

More Criminal Payroll Cases Coming

By Robert W. Wood

Most tax cases are civil. As complex as our system is, many tax mistakes can be forgiven. Sure, you might still end up with civil penalties, depending on how big your mistake is, how much you tried to comply, and who you relied upon, among other variables.

But some things cannot be excused. One the IRS often has a hard time accepting is when employers mess up on their payroll taxes. I'm not talking about the wrong number of withholding exemptions, or being a day late. You might get penalized for such mistakes, but it is unlikely that the consequences will be dire. A criminal tax case is a different story. Even an indictment — let's assume that you later can obviate the case, or are acquitted — can be devastating.

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. See TIGTA Report No. 2017-IE-R004, A More Focused Strategy Is Needed to Effectively Address Egregious Employment Tax Crimes (March 21, 2017). The report makes clear that 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 the IRS Criminal Investigations Division — to act. Why? Because 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 report recommends that the civil and criminal divisions of the IRS should take on a new strategy to become more effective against egregious employment tax cases. The report also suggests that IRS collection personnel should expand their criteria for referring potential criminal cases. Remember, the majority of criminal tax cases come from simple criminal referrals within the IRS. That is, a civil IRS auditor sees something odd, and sends it along for a criminal IRS employee to investigate. The IRS is not obligated to tell you that this is happening.

More payroll tax infractions are likely to go this way. The report urges the IRS to consider prosecution for cases involving over \$1 million, and individuals involved in 10 or more companies with payroll tax failures. That may sound big. In fact, though, it can be pretty easy to reach \$1 million.

IRS officials have already agreed with a number of the recommendations in the report. For example, 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 the internal IRS debates over these issues get resolved, it seems reasonable to assume that more prosecutions are likely. Make no mistake, employment tax noncompliance can be a serious crime. As the IRS sees it, 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.

The report tracks a growing trend. As of December 2015, 1.4 million employers owed approximately \$45.6 billion in unpaid employment taxes, interest, and penalties. The report says that assessing 100 percent trust fund penalties on all responsible persons is an effective civil enforcement tool. The IRS can use it to discourage employers from continuing egregious employment tax noncompliance.

Even so, we should expect more criminal enforcement, and earlier identification of payroll tax problems from the IRS. In 2015, the IRS assessed the 100 percent 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. This figure has more than tripled in a 17-year period. Even the 100 percent trust fund recovery penalty fails to deter some violations.

The report says that 59 individual taxpayers were slapped with 100 percent trust fund recovery penalties 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. However, fewer than 50 of those individuals were the subject of criminal investigations.

The willful failure to remit employment taxes is a felony. Even so, there are fewer than 100 criminal convictions per year. Since the number of actual convictions is so small, the report suggests that fear of prosecution does not deter payroll tax violators. But more prosecutions might change that. Whatever happens to criminal enforcement, try not to have even civil payroll tax problems!

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