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Robert W. Wood
THE TAX LAWYER

IRS Urged To Penalize — And Prosecute Payroll Tax Violations

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The IRS watchdog known as the Treasury Inspector General for Tax Administration has issued a report with some shocking figures about serious employment tax crimes. The number and size of payroll tax violations is going up, and mere IRS penalties are not enough to stop the trend. The report urges two parts of the IRS–including its Criminal Investigations Division–to act. Employment tax embezzlement is a felony punishable by up to five years in prison. Employers are required to withhold and remit payroll taxes including federal income taxes, Social Security and hospital insurance (Medicare) taxes withheld from employee pay. Willful failure to remit them is a crime.

The new report first tries to lay out the levels of payroll tax noncompliance. It also assesses the extent of civil and criminal enforcement actions taken by the IRS. And change is probably coming. The watchdog report recommends that the civil and criminal parts of the IRS take on a new and focused strategy to become more effective against egregious employment tax cases. In addition, the report suggests that IRS collection personnel should expand their criteria for referring potential criminal cases to that division of the IRS. In particular, cases involving over $1 million, and individuals involved in 10 or more companies with payroll tax failures.

In part, IRS officials have already agreed with the recommendations. The IRS agreed with the need to develop a focused strategy. The IRS disagreed that its collection function should expand the criteria for referring cases to the Criminal Investigation Division. But as these issues get resolved, make no mistake, employment tax noncompliance is a serious crime. When employers fail to account for and deposit employment taxes, which they hold in trust on behalf of the federal government, they are stealing from the government.

These stolen funds include amounts used to fund important federal programs including Social Security and Medicare. The federal government must use general tax revenues to make whole the Social Security and Medicare trust funds for uncollected employment taxes. The report sees growing problems. As of

December 2015, 1.4 million employers owed approximately $45.6 billion in unpaid employment taxes, interest, and penalties. Assessing 100% trust fund penalties on all responsible persons is an effective civil enforcement tool that the IRS can use to discourage employers from continuing egregious employment tax noncompliance. Even so, we should expect more enforcement, and earlier identification of payroll tax problems from the IRS.

In 2015, the IRS assessed the 100% trust fund recovery penalty against approximately 27,000 responsible persons. That may seem a high number, but it was 38 percent fewer than just five years before. Meanwhile, the number of employers with employment tax noncompliance for 20 or more quarters of delinquent employment taxes is steadily growing. It has more than tripled in a 17-year period. Even the 100% trust fund recovery penalty fails to deter some violations.

The report says that 59 individual taxpayer accounts assessed the trust fund recovery penalty for 10 or more entities. That sounds recurrent if not downright flagrant. Yet the report reveals that only 5 of the 59 individuals (a mere 8.5 percent) had been investigated by the Criminal Investigation Division of the IRS for potential criminal prosecution. The report also notes that there were many taxpayer accounts with over $1 million in trust fund recovery penalty assessments from 2010 through 2015. Approximately 700 individuals were assessed penalties in excess of $1 million each during this period, yet there were fewer than 50 of those individuals who were the subject of criminal investigations.

Although the willful failure to remit employment taxes is a felony, there are fewer than 100 criminal convictions per year. In addition, since the number of actual convictions is so tiny, the report suggests that fear of prosecution does not deter payroll tax violators. Even though willful failure to remit employment taxes is a felony, prosecutors obtain fewer than 100 criminal convictions each year.

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