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MANAGEMENT

COVID-19-Related Government Budget Deficits May Spur Aggressive Payroll and Sales Tax Audits

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Since COVID-19 invaded the United States earlier this year, the restaurant industry has not been the same. The days of full dining rooms and crowded bars are gone for now leaving many businesses struggling to pay employees and keep its doors open. However, restaurants are not alone in their struggles. Businesses across America are facing decreases in revenue.

America's economic struggles are not just a private sector problem. Less revenue for businesses and income for individuals means less tax dollars for federal and state governments. On July 13, the U.S. Treasury Department reported a monthly federal deficit of $864 billion. States are facing similar problems. The Center on Budget and Policy Priorities estimates that state budget shortfalls will reach almost 10 percent in the current fiscal year and about 25 percent in fiscal year 2021.

Although the IRS and state taxing authorities have initially slowed their pace of audit activity to protect the health and safety of their own employees during these turbulent times, this is only temporary. Given the budget deficits faced by federal and state governments, taxing authorities are likely to begin encountering increased pressure to collect more revenue. Consequently, restaurants can expect more aggressive payroll and sales tax enforcement in the near future. By keeping proper records, using collected and withheld funds

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for only their designated purpose, and working with competent ta
themselves against potentially costly sales and payroll tax assessments and, in more egregious situations, criminal prosecutions.

Payroll and Sales Tax Overview

Payroll and sales tax are trust fund taxes. Trust fund taxes require business like restaurants to collect or withhold certain funds on behalf of a state or federal government and then report and pay these amounts over. In times of economic struggle, it is not uncommon for restaurants to lose track of the collected or withheld trust funds or, in more egregious cases, consciously decide to use them to pay other expenses. When these things occur, restaurants subject themselves to significant financial and punitive exposure.

Sales tax is levied by states. For this type of tax, restaurants must collect a percentage of taxable sales and pay it over to its state taxing authority.

Payroll taxes are levied by the U.S. Internal Revenue Service (IRS) for Social Security and Medicare and by federal and state tax authorities for unemployment funds. Some taxes are the sole responsibility of the restaurant-employer such as Federal Unemployment Tax Act (FUTA), most State Unemployment Tax Act (SUTA), and a portion of Federal Insurance Contributions Act (FICA) taxes. However, a portion of FICA taxes must be withheld from employee compensation and paid over to the IRS by the restaurant-employer in a manner similar to sales tax.

While many think of sales and payroll taxes as company liabilities, they can be imputed to individuals considered to be “responsible parties” in certain cases. Often times, soon after a company is assessed for payroll or sales tax that was deemed to be withheld or collected but not paid over, the IRS or state taxing authority will issue an assessment in an equivalent amount against its principals and/or managers. If not satisfied, this assessment will follow these individuals even if the restaurant ultimately shuts down and will subject them to the full panoply of tax collection mechanisms.

Recordkeeping Tips

When it comes to sales and payroll taxes, there is always a danger that the funds collected or withheld will be used for unauthorized purposes rather than be paid over to the government. This is especially true when times are tough and managers are looking for ways to pay bills. A good practice for restaurants is to move these trust fund monies into separate bank accounts. This will make is harder for those funds to be used to pay general business expenses and will help to ensure that the funds are available when it is time to report and pay its sales and payroll taxes.

Additionally, while some accountants only require restaurants to provide sales ledgers showing cash and credit totals of taxable, non-taxable sales, and tips for each day to prepare sales tax returns, these records may not be enough to escape a potential sales tax audit unscathed. Restaurants should consider maintaining guest receipts and daily point of sale printouts detailing individual sales transactions. Some state taxing authorities require this information. Without it, an auditor may use an alternate methodology to estimate the restaurant’s taxes such as a sampling methodology or a comparison to industry standards, which could result in a sales tax assessment far in excess of its actual liability.

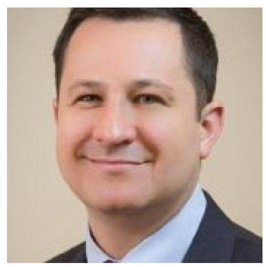
Keep Your Hand Out of the Cookie Jar

Not all payroll and sales tax issues are created equal. Some are treated more seriously. Withheld and collected tax funds belong to the government and not to the restaurant. Consequently, when funds collected or withheld on behalf of a government are misused by a restaurant, it may be treated as theft.

In these situations, restaurant principals and managers, dependin
egregiousness of the conduct, could be criminally prosecuted for the money they failed to pay over. Consequently, while struggling restaurants often have no choice but to triage its expenses and pay only those that are most pressing, it is critically important that they not utilize this practice when it comes to withheld payroll and collected sales taxes.

What If You Get Contacted

If you receive a letter from the IRS or state taxing authority stating that your restaurant is under audit, you should consider contacting a tax attorney with experience in payroll and sale tax audits. These proceedings often raise legal issues that can significantly impact your financial exposure such as whether particular sales are taxable or nontaxable, whether the records maintained by the restaurant are sufficient, and whether particular restaurant owners and managers should be individually assessed as responsible parties. Even more significantly, they can result in a criminal referral in egregious cases. By working with a tax attorney experienced in civil and criminal tax controversy matters, restaurants can significantly limit their financial and punitive exposure.



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