics of Tax Court practice and procedure, including motions practice, discovery procedures, summary judgment and remand, and stipulations and agreed settlement procedures.

Understanding and Avoiding Conflicts of Interest

This session addresses essential considerations for avoiding conflicts of interest. Special emphasis is placed on potential and actual husband/wife conflicts and conflicts arising from corporation tax issues, including especially the Trust Fund Recovery Penalty. Here we also address the Tax Court Rules of Practice regarding the process of avoiding conflicts of interest.

Ascertaining "Reasonable Fees"

This session addresses the ethical considerations encompassed in the professional responsibility to charge fees for services that are "reasonable." Specifically, we address IRS Circular 230 governing the practice before the IRS of attorneys, CPAs and Enrolled Agents as it relates to charging fees.

Moderated Discussion

Group discussion of problems, questions and strategies based upon all earlier presentations. We will present and discuss hypothetical [[and real?]] cases involving various aspects of IRS problems resolution.

We are approved for 12 hours of standard continuing education credits and 2 hours of ethics credits. T hese are available for all tax pros. TFI is an IRS-approved continuing education provider

Check TaxFreedomInstitute.com for more details and updates. | 1-800-346-6829

"Speak Into The Pen"

Tax Practitioners Beware: The IRS's Orwellian Scheme Development Center

BY NATHAN MACPHERSON *

Those who attended my session *Avoiding Criminal and Civil Practitioner Liability* at the 2019 Taxpayers Defense Conference will recall not only the fact that return preparers can be prosecuted under code *§ 7206(2)* for "aiding or assisting" the filing of false returns, but also that the government prosecutes such cases based upon evidence obtained by undercover agents (UCAs) posing as clients. I told the story of the agents who posed as Wyoming cattle rancher clients to my father. They did not realize that he has a Masters in Agricultural Economics, and thus called their bluff when they didn't know cattle ranching lingo or have a cowboy's tan on their necks. As *Orwellian* as that is, 1984 is nothing compared to 2020, when HAL 9000 from 2001 has now become a reality.

In 1948 George Orwell wrote *1984*. Twenty years later, Arthur C. Clarke's *2001: A Space Odyssey* debuted with the AI character HAL 9000. From the *Thought Police* political order of the *New Millennium* in the United States – and elsewhere – Orwell's prediction of a new *Big Brother* authoritarian order has proven eerily accurate.

In 2020, besides the infamous *"Your papers please"*

from the SS – now required in some jurisdictions to venture out during "lockdown," tax practitioners (who are at least "essential" in most if not all jurisdictions) face referral to the IRS's *Scheme Development Center* (SDC), effectively the AI of HAL 9000 now looking over our shoulders, checking our work, watching every move we make. Beware your statistics: e.g., a high percentage of your clients with refunds, or self-employment income, or the Earned Income Credit (EIC), Child Tax Credits (CTC), or American Opportunity Credit (AOC). This much is clear: to *all* discussions with *both* IRS and *all* of your clients: *"Smile. You're on Candid Camera!"*

Last year tax preparer Joe Brown, part of *Number 1 Tax LLC*, a mom-and-pop tax preparation business made up of three preparers, was indicted in Minneapolis on seven counts of aiding in the filing of false tax returns under *§ 7206(b)*. Each count carries a maximum sentence of three years. Unusual about Joe's case are the following: (1) it was initially flagged by the *SDC* computer; (2) the indictment only includes charges of aiding in the filing of false tax returns; (3) the total indictment tax loss claim is only about $33,000, an average of about $4,700 per count (*small potatoes* for a criminal tax indictment); and (4) IRS utilized only one sting operation.

WHAT IS THE SCHEME DEVELOPMENT CENTER?

A total of ten SDCs are located at or close to eight IRS Campuses. "The primary function of the SDC is to identify schemes for the purpose of referring and supporting high-impact criminal tax and related financial investigations." *See*: IRM 9.8.1 (October 29, 2019). The SDC's mission is "achieved through the use of human and artificial intelligence and via collaboration with stakeholders." Like the song, *Eye in the Sky:* "I am the eye in the sky, looking at you, I can read your mind."

IRS acronyms are – as always – prolific. For example: QRP—Questionable Refund Program; QRDT—Questionable Refund Detection Teams. Such teams are located at each of the ten SDCs. However, the QRP business return detection efforts take place at the Cincinnati and Ogden SDCs only.

Questionable returns are "identified by manual or computerized screening techniques." The Electronic Fraud Detection System (EFDS) is a Criminal Investigation (CI), "computer system that automates the computer identification output for potentially fraudulent electronic filed tax returns, increases data available for analysis, and assists in the development of information relating to paper and ELF [Electronic Filing] schemes detected by the QRDTs." Not to be confused with: LDC, the Lead Development Center in Laguna Niguel, CA, to which are reported "Abusive Shelters and Preparers of Fraudulent Returns." See also: IRM 5.20.8 (August 23, 2019), Promoter/Preparer Investigations.

Clearly, Big Brother is watching not only taxpayers, but also tax practitioners!

The SDC "human and artificial intelligence" examination of the *Number 1 Tax LLC* returns resulted in an alert to CI Special Agent Marissa Pitzen (SA Pitzen).

SA PITZEN'S ANALYSIS OF RETURNS FILED

According to SA Pitzen's affidavit filed with the U.S. District Court in support of a search warrant, as to the returns filed by Joe Brown's company for the 2014 filing season: (1) 98% resulted in refunds; (2) 69% claimed the EITC; (3) 42% included one or more Schedule C businesses, which "is a common method that unscrupulous tax return preparers use to increase their clients' refunds by manipulating the trend income of the client in order to increase or qualify clients for refundable credits such as the [AOC, CTC] and EITC, all of which are based, in part, on the amount of earned income a taxpayer reports;" (4) the vast majority of businesses were small, commonplace mom-and-pop businesses; e.g., barber shops, hair stylists, cleaners, housekeepers, and daycares; (5) 93 returns reported wages and/or withholding amounts that did not correspond with the W-2s filed with IRS, with at least 25 reporting wages and/

or withholdings higher than that reported to IRS by the employer; (6) at least 40% of the returns claimed the AOC which is a refundable tax credit for college expense. Similar results were obtained from review of the 2015 returns filed by the company.

THE STING OPERATION

In 2015 an IRS undercover agent (UCA), acting as a client, presented to Brown a W-2 showing wages of only $871. Brown explained that he increased the income amount "a little but not too much" so as to obtain a larger refund for the UCA. Brown prepared and filed a return showing $8,371 in wages, almost ten times as much as shown on the W-2 filed by the employer.

According to the UCA, Brown told him that, "because he had a W-2 it was easy for him to report extra income for him but that he didn't have to do it in a way where it was 'self-employed.'" Brown told the UCA, "he just added a couple extra thousand of income and that it was okay so long as he had a W-2." Also, Brown offered to make the UCA receipts if "they" were to request such, and that, "it's not a big deal." The UCA should have claimed a lawful refund of $350. Instead, the return prepared by Brown claimed a bogus refund of $4,575. The lawful refund from Minnesota should have been $94; instead, it was $919.

In addition to preparing false returns, Brown "offered the UCA an opportunity to earn extra money by bringing in clients" and "provided the UCA with a *Number 1 Tax LLC Compensation Plan* that detailed how much weekly pay and 'commission' the UCA would earn as a 'temporary' employee by the number of clients he brought in per week."

And the *Number 1 Tax LLC conspirators practiced what they preached.* Brown's filed returns included "similar characteristics to the questionable returns filed by Brown and others at *Number 1 Tax LLC* on behalf of their clients." Preparer Williams' 2014 return qualified her to receive a refund of $6,709 based largely on the EITC. Education credits claimed on preparer Karn's returns for 2013 and 2014 did not match IRS records and a 2012 return claimed a refund "comprised entirely of false federal withholdings reported on the return." The conversation between Brown and the UCA was recorded *surreptitiously* by the UCA using both audio and video. *"Smile, you're on Candid Camera!"*

SA PITZEN'S QUESTIONING OF BROWN

Picture the simple, small office of *Number 1 Tax LLC*. Now picture SA Pitzen and the "IRS team," which executed the search warrant in 2015, consisting of thirteen IRS agents, eleven of whom were CI Special Agents, armed and wearing "IRS enforcement vests and jackets." *Gangbusters. Eliot Ness and The Untouchables.*

Not finding the office open at 9 AM on Thursday, June 11, 2015, SA Pitzen went to Brown's residence and met with him to obtain the key to his office. Brown provided SA Pitzen with the office key and she attempted "to talk to him about the business" and "ask him questions." Brown declined to talk, but went to the office and sat down with SA Pitzen who explained the nature of the charges and read Brown his noncustodial rights.

The interview lasted almost two hours; the search and seizure a little longer. Brown waived his *5th Amendment* right to remain silent and admitted to filing false tax returns. In the process, he asked, "How much time am I looking at?" The interview was not recorded. Rather SA Pitzen took notes from which she later prepared a memorandum of interview. Computers seized by IRS were returned to Brown the next day.

THE INDICTMENT

After exercise of the search and seizure warrant, Department of Justice (DOJ) obtained an indictment against Joe Brown only, leading to the logical conclusion that deals were cut with the other targets. Brown was charged with seven counts of "Aiding and Assisting in the Preparation of False Individual Income Tax Returns" under *§ 7206(2)*, each count bearing a maximum possible sentence of three years.

The grand jury claimed that, "The returns were

false and fraudulent as to material matters, in that they represented that the taxpayers received certain business income and wage amounts; however, as the defendant then and there well knew and believed, the taxpayers did not have the business income and wages specified and, therefore, were not entitled to the tax refund amounts claimed below: [returns filed in the year 2013, 2014, or 2015, with refunds claimed ranging from $2,755 to $8,375, and totaling about $33,000]…."

Surprisingly there were no additional charges asserted. As such, the resultant additional prison sentence exposure, including, *inter alia*, possible charges of conspiracy, interference with IRS, defrauding IRS, tax evasion, mail fraud, wire fraud, money laundering, and forfeiture, were not at stake.

Not surprisingly, Brown's motions to suppress evidence obtained during the search and seizure and to suppress statements, admissions, and answers made by Brown to SA Pitzen were, after an evidentiary hearing at which Pitzen testified, denied. What is surprising is why the IRS bothered with the investigation and indictment of this mom-and-pop operation in the first place, especially given the obvious: *much bigger fish to fry,* and just as easily as *Number 1 Tax LLC.*

FOR IRS: BIGGER FISH TO FRY?

For example, the IRS recently passed up the simple and easy opportunity of prosecuting promoters of a bogus solar energy credit program, under which several individuals claimed credits exceeding $1 million, the operation of which resulted in a total of tens of millions in dollars in fraudulent credits. Instead of proceeding criminally, the IRS was satisfied with a civil audit resulting in a currently pending Tax Court case.

But the solar energy scam pales in comparison to tax scams of *"the rich and famous,"* including the newsworthy scam: sale of California petroleum coke, purportedly perpetrated by billionaire Bill Koch. Under the scheme, according to a former *insider* – a Koch attorney whistleblower – and public reports, cost the government hundreds of millions of dollars.

Ironically, as to structure, Bill Koch's plan was as simple as that of low roller Joe Brown. Through a Swiss company, Koch created a Bahamian company and claimed all of his California company's coke production income – clearly earned by its operation in the United States – as *tax-free income* made offshore. Presto! At the snap of finger!

Of note is that Koch's coke company in California had 300 employees. In the Bahamas, it had seven. In fact, use by United States companies of offshore tax havens for tax evasion purposes continues to proliferate, despite more recent IRS and DOJ crackdowns, including a major *coup de grâce* in 2013. Switzerland and other countries threw in the towel as to their bank secrecy policies, which were considered sacrosanct for centuries.

Why, then, the time and resources expended on the likes of minor, insignificant players like Joe Brown? *Granted*, the IRS wants to send a warning shot across the bow of the small business operators. After all, there are far more of those than there are of the mega-buck targets. Remember that the name of the game is to "ensure voluntary compliance." About 155 million individual tax returns filed annual, many of which are prepared by mom-and-pop tax preparers. The IRS's justification for prosecution of the mom-and-pop preparers lies in the answer to this question: To which case will TFI members now give greater attention: Joe Brown or Bill Koch?

BIG BROTHER IS WATCHING

Ironically, the biggest pop music hit in both the USA and the UK in 1983 – just one year before the Orwellian benchmark of 1984 – was the song *Every Breath You Take,* written by Gordon Matthew Thomas Sumner, better known as Sting, and performed by his English rock band *The Police. Consider these lyrics:*

Every breath you take
Every move you make
Every bond you break

Every step you take
I'll be watching you.

Every single day
Every word you say

Every game you play
Every night you stay
I'll be watching you.

***Nathan MacPherson** *is an attorney licensed in California, England, and Wales. He is the son of Mac MacPherson, and thus a second generation member of TDI/TFI. This article serves as an addendum to Nathan's oral presentation at the 2019 TFI conference,* Session 8, Avoiding Criminal and Civil Practitioner Liability (2019).

State And Local Governments Looking For Creative Ways To Steal More Money

No, We are NOT All in this Together

Since much of America is out of work, languishing at home under draconian "shelter in place" orders, people stopped going to restaurants, bars, theaters, sports venues, clubs, etc. Instead, they streamed movies, music and TV shows from the Internet. As a result, state and local governments have lost billions in tax revenue from sales and other taxes. In the meantime, millions of small businesses are simply shutting down operations permanently because they cannot survive the ongoing orders that closed our economy.

But rather than suck it up, or find ways to stop spending money (even just temporarily), states are instead looking for creative ways to bleed even more money from their already cash-strapped citizens. The following article is reprinted from Daily Tax News. It illustrates how out of touch government employees and policymakers are with real-world problems. It clearly shows that we most certainly are not "all in this together."

NETFLIX TAX

Stung by revenue losses from the closure of movie theaters, concert halls, and stadiums during the COVID-19 pandemic, cities across Illinois are considering ways to capture tax dollars from streaming entertainment. The trend has implications for cash-strapped governments across America.

The city of Evanston recently joined its much larger southern neighbor, Chicago, expanding the reach of its amusement tax ordinance to take advantage of surging consumer demand for movies on Netflix, music on Spotify, and gaming on PlayStation Now. Other cities could broaden their tax bases to online entertainment in the coming months to replenish coffers strangled by the public health crisis. The Illinois Municipal League is supporting the effort with a model ordinance.

States have been trying to figure out how to tax streaming services for years, and the issue is only getting more urgent as digital conversion grows. An analysis by

the Urban-Brookings Tax Policy Center found 33 states tax online entertainment through their sales taxes, but the rest, including Illinois, have struggled to tax this emerging feature of the economy. "Local governments in Illinois have been feeling financial stress for some time, and of course now it's even worse," said Carol Portman, president of the Taxpayers' Federation of Illinois. "So it's no wonder they're looking for alternative revenue sources."

Alex Thorpe, revenue manager for Evanston, said cities in "downstate Illinois" frequently conform to tax innovations developed in Chicago and its suburbs. Evanston, which prides itself as a tax policy trendsetter, made several changes to its amusement tax on June 8. The city established a new 5% tax on streaming entertainment and a new tax rate of 7% on large events. Chicago and Evanston are the only jurisdictions in the country that tax electronically provided entertainment the same way they tax tickets for movies, concerts, and carnivals.

"I could see this picking up traction in a lot of Illinois communities," Thorpe said. "They read the same publications we read, and they are waiting for the first domino, like Evanston, to fall. So after our tax clears in a couple of months I would imagine you'll see some communities move it forward."

"Let the Lawsuits Begin"

Still, Illinois cities following Evanston's lead could be placing themselves in legal jeopardy, said Stephen Kranz, a partner in the Washington office of McDermott Will & Emery LLP. Kranz, who is representing tech giant Apple Inc. in a legal challenge to Chicago's so-called Netflix tax, said Evanston's law and the model pushed by the Illinois Municipal League suffer from "serious legal infirmity" under the commerce clause of the U.S. Constitution and the Internet Tax Freedom Act.

"Let the lawsuits begin," Kranz told Bloomberg Tax.

Despite such warnings, towns and cities have been emboldened by an Illinois Supreme Court decision at the end of March declining to intervene in a constitutional challenge to Chicago's Netflix tax, Thorpe and Portman said.

LEGAL THREAT GONE

Users of Netflix, Hulu, and Spotify argued that Chicago's Amusement Tax Ruling No. 5, a revenue program created in 2015 to impose the 9% amusement tax on streaming entertainment, should be voided because it treats taxpayers inconsistently. The plaintiffs called the tax an illegal and extraterritorial exercise of the city's taxing authorities. In October 2019 a unanimous three-judge appeals panel affirmed an earlier circuit court ruling, finding the tax program had no unconstitutional extraterritorial effect. The court also rejected alleged violations of the federal tax freedom act, which generally prohibits political jurisdictions from imposing discriminatory taxes on electronic commerce. "In my view, some folks held back on this because the court case was still active and people wanted to see what the outcome would be," Thorpe said.

Municipalities throughout the country are taking a keen interest in streaming entertainment taxes as the industry flourishes during the pandemic, said Toby Bargar, a senior consultant with the tax compliance company Avalara. Some jurisdictions have applied their sales taxes to the sector, but that hasn't been possible in states and cities that don't tax services. In response, creative approaches have emerged by which existing tax structures are stretched over digitally delivered products and services, including Chicago's Netflix tax, California's public utility users tax, and Florida's communications services tax.

"We are seeing local home-rule jurisdictions finding interpretations that fit this activity within existing broad definitions," Bargar said. "That's what Chicago did, that's what some of the California home rules have done."

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