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IRS Payroll Tax Violations Can Draw Big Penalties And Even Prison Time

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The IRS can be tough on collecting income taxes, and even tougher where payroll taxes are concerned. The money is withheld from employee wages, and is *supposed* to be paid over to the IRS, promptly. If the IRS doesn't get it, the losses can mount quickly. This is trust fund money that belongs to the government, and no matter how good a reason the employer has for using the money for something else, the IRS is strict. The IRS can target the owners of the business, plus check signers and other responsible persons who had a role—or could have had a role—in the failures to pay. Sometimes, the IRS even goes after third parties, even criminally. If convicted, the sentences can be stiff.

Any failure to pay—even late payment—is serious, regardless of how or why the employer or its principals use the tax money for something else. Using the money to pay suppliers and keep the business open isn't a good reason in the IRS view. Payroll services are one common answer, so the employer doesn't have discretion to use the money to pay vendors or for anything else. But what if the payroll service takes the money? That horrific possibility features prominently in a report from the Treasury Inspector General.

So be careful who you hire too. When a tax shortfall occurs, the IRS will usually make personal assessments against all responsible persons who have ownership in or signature authority over the company and its payables. The IRS can assess a Trust Fund Recovery Assessment, also known as a 100% penalty, against every "responsible person" under Section 6672(a). You can be liable even if have no knowledge the IRS is not being paid.

If you are a responsible person the IRS can pursue you personally for payroll taxes if the company fails to pay. The 100% penalty equals the taxes not collected. The penalty can be assessed against multiple responsible persons, allowing IRS to pursue them all to see who coughs up the money first.

"Responsible" means officers, directors, and anyone who makes decisions about who to pay or has check signing authority.

A recent example involved a Maryland man who was convicted of 16 counts of failing to collect and pay over payroll taxes. Brett Hill, of Parkton and Berlin, was the Chief Executive Officer of two telecommunications companies, who was recently convicted of failing to pay payroll taxes according to a Department of Justice release. Hill was responsible for withholding taxes from employee wages and paying them promptly over to the government. He was responsible for filing employment tax returns, and for paying the companies' share of the employment taxes as well.

He withheld the taxes, but he failed to file the tax returns or to pay the withheld amounts to the government. In all, the government tallied the tax loss to the government at over $1 million. Penalties can be stiff. When Mr. Hill is sentenced, he could face a maximum penalty of five years in prison, and that could apply to *each* count of failing to collect and pay over taxes.

The IRS focus on payroll taxes is nothing new. Some years ago, the Treasury Inspector General for Tax Administration issued a report with some shocking figures about serious employment tax crimes. The number and size of payroll tax violations is up, and mere IRS penalties are not enough to stop the trend. Employment tax embezzlement is a felony punishable by up to five years in prison, and the report urged the IRS Criminal Investigations Division to act.

The report recommended that both the civil and criminal divisions of the IRS should be more aggressive with egregious employment tax cases. The report suggested that IRS collection personnel should expand their criteria for referring potential criminal cases to that division of the IRS. When employers fail to timely account for and deposit employment taxes, which they hold in trust on behalf of the federal government, the consequences can be serious.