

July 2008

# TAX COMPLIANCE

## Businesses Owe Billions in Federal Payroll Taxes





Highlights of [GAO-08-617](#), a report to Congressional Committees

## TAX COMPLIANCE

### Businesses Owe Billions in Federal Payroll Taxes

#### Why GAO Did This Study

GAO previously reported that federal contractors abuse the tax system with little consequence. While performing those audits, GAO noted that much of the tax abuse involved contractors not remitting to the government payroll taxes that were withheld from salaries.

As a result, GAO was asked to review the Internal Revenue Service's (IRS) processes and procedures to prevent and collect unpaid payroll taxes. Specifically, GAO was asked to determine (1) the magnitude of unpaid federal payroll tax debt, (2) the factors affecting IRS's ability to enforce compliance or pursue collections, and (3) whether some businesses with unpaid payroll taxes are engaged in abusive or potentially criminal activities with regard to the federal tax system. To address these objectives GAO analyzed IRS's tax database, performed case study analyses of payroll tax offenders, and interviewed collection officials from IRS and several states.

#### What GAO Recommends

GAO makes six recommendations to IRS to address issues identified in this report, including development of (1) processes and performance measures to monitor collection actions against egregious payroll tax offenders and (2) procedures to timely file tax liens and assess penalties to hold responsible parties personally liable for not remitting withheld payroll taxes. IRS agreed to our recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-617](#). For more information, contact Steven J. Sebastian at (202) 512-3406 or [sebastians@gao.gov](mailto:sebastians@gao.gov).

#### What GAO Found

IRS records show that, as of September 30, 2007, over 1.6 million businesses owed over \$58 billion in unpaid federal payroll taxes, including interest and penalties. Some of these businesses took advantage of the existing tax enforcement and administration system to avoid fulfilling or paying federal tax obligations—thus abusing the federal tax system. Over a quarter of payroll taxes are owed by businesses with more than 3 years (12 tax quarters) of unpaid payroll taxes. Some of these business owners repeatedly accumulated tax debt from multiple businesses. For example, IRS found over 1,500 individuals to be responsible for nonpayment of payroll taxes at three or more businesses, and 18 were responsible for not remitting payroll taxes for a dozen different businesses.

Although IRS has powerful tools at its disposal to prevent the further accumulation of unpaid payroll taxes and to collect the taxes that are owed, IRS's current approach does not provide for their full, effective use. IRS's overall approach to collection focuses primarily on gaining voluntary compliance—even for egregious payroll tax offenders—a practice that can result in minimal or no actual collections for these offenders. Additionally, IRS has not always promptly filed liens against businesses to protect the government's interests and has not always taken timely action to hold responsible parties personally liable for unpaid payroll taxes.

GAO selected 50 businesses with payroll tax debt as case studies and found extensive evidence of abuse and potential criminal activity in relation to the federal tax system. The business owners or officers in our case studies diverted payroll tax funds for their own benefit or to help fund business operations.

#### Examples of Tax-Related Abusive and Potentially Criminal Activity

| Business     | Unpaid payroll taxes               | Activity   |
|--------------|------------------------------------|--|
| Construction | Almost \$2.5 million over 12 years | Potential illegal check kiting and money laundering  |
| Health care  | Almost \$2.5 million over 7 years  | Officers took large cash withdrawals prior to filing bankruptcy multiple times   |
| Dentist      | Over \$500,000 over 10 years       | Owner owed over \$500,000 in personal taxes, put property in spouse's name, and sold property to children for less than market value |

Sources: GAO analysis of IRS, public, and other records.

---

# Contents

---

|                     |   |           |
|---------------------|---|-----------|
| <b>Letter</b>       |   | <b>1</b>  |
|                     | Results in Brief  | 3         |
|                     | Background  | 6         |
|                     | A Significant Number of Businesses Are Not Paying Billions of Dollars of Payroll Taxes            | 15        |
|                     | IRS's Collection Approach Does Not Always Prevent the Accumulation of Unpaid Payroll Taxes        | 25        |
|                     | Businesses Engaged in Abusive and Potentially Criminal Activity Related to the Federal Tax System | 43        |
|                     | Conclusions   | 50        |
|                     | Recommendations for Executive Action  | 51        |
|                     | Agency Comments and Our Evaluation  | 52        |
| <b>Appendix I</b>   | <b>Scope and Methodology</b>  | <b>56</b> |
| <b>Appendix II</b>  | <b>Businesses with Unpaid Payroll Taxes</b>   | <b>60</b> |
| <b>Appendix III</b> | <b>Comments from the Internal Revenue Service</b>   | <b>66</b> |
| <b>Appendix IV</b>  | <b>GAO Contact and Staff Acknowledgments</b>  | <b>70</b> |
| <b>Tables</b>       |   |           |
|                     | Table 1: Changes In Payroll Tax Debt, 1998 to 2007  | 24        |
|                     | Table 2: Number of Individuals with Trust Fund Recovery Penalties for Two or More Businesses      | 44        |
|                     | Table 3: Businesses That Fail To Remit Payroll Taxes  | 45        |
|                     | Table 4: Businesses That Fail To Remit Payroll Taxes  | 60        |
| <b>Figures</b>      |   |           |
|                     | Figure 1: Types of Business Taxes Owed  | 8         |
|                     | Figure 2: Summary of Payroll Tax Debt Categorized by Number of Tax Quarters Outstanding           | 17        |
|                     | Figure 3: Summary of Payroll Tax Debt by Tax Year   | 18        |

---

---

|   |    |
|---|----|
| Figure 4: Breakdown of Components of Payroll Taxes by the Amount of Unpaid Interest, Tax, and Penalties (dollars in billions) | 19 |
| Figure 5: Summary of Unpaid Payroll Taxes by Related Industry (dollars in billions)   | 20 |
| Figure 6: Summary of Payroll Tax Debt by Collection Status (dollars in billions)  | 22 |
| Figure 7: Summary of Payroll Taxes Considered Currently Not Collectible (dollars in billions)                                 | 23 |
| Figure 8: Summary of Outstanding Payroll Tax Debt by Year of Statutory Collection Period Expiration (dollars in billions)     | 25 |

---

## Abbreviations

|       |   |
|-------|---|
| ACS   | Automated Collection System                       |
| FICA  | Federal Insurance Contribution Act                |
| IRC   | Internal Revenue Code                             |
| IRM   | <i>Internal Revenue Manual</i>                    |
| IRS   | Internal Revenue Service                          |
| NAIC  | North American Industry Classification            |
| RRA   | Restructuring and Reform Act of 1998              |
| TIGTA | Treasury Inspector General for Tax Administration |
| TFRP  | Trust Fund Recovery Penalty                       |

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.



United States Government Accountability Office  
Washington, DC 20548

July 25, 2008

Congressional Committees

The operations of the Internal Revenue Service (IRS) potentially impact the lives of every American and are critical to the fiscal well being of the federal government. IRS's taxpayer service and enforcement efforts generate 96 percent of the federal revenue for the United States government. In 2007, IRS processed over 230 million tax returns and collected over \$2.7 trillion in taxes. Although the majority of businesses and individuals voluntarily comply with the nation's tax laws, many do not. For those that do not, IRS's enforcement programs collected over \$40 billion in taxes from businesses and individuals in 2007. In spite of these efforts, IRS has a significant gap between what taxpayers should pay and what IRS actually collects. IRS estimates that the annual net tax gap—the amount of taxes that go unidentified and uncollected each year—amounts to nearly \$300 billion.

One of the elements of this tax gap is unpaid payroll taxes. Payroll taxes are amounts employers withhold from employee's wages for federal income taxes, Social Security, and Medicare, as well as the employer's mandatory matching contributions for Social Security and Medicare taxes. In our previous reports and in related testimonies on federal contractors with tax debt,<sup>1</sup> we reported that tens of thousands of federal contractors were not paying billions of dollars in taxes owed and that most of those contractors had failed to remit to the government amounts they had

---

<sup>1</sup>GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-04-95](#) (Washington, D.C.: Feb. 12, 2004); GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-04-414T](#) (Washington, D.C.: Feb. 12, 2004); GAO, *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-05-637](#) (Washington, D.C.: June 16, 2005); GAO, *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax Systems with Little Consequence*, [GAO-05-683T](#) (Washington, D.C.: June 16, 2005); GAO, *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, [GAO-06-492T](#) (Washington, D.C.: Mar. 14, 2006); GAO, *Medicare: Thousands of Medicare Part B Providers Abuse the Federal Tax System*, [GAO-07-587T](#) (Washington, D.C.: Mar. 20, 2007); GAO, *Tax Compliance: Thousands of Federal Contractors Abuse the Federal Tax System*, [GAO-07-742T](#) (Washington, D.C.: Apr. 19, 2007); and GAO, *Medicaid: Thousands of Medicaid Providers Abuse the Federal Tax System*, [GAO-08-239T](#) (Washington, D.C.: Nov. 14, 2007).

---

withheld from their employees' salaries to satisfy their tax obligations. The willful failure to remit payroll taxes is a felony under federal law.<sup>2</sup> Due to the continuing significance of this issue, you asked us to review IRS's overall approach to the prevention and collection of unpaid payroll taxes.

The specific objectives of this report were to determine (1) the magnitude of unpaid federal payroll tax debt, (2) the factors affecting IRS's ability to enforce compliance or pursue collections against businesses with unpaid payroll taxes, and (3) whether some businesses with unpaid payroll taxes are engaged in abusive<sup>3</sup> or potentially criminal activities with regard to the federal tax system.

To meet our objectives, we analyzed IRS's database of unpaid taxes as of September 30, 2007, to determine the magnitude of unpaid payroll taxes and to identify, to the extent possible, owners or officers who repeatedly abused the tax system by not remitting withheld payroll taxes. To determine IRS's procedures to prevent the accumulation of unpaid payroll taxes and to collect such taxes, we reviewed IRS's policies as laid out in its *Internal Revenue Manual* (IRM) and discussed those policies and procedures with cognizant IRS officials and revenue officers. We reviewed a sample of 76 businesses whose owners IRS found personally liable for the failure to remit payroll taxes withheld from employees' paychecks.<sup>4</sup> Although the sample was selected as a part of our audit of IRS's fiscal year 2007 financial statements, for the purposes of this report we reviewed

---

<sup>2</sup>26 U.S.C. § 7202.

<sup>3</sup>We considered activity to be abusive when a business's actions or inactions, though not illegal, took advantage of the existing tax enforcement and administration system to avoid fulfilling federal tax obligations and were deficient or improper when compared with behavior that a prudent person would consider reasonable.

<sup>4</sup>Under section 6672 of the Internal Revenue Code (IRC), individuals who are determined by IRS to be responsible for collecting, accounting for, and paying over payroll taxes who willfully fail to collect or pay these taxes can be assessed a Trust Fund Recovery Penalty (TFRP). This penalty, typically assessed against owners or officers of a corporation, such as a president or treasurer, is assessed for the amount of taxes the business withheld from its employees' salaries but did not remit to the federal government, the so-called trust fund portion of payroll taxes. The business itself is still liable for the entire amount of the unpaid payroll taxes, but IRS can seek collection from the responsible owner/officers for the trust fund portion of the unpaid taxes when they are assessed this penalty.

---

those cases to identify the timeliness of IRS's collection actions.<sup>5</sup> To further review IRS's collection actions, we also performed a macro-analysis of IRS's overall inventory of unpaid tax debts. Finally, to determine whether businesses with unpaid payroll taxes were engaged in abusive or potentially criminal activities with regard to the federal tax system, we reviewed documentation on IRS's collection actions and discussed the appropriateness of those actions or the absence of actions with IRS revenue officers for 50 businesses selected as case studies. See appendix I for more detailed information on the scope and methodology of our work. The results of 12 of the 50 case studies we audited are shown in table 3. The results of the other 38 case studies are included in appendix II.

We conducted this performance audit from April 2007 through May 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

---

## Results in Brief

While most businesses fulfill their fiduciary responsibility to the government to withhold taxes from their employee's salaries, make matching contributions, and remit these sums to the government, a significant number do not. As of September 30, 2007, IRS's records showed that over 1.6 million businesses owed over \$58 billion in unpaid payroll taxes, including interest and penalties. Of that amount, 70 percent of all unpaid payroll taxes are owed by businesses with more than a year (4 tax quarters) of unpaid federal payroll taxes, and over a quarter of unpaid payroll taxes were owed by businesses that accumulated tax debt for more than 3 years (12 tax quarters). Because unpaid payroll taxes include amounts owed for Social Security and Hospital Insurance (Medicare

---

<sup>5</sup>The sample was originally selected as part of our audit of IRS's financial statements, see GAO, *Financial Audit: IRS's Fiscal Years 2007 and 2006 Financial Statements*, [GAO-08-166](#) (Washington, D.C.: Nov. 9, 2007). The primary purpose of the sample was to determine whether IRS was properly recording payments to all related parties. However, we also performed other tests of IRS's controls using this same sample. Although we identified issues related to IRS's assignment of cases among revenue officers and the timeliness of certain collection actions based upon that sample, we are unable to project these results because the sampling unit used for the financial statement audit was payments rather than accounts.

---

Part A) taxes,<sup>6</sup> the federal government may have to transfer higher amounts from the General Fund to the Social Security and Hospital Insurance Trust Funds to make up for the amounts businesses fail to remit. IRS estimated that for the tax debt it had in its inventory of unpaid assessments as of November 1, 2007, the General Fund had transferred \$44 billion to the trust funds over what IRS collected.

IRS has a number of powerful tools at its disposal to prevent the accumulation of unpaid taxes and to collect the taxes that are owed. However, IRS acknowledges that its traditional collection methods do not always bring taxpayers into compliance and that there is a major compliance problem regarding the large number of businesses that repeatedly do not remit payroll taxes. In reviewing IRS's collection actions for egregious payroll tax offenders, we identified several issues that limit the effectiveness of IRS's current approach.

- IRS's overall approach to collection focuses primarily on gaining voluntary compliance, which can allow egregious payroll tax offenders to continue to accumulate payroll tax debt for years that may never be collected.
- IRS is not timely filing liens. Our analysis of IRS's inventory of unpaid payroll tax cases as of September 30, 2007, found that for over a third of all businesses with unpaid payroll taxes assigned to the field, IRS had not filed a lien. Over 80 percent of payroll cases in the queue awaiting assignment did not have a lien filed. Circumstances may not warrant a lien being filed in all cases, such as when businesses are highly leveraged or have few tangible assets. However, for cases in which IRS has not filed a lien, the government's interest in the tax debtor's property is not protected.
- IRS is not timely assessing penalties to individuals responsible for not remitting business's payroll tax debts. IRS has a powerful tool to hold responsible owners and officers personally liable for withheld payroll taxes—a Trust Fund Recovery Penalty (TFRP). We found that, in a sample of 76 TFRP assessments, it took IRS over 40 weeks, on average, to decide to pursue collection against responsible owners/officers and an additional 40 weeks to actually assess the TFRP. Delays in assessing a TFRP can result in lost opportunities to collect unpaid payroll tax debts from the owners/officers while allowing them to continue to use the business to

---

<sup>6</sup>These amounts are collected pursuant to the Federal Insurance Contributions Act. 26 U.S.C. ch. 21.



---

fund a personal lifestyle through the non-remittance of payroll taxes. We also found that IRS does not place as high a priority on collection efforts against the responsible owners/officers as it does the business, and treats the TFRP as a separate collection effort unrelated to the business.

- IRS actions do not always prevent egregious payroll tax offenders from accumulating additional unpaid payroll tax debt.
- IRS does not have performance measures to establish goals related to the collection and prevention of unpaid payroll taxes and to track its actual performance against these goals.

Further, we found that some states have additional tools they use to collect unpaid taxes at the state level and to help prevent the further accumulation of these unpaid taxes.

- Publishing tax debtor names: An increasing number of states—currently around 19 and the District of Columbia—now publish the names of tax debtors on Web sites as a means of both collecting unpaid taxes and stopping the further accumulation of these taxes. Currently, IRS is prohibited by law from publicly disclosing names of tax debtors in this manner.
- Identifying levy sources: Several states have initiated legislation or entered into agreements with financial institutions to match account information against tax debts, allowing states to more easily identify levy sources to aid in the collection of unpaid taxes.

Our analysis and data mining of IRS tax records indicated that some businesses were involved in abusive or potentially criminal activity related to the tax system. Some of these business owners repeatedly accumulated tax debt from multiple businesses. For example, IRS found over 1,500 individuals to be responsible for non-payment of payroll taxes at 3 or more businesses, and 18 had been found responsible for not remitting payroll taxes for 12 different businesses. We selected 50 businesses with payroll tax debt as case studies. Our analysis of those businesses showed some owners/officers abuse the tax system, willfully diverting amounts withheld from their employees' salaries to fund their business operations or their own personal lifestyle. For example, the owner of one of our case study businesses that owed almost \$2.5 million was under-reporting their personal income and was involved in possible check kiting and money laundering. Another had accumulated almost \$2.5 million in unpaid payroll taxes and made large cash withdrawals prior to filing bankruptcy multiple

---

times. A third had accumulated over \$500,000 in unpaid payroll taxes over a 10-year period as well as another \$500,000 in personal taxes. The owner had put property in a spouse's name and sold property to children for less than market value to avoid IRS collection action.

To address the issues identified in this report, we are making six recommendations to the Commissioner of IRS. Five of those recommendations are for IRS to review or revise its collection policies to provide better monitoring or more detailed guidance on collection actions to be taken against egregious payroll tax offenders and to strengthen its existing collection tools. We are also recommending that IRS work with states to develop ways of more effectively identifying potential levy sources. In comments on a draft of this report, IRS concurred with all six of our recommendations and agreed that all appropriate tools must be used to bring payroll tax offenders into compliance. Specifically, IRS agreed to evaluate its existing practices and determine appropriate changes. IRS also said it would work with the states that are matching financial institution accounts to tax debt to identify levy sources to determine whether a similar program in IRS would be cost effective and consistent with privacy laws.

See the "Agency Comments and Our Evaluation" section of this report for a more detailed discussion of agency comments. We have reprinted IRS's written comments in appendix III.

---

## Background

In its role as the nation's tax collector, IRS is responsible for collecting taxes, processing tax returns, and enforcing the nation's tax laws. Since 1990, we have designated IRS's enforcement of tax laws as a governmentwide high-risk area.<sup>7</sup> In attempting to ensure that taxpayers fulfill their obligations, IRS is challenged on virtually every front. IRS's enforcement workload—measured by the number of tax returns filed—has continually increased, while the number of staff dedicated to collections has not.

---

<sup>7</sup>Additionally, we designated IRS's financial management and systems modernization as high-risk areas in 1995. GAO, *High-Risk Series: An Overview*, [GAO/HR-95-1](#) (Washington, D.C.: February 1995). In 2005, two of IRS's high-risk areas—collection of unpaid taxes and earned income credit non-compliance—were consolidated to make a single high-risk area called enforcement of tax laws. Also in 2005, IRS's high-risk areas of business systems modernization and financial management were merged into a single high-risk area called business systems modernization. GAO, *High-Risk Series, An Update*, [GAO-05-207](#) (Washington, D.C.: January 2005).

---

As of September 30, 2007, IRS's master file database of taxpayer accounts reflected about \$282 billion in outstanding taxes owed by businesses and individuals.<sup>8</sup> This amount understates the true cumulative amount of unpaid taxes. For example, IRS has a statutory limitation on the length of time it can pursue unpaid taxes, generally 10 years from the date of the assessment.<sup>9</sup> After that period, IRS removes the tax debt from its records. Additionally, the amount of unpaid taxes is understated because many tax debts go unidentified and unrecorded on IRS's tax records due to non-filing or underreporting of tax liabilities. These unidentified and uncollected taxes are part of IRS's estimate of the annual tax gap. Therefore, the true cumulative amount of unpaid taxes would be far higher than \$282 billion.

The amount of unpaid taxes ranges from small amounts owed by individuals for a single tax period<sup>10</sup> to millions of dollars owed by businesses over multiple periods. For businesses, the taxes owed include corporate income, estate, excise, and payroll taxes, as shown in figure 1.

---

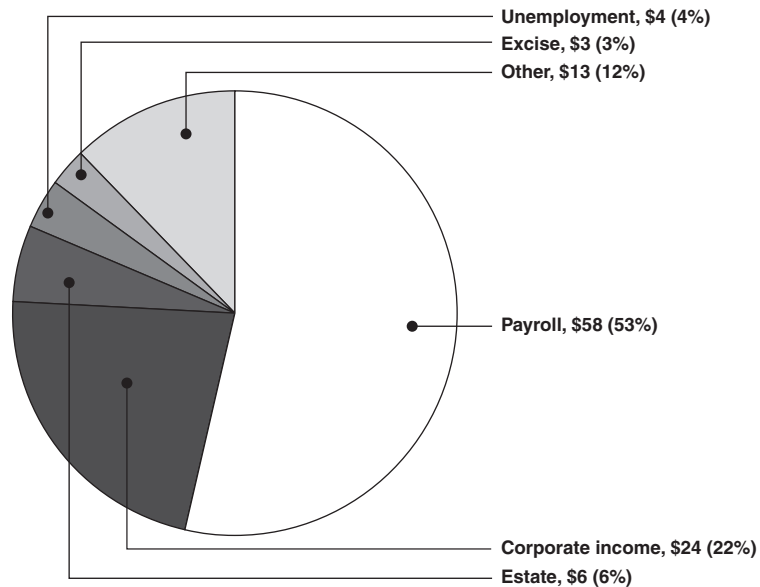
<sup>8</sup>For financial reporting purposes, IRS reported \$263 billion for the total amount of unpaid taxes. IRS's financial statements reflect a lower amount of tax debt for a number of reasons, including the removal of duplicate tax assessments for multiple officers of a business assessed a TFRP.

<sup>9</sup>26 U.S.C. § 6502. The 10-year period can be extended or suspended under a variety of circumstances, such as agreements by the taxpayer to extend the collection period in connection with an installment agreement, bankruptcy litigation, and court appeals. Consequently, some tax assessments can and do remain on IRS's records for decades.

<sup>10</sup>A "tax period" varies by tax type. For example, the tax period for payroll and excise taxes is one quarter of a year. The taxpayer is required to file quarterly returns with IRS for these types of taxes, although payment of the taxes occurs throughout the quarter. In contrast, for income, corporate, and unemployment taxes, a tax period is 1 year.

---

**Figure 1: Types of Business Taxes Owed (dollars in billions)**



Source: GAO analysis of IRS data as of September 30, 2007.

The total amount of tax debt includes interest and penalties that are added to or accumulate on the original taxes owed.

---

## Payroll Taxes

Employers are required to withhold from their employees' salaries amounts for individual federal income taxes and for Federal Insurance Contribution Act (FICA) taxes, which includes Old-Age, Survivors and Disability Insurance (Social Security) and Hospital Insurance (Medicare Part A) taxes. In 2007, the FICA taxes to be withheld consisted of 6.2 percent of an employee's gross salary up to \$97,500 for Social Security taxes and an additional 1.45 percent of the gross salary for hospital insurance. Employers are also required to match the amounts withheld from an employee's salary for Social Security and hospital insurance taxes. Taken together, the amounts withheld from an employee's salary for federal individual income and FICA taxes, along with the employer's matching portion of FICA taxes, comprise the business's payroll taxes.<sup>11</sup>

---

<sup>11</sup>Federal unemployment taxes are also paid by employers. However, these taxes are not included in the unpaid payroll taxes discussed in this report.

---

Employers are generally required to remit payroll taxes periodically through the Federal Tax Deposit system. The frequency of those deposits depends on the amount of taxes due and the frequency of the employer's payroll. Employers must remit payroll taxes either (1) semiweekly if their total tax liability is more than \$50,000 during a 12-month period ending June 30 of the prior year or (2) monthly if their total tax liability is \$50,000 or less during this same 12-month period. The business tax liability is reported to IRS either quarterly on Form 941 or annually on Form 944. Additionally, employers are required to report employees' earnings to the Social Security Administration annually.

---

## IRS's Payroll Tax Collection Process

When a business files a tax return indicating that it owes more in payroll taxes than it has deposited, IRS records or assesses the tax liability in its systems. IRS can also identify and assess tax liabilities through its enforcement efforts, such as its examination or nonfiler programs.<sup>12</sup> Once payroll tax debt is assessed and recorded in its database of unpaid taxes, IRS has a number of collection tools at its disposal to attempt to collect from tax debtors who do not voluntarily comply with the tax laws. Each case has unique aspects and therefore may require varying collection methods. However, for payroll tax cases, IRS generally follows a three-step collection process.

- *Step 1—Notification of tax debt*—Once a business fails to remit taxes owed, IRS sends the business a series of notice letters. Business tax debt typically stays in the notification phase about 15 weeks.
- *Step 2—Assignment for collection*—After tax debt leaves the notice phase, it may be placed in a queue awaiting assignment to collection personnel. If a tax debtor already has tax debt being worked on by collections personnel, it will generally bypass the queue and be assigned directly to the collection officer already working to collect the other tax debt. When a case leaves the queue and is assigned to the field for collections, it is first assigned to a manager. The manager has a waiting list of cases held for assignment to individual revenue officers. A case may be assigned to the field, but not be actively worked on because it is awaiting assignment by the manager.

---

<sup>12</sup>Under the nonfiler program (26 U.S.C. § 6020(b)) IRS contacts businesses that have not filed tax returns. If they do not respond, for enforcement purposes, IRS independently prepares their tax returns and makes a proposed tax assessment. These assessments are generally based on very limited information.

- 
- *Step 3—Collection actions*—IRS pursues collection of taxes owed either through direct contact by revenue officers in the field (referred to as the collection field function) or through calls and correspondence by IRS's Automated Collection System (ACS).

IRS's ACS process consists primarily of telephone calls to the tax debtor through IRS's nationwide network of call centers. ACS generally handles less complex and lower priority taxes. Because IRS has designated the collection of payroll taxes as one of its top priorities, payroll tax cases generally do not go through the ACS process. Also, although cases may move through the steps sequentially, it is not necessary that they do so. Cases begin in the notice phase, but they may enter the queue or field collection repeatedly.

---

## IRS's Tax Collection Tools

IRS has numerous enforcement tools that it can use when businesses fail to remit payroll taxes as required. IRS's tools begin with a series of letters sent to the business in the notice phase to encourage voluntary compliance, which, if not accomplished, can lead to the use of increasingly more aggressive or invasive tools, including filing liens or seizing business assets, and filing for court-ordered injunctive relief.

Once assigned a tax debt for collection, the revenue officer will seek to get full payment from the tax debtor. If the tax debtor is unable to pay in full, the revenue officer will seek to get the debtor to agree to a repayment plan, either an installment agreement or an offer-in-compromise.<sup>13</sup> In general, the revenue officer will seek to get the tax debtor to become compliant and voluntarily pay the tax debt without IRS having to take more intrusive collection actions. In fiscal year 2007, IRS collected over \$17 billion of all types of taxes from almost 3 million tax debtors through installment agreements.

If, however, a tax debtor fails to agree to voluntarily pay the tax debt, the revenue officer can increase the invasiveness of their collection efforts and use its three primary tools to achieve compliance and tax collection: lien, levy, or seizure. If those are not successful at bringing a tax debtor into compliance, in certain circumstances, IRS can seek injunctive relief to close a non-compliant business or seek criminal prosecution for failing to

---

<sup>13</sup>Installment agreements allow for payments on the debt in smaller, more manageable amounts. An offer-in-compromise approved by IRS allows a tax debtor to settle unpaid tax debt for less than the full amount due.

---

pay payroll taxes, particularly if there are indications of fraud. An overview of each of these tools follows.

## Liens

Among IRS's tools to collect outstanding taxes is its ability to use the property of a taxpayer as security for an outstanding tax debt. This is accomplished by filing a notice of federal tax lien. The lien serves to protect the interest of the federal government and as a public notice to current and potential creditors of the government's interest in the taxpayer's property.<sup>14</sup> Although the tax lien exists under the law even before a notice is filed, the lien is perfected when IRS provides notice of its interest by filing the lien with a designated office, such as a local courthouse in the county where the taxpayer's property is located. If the Service does not file a Notice of Federal Tax Lien (NFTL) with a state or local recording office where the taxpayer's property is situated, the Government will have a more junior position to other creditors who have perfected their judgments or security.<sup>15</sup>

IRS reported filing more than 680,000 tax liens in fiscal year 2007.<sup>16</sup> Since a lien encumbers taxpayer property and because federal tax liens appear on commercial credit reports, IRS's ability to file a lien is a powerful tool in enforcing the tax laws. Filing a lien prevents the taxpayer from selling an asset, with clear title, without first paying off the outstanding tax debt.<sup>17</sup>

## Levies and Seizures

Levies are legal seizures of tax debtors' assets to satisfy tax delinquencies.<sup>18</sup> A levy is different from a lien in that a lien is a claim used as security for the tax debt, while a levy actually takes the property to satisfy the tax debt. Generally, IRS is authorized to levy property of the tax debtor in the possession of a third party, such as bank accounts, federal

---

<sup>14</sup>Under IRC sections 6321 and 6322, a federal tax lien arises by operation of law when the IRS assesses the tax debt and the taxpayer neglects or refuses to pay the liability upon receiving notice and demand for payment. The tax lien encumbers the taxpayer's property or rights to property.

<sup>15</sup>The federal tax lien is not valid against purchasers, holders of security interests, mechanics lienors, and judgment lien creditors until a NFTL has been filed (26 U.S.C. § 6323(a)).

<sup>16</sup>IRS can file multiple liens against a taxpayer to cover property the taxpayer owns in different geographical locations.

<sup>17</sup>Filing a federal tax lien makes it much more difficult for a taxpayer to sell or otherwise dispose of an asset because of the cloud on title created by the notice.

<sup>18</sup>26 U.S.C. § 6331.

---

payments, and wages.<sup>19</sup> IRS records indicate that it filed over 3.7 million levy actions against tax debtors for property held by third parties in fiscal year 2007. IRS also may seize and sell real or personal property held directly by the tax debtor, such as business assets like business equipment, cars, or paintings. However, under reforms put in place under the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA),<sup>20</sup> IRS cannot seize assets before determining whether the tax debtor has equity in the property subject to seizure. For example, if an asset is fully encumbered with commercial loans, IRS may not seize the asset. Although IRS records indicate that the number of actions to seize and sell assets held by the tax debtor has been steadily rising over the past several years, reaching 676 seizure actions in fiscal year 2007, the number is far below the over 10,000 seizure actions taken in 1997 prior to the enactment of RRA.<sup>21</sup>

## Injunctive Relief

In addition to actions it can take to collect unpaid taxes, IRS can also take action to attempt to stop businesses from continuing to accumulate unpaid taxes. One tool IRS has is injunctive relief.<sup>22</sup> Injunctive relief is a court ordered “prohibition of an act.” If the act, or practice covered under the court order continues, the business can be found in contempt of court, and IRS can force it to cease operations. The IRM states that injunctive relief is an “extraordinary remedy” used only if previous actions have either been exhausted or it would have been futile to continue. Injunctive relief can be an important tool for IRS when businesses have no equity and therefore are impervious to seizure actions.

---

<sup>19</sup>By law, some property cannot be levied or seized. For example, IRS may not seize any of the taxpayer’s property when the expense of selling the property would be more than the fair market value of the property. 26 U.S.C. § 6331(f). Other items IRS may not levy or seize include: unemployment benefits; certain annuity and pension benefits; certain service-connected disability payments; workmen’s compensation; salary, wages, or income included in a judgment for court-ordered child support payments; and certain public assistance payments. 26 U.S.C. § 6334(a).

<sup>20</sup>Pub. L. No. 105-206, 112 Stat. 685 (July 22, 1998) (pertinent section codified at 26 U.S.C. § 6331(j)).

<sup>21</sup>Section 1203 of RRA required the IRS Commissioner to terminate the employment of employees for misconduct in the seizure of taxpayers’ property.

<sup>22</sup>Injunctive relief is a judicial remedy for non-compliance that requires a party either to refrain from certain actions or to perform certain actions. Federal courts have jurisdiction to issue injunctions when necessary to enforce internal revenue laws under section 7402(a) of the IRC.



---

To obtain an injunctive relief order, IRS must demonstrate to the court the (1) tax debtor's persistent failure to comply with the law despite IRS's repeated efforts to bring the tax debtor into compliance and (2) likelihood of future violations (i.e., the tax debtor will continue to accumulate tax debt). To gain an injunction, IRS first issues a letter to the tax debtor that includes strong language, including threats of criminal prosecution for failure to comply.<sup>23</sup> The IRM notes that before seeking injunctive relief, the revenue officer should require the business to (1) file monthly employment tax returns (instead of quarterly), (2) establish a separate bank account for payroll taxes withheld, and (3) make all payroll tax deposits to that account within 2 days of paying employees.

## Criminal Investigations

Although the willful failure to remit payroll taxes is a felony, IRS generally does not pursue a criminal prosecution unless fraud can be determined. In the past, we have reported that some IRS employees believe IRS and the District Counsel are reluctant to pursue prosecution against even egregious offenders.<sup>24</sup>

---

## Trust Fund Recovery Penalty

When businesses withhold funds from an employee's salary for federal income taxes and the employee's FICA obligations, they are deemed to have a fiduciary responsibility to hold these amounts "in trust" for the federal government. To the extent that the business does not forward withholdings to the federal government, it is liable for these amounts, as well as its matching FICA contribution. Officials of the business can also be held personally liable for payment of the withheld amounts.

Under section 6672 of the IRC, individuals who are determined by IRS to be responsible for collecting, accounting for, and paying over payroll taxes who willfully fail to collect or pay this tax can be assessed a TFRP. To show willfulness, IRS must show that the responsible individual was aware of the outstanding taxes and either deliberately chose not to pay the

---

<sup>23</sup>This letter, known as the 903 Letter, says in part: "We may file a public notice (federal tax lien) showing that the government has a right to the interest in your property or seize (levy) your property or rights to property to enforce collecting taxes we've determined you owe based on information available to us. Under the law we may charge you criminal penalties, such as a fine up to \$100,000 and up to one year in jail upon conviction, if you don't comply with the special bank deposit requirements. We encourage you to comply with the employment tax deposit rules."

<sup>24</sup>GAO, *Payroll Taxes: Billions in Delinquent Taxes and Penalties Due But Unlikely to Be Collected*, GAO/T-AIMD/GGD-99-256 (Washington, D.C.: Aug. 2, 1999).

---

taxes or recklessly disregarded an obvious risk that the taxes would not be paid. It should be noted that the deliberate intent or desire to defraud the federal government is not necessary for IRS to assess a TFRP. For example, an individual, in a business, who is responsible for collecting payroll taxes who decides to pay the business's monthly rent payment instead of remitting employee withholdings to the federal government, can be found to be acting willfully and thus assessed a TFRP. Typically, these responsible individuals are owners or officers of a corporation, such as a president or treasurer.

More than one person may be a "responsible individual" under section 6672, and thus multiple people in the business may be assessed a TFRP. The amounts assessed against each individual can vary depending on an individual's responsibility to collect payroll taxes and the extent of the willful failure to pay over this tax for multiple periods; however, each responsible individual can be assessed a TFRP for the total amount of the withholdings not paid. Additionally, the business itself is still liable for the entire amount of the unpaid payroll taxes. However, it has long been IRS's policy to only collect the unpaid tax once. For example, if, after IRS assesses a TFRP against an officer of a corporation, the business pays the entire balance of the unpaid payroll taxes, the officer would no longer be liable for the TFRP assessment. Similarly, if two officers are each assessed TFRPs related to their business covering the same period of unpaid payroll taxes and one of the officers makes a partial payment, the liabilities of both officers, as well as the liability of the business, are to be reduced by the amount of the payment.

IRS uses the TFRP as a tool to hold owners and other officials associated with a business individually liable for the business's failure to remit withheld payroll taxes. As such, the TFRP provides a means for IRS to seek collection from those responsible for failing to remit the withheld payroll taxes even if the business closes. The TFRP may also be used as a compliance tool to deter future non-payment of taxes by the business. TFRP assessments are also subject to the 10-year statutory collection limitation.

---

## A Significant Number of Businesses Are Not Paying Billions of Dollars of Payroll Taxes

Employers are required to withhold from their employees' salaries amounts for both individual federal income taxes and FICA taxes, which include Social Security and Hospital Insurance taxes.<sup>25</sup> While the majority of businesses pay the taxes withheld from employees' salaries as well as the employer's matching amounts, a significant number of businesses do not. Our review of IRS tax records showed that over 1.6 million businesses owed over \$58 billion in unpaid payroll taxes to the federal government as of September 30, 2007. The failure by businesses to remit payroll taxes results in the loss of revenues to the federal government. In addition, it creates a situation in which the general revenue fund subsidizes the Social Security and Hospital Insurance trust funds to the extent that Social Security and Hospital Insurance taxes owed are not collected. Over time, the amount of this shortfall, or subsidy, is significant. IRS estimated that the General Fund has transferred to the trust funds \$44 billion<sup>26</sup> over what IRS collected in self employment and payroll taxes for the inventory of total unpaid taxes on record as of November 1, 2007. The estimate does not include an estimate for tax debts that have been written off of IRS's tax records in previous years due to expiration of the statutory collection period. As a result of the failure of these businesses to pay payroll taxes, the compliant taxpayer bears an increased burden to fund the nation's commitments. Although IRS has made the collection of unpaid payroll taxes one of its top priorities, most of the unpaid payroll tax inventory (52 percent, equal to \$30 billion) was classified as currently uncollectible by IRS. While IRS has assigned about \$7 billion to revenue officers for collection, about \$9 billion of unpaid payroll taxes are in a queue awaiting assignment. Our analysis of the unpaid payroll tax inventory shows that the number of businesses with more than 20 quarters of tax debt (5 years of unpaid payroll tax debt) more than doubled between 1998 and 2007. Because IRS is statutorily limited in the length of time it has to collect unpaid taxes—generally 10 years from the date the tax debt is assessed—

---

<sup>25</sup>Amounts transferred by the Department of the Treasury to these trust funds are an estimate of taxes received determined by applying applicable tax rates to wage amounts certified by the Commissioner of Social Security (42 U.S.C. §§ 401, 1395i). Because wage information is provided only quarterly to IRS and only annually to the Social Security Administration, initial distributions to the trust funds are based on estimates prepared by Treasury's Office of Tax Analysis and the Social Security Administration's Office of the Chief Actuary, with adjustments subsequently made as a result of the Commissioner's certifications. Consequently, the amounts distributed to the Social Security and Hospital Insurance trust funds are based on the wages an individual earns, not the amount the employer actually forwards to the government.

<sup>26</sup>Accrued interest is included in this amount because assessments distributed to the trust funds earn interest at Treasury-based interest rates, similar to IRS's interest accruals.

---

the federal government will lose its right to collect billions of dollars in payroll taxes each year if IRS does not obtain payment from tax debtors before the statutory period for collection expires.

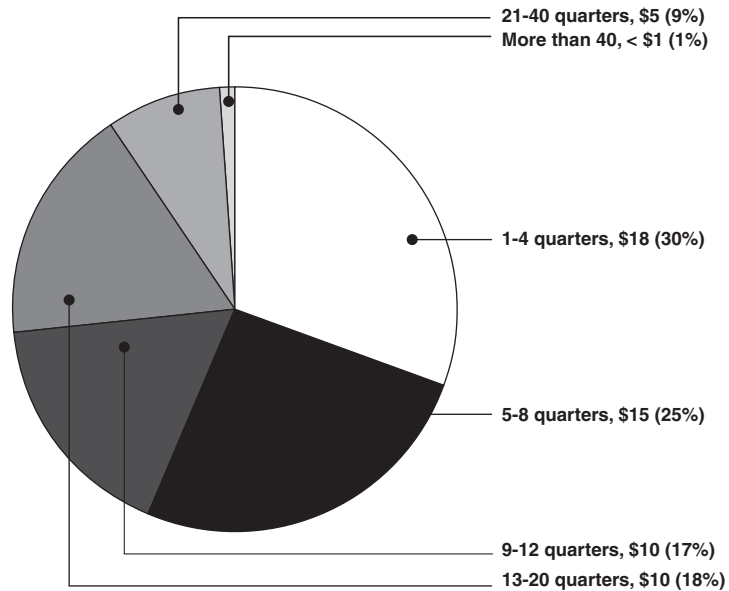
---

### Magnitude of Unpaid Payroll Tax Debt

Of the \$282 billion in cumulative, identified, unpaid taxes owed to the federal government as of September 30, 2007, IRS records show that over \$58 billion (over 20 percent) is owed for unpaid payroll taxes. This total includes amounts, earned by employees, that were withheld from their salaries to satisfy their tax obligations, as well as the employers' matching amounts, but which the business diverted for other purposes. Over 1.6 million businesses have unpaid payroll tax debt. Many of these businesses repeatedly failed to remit amounts withheld from employees' salaries. For example, 70 percent of all unpaid payroll taxes are owed by businesses with more than a year (4 tax quarters) of unpaid payroll taxes, and over a quarter of unpaid payroll taxes are owed by businesses that have tax debt for more than 3 years (12 tax quarters). Figure 2 shows the total dollar amount of payroll tax debt summarized by the number of unpaid payroll tax quarters outstanding.

---

**Figure 2: Summary of Payroll Tax Debt Categorized by Number of Tax Quarters Outstanding (dollars in billions)**



Source: GAO analysis of IRS data as of September 30, 2007.

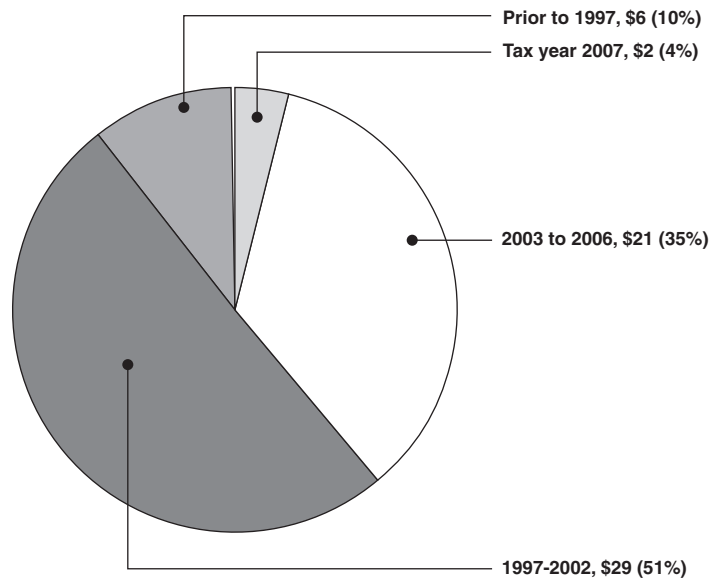
Much of the unpaid payroll tax debt has been outstanding for several years. As reflected in figure 3, our analysis of IRS records shows that over 60 percent of the unpaid payroll taxes was owed for tax periods from 2002 and prior years.<sup>27</sup>

---

<sup>27</sup>The tax period may not always correspond to the age of the tax debt. For example, tax debt may be fairly new even if it is for an earlier tax period when a taxpayer files a tax form years after the due date or when IRS assesses additional taxes for an earlier tax period.

---

**Figure 3: Summary of Payroll Tax Debt by Tax Year (dollars in billions)**



Source: GAO analysis of IRS data as of September 30, 2007.

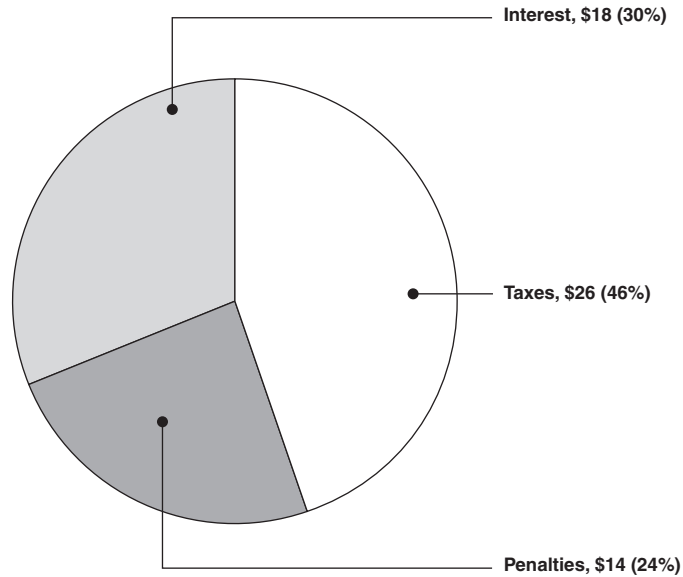
Prompt collection action is vital because, as our previous work has shown, as unpaid taxes age, the likelihood of collecting all or a portion of the amount owed decreases.<sup>28</sup> Further, the continued accrual of interest and penalties on the outstanding federal taxes can, over time, eclipse the original tax obligation. Figure 4 shows that over half of the unpaid payroll taxes owed is for interest and penalties on the original tax debt.

---

<sup>28</sup>GAO, *Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence*, [GAO-05-637](#) (Washington, D.C.: June 16, 2005).

---

**Figure 4: Breakdown of Components of Payroll Taxes by the Amount of Unpaid Interest, Tax, and Penalties (dollars in billions)**



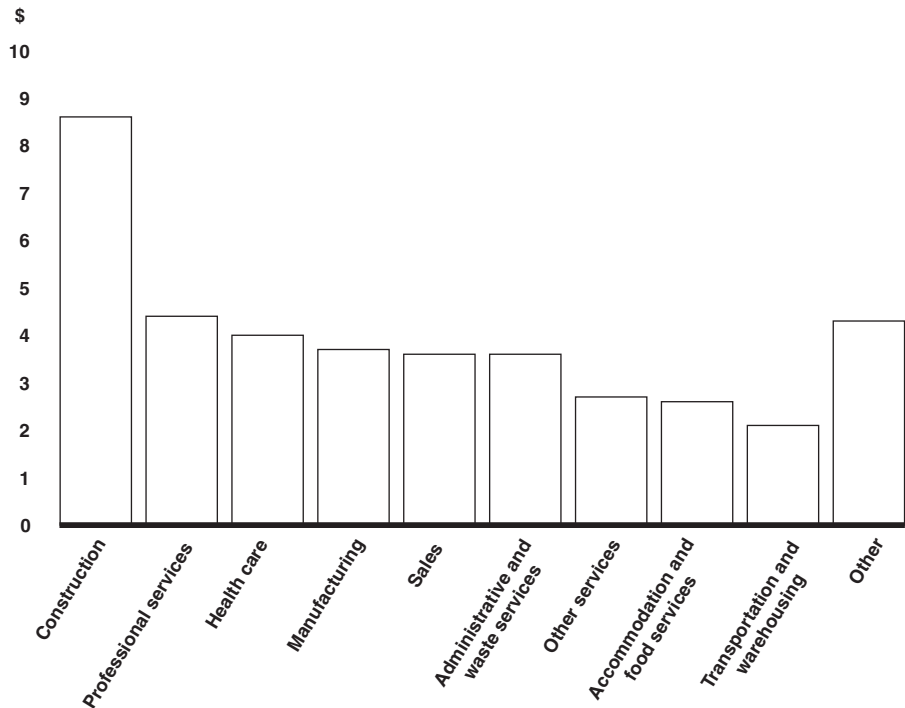
Source: GAO analysis of IRS data as of September 30, 2007.

Using IRS's database of unpaid taxes, we were able to identify many of the industry types associated with businesses owing payroll taxes. Figure 5 presents the major industries with outstanding unpaid payroll taxes according to IRS records.<sup>29</sup>

---

<sup>29</sup>We analyzed IRS's database of unpaid taxes and the information on the North American Industry Classification (NAIC) system codes in that database. The NAIC system is used by federal statistical agencies in classifying business establishments. Using those codes, we were able to identify the industry type for about 70 percent of the payroll tax debt.

**Figure 5: Summary of Unpaid Payroll Taxes by Related Industry (dollars in billions)**



Source: GAO analysis of IRS data as of September 30, 2007.

## Unpaid Payroll Taxes Result in the General Fund Subsidizing Social Security and Hospital Insurance Trust Funds

When businesses fail to remit taxes withheld from employees' salaries, the payroll tax receipts are then less than the payroll taxes due, and the Social Security and Hospital Insurance trust funds will have less financial resources available to cover current and future benefit payments. However, the trust funds are funded based on wage estimates and not actual payroll tax collections. Therefore, the General Fund transfers to the trust funds amounts that should be collected but are not necessarily collected, resulting in the General Fund subsidizing the trust funds for amounts IRS is unable to collect. As of November 1, 2007, IRS estimated that the amount of unpaid taxes and interest attributable to Social Security and hospital insurance taxes in IRS's \$282 billion unpaid assessments



---

balance was approximately \$44 billion.<sup>30</sup> This estimate represents a snapshot of the amount that needed to be provided to the Social Security and Hospital Insurance trust funds based on the outstanding tax debt on IRS's books at the time. It does not include an estimate for tax debts that have been written off of IRS's tax records in previous years due to expiration of the statutory collection period.<sup>31</sup> Recent IRS data indicate that the shortfall is about \$2 billion to \$4 billion annually due to uncollected payroll taxes.

---

## Collection Status of Payroll Tax Debt

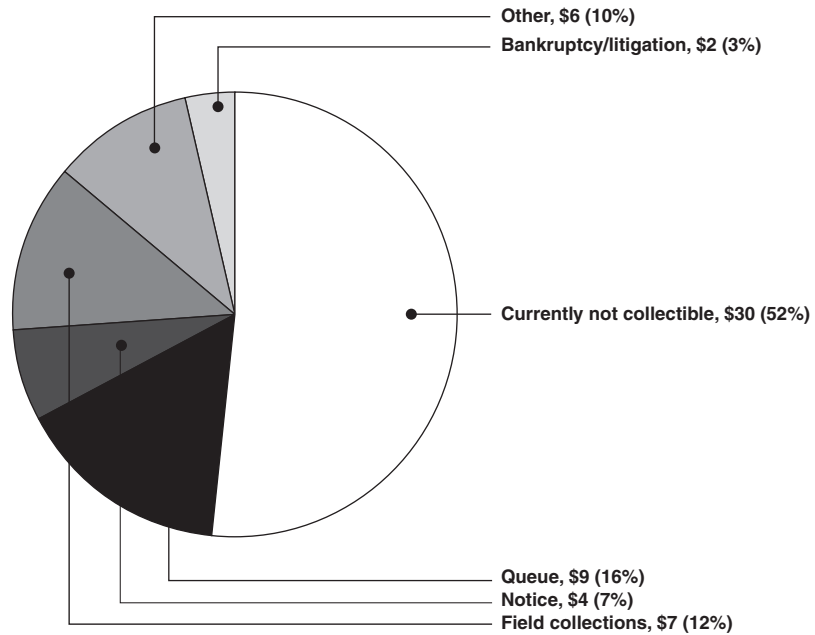
Of the \$58 billion in unpaid payroll taxes as of September 30, 2007, IRS categorized about \$4 billion as going through IRS's initial notification process. The notification process results in significant collections, particularly with respect to generally compliant taxpayers who respond to the notices by paying off the outstanding taxes owed or entering into installment agreements to pay off the tax debt over time. IRS records indicate that over half of all unpaid tax collections result from the notification process. Because IRS has made the collection of payroll taxes one of its highest priorities, once a case completes the notification process, it is generally sent to IRS's field collections staff for face-to-face collection action. However, IRS does not have sufficient resources to immediately begin collection actions against all of its high-priority cases. As a result, IRS holds a large number of cases in a queue awaiting assignment. Of the \$54 billion in unpaid payroll taxes that had completed the notification process, about \$7 billion was being worked on by IRS revenue officers for collection and about \$9 billion was in a queue awaiting assignment for collection action. Most of the unpaid payroll tax inventory was classified as currently uncollectible by IRS. As shown in figure 6, IRS considered \$30 billion—52 percent of all payroll tax debt—to be currently not collectible.

---

<sup>30</sup>IRS's \$282 billion in unpaid assessments are as of September 30, 2007. Although the dates of IRS's estimate of total unpaid Social Security and hospital insurance taxes, and IRS's total unpaid assessments, are about 1 month apart, we believe that for comparison purposes it is appropriate. About \$21 billion of the \$44 billion was due to businesses' unpaid payroll taxes, while \$23 billion was the result of unpaid individual self-employment taxes.

<sup>31</sup>Because of its statutory limitation, this amount represents an estimate of the subsidy provided over approximately a 10-year period.

**Figure 6: Summary of Payroll Tax Debt by Collection Status (dollars in billions)**

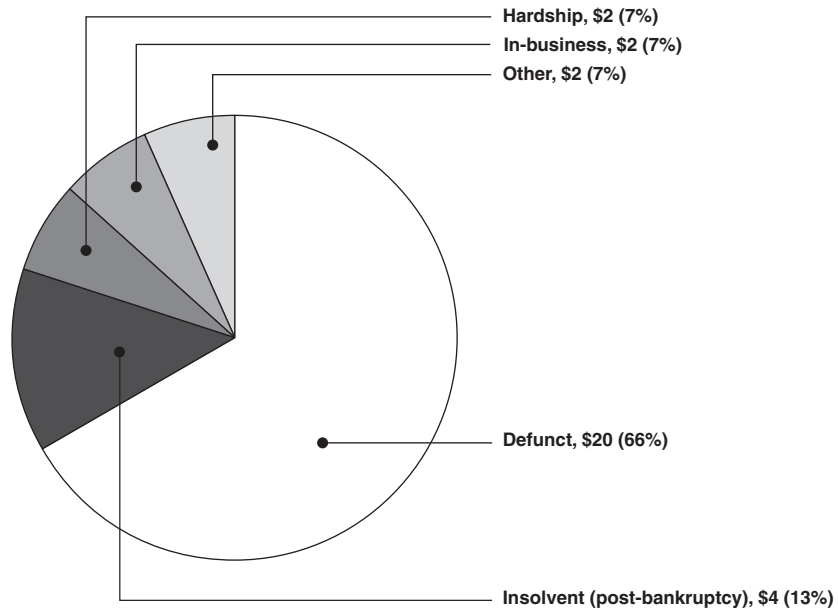


Source: GAO analysis of IRS data as of September 30, 2007.

IRS classifies tax debt cases as currently not collectible for several reasons, including (1) the business owing the taxes is defunct,<sup>32</sup> (2) the business is insolvent after bankruptcy, or (3) the business is experiencing financial hardship. As shown in figure 7, of those unpaid payroll tax cases IRS has classified as currently not collectible, almost two-thirds were as a result of a business being defunct.

<sup>32</sup>IRS defines a defunct business as one that is inactive with no leviable assets.

**Figure 7: Summary of Payroll Taxes Considered Currently Not Collectible (dollars in billions)**



Source: GAO analysis of IRS data as of September 30, 2007.

Note: The category “In-business” generally refers to a business that IRS deems does not have the resources to pay taxes owed and therefore no further collection will be attempted. Similarly, primarily for sole proprietors, if IRS determines the owner is financially unable to pay taxes, it categorizes both the owner’s personal account and the related business as being in financial hardship so that no further collection action is taken against them until their financial condition improves. The “other” designation includes cases in which IRS has been unable to locate or contact the business owing the payroll tax debt.

Although IRS has taken a number of steps to improve collections by prioritizing cases with better potential for collectibility, the collection of payroll taxes remains a significant problem for IRS. From 1998, when we performed our last in-depth review of payroll taxes,<sup>33</sup> to September 2007, we found that while the number of businesses with payroll tax debt decreased from 1.8 million to 1.6 million, the balance of outstanding payroll taxes in IRS’s inventory of tax debt increased from about \$49 billion to \$58 billion. Our analysis of the unpaid payroll tax inventory shows that the number of businesses with more than 20 quarters of tax debt (5 years of unpaid payroll tax debt) more than doubled between 1998

<sup>33</sup>GAO, *Unpaid Payroll Taxes: Billions in Delinquent Taxes and Penalty Assessments Are Owed*, [GAO/AIMD/GGD-99-211](#) (Washington, D.C.: Aug. 2, 1999).

and 2007, from just over 5,000 businesses in 1998 to over 14,000 as of September 30, 2007. The number of businesses that had not paid payroll taxes for over 40 quarters (10 years or more) during this period increased almost 500 percent, from 86 businesses to 490 businesses. These figures are shown in table 1.

**Table 1: Changes In Payroll Tax Debt, 1998 to 2007**

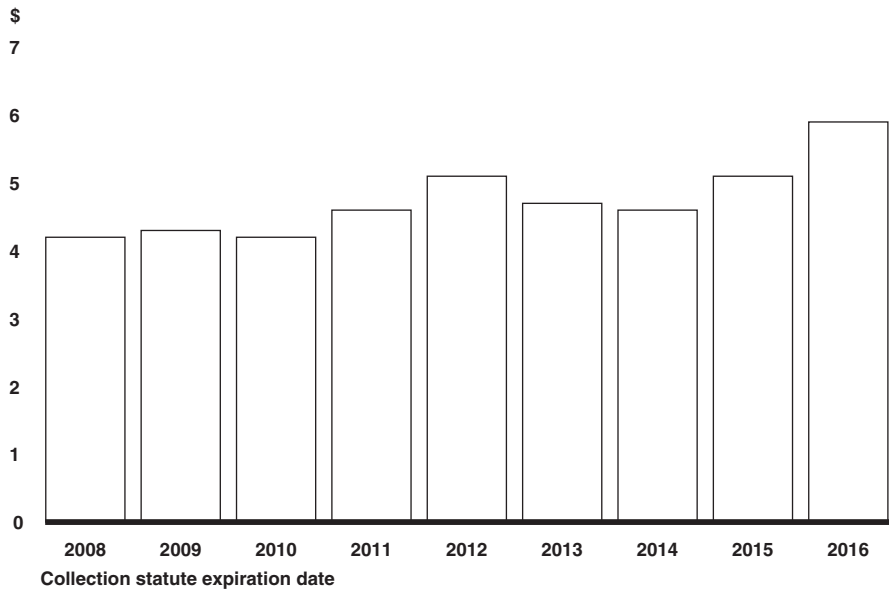
|   | As of September<br>30, 1998 | As of September<br>30, 2007 | Percentage<br>increase |
|---|-----------------------------|-----------------------------|------------------------|
| Businesses with over 20<br>quarters of payroll tax debt | 5,367                       | 14,681                      | 174                    |
| Businesses with over 40<br>quarters of payroll tax debt | 86                          | 490                         | 470                    |

Source: GAO analysis of IRS data as of September 30, 2007.

As discussed previously, IRS is statutorily limited in the length of time it has to collect unpaid taxes—generally 10 years from the date the tax debt is assessed.<sup>34</sup> Once that statutory period expires, IRS can no longer attempt to collect the tax. IRS records indicate that over \$4 billion of unpaid payroll taxes will expire in each of the next several years due to this statutory period. Figure 8 shows the amount of unpaid payroll taxes that will statutorily expire and be written off by IRS over the next several years if IRS is unable to collect the taxes.

<sup>34</sup>26 U.S.C. § 6502.

**Figure 8: Summary of Outstanding Payroll Tax Debt by Year of Statutory Collection Period Expiration (dollars in billions)**



Source: GAO analysis of IRS data as of September 30, 2007.

As figure 8 indicates, the federal government will lose its right to collect billions of dollars in payroll taxes each year if IRS does not obtain payment from tax debtors before the statutory period for collection expires.<sup>35</sup>

## IRS's Collection Approach Does Not Always Prevent the Accumulation of Unpaid Payroll Taxes

Our audit of payroll tax cases identified several issues that adversely affect IRS's ability to prevent the accumulation of unpaid payroll taxes and to collect these taxes. Foremost is that IRS's approach focuses on getting businesses—even those with dozens of quarters of payroll tax debt—to voluntarily comply. We found IRS often either did not use certain collection tools, such as liens or TFRPs, or did not use them timely, and that IRS's approach does not treat the business's unpaid payroll taxes and responsible party's penalty assessments as a single collection effort.

<sup>35</sup> A certain percentage of unpaid payroll taxes that will expire include taxes due on accounts that have been investigated and determined to be uncollectible. Specifically, the unpaid payroll taxes of an out of business and defunct corporation will be reported as currently not collectible and allowed to expire as prescribed by law. IRS may use a TFRP to collect from the responsible individuals.

---

Additionally, although unpaid payroll taxes are one of their top collection priorities, IRS did not have performance measures to evaluate the collection of unpaid payroll taxes or the related TFRP assessment. Finally, we found some state revenue agencies are using tools to collect or prevent the further accumulation of unpaid taxes that IRS is either legally precluded from using or which it has not yet developed.

---

### IRS's Approach Focuses On Voluntary Compliance, Even for Egregious Payroll Tax Offenders

As discussed previously, IRS has a number of powerful tools at its disposal to help prevent the accumulation of unpaid taxes and to collect the taxes that are owed. Those tools include the ability to file liens on a tax debtor's property, levy available funds from bank accounts and other financial sources, and seize and sell property owned by the tax debtor to help satisfy the tax debt. However, even with such tools, we found that some businesses continued to accumulate payroll tax debt for dozens of tax quarters. This is partly because IRS's approach to collection focuses first on gaining voluntary compliance, even for more egregious payroll tax offenders. IRS acknowledges that in some instances its collection methods do not bring taxpayers into compliance.

We have previously reported that IRS subordinates the use of some of its collection tools in order to seek voluntary compliance, and that IRS's repeated attempts to gain voluntary compliance often results in minimal or no actual collections.<sup>36</sup> Our audit of businesses with payroll tax debt and our analysis of businesses with multiple quarters of unpaid payroll taxes again found revenue officers continuing to work with a business to gain voluntary compliance while the business continued to accumulate unpaid payroll taxes. As discussed earlier, our analysis of IRS's inventory of unpaid payroll taxes found that over 14,000 businesses owed payroll taxes for 20 or more quarters—5 years or more.

One of our case studies illustrates the extent to which unpaid payroll taxes can accumulate using a voluntary compliance approach for unpaid payroll taxes. In this case, the business was opened in 1994, after its owner closed a similar business that owed payroll taxes. From its inception, the case study business was not compliant with tax laws, making some tax payments, but not filing any of the required tax returns. In July 1999, IRS identified that the business was not filing its required payroll tax returns

---

<sup>36</sup>GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-95 (Washington, D.C.: Feb. 12, 2004).

---

and assigned the case to a revenue officer for investigation. After working with the business for 5 months, the revenue officer secured 22 quarters of delinquent payroll tax returns. Those returns indicated a total tax debt, including interest and penalties, of almost \$500,000. In March 2000, the business requested to be put on an installment agreement to repay over time the known outstanding taxes it owed. However, the business was not eligible for an installment agreement because it was not compliant with its filing requirements. The revenue officer worked with the business for another 9 months attempting to obtain the financial information needed to initiate an installment agreement. Meanwhile, the business continued to accumulate unpaid payroll tax debt of about \$20,000 each quarter. The revenue officer continued to work with the business to gain voluntary compliance, but the business did not provide the needed financial information until the revenue officer filed levies against the business's known bank accounts in early 2001. The levies resulted in collections of less than \$5,000 toward the unpaid tax debt. After 2-1/2 more years, in August 2003, the revenue officer noted that, though IRS had been seeking compliance for several years, the business was still not compliant with filing requirements, had not provided current financial information, and was generally unresponsive. Although the revenue officer continued to obtain some delinquent tax returns and some payroll tax payments as a result of the officer's efforts, the business continued to accumulate additional tax debt. As of July 2007, the business had accumulated payroll taxes from over 30 quarters totaling almost \$1 million, and other taxes, including business income taxes, of almost \$400,000. Those unpaid taxes stretch back to the inception of the business in 1994. Additionally, the business has not filed required payroll tax returns since the fourth quarter of 2004—potentially accruing a quarter million dollars in additional unpaid payroll tax debt.

Failing to take more aggressive collection actions against businesses that repeatedly fail to remit payroll taxes has a broader impact than on just a single business. If left to accumulate unpaid payroll taxes, businesses gain an unfair business advantage over their competitors at the expense of the government. As we have found previously,<sup>37</sup> in at least one of our case study businesses, IRS determined that the non-compliant business obtained contracts through its ability to undercut competitors due in part to the business's reduced costs associated with its non-payment of payroll

---

<sup>37</sup>GAO, *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, [GAO-06-492T](#) (Washington, D.C.: Mar. 14, 2006).

---

taxes. Similarly, in another case the revenue officer noted that the business was underbidding on contracts and was using unpaid payroll taxes to offset the business's losses.

Failure to take prompt actions to prevent the further accumulation of unpaid payroll taxes can also have a detrimental impact on the business and the associated owners/officers. As we have reported in the past, non-compliant businesses can accumulate substantial unpaid taxes as well as associated interest and penalties.<sup>38</sup> Over time, these unpaid balances may compound beyond the business's ability to pay—ultimately placing the business and responsible officers in greater financial jeopardy.

It should be noted that IRS is legally precluded from taking collection actions during certain periods, such as when a tax debtor is involved in bankruptcy proceedings. During those periods, even though IRS may not be able to take collection actions, tax debtors may continue to accumulate additional tax debt. However, IRS's focus on voluntary compliance has negatively affected IRS's collection efforts for years. Our current findings on IRS's focus on voluntary compliance are similar to those of the Treasury Inspector General for Tax Administration (TIGTA) in a study from 8 years ago. In its 2000 study, TIGTA found that revenue officers were focused on IRS's customer service goals and therefore were reluctant to take enforcement actions. As a result, they continued to work with tax debtors to gain voluntary payment rather than using more aggressive enforcement tools such as levies or seizures. TIGTA found that in 116 cases they reviewed, revenue officers did not file a lien, issue a summons, or levy or seize assets in almost a third of the cases. Revenue officers considered seizing assets in just 3 of the 116 cases, but actually seized assets in just 1 case.<sup>39</sup> TIGTA also reported that as a result of IRS not taking effective collection actions, the cases (while under review by TIGTA) accrued more unpaid taxes while assigned to revenue officers than the revenue officers were able to collect. Again in 2005, TIGTA reported that IRS allowed tax debtors to continue to delay taking action

---

<sup>38</sup> GAO, Tax Administration: IRS's Efforts to Improve Compliance with Employment Tax Requirements Should Be Evaluated, [GAO-02-92](#) (Washington, D.C.: Jan. 15, 1992).

<sup>39</sup> Treasury Inspector General for Tax Administration, *Improvements Are Needed In Resolving In-Business Trust Fund Delinquencies to Prevent Tax Liabilities from Pyramiding*, 2000-30-111 (Washington, D.C.: August 2000).



---

on their tax debt by failing to take aggressive collection actions.<sup>40</sup> TIGTA found that IRS did not take timely follow-up action for half of the cases for which tax debtors missed specific deadlines.

IRS has recently strengthened its IRM to include some specific steps for dealing with businesses that repeatedly fail to remit payroll taxes and to stress the importance of preventing the further accumulation of unpaid payroll taxes. The revised IRM advises revenue officers to take all appropriate remedies to bring the tax debtor into compliance and that they should consider seizing assets and pursuing TFRP assessments against responsible parties. It is important for IRS to support taxpayers in remaining compliant and to facilitate businesses becoming compliant; however, having a primary focus on voluntary compliance can lead to delays in taking stronger actions against flagrant tax debtors who refuse to comply with the tax laws and accumulate dozens of quarters of payroll tax debt. Having a reticence to use enforcement tools may, over time, actually diminish voluntary compliance and collections. IRS's guidance states that businesses that fail to comply with the tax law jeopardize the public perception of tax enforcement, which has a detrimental effect both on compliance and collections.

One official from a state taxing authority told us that the state benefited from IRS's approach because it allowed the state to collect its unpaid taxes from business tax debtors before IRS. In one of our case study businesses, although IRS successfully levied some financial assets, a mortgage holder and state and local officials seized the business's assets to satisfy the business's debts. In another case, IRS did not seize assets, but received some collections because local officials seized and sold the business owner's house. We noted this issue in our previous report on DOD contractors with tax debt.<sup>41</sup>

---

## IRS's Approach Can Result in Delayed Enforcement Actions

In reviewing specific collection actions taken by IRS, we found that revenue officers often did not timely take basic steps to protect the government's interest in a tax debtor's property by filing a lien or to hold the business's owners and officers personally responsible for willfully

---

<sup>40</sup>Treasury Inspector General for Tax Administration, *The Collection Field Function Needs to Improve Case Actions to Prevent Employers From Incurring Additional Trust Fund Tax Liabilities*, 2005-30-142 (Washington D.C.: Sept. 21, 2005).

<sup>41</sup>[GAO-04-95](#).

---

failing to remit withheld payroll taxes. Our analysis indicated that IRS had not filed a lien to protect the government's interest in a business property in over 30 percent of all payroll tax cases assigned to the field for collection effort. Additionally, our review of recent IRS actions to assess TFRPs against owners/officers of businesses with payroll tax debt found that revenue officers took 40 weeks on average to determine that a TFRP should be assessed and an additional 40 weeks on average to actually assess the penalty.

Failure to take timely action to file liens or assess TFRPs has been a long-standing problem. In 2005, TIGTA reported that IRS's revenue officers often failed to take timely collection actions on payroll tax cases and concluded that not taking timely and aggressive collection actions on cases allowed businesses to continue to accumulate unpaid payroll taxes.<sup>42</sup> IRS's own analysis of TFRP assessments, also done in 2005, found that less than half of all TFRP cases had a lien filed to protect the interest of the government.<sup>43</sup>

## IRS Does Not Always File Tax Liens Timely

Our audit found that for payroll tax debt, one of its highest collection priorities, IRS does not always file liens to protect the government's interest in property and, when it does so, it does not always do so timely. Our analysis of IRS's inventory of unpaid payroll taxes as of September 30, 2007, found that IRS had not filed liens on over one-third of all businesses with payroll tax debt cases assigned to the field for collection efforts – over 140,000 businesses. IRS guidance states that filing a lien is extremely important to protect the interests of the federal government, creditors, and taxpayers in general, and that the failure to file and properly record a federal tax lien may jeopardize the federal government's priority right against other creditors.<sup>44</sup>

The ability to file a tax lien in the public records is a powerful tool for IRS. The lien appears on credit reports for both individuals and businesses and

---

<sup>42</sup>Treasury Inspector General for Tax Administration, *The Collection Field Function Needs to Improve Case Actions to Prevent Employers From Incurring Additional Trust Fund Tax Liabilities*, 2005-30-142 (Washington D.C.: Sept. 21, 2005).

<sup>43</sup>Internal Revenue Service Small Business /Self Employed (SB/SE) internal research report, *Research Report on the Collectibility of Trust Fund Recovery Penalty (TFRP) Assessments*, 03.01.001.05 (Denver project, Aug. 31, 2005).

<sup>44</sup>Internal Revenue Service noted that there are a number of factors that serve to delay the filing of a lien, including cases being placed in the queue for extended periods of time.

---

can stay there for approximately 10 years. For an individual, the presence of a tax lien can make it more difficult to obtain credit, in turn making it more difficult to buy a home, rent an apartment, or buy a car. Tax debtors that are able to get credit may have to pay higher credit rates. For businesses, the presence of a tax lien can result in a creditor no longer shipping inventory unless paid for by cash and banks withdrawing lines of credit. This can ultimately cause businesses to fail. Lien filing may also increase the likelihood of collection by IRS. The 2005 IRS study of TFRP cases found that cases where a lien had been filed had more average payments—about a third more—than where a lien had not been filed.<sup>45</sup>

Although the IRM does not explicitly state that liens should be filed, it does emphasize the need to do so to protect the interest of the federal government. Because businesses may be highly leveraged or have few tangible assets, the filing of a lien may not always be advantageous to the government; other situations may also make it counterproductive to file a lien. The IRM does allow revenue officers to not file a lien in order to allow a business to obtain a loan or to otherwise continue operating so that the business may become compliant and pay the past due tax debt. However, failure to file a lien can have a negative impact on tax collections. For example, IRS assessed the business owner in one of our case studies a TFRP to hold the owner personally liable for the withheld payroll taxes owed by the business. However, IRS did not assign the assessment to a revenue officer for collection, and thus did not file a Notice of Federal Tax Lien on the owner's property. Because there was no lien filed, the owner was able to sell a vacation home in Florida and IRS did not collect any of the unpaid taxes from the proceeds of the sale.

As in the case above, IRS's case assignment policy can delay the filing of liens for payroll tax cases. Because payroll tax cases are one of IRS's top collection priorities, once the notification process is complete, IRS bypasses its ACS process and routes these cases to revenue officers for collection. However, IRS generally must place cases in a queue until a revenue officer is available to work the cases. Cases can be in the queue for extended periods of time awaiting assignment. For the period that a case is in the queue, revenue officers are not assigned to file liens and take

---

<sup>45</sup>Internal Revenue Service Small Business /Self Employed (SB/SE) internal research report, *Research Report on the Collectibility of Trust Fund Recovery Penalty (TFRP) Assessments*, 03.01.001.05 (Denver project, Aug. 31, 2005).

---

other collection actions.<sup>46</sup> Our analysis found that for the \$9 billion of payroll tax cases in the queue awaiting assignment as of September 30, 2007, over 80 percent of the cases did not have a lien filed. As a result, lower priority tax cases that go through the ACS process may have liens filed faster than the higher priority payroll tax cases.

IRS has been aware of this issue. Its own study in 2005 found less than half of payroll tax cases in which IRS assessed the business owner or officer a TFRP had a lien filed to protect the interest of the government, and only 27 percent of TFRP assessments that were under a year old had a lien filed. As the previously discussed case study illustrates, the timeliness of lien filing is critical in such cases to protect the government's interest in the owner's personal property and to encourage the owners/officers to make the business compliant.

IRS is taking some steps to address these issues. For example, IRS is investigating the feasibility of routing payroll tax cases that might otherwise be sent to the queue through the ACS process to have a lien filed. Additionally, in recent years IRS has begun to put in the IRM timeliness guidelines for the use of certain collection tools, including lien filings. The IRM now calls for revenue officers to make a determination to file a lien within 10 days of initial contact. These are positive steps which could help improve the timeliness of IRS's lien filings in the future. However, while not all cases warrant having a lien filed, our analysis has shown that, overall, 60 percent of all unpaid payroll tax cases currently in IRS's inventory do not have a lien filed to protect the government's interest in tax debtors' property.

### IRS Does Not Always Assess Trust Fund Recovery Penalties Timely

Although IRS has a powerful tool to hold responsible owners and officers personally liable for unpaid payroll taxes through assessing a TFRP, we found that IRS often takes a long time to determine whether to hold the owners/officers of businesses personally liable and, once the decision is made, to actually assess penalties against them for the taxes. In reviewing the sample of TFRP assessments selected as part of our audit of IRS's fiscal year 2007 financial statements, we found that from the time the tax debt was assessed against the business, IRS took over 2 years, on average,

---

<sup>46</sup>Cases may move in and out of the queue several times, so some cases may have liens filed even though the business or owner/officer case is currently in the queue.

---

to assess a TFRP against the business owners/officers.<sup>47</sup> We found that revenue officers, once assigned to a payroll tax case, took an average of over 40 weeks to decide whether to pursue a TFRP against business owners/officers and an additional 40 weeks on average to formally assess the TFRP.<sup>48</sup> For 5 of the 76 sampled cases, IRS took over 4 years to assess the TFRP. We did not attempt to identify how frequently IRS assesses a TFRP against responsible owners/officers. However, in TIGTA's 2005 report on its review of IRS's collection field function, it noted that for cases where a TFRP was applicable, revenue officers did not initiate or conduct the interview to begin the TFRP process in over a quarter of the cases TIGTA reviewed.<sup>49</sup>

The timely assessment of TFRPs is an important tool in IRS's ability to prevent the continued accumulation of unpaid payroll taxes and to collect these taxes. Once a TFRP is assessed, IRS can take action against both the owners/officers and the business to collect the withheld taxes. For egregious cases, such as some of those in our case studies, taking strong collection actions against the owners' personal assets may be the best way to either get the business to become tax compliant or to convince the owners to close the business, thus preventing the further accumulation of unpaid taxes. Failure to timely assess a TFRP can result in businesses continuing to accumulate unpaid payroll taxes and lost opportunities to collect these taxes from the owners/officers of the businesses. For example, one business had tax debt from 2000, but IRS did not assess a TFRP against the business's owner until the end of 2004. In the meantime, the owner was drawing an annual salary of about \$300,000 and had sold property valued at over \$800,000. Within 1 month of IRS assessing the

---

<sup>47</sup>Taxpayers have 60 days from the date of proposed assessment to make an appeal of the TFRP assessment. According to IRS, during the period July 10, 2007 through July 11, 2008, approximately 6.1% individual TFRP recommendations were sent to Appeals. IRS stated that, on average, its process took 236 days to resolve the appeal. IRS's lengthy appeals process also contributes to long delays in making some TFRP assessments.

<sup>48</sup>The results of this sample, while statistically selected, are not projectible to the universe because the sample was not specifically designed to assess the timeliness of collection actions.

<sup>49</sup>Treasury Inspector General for Tax Administration's sample included 166 businesses for which a TFRP interview was applicable. TIGTA 2005-30-142.

---

TFRP, the owner closed the business, which by then had accumulated about \$3 million in unpaid taxes.<sup>50</sup>

Lack of timeliness in assessing TFRPs has been a long-standing problem for IRS. Our annual audit of IRS's financial statements in the late 1990's identified this problem and we made recommendations for IRS to analyze and determine the factors causing delays in both processing and recording TFRP assessments. Although IRS has taken many steps to improve the timeliness of TFRP assessments, such as centralizing TFRP assessment processing and implementing a new Web-based application, these actions have not been fully effective in resolving this issue. During our audit of IRS's fiscal year 2007 financial statements, we continued to find long delays in IRS's processing and posting of TFRP assessments.<sup>51</sup>

For most of the time our case study businesses were being worked on by revenue officers, the IRM required them to make a determination of whether to pursue a TFRP assessment within 180 days—about 26 weeks. However, the IRM was silent about how long it should take to actually assess the TFRP once revenue officers determined that the failure by the responsible individuals to remit payroll taxes was willful. Additionally, although IRS had a 180-day requirement to make a determination, revenue officers could make the determination to delay the assessment, thus making a timely determination while still not moving forward to formally assess the TFRP against the responsible individuals.

In September 2007, IRS implemented new IRM requirements to address the timeliness of TFRP assessments. Under the new policy, revenue officers are now required to make the determination as to whether to pursue a TFRP within 120 days of the case being assigned and to complete the assessment within 120 days of the determination. However, the revised IRM maintains the provision to allow the revenue officer, with manager authorization, to delay the TFRP determination. Additionally, the IRM does not include a requirement for IRS to monitor the new IRM standards for assessing TFRPs.

---

<sup>50</sup>This example was originally reported in our prior report on GSA contractors, GAO, *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, [GAO-06-492T](#) (Washington, D.C.: Mar. 14, 2006). For this report, we performed additional analysis of the business.

<sup>51</sup>[GAO-08-166](#).

---

## IRS's Approach for Businesses and Responsible Parties Is Inconsistent

IRS assigns a higher priority to collection efforts against the business with unpaid payroll taxes than against the business's responsible owners/officers. Further, it treats the TFRP assessments as a separate collection effort unrelated to the business tax debt, even though the business payroll tax liabilities and the TFRP assessments are essentially the same tax debt. As a result, once the revenue officer assigned to the business payroll tax case decides to pursue a TFRP against the responsible owners/officers, the TFRP case does not automatically remain with this revenue officer. Accordingly, IRS often does not assign the TFRP assessment to a revenue officer for collection, and when it does, it may not assign it to the same revenue officer that is responsible for collecting unpaid taxes from the business. In reviewing the sample of TFRP assessments selected as part of our audit of IRS's fiscal year 2007 financial statements, we found that half of the TFRP assessments had not been assigned to a revenue officer by the time of our audit.<sup>52</sup> Of those that had been assigned, over half of the TFRP assessments had not been assigned to the same revenue officer that was working the related business case.

Assigning the collection efforts against the business and the TFRP assessments to different revenue officers can result in the responsible owners/officers being able to continue to use the business to fund a personal lifestyle while not remitting payroll taxes. For example, in one of our case studies the owner was assessed a TFRP, but continued to draw a six-figure income while not remitting amounts withheld from the salaries of the business's employees.

In contrast, having either a single revenue officer assigned or coordinating the efforts of multiple revenue officers could provide IRS with several advantages, including the following:

- For egregious cases, taking strong collection actions against the owner's personal assets may be a more effective means of either getting the business to be compliant or convincing the owner to close the unprofitable business to prevent the further accumulation of unpaid payroll taxes.
- Assigning a single revenue officer could expedite the assignment of TFRP assessments and collection efforts against those cases. For example, one

---

<sup>52</sup>The sample consisted of 76 TFRP payments in 2007. We were able to obtain sufficient data to perform our analysis for 60 percent of the cases in the sample (45 of the 76 cases). We were unable to project these results because the sampling units used for the financial statement audit were payments rather than accounts.

---

of our case study businesses was assessed a TFRP, but since the TFRP had a lower priority, it was sent to the queue. Because the case had not been assigned, IRS did not file a tax lien on the owner of the business and thus the assessment of the TFRP had very little impact. Additionally, since IRS has a statutory time limitation to collect against a tax debt, this owner was almost half-way through the statutory period before the case was ever worked on.

- Assigning a single revenue officer could help improve IRS's ability to ensure assessments are made, transaction codes are input, and collections are properly posted against trust fund amounts to all related parties, a long-standing problem identified as a part of our financial statement audits.<sup>53</sup>

IRS collection officials said the agency categorizes the unpaid payroll tax debt of the business as a high priority to ensure that higher-level revenue officers are assigned mainly to the more complex business cases.<sup>54</sup> IRS may also assign the business payroll tax debt and the TFRP assessment to different collection officials because the business and the responsible owners/officers are not located in the same zip code area. For example, if an officer is in a different state than the business, the collection efforts would be handled by separate officials to facilitate face-to-face collection efforts and to allow the revenue officer to physically go to courthouses to perform property searches. IRS collection officials also stated that attempting to assign the same revenue officer both the TFRP assessments and the business payroll tax case for collection would overload the revenue officers with work and result in fewer high-priority payroll tax cases being worked on. This view, however, stems from separating the collection efforts of the business and the individual and not considering the business's unpaid payroll taxes and the TFRP assessment as a single case. In essence, the TFRP assessment is the same tax debt as the business's payroll tax debt; the assessment is merely another means through which IRS can attempt to collect the monies withheld from a business's employees for income, Social Security, and hospital insurance

---

<sup>53</sup>GAO, *Financial Audit: IRS's Fiscal Years 2007 and 2006 Financial Statements*, GAO-08-166 (Washington, D.C.: Nov. 9, 2007).

<sup>54</sup>IRS officials told us that IRS's procedures allow the revenue officer in charge of the business case to take control of the collection efforts of the related owners/officers so long as the revenue officer and owners/officers are in the same assignment area (usually a zip code).



---

taxes that were not remitted to the government.<sup>55</sup> This view that the payroll tax debt and the TFRP assessment are essentially the same tax debt is reinforced by IRS's own practice of crediting all related parties' accounts whenever a collection is made against either assessment.

Prior studies have found that IRS's practice of assigning TFRP assessments a lower priority than business cases has not been very successful for collecting the unpaid taxes. In its own August 2005 study, IRS reported that it had assessed over \$11.9 billion in TFRP assessments (including interest) between 1996 and 2004, yet had collected only 8 percent of those assessments. IRS reported that for those assessments made in 1996, for which IRS had been attempting collection for at least 8 years, the collection rate was only 13 percent. For all responsible owners/officers that were assessed a TFRP, 43 percent never made a payment on their trust fund penalty. IRS reported that of those TFRP assessments that had been resolved, almost half were resolved in the first year of the assessment, and almost 93 percent were resolved in the first 4 years.<sup>56</sup>

---

## IRS's Approach Does Not Prevent Egregious Accumulation of Unpaid Payroll Taxes

IRS policies have not resulted in effective steps being taken against egregious businesses to prevent the further accumulation of unpaid payroll taxes. Our audit found thousands of businesses that had accumulated more than a dozen tax quarters of unpaid payroll tax debt. The IRM states that revenue officers must stop businesses from accumulating payroll tax debt, and instructs revenue officers to use all appropriate remedies to bring the tax debtor into compliance and to immediately stop any further accumulation of unpaid taxes. It further states that if routine case actions have not stopped the continued accumulation of unpaid payroll taxes, revenue officers should consider seizing the business's assets or pursuing a TFRP against the responsible parties. However, IRS successfully pursued less than 700 seizure actions in fiscal year 2007. We were unable to determine how many of those seizure actions were taken against payroll tax debtors. Regarding TFRPs, as discussed previously, IRS does not always assess the TFRPs timely and

---

<sup>55</sup>Under the law, TFRP assessments, while equal to the total amount of unpaid payroll taxes, constitute a separate liability from the payroll taxes. However, it is IRS's policy to collect only the amount of the unpaid payroll tax debt, whether from the business, in the form of a TFRP, or a combination of both.

<sup>56</sup>Internal Revenue Service SB/SE Research Denver, Project 03.01.001.05.

---

IRS does not prioritize the TFRP assessment against the owner as highly as it does the business payroll taxes. This can result in little collection action being taken against the parties responsible for the failure to remit withheld payroll taxes.

When a business repeatedly fails to comply after attempts to collect, the IRM states that the business should be considered an egregious offender and IRS should take aggressive collection actions, including threats of legal action that can culminate in court-ordered injunctions for the business to stop accumulating unpaid payroll taxes or face business closure. However, IRS obtained less than 10 injunctions in fiscal year 2007 to stop businesses from accumulating additional payroll taxes. Revenue officers we spoke to believe the injunctive relief process to be too cumbersome to use effectively in its present form.<sup>57</sup> One revenue officer stated that because of the difficulty in carrying out the administrative and judicial process to close a business through injunctive relief, he had not attempted to take such action in over a decade. We have reported in the past that the U.S. Attorney's Office and the District Counsel prefer not to seek such injunctions due to the time and expense required to prosecute these cases.<sup>58</sup> IRS is taking some action to attempt to address this issue by piloting a Streamline Injunctive Relief Team to identify cases and develop procedures to quickly move a case from administrative procedures to judicial actions.<sup>59</sup> These procedures will be used for the most egregious taxpayers when the revenue officer can establish that additional administrative procedures would be futile.

---

<sup>57</sup>The IRM places a high standard for seeking an injunction against a business. It states that the revenue officer must be able to show irreparable harm and that IRS has no adequate remedy at law other than the injunction.

<sup>58</sup>[GAO/GGD/AIMD-99-211](#).

<sup>59</sup>According to IRS, it is developing and testing streamlined injunctive relief procedures for requesting a suit for injunctive relief without the burden of proceeding with trust fund compliance procedures, including monthly filing and special bank accounts. The cases being tested are those in which the facts show that the taxpayer knows about the federal tax deposit laws, and show that further administrative activity would be futile due to the egregious nature of the taxpayer's history of non-compliance. Taxpayers to whom these streamlined procedures are designed to apply include the following: (1) taxpayers who may have received a Letter 903 in the past; (2) taxpayers who were previously assessed a Trust Fund Recovery Penalty; (3) taxpayers who have engaged in multiple entities to avoid paying trust fund taxes; (4) taxpayers who have a history of filing bankruptcies to avoid employment tax collection or continue to pyramid taxes while in bankruptcy.

---

Similar to IRS, all of the state tax collection officials we contacted told us that their revenue department's primary goal was to prevent businesses from continuing to flaunt tax laws and to stop them from accumulating additional tax debt. They said that after a business had been given a period of time to comply with its current tax obligations and begin paying past taxes, state tax collection officials changed their focus to one of "stopping the bleeding." As such, some have made the policy decision to seek to close non-compliant businesses, as discussed in the following two examples.

- One Georgia state official we spoke to said the state had passed laws to allow businesses to be closed through administrative procedures within the department of revenue without judicial intervention. The procedure is tied to the state's ability to seize the assets of the business. The state may seize the assets of businesses that do not comply with their tax obligations as a means of closing the business to prevent the further accumulation of unpaid taxes, even if the sale of those assets do not result in collections to reduce the business's current tax debt.<sup>60</sup> The official we spoke to stated that it is a routine part of the state's collection arsenal and the state closed several dozen businesses this way in 2007 to prevent the further accumulation of unpaid trust fund taxes.
- Kentucky developed a procedure to close businesses that does not involve the seizure of the business's assets. That state centralized the judicial proceedings for closing a business in a single court that is experienced in tax-related injunctions and therefore is willing and able to move through the process quickly. One official told us the state closed about 100 businesses a month through such proceedings to prevent the further accumulation of unpaid payroll tax debt.

To the extent IRS is not taking effective steps to deal with egregious payroll tax offenders that repeatedly fail to comply with the tax laws, businesses may continue to withhold taxes from employees' salaries but divert the funds for other purposes.

---

## IRS's Approach Does Not Measure Effectiveness

Although IRS has made the collection of unpaid payroll taxes one of its top priorities, IRS has not established goals or measures to assess its progress in collecting or preventing the accumulation of payroll tax debt.

---

<sup>60</sup>As noted earlier, IRC 6331(f) prohibits IRS from taking seizure action on a case where the expenses of seizure exceed the fair market value of the asset.

---

Performance measurement and monitoring supports resource allocation and other policy decisions to improve an agency's operations and the effectiveness of its approach. Performance monitoring can also help an agency by measuring the level of activity (process), the number of actions taken (outputs), or the results of the actions taken (outcomes).

Although IRS does have a broad array of operational management information available to it, we did not identify any specific performance measures associated with payroll taxes or TFRP assessments. IRS has caseload and other workload reports for local managers (to measure process and outputs); however, these localized reports are not rolled up to a national level to allow IRS managers to monitor the effectiveness or efficiency of its collection and enforcement efforts. Additionally, these operational reports do contain information about unpaid payroll tax and TFRP case assignments, but rather are used primarily to monitor workload issues, not program effectiveness. For example, IRS has developed some reports that identify "over-aged" cases (those that have not been resolved within a certain length of time), and to identify businesses that continue to accrue additional payroll tax debt, but those reports are designed for workload management.

To report on its outcomes or the effectiveness of its operations, IRS reports on overall collection statistics and presents that information in the Management Discussion and Analysis accompanying its annual financial statement and in its IRS Data Book.<sup>61</sup> However, IRS does not specifically address unpaid payroll taxes as a part of those discussions. IRS officials stated that they do not have specific lower-level performance measures that target collection actions or collection results for unpaid payroll taxes or TFRP assessments. Such performance measures could be useful to assist IRS in measuring the success of its efforts to collect or prevent the further accumulation of unpaid payroll taxes and to formulate more effective approaches to dealing with this compliance issue.

---

## IRS's Approach Could Benefit from Additional Tools

In our discussions with IRS revenue officers concerning some of the egregious payroll tax offenders included in our case studies, they noted that having certain additional tools available to them could allow them to more effectively deal with recalcitrant businesses. Those tools include (1)

---

<sup>61</sup>*Data Book 2007*, Internal Revenue Service Publication 55B (Washington, D.C.: March 2008).

---

the ability to publish the names of tax debtors and (2) improved methods of identifying business assets for levy.<sup>62</sup>

Revenue officers stated, and we acknowledge, that IRS faces challenges in balancing voluntary compliance with the need to enforce the tax laws. Many businesses have accumulated dozens of tax quarters worth of payroll tax debt, sometimes accumulating over a million dollars in unpaid payroll taxes. In those egregious situations, including many of our case studies, IRS's policy to encourage voluntary compliance and use of available collection tools neither resulted in the collection of the unpaid portion nor prevented the further accumulation of more unpaid payroll taxes. As part of our audit, we spoke with a number of state revenue department officials to identify specific collection approaches and tools used by those states to pursue payment of unpaid taxes. We found that several states had already developed and were effectively using the types of tools IRS revenue officers said would be beneficial to them.

## IRS Cannot Publish Tax Debtor Information

The IRC generally prohibits IRS from publicly disclosing federal tax information without taxpayer consent.<sup>63</sup> Although IRS tax liens are public information, IRS does not centrally publish its lien filings or otherwise make available information about businesses or individuals with tax debt. However, during our discussions, IRS officials told us that being able to do so could increase IRS's ability to collect payroll tax debts.

In contrast, an increasing number of states—at least 19 including New Jersey, Connecticut, Indiana, and California—are seeking to increase tax collections by publicizing the names of those with delinquent tax bills.<sup>64</sup> For example, a recent California law mandates the state to publish each year the names of the top 250 personal and corporate state tax debtors with at least \$100,000 in state tax debt.<sup>65</sup> The list does not include those

---

<sup>62</sup>Some collection officials thought the tools IRS currently has at its disposal were sufficient to prevent and collect unpaid payroll taxes. They stated that what was needed was timelier contact and more diligent follow-up on deadlines.

<sup>63</sup>26 U.S.C. § 6103. Subsection 6103(k) provides exceptions to the disclosure prohibition. For example, IRS can disclose the amount of the taxpayer's outstanding debt secured by a lien to persons with evidence of rights in the property subject to the lien.

<sup>64</sup>The 19 states we identified that disclose information about those with unpaid tax debt were California, Colorado, Connecticut, Delaware, Georgia, Indiana, Illinois, Kansas, Kentucky, Maryland, Minnesota, Montana, North Carolina, New Jersey, Pennsylvania, Rhode Island, South Carolina, Washington, and Wisconsin.

<sup>65</sup>Cal. Rev. & Tax. Code § 19195.

---

who are fighting the tax bills in courts, have sought bankruptcy protection, or have set up payment plans with the state. Public disclosure of tax debtors can be very effective. Just threatening to publish the names of tax offenders can bring some into compliance, while actually appearing on a tax offender list can bring about societal pressure to comply. For example, in California 26 tax debtors threatened with public disclosure stepped forward to settle their tax debts and thus avoided appearing on the list. In Connecticut, the state claims the public disclosure of tax debtors has resulted in over \$100 million in collections from the first 4 years of the program. The potential public disclosure of tax debtors may also encourage greater tax compliance among the general population of taxpayers to avoid potentially being on the list.

#### IRS Cannot Always Identify Levy Sources

As discussed previously, IRS has the authority to levy a tax debtor's income and assets when there is a demand for payment and there has been a refusal or an inability to pay by the taxpayer subject to the levy.<sup>66</sup> Although IRS has this authority, IRS officials stated that they often have difficulty using levies to collect unpaid payroll taxes because, for example, the levy may be made against funds in a bank account at a certain point in time when little or no funds are available. Additionally, IRS officials told us, and in our case studies we found, that IRS sometimes has difficulty identifying which banks or financial institutions a tax debtor is using. This is the case because tax debtors will often change financial institutions to avoid IRS levies. Once a levy is served against an account, a tax debtor will often close the account and open an account in a different financial institution. IRS must then search for where the tax debtor is now doing business and attempt to serve a new levy. One IRS official stated that IRS may serve levies on multiple banks while searching for the new accounts. Such a process of searching for accounts is very time consuming for both the revenue officers and the financial institutions being served the levies and is a burden to these financial institutions.

Several states use legal authorities to assist in identifying levy sources. States such as Kentucky, Maryland, Massachusetts, Indiana, and New

---

<sup>66</sup>As discussed previously, levy is the legal seizure of the taxpayer's property to satisfy a tax debt. IRS may order a third party to turn over property in its possession that belongs to the delinquent taxpayer named in a notice of levy. IRS levies against bank accounts, brokerage accounts, or business account receivables are generally one-time levies of amounts in the account at the time the levy is served. However, IRS can also use a "continuous" levy against wages or certain federal payments. IRS officials stated that finding an account with money in it is often a "hit or miss" proposition since they are one-time levies.

---

Jersey have enacted legislation for matching programs or entered into agreements with financial institutions to participate in matching bank account information against state tax debts. This matching allows states to more easily identify potential levy sources and simplifies the financial institution's obligations to respond to multiple levies. IRS is currently working with at least one state to investigate the potential for this matching, but in our discussions with IRS collection officials, they stated that IRS has not sought legislation or agreements with financial institutions to enhance its levying powers.

---

## Businesses Engaged in Abusive and Potentially Criminal Activity Related to the Federal Tax System

Our analysis of unpaid payroll tax debt found substantial evidence of abusive and potentially criminal activity related to the federal tax system by businesses and their owners or officers. As noted, over 1.6 million businesses owe unpaid payroll taxes. We identified tens of thousands of businesses that filed 10 or more tax returns acknowledging that the business owed payroll taxes, yet failed to remit those taxes to the government. While much of the tax debt may be owed by those with little ability to pay, some abuse the tax system, willfully diverting amounts withheld from their employees' salaries to fund their business operations or their own personal lifestyles.

In addition to owing payroll taxes for multiple tax periods and accumulating tax debt for years, many of the owners and officers of these businesses are repeat offenders. We identified owners who were involved in multiple businesses, all of which failed to remit payroll taxes as required. For example, in one of our case studies in which a business owed almost \$2.5 million, the owner was involved in multiple other businesses, all of which owed unpaid payroll taxes. IRS records indicated that the owner was also underreporting personal income to avoid paying personal income taxes. Additionally, the owner was the subject of at least 10 lawsuits either pending or settled and was involved in possible check kiting and money laundering. In total, IRS records indicate over 1,500 owners/officers had been found by IRS to be responsible for non-payment of payroll taxes at 3 or more businesses, and 18 business owners/officers had been found by IRS to be responsible for not paying the payroll taxes for over 12 separate businesses. It should be noted that these numbers represent only those responsible individuals IRS found acted willfully in the non-payment of the businesses' payroll taxes and who were assessed TFRPs—they do not represent the total number of repeat offenders with respect to non-payment of payroll taxes. Table 2 shows the number of individuals with TFRPs for two or more businesses.

---

**Table 2: Number of Individuals with Trust Fund Recovery Penalties for Two or More Businesses**

| <b>Number of businesses associated with owner/officer</b> | <b>Number of individuals</b> |
|---|------------------------------|
| 2   | 7,716                        |
| 3   | 1,011                        |
| 4   | 290                          |
| 5   | 101                          |
| 6   | 60                           |
| 7-12  | 72                           |
| Over 12   | 18                           |
| <b>Total</b>  | <b>9,268</b>                 |

Source: GAO analysis of IRS data as of September 30, 2007

Our audits and investigations of the 50 case study businesses with tax debt found substantial evidence of abuse and potential criminal activity related to the tax system; 12 of these case studies follow. All of the case studies involved businesses that had withheld taxes from their employees' paychecks and diverted the money to fund business operations or for personal gain. Employers are required by law to remit withheld taxes, and the employer's matching contributions, to IRS or face potential civil or criminal penalties. Although we reviewed tax records and other information for all 50 cases, we performed a more in-depth review of 12 case study businesses for this report. IRS had filed a lien to protect the government's interests for all of the 12 case studies, and had filed liens for all but 5 of the 38 cases presented in appendix II.<sup>67</sup> Table 3 shows the results of 12 of the case studies we performed.

---

<sup>67</sup>IRS noted that in half of the 12 case studies presented here IRS was stayed from collection action for various lengths of time due to factors such as bankruptcy filings. IRS noted that during those periods in which IRS collection action was stayed, some businesses continued to accumulate additional unpaid payroll taxes.



**Table 3: Businesses That Fail To Remit Payroll Taxes**

| Case study | Nature of business | Unpaid payroll tax                        | Comments  |
|------------|--------------------|---|---|
| 1          | Automotive         | Over \$3.5 million for almost 40 quarters | <ul style="list-style-type: none"> <li>• Business also owes non-payroll tax debt of almost \$70,000.</li> <li>• Widely advertised business with dozens of employees.</li> <li>• For last decade the business has not remitted the payroll taxes withheld from its employees, paying less than a quarter of the payroll taxes owed.</li> <li>• For the last 2 years the owner reported making about \$100,000 in salary.</li> <li>• Owner transferred \$1.5 million in property after being assessed a TFRP.</li> <li>• Recently the owner’s personal residence sold for over \$600,000.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found owner willful and responsible for not remitting taxes withheld from employees and assessed a TFRP.</li> </ul>   |
| 2          | Healthcare         | Almost \$2.5 million for over 30 quarters | <ul style="list-style-type: none"> <li>• Business also owes almost \$500,000 in non-payroll tax debt.</li> <li>• Business is currently in business with over 100 employees.</li> <li>• IRS stated that the officers consistently avoided IRS action by filing bankruptcy. Business filed for bankruptcy three times, two of which were dismissed.</li> <li>• Around the time of bankruptcy filings, officers made large cash withdraws from the business of about \$700,000.</li> <li>• IRS found two officers of business were paying personal expenses through the business.</li> <li>• One officer purchased luxury vehicles and personal property while business was not remitting payroll taxes.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found three officers willful and responsible for not remitting taxes withheld from employees and assessed them a TFRP.</li> </ul> |
| 3          | Janitorial         | Almost \$500,000 for almost 30 quarters   | <ul style="list-style-type: none"> <li>• Business also owes over \$10,000 in non-payroll tax debt.</li> <li>• Business is currently in business.</li> <li>• Owner has an extensive criminal history.</li> <li>• IRS agreed to allow business to pay via an installment agreement, but the payments will cover only a small percentage of the payroll tax debt owed.</li> <li>• Owner owns multiple rental properties and a \$500,000 personal residence.</li> <li>• IRS noted that owner had the ability to pay the tax liability.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found owner willful and responsible for not remitting taxes withheld from employees and assessed a TFRP.</li> </ul>  |
| 4          | Legal services     | Over \$500,000 for over 50 quarters       | <ul style="list-style-type: none"> <li>• Business also owes almost \$10,000 in non-payroll tax debt.</li> <li>• Owner is currently in business as a lawyer, but continues to accumulate unpaid payroll taxes.</li> <li>• Owner owes more than \$600,000 on over 10 years of personal taxes, and did not file most recent years’ personal tax returns.</li> <li>• Owner has multiple real estate properties, including property on a tropical island.</li> <li>• IRS notes that owner has the ability to pay, but refuses.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> </ul>   |

| <b>Case study</b> | <b>Nature of business</b> | <b>Unpaid payroll tax</b>                 | <b>Comments</b>   |
|-------------------|---------------------------|---|---|
| 5                 | Dentist                   | Over \$500,000 for over 40 quarters       | <ul style="list-style-type: none"> <li>• Business also owes over \$7,000 in non-payroll tax debt.</li> <li>• Business is still operating with employees, but for over 15 years it has not remitted all required payroll taxes to IRS.</li> <li>• Owner lives in a large home with acreage valued at over \$700,000. The house is deeded under spouse's name, but spouse's income is insufficient to pay the interest on the mortgage. Owner admits to paying the mortgage.</li> <li>• Owner sold real estate to children for less than market value.</li> <li>• Owner drives a later model luxury vehicle registered under wife's name.</li> <li>• Owner stated he would pay all the business's expenses before paying taxes.</li> <li>• Owner is not compliant with personal taxes, owing over \$500,000.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found owner willful and responsible for not remitting taxes withheld from employees and assessed a TFRP.</li> </ul>  |
| 6                 | Consulting                | Almost \$1.5 million for over 30 quarters | <ul style="list-style-type: none"> <li>• Business also owes over \$500,000 in non-payroll tax debt.</li> <li>• Business gave owner cash loans.</li> <li>• IRS found that business monies flowed into owner's personal accounts.</li> <li>• Owner has not filed personal tax returns since early 1990s and owes over \$400,000 in personal taxes.</li> <li>• Owner has multiple businesses that have been delinquent since 1994.</li> <li>• According to IRS, owner kept changing legal representatives to stall collection efforts with repeated requests for the same information.</li> <li>• Owner sold assets to relative after receiving notice of potential TFRP issued by IRS.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found owner willful and responsible for not remitting taxes withheld from employees and assessed a TFRP for this and other businesses.</li> </ul>  |
| 7                 | Manufacturing             | Almost \$1.5 million for over 40 quarters | <ul style="list-style-type: none"> <li>• Business also owes non-payroll tax debt of almost \$70,000.</li> <li>• IRS revenue officer notes indicate business monies may have been flowing into owner's personal accounts while withheld payroll taxes were not being remitted.</li> <li>• IRS found owner hid business assets in personal name, keeping IRS from seizing them.</li> <li>• Owner is also delinquent on personal taxes.</li> <li>• IRS officials stated that owner used appeals and offers in compromise (OIC) to delay IRS collection efforts.</li> <li>• Owner defaulted on OIC for TFRPs.</li> <li>• IRS found owner had underreported tax liabilities for at least one tax quarter.</li> <li>• Business assets given to relative, who used them to start a new business.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found owner willful and responsible for not remitting taxes withheld from employees and assessed a TFRP for both this business and at least two previous businesses.</li> </ul> |

| <b>Case study</b> | <b>Nature of business</b> | <b>Unpaid payroll tax</b>                 | <b>Comments</b>   |
|-------------------|---------------------------|---|---|
| 8                 | Construction              | Almost \$2.5 million for over 20 quarters | <ul style="list-style-type: none"> <li>• Business also owes non-payroll tax debt of almost \$100,000.</li> <li>• IRS found business was underbidding contracts while using unpaid payroll taxes to subsidize its losses.</li> <li>• Business claimed that if it paid payroll taxes, it would not be able to pay employees or other business expenses and would have to close.</li> <li>• Business has not filed taxes for all tax quarters.</li> <li>• IRS considered pursuing business for fraud charges, but did not pursue.</li> <li>• Business/owners have received four civil judgments against it and almost 20 liens.</li> <li>• Revenue officer notes state that the owners have repeatedly taken steps to avoid IRS collection action including the following: filed bankruptcy (which was dismissed), filed appeals against liens, requested abatements of penalties (which were denied), appealed the denial (which was sustained by appeals), submitted a request for installment agreement (which was denied as being insufficient), then appealed the denial of the installment agreement (which was upheld by appeals), “and every other conceivable action to delay or hinder IRS’s collection efforts.”</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found three owners willful and responsible for not remitting taxes withheld from employees and assessed them TFRPs.</li> </ul> |
| 9                 | Manufacturing             | Almost \$1 million for almost 40 quarters | <ul style="list-style-type: none"> <li>• Business also owes over \$400,000 in non-payroll tax debt.</li> <li>• Owners and business investigated for bankruptcy fraud.</li> <li>• Revenue officer stated the business was a “sweat shop.”</li> <li>• IRS found owner had closed several businesses with tax debt when investigated by IRS and opened new ones.</li> <li>• Business has not filed payroll returns since late 2005.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found two owners willful and responsible for not remitting taxes withheld from employees and assessed them TFRPs.</li> </ul>   |
| 10                | Healthcare                | Over \$8 million for nearly 30 quarters   | <ul style="list-style-type: none"> <li>• Business also owes almost \$20,000 in non-payroll tax debt.</li> <li>• Although owner has luxury cars and a multimillion dollar home, he claimed inability to pay taxes due to financial hardship.</li> <li>• Owner also owed city and state government agencies for taxes.</li> <li>• One commercial creditor seized and sold some of owner’s assets to satisfy debts.</li> <li>• Owner has pled guilty to and was incarcerated for fraud and the business and owner together have almost 100 judgments and liens filed against them.</li> <li>• Owner evaded IRS levies by using check cashing businesses and continued to write checks to himself.</li> <li>• A relative purchased a commercial building that had been sold to satisfy owner’s debts and the owner has since set up another business therein.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found owner willful and responsible for not remitting taxes withheld from employees and assessed a TFRP.</li> </ul>   |

| Case study | Nature of business | Unpaid payroll tax                        | Comments  |
|------------|--------------------|---|---|
| 11         | Construction       | Almost \$2.5 million for over 50 quarters | <ul style="list-style-type: none"> <li>• Business also owes non-payroll tax debt of almost \$70,000.</li> <li>• Owners owe multi-million dollar tax debt for multiple companies since the early 2000s, and IRS records indicate that the owners have also underreported personal income.</li> <li>• Financial records indicate business may be guilty of illegal check kiting and money laundering.</li> <li>• Owners have several judgments outstanding and at least 10 lawsuits pending or settled.</li> <li>• IRS officials indicated that the owners consistently stalled collection efforts through such means as using multiple representatives and filing for bankruptcy, which has kept IRS from seizing assets.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found two owners willful and responsible for not remitting taxes withheld from employees and assessed them TFRPs.</li> </ul>   |
| 12         | Transportation     | Almost \$1.5 million for over 20 quarters | <ul style="list-style-type: none"> <li>• Business also owes non-payroll tax debt of almost \$100,000.</li> <li>• Business has not filed taxes for all tax quarters.</li> <li>• Business has 17 judgments and state and federal tax liens, while one officer has over 50 such judgments and liens.</li> <li>• Another officer has unpaid personal taxes and IRS has investigated the officer for potential criminal activity.</li> <li>• IRS records indicate the officers commingled business and personal funds and that they consistently evaded assessment by refusing to cooperate.</li> <li>• Officers misrepresented tax delinquencies to a potential lender.</li> <li>• Officers investigated by IRS for establishing networks of short-lived corporations that accrue significant tax liabilities and then close, leaving a large amount of uncollectible payroll taxes.</li> <li>• IRS filed a lien against the business for unpaid taxes.</li> <li>• IRS found three officers willful and responsible for not remitting taxes withheld from employees and assessed them TFRPs.</li> </ul> |

Source: GAO analysis of IRS data, including unpaid federal tax debt as of September 30, 2007.

Our audits and investigations of the 50 case study businesses with tax debt, 12 of which are detailed in table 3, showed abuse and potential criminal activity related to the tax system. The following provides some illustrative examples of several of these cases.

- **Case 1** The owner of this automotive firm continued to draw about a six-figure income from the business and owned substantial real property while the business accumulated more than \$3.5 million in unpaid federal payroll taxes over a 10-year period. For the last decade, this business has withheld taxes from its employees but remitted less than a quarter of the taxes actually owed. IRS found the owner of the company willful and responsible for not remitting the taxes, and IRS records indicate the owner avoided paying taxes and trust fund amounts by transferring \$1.5 million

---

in property after being assessed the TFRP and selling a personal residence valued at over \$600,000.

- **Case 2** This healthcare business, which owes almost \$2.5 million of unpaid payroll taxes, repeatedly refused to remit withheld federal payroll taxes and the officers used the business to pay personal expenses. In addition, IRS records indicated the business's officers attempted to avoid paying taxes by filing Chapter 11 bankruptcy on three separate occasions, two of which were dismissed. Around the time of the bankruptcy filings, the officers withdrew about \$700,000 of cash from the business. IRS found three officers of the business to be willful and responsible for not remitting payroll taxes.
- **Case 6** This consulting business accumulated almost \$1.5 million in unpaid federal payroll taxes beginning over 10 years ago and over a half-million dollars in other federal taxes. The owner had multiple businesses that have not filed required tax returns. Additionally, the business owner has not filed personal returns since the early 1990s and owes over \$400,000 in personal taxes. The owner received several cash loans from the business while not paying taxes, and business monies were diverted into the owner's personal bank accounts. This business owner avoided IRS by changing representatives and attorneys, which has had the effect of stalling IRS actions with repeated requests for the same information. To avoid collection action, the owner sold assets to a relative after receiving notice that IRS was about to assess a TFRP.
- **Case 7** This manufacturing business owes almost \$1.5 million in unpaid payroll taxes for over 40 tax quarters. The owner also underreported tax liabilities and was found willful and responsible for not remitting payroll taxes from two other businesses. IRS found that business monies may be flowing into personal accounts, and that the owner has hidden business assets in his own name in order to prevent IRS seizures. The owner also gave business assets to a relative who has used them to start a new business. The owner used appeals and offers in compromise as a means to delay IRS collection efforts, and has already defaulted on an offer in compromise for earlier TFRPs.
- **Case 10** This healthcare business has accumulated over \$8 million in unpaid payroll taxes for almost 30 quarters. The owner was convicted of tax fraud. Despite living in a multi million dollar home, the taxpayer claimed inability to pay taxes due to financial hardship, and evaded IRS levies by using check cashing businesses and writing checks to himself, even paying himself a salary while incarcerated. Some of the owner's properties were sold by creditors, and the owner set up a new business in

---

one of the business's properties bought by a relative. Although other creditors seized and sold property to settle debts, we found no evidence of IRS taking such actions.

- **Case 11** The owners of this construction company accumulated almost \$2.5 million in unpaid payroll taxes from over 50 tax quarters (over 12 years of non-payment). The owners also had tax debt from other businesses dating back to the early 2000s. IRS records indicate that the business owners underreported their personal income. Financial records indicate that the owners may be involved in illegal check kiting and money laundering dating back to the late 1990s, have several judgments outstanding, and at least 10 lawsuits pending or settled. IRS officials indicated that the owners have consistently stalled collection efforts through such means as filing for bankruptcy, which has kept IRS from seizing assets.

---

## Conclusions

Businesses that withhold money from their employees' salaries are required to hold those funds in trust for the federal government. Willful failure to remit these funds is a breach of that fiduciary responsibility and is a felony offense. A business's repeated failure to remit payroll taxes to the government over long periods of time affects far more than the collection of the unpaid taxes. First, allowing businesses to continue to not remit payroll taxes affects the general public perception regarding the fairness of the tax system, which may result in lower overall compliance. Second, because of failure of businesses to remit payroll taxes, the burden of funding the nation's commitments, including payments to the Social Security and Hospital Insurance trust funds, falls more heavily on taxpayers who willingly and fully pay their taxes. Third, the failure to remit payroll taxes gives the non-compliant business an unfair competitive advantage because that business can use those funds that should have been remitted for taxes to either lower overall business costs or increase profits. Businesses that fail to remit payroll taxes may also under bid tax-compliant businesses, causing them to lose business and encouraging them to also become non-compliant. Fourth, allowing businesses to continue accumulating unpaid payroll taxes has the effect of subsidizing their business operations, thus enriching tax abusers or prolonging the demise of a failing business. Fifth and last, in an era of growing federal deficits and amidst reports of an increasingly gloomy fiscal outlook, the federal government cannot afford to allow businesses to continue to accumulate unpaid payroll tax debt with little consequence.

---

For these reasons, it is vital that IRS use the full range of its collection tools against businesses with significant payroll tax debt and have performance measures in place to monitor the effectiveness of its actions to collect and prevent the further accumulation of unpaid payroll taxes. IRS has stated that the collection of unpaid payroll taxes is one of its highest priorities. However, IRS's collection philosophy focuses on gaining voluntary compliance, even for recalcitrant businesses that repeatedly fail to remit payroll taxes and whose actions indicate no intention to become compliant. Businesses that continue to accumulate unpaid payroll tax debt despite efforts by IRS to work with them are demonstrating that they are either unwilling or unable to comply with the tax laws. In such cases, because the decision to not file or remit payroll taxes is made by the owners or responsible officers of a business, IRS should consider strong collection action against both the business and the responsible owners and officers to prevent the further accumulation of unpaid payroll taxes and to collect those taxes for which the business and owners have a legal and fiduciary obligation to pay.

IRS faces difficult challenges in balancing aggressive collection actions against taxpayer rights and individuals' livelihoods. However, to the extent IRS does not pursue aggressive collection actions against businesses with multiple quarters of unpaid payroll taxes, IRS is not acting in the best interests of the federal government, the employees of the businesses involved, the perceived fairness of the tax system, or overall compliance with the tax laws. Therefore, it is incumbent upon IRS to revise its approach and develop performance measures to provide for the effective use of the full range of available enforcement tools against egregious offenders to prevent those businesses from continuing to accumulate payroll tax debt. It is also incumbent upon IRS to proactively seek out and appropriately implement other tools (particularly those with demonstrated success at the state level) to enhance its ability to prevent the further accumulation of unpaid payroll taxes and to collect those taxes that are owed. Although IRS does need to work with businesses to try to gain voluntary tax compliance, for businesses with demonstrated histories of egregious abuse of the tax system, IRS needs to alter its approach to include focusing on stopping the accumulation of additional unpaid payroll tax debt by egregious businesses.

---

## Recommendations for Executive Action

To provide better monitoring and more detailed guidance on collection actions to be pursued against egregious payroll tax offenders, to strengthen existing collection tools, and to develop additional enforcement tools to effectively identify potential levy sources, we recommend that the Commissioner of Internal Revenue take the following six actions:

- 
- Develop a process to monitor collection actions taken by revenue officers against egregious payroll tax offenders to ensure collection actions appropriately utilize all available collection tools contained in the IRM.
  - Review current case prioritization and assignment practices to determine if IRS's enforcement and collection procedures could be enhanced by requiring, to the maximum extent feasible, businesses with egregious payroll tax debt and the responsible owners/officers with a TFRP assessment be treated as a single unified and coordinated collection effort assigned to a single revenue officer.
  - Develop and implement procedures to expeditiously file a Notice of Federal Tax Lien against property as soon as possible after payroll tax debt is identified (including cases in the queue awaiting assignment) and ensure liens are filed on both businesses with unpaid payroll taxes and owners/officers assessed a TFRP.
  - Develop and implement procedures to monitor and report on revenue officers' compliance with the new TFRP assessment time frames to ensure revenue officers are making TFRP determinations and assessments in a timely manner.
  - Develop performance goals and measures that specifically evaluate the accumulation of unpaid payroll taxes by businesses (especially egregious businesses with over 20 quarters of payroll tax debt), the extent and timeliness of TFRP assessments, and the effectiveness of actions taken to collect unpaid payroll taxes and TFRP assessments.
  - Work with states that have developed procedures for matching financial accounts to tax debts to evaluate the potential for IRS to either develop and implement similar measures or partner with states that currently have that tool to leverage their efforts to assist revenue officers in identifying a business's leviable assets.

---

## Agency Comments and Our Evaluation

In commenting on a draft of this report, IRS recognized that all appropriate tools must be used to bring payroll tax offenders into compliance and concurred with all six of our recommendations. IRS noted that it had implemented numerous actions to improve its tax collection processes and procedures as well as to prioritize assignment of cases. It also noted that it continues to explore other opportunities. In particular, IRS cited its projects to increase its focus on businesses that accumulate



---

multiple periods of unpaid payroll taxes and to improve the timeliness of lien filing and TFRP determinations.

With respect to our five recommendations for IRS to review or revise its collection policies and to strengthen its existing collection tools to be used in dealing with egregious payroll tax offenders, IRS agreed to evaluate its practices and develop appropriate changes. Specifically, IRS agreed to (1) explore the value of using existing data to evaluate collection actions taken by revenue officers, (2) assign a single revenue officer to collect both a business's egregious unpaid payroll tax debt and the responsible owners/officers with a TFRP assessment when feasible, (3) evaluate its existing practices and determine appropriate changes to its lien filing procedures to allow liens to be filed as soon as a payroll tax liability is identified, (4) consider ways to use its TFRP reports to monitor and report on revenue officers' compliance with new TFRP assessment time frames, and (5) evaluate the effectiveness and feasibility of establishing performance goals and measures on the timeliness of TFRP assessments.

With respect to our recommendation to work with states that have developed procedures for matching financial accounts to tax debts to identify levy sources, IRS agreed with our recommendation. IRS said it would work with those states to determine the effectiveness of their programs and whether a similar program in IRS would be cost effective and consistent with privacy laws.

---

As agreed with your offices, unless you announce its contents earlier, we will not distribute this report until 30 days from its date. At that time, we will send copies of this report to the Secretary of the Treasury, the Commissioner of the Financial Management Service, the Commissioner of Internal Revenue, and interested congressional committees and members. We will also make copies available to others upon request. In addition, this report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

---

If you or your staff have any questions concerning this report, please contact me at (202) 512-3406 or [sebastians@gao.gov](mailto:sebastians@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink that reads "Steven J. Sebastian". The signature is written in a cursive style with a large, stylized initial 'S'.

Steven J. Sebastian  
Director  
Financial Management and Assurance

---

*List of Committees*

The Honorable Carl Levin  
Chairman  
The Honorable Norm Coleman  
Ranking Member  
Permanent Subcommittee on Investigations  
Committee on Homeland Security  
and Governmental Affairs  
United States Senate

The Honorable Max Baucus  
Chairman  
The Honorable Charles E. Grassley  
Ranking Member  
Committee on Finance  
United States Senate

---

# Appendix I: Scope and Methodology

---

- To identify the magnitude of unpaid payroll tax debt, we obtained IRS's database of unpaid taxes as of September 30, 2007. We extracted all payroll tax debt from that database and performed analysis to identify the number of businesses with tax debt and the total dollar value of tax debt associated with those businesses. We analyzed and summarized the overall payroll tax debt by
  - the number of tax quarters of payroll tax owed by businesses;
  - the tax period for which the debt was owed;
  - the amount of the tax debt associated with interest, penalties, and assessed taxes; and
  - the collection status of the debt, such as whether it is awaiting assignment, assigned in the field for collections, or coded as being currently not collectible.

We also analyzed the tax debt to determine the date on which IRS will be statutorily prohibited from seeking collection from tax debtors and will remove the tax debt from its records.<sup>1</sup>

We requested that IRS perform specific data analysis of its tax records to identify amounts that should have been remitted by businesses for those trust funds, but were not, to develop an estimate of the total amount that the General Fund subsidizes the Social Security and Medicare Part A trust funds due to unpaid taxes. To validate IRS's estimate, we compared that analysis to one prepared by IRS as of September 30, 1998, during one of our previous audits.<sup>2</sup> At that time, IRS estimated the cumulative amount of the subsidy to be \$38 billion. Because IRS removes tax debt from its records once the debt's statutory collection period expires (generally 10 years from the date the tax is assessed), those estimates represented approximately a 10-year subsidy. To further validate the 10-year estimate, we obtained from IRS the annual increase in the subsidy based on unpaid taxes. IRS determined the subsidy to be between \$2 billion to \$4 billion annually. IRS developed its estimates based on data contained in its

---

<sup>1</sup>IRS has a statutory limitation on the length of time it can pursue unpaid taxes, generally 10 years from the date of the assessment. After that period, IRS removes the tax debt from its records.

<sup>2</sup>[GAO/AIMD/GGD-99-211](#).

masterfile of tax information, which we audit as part of IRS's annual financial statement audit.

To identify IRS's reports and measures to manage unpaid payroll taxes, we discussed IRS's tracking of cases with cognizant managers and revenue officers. In addition, we reviewed IRS's reported measures in both the IRS Databook and IRS's Management Discussion and Analysis accompanying its annual financial statements.

To determine IRS policies and procedures in place to prevent the non-payment of payroll taxes and to collect outstanding payroll taxes, we reviewed IRS's policies as laid out in the Internal Revenue Manual (IRM) and discussed those policies and procedures with cognizant IRS officials and revenue officers. We also reviewed certain Treasury Inspector General for Tax Administration (TIGTA) and IRS reports related to the collection of unpaid payroll taxes. To supplement our discussions with IRS officials on tax collection activities, we also interviewed a number of state tax collection officials, including officials from Georgia, Kentucky, Maryland, and North Carolina, regarding tools and procedures used by those states to collect unpaid taxes.

Additionally, we reviewed a sample of 76 businesses whose owners/officers IRS found personally liable for the failure to remit payroll taxes withheld from employees' paychecks.<sup>3</sup> The sample was originally selected as part of our audit of IRS's fiscal year 2007 financial statements. The primary purpose of the sample was to determine whether IRS was properly recording payments to all related parties. However, we also performed other tests of IRS's controls using this same sample. Although we identified issues related to the timeliness of certain collection actions based upon that sample, we are unable to project these results because the sampling units used for the financial statement audit were payments rather than accounts. We analyzed tax transcripts and other IRS records for those cases with assessed TFRPs to identify the dates that IRS revenue officers

---

<sup>3</sup>Under section 6672 of the IRC, individuals who are determined by IRS to be responsible for collecting, accounting for, and paying over payroll taxes who willfully fail to collect or pay these tax can be assessed a TFRP. Typically, these individuals are owners or officers of a corporation, such as a president or treasurer. More than one individual can be found willful and responsible for a business's failure to pay the federal government withheld payroll taxes and thus be assessed a TFRP. The business itself is still liable for the entire amount of the unpaid payroll taxes. However, IRS policies require that it only collect the unpaid tax once.

(1) initiated contact with the business, (2) made the determination to pursue the TFRP against the officers, and (3) assessed the TFRP.

To further review IRS's collection actions, we also performed a macro-analysis of IRS's overall inventory of unpaid payroll tax debts. We used macro-analysis to determine such factors as the percentage of payroll tax debt with liens. We also used macro-analysis to determine the most common types of industries with unpaid payroll taxes. We analyzed IRS's database of unpaid taxes and the information using the North American Industry Classification (NAIC) system codes in that database.<sup>4</sup> Using those codes, we were able to identify the industry type for about 70 percent of the payroll tax debt.<sup>5</sup>

To determine whether businesses with unpaid payroll taxes were engaged in abusive or potentially criminal activities with regard to the federal tax system, we used data mining techniques to identify 50 businesses as illustrative case studies based on criteria such as businesses with large dollar amounts of unpaid payroll taxes accumulated over multiple tax quarters. For those businesses, we reviewed IRS's collection actions and discussed the appropriateness of those actions or lack of actions with IRS revenue officers. We obtained copies of IRS's automated tax transcripts and other tax records (e.g., revenue officers' notes) from IRS. We also performed additional searches of financial and public records. In cases where record searches and IRS tax transcripts indicated that the owners or officers of a business were involved in other related businesses that had unpaid federal taxes, we performed additional analysis of those related businesses and the owners/officers.

We conducted this performance audit from April 2007 through May 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence

---

<sup>4</sup>The NAIC was developed as the standard for use by federal statistical agencies in classifying business establishments in the U.S. The NAIC codes provide a guide to the type of activity the business is engaged in although it may be engaged in multiple activities, some of which are not reflected in its NAIC code.

<sup>5</sup>The remaining payroll tax debt could not be classified by industry either because the NAIC codes were not available or were not in a format we could analyze.

---

obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

---

**Data Reliability  
Assessment**

For the IRS databases we used, we relied on the work we performed during our annual audits of IRS's financial statements. While our financial statement audits have identified some data reliability problems associated with the coding of some of the fields in IRS's tax records, including errors and delays in recording taxpayer information and payments, we determined that the data were sufficiently reliable to address the report's objectives. Our financial audit procedures, including the reconciliation of the value of unpaid taxes recorded in IRS's masterfile to IRS's general ledger, identified no material differences.

# Appendix II: Businesses with Unpaid Payroll Taxes

Table 3 provided data on 12 detailed case studies. Table 4 shows the remaining 38 case studies that we audited. As with the 12 cases, we also found substantial evidence of abuse or potentially criminal activity related to the federal tax system during our review of these 38 case studies.

**Table 4: Businesses That Fail To Remit Payroll Taxes**

| Case study | Nature of business             | Number of unpaid payroll tax quarters | Unpaid payroll taxes/other federal tax debt | Did IRS file a lien? | Comments   |
|------------|--------------------------------|---------------------------------------|---|----------------------|--|
| 13         | Construction                   | Over 30                               | Over \$500,000 / over \$100,000             | Yes                  | Since the late 1990s the business has only paid a small amount of the payroll taxes due. At the time of our review, IRS was trying to seize commercial property from officer.  |
| 14         | Transportation and warehousing | Almost 30                             | Over \$1 million / over \$100,000           | Yes                  | Company went out of business but not before owners made cash withdrawals of over \$50,000. Owner has another company with payroll tax debt.  |
| 15         | Construction                   | Almost 30                             | Over \$500,000 / under \$50,000             | Yes                  | Owner closed this business with tax debt and started another, which has also accumulated unpaid payroll taxes.   |
| 16         | Construction                   | Almost 30                             | Over \$2 million / under \$50,000           | Yes                  | This business is a sole proprietorship. Owner withdrew over \$20,000 cash from business before going into bankruptcy.  |
| 17         | Construction                   | Almost 30                             | Over \$1 million / over \$50,000            | Yes                  | Although business has recently begun paying payroll taxes, it has unpaid payroll tax debt dating back to the mid-1990s. Owner had over \$1 million converted from the business's name to the owner's personal name.    |
| 18         | Transportation and warehousing | Over 50                               | Over \$500,000 / over \$100,000             | Yes                  | Business accumulated unpaid payroll tax debt for 10 years until mid-2000s, then declared bankruptcy and closed.  |
| 19         | Mining                         | Over 40                               | Almost \$2.5 million / over \$50,000        | Yes                  | Business accumulated unpaid payroll taxes since early 1990s and only stopped when business was destroyed by a natural disaster. At the time of our review, federal agencies were paying to clean up the business site. |
| 20         | Manufacturing                  | Almost 30                             | Over \$2 million / over \$50,000            | Yes                  | Business accumulated unpaid payroll taxes since late 1990s. In the mid-2000s, the business entered into an installment agreement with IRS to pay on the debt.  |



**Appendix II: Businesses with Unpaid Payroll Taxes**

| <b>Case study</b> | <b>Nature of business</b>                        | <b>Number of unpaid payroll tax quarters</b> | <b>Unpaid payroll taxes/other federal tax debt</b> | <b>Did IRS file a lien?</b> | <b>Comments</b>   |
|-------------------|--|--|--|-----------------------------|---|
| 21                | Construction                                     | Over 40                                      | Over \$1 million / almost \$100,000                | Yes                         | Business accumulated unpaid tax debt beginning in the late 1980s. IRS revenue officer notes showed little collection action taken against this business since then.   |
| 22                | Construction                                     | Over 30                                      | Almost \$1.5 million / over \$100,000              | Yes                         | Business accumulated unpaid payroll tax debt from the late 1990s to the early 2000s, became relatively compliant in the mid-2000s, but then began accruing more payroll tax debt. IRS designated the case as currently not collectible due to owner's financial hardship and has not been seeking collection of the unpaid taxes. |
| 23                | Other services                                   | Over 40                                      | Almost \$1 million / none                          | Yes                         | While accumulating unpaid payroll tax debt for over 10 years, the owner of this business withdrew almost \$500,000 in cash. Business has since closed leaving almost \$1 million in unpaid payroll taxes.   |
| 24                | Construction                                     | Over 30                                      | Almost \$1 million / under \$50,000                | No                          | Business has continued to accumulate unpaid payroll taxes since the early 1990s through the time of our review. IRS records indicated that this case has not been worked on even though the business continued to operate and not pay payroll taxes.  |
| 25                | Construction                                     | Over 30                                      | Over \$500,000 / under \$50,000                    | Yes                         | Although IRS was attempting to seize business assets at the time of our review, this sole proprietor business has been accumulating unpaid payroll tax debt sporadically since the late 1990s. When contacted by IRS, owner claimed its bookkeeper was embezzling funds.  |
| 26                | Professional, scientific, and technical services | Over 20                                      | Over \$3 million / under \$50,000                  | Yes                         | This business has payroll tax debt dating back to the late 1990s, but IRS records indicate few collection actions have been taken. IRS has found owner personally liable for willful failure to remit payroll taxes.  |
| 27                | Construction                                     | Almost 30                                    | Almost \$1 million / almost \$200,000              | Yes                         | This business has unpaid payroll tax debt dating back to the early 1990s. Although business was given an installment agreement to pay the tax debt, it did not make payments. At the time of our review, the case had been in the queue since the mid-2000s awaiting assignment.  |

**Appendix II: Businesses with Unpaid Payroll Taxes**

| <b>Case study</b> | <b>Nature of business</b>                        | <b>Number of unpaid payroll tax quarters</b> | <b>Unpaid payroll taxes/other federal tax debt</b> | <b>Did IRS file a lien?</b> | <b>Comments</b>   |
|-------------------|--|--|--|-----------------------------|---|
| 28                | Healthcare and social assistance                 | Almost 80                                    | Over \$500,000 / under \$50,000                    | Yes                         | This business has tax debt dating back to the early 1980s. Case was considered for possible criminal investigation, but not yet pursued.  |
| 29                | Educational services                             | Almost 40                                    | Over \$2 million / under \$50,000                  | Yes                         | This business has been accumulating tax debt for a decade. Although it was granted an offer-in-compromise to settle the tax debt for less than was owed, business did not make payments. Business has numerous judgments from creditors.      |
| 30                | Transportation and warehousing                   | Almost 40                                    | Over \$500,000 / over \$50,000                     | Yes                         | The owner of this business has a criminal record and has had various judgments from creditors. IRS chose not to assess a TFRP since the owner would be unable to pay. Business twice filed bankruptcy and each time it was dismissed.         |
| 31                | Healthcare and social assistance                 | Over 40                                      | Over \$1.5 million / over \$100,000                | Yes                         | IRS has chosen not to take collection actions against this business due to the needs of the local community.  |
| 32                | Other services (except public administration)    | Over 20                                      | Over \$1.5 million / none                          | Yes                         | This business has periodically not paid taxes for over 20 years. Business has applied various times for installment agreements or an offer-in-compromise. Business has multiple state and federal liens.                                      |
| 33                | Construction                                     | Over 40                                      | Almost \$1 million / over \$50,000                 | Yes                         | This business has tax debt dating back to at least the early 1990s. It has multiple judgments against it including a tort suit, and multiple state and federal liens.   |
| 34                | Construction                                     | Over 50                                      | Over \$1 million / under \$50,000                  | Yes                         | Business accumulated unpaid taxes for over 12 years, then closed with over \$1 million in tax debt. Although IRS considered the case for a fraud investigation, it did not pursue this due to health issues in the business officer's family. |
| 35                | Professional, scientific, and technical services | Almost 50                                    | Over \$1 million / over \$50,000                   | Yes                         | Business has tax debt dating back to the late 1980s. The owner has sold commercial property to a related party, shielding it from IRS collection action, and has applied for an offer-in-compromise to pay less than it owes.                 |
| 36                | Professional, scientific, and technical services | Over 30                                      | Over \$1 million / under \$50,000                  | Yes                         | This business has tax debt back to the early 2000s and has not filed returns since 2006.  |

**Appendix II: Businesses with Unpaid Payroll Taxes**

| <b>Case study</b> | <b>Nature of business</b>                     | <b>Number of unpaid payroll tax quarters</b> | <b>Unpaid payroll taxes/other federal tax debt</b> | <b>Did IRS file a lien?</b> | <b>Comments</b>   |
|-------------------|---|--|--|-----------------------------|---|
| 37                | Accommodation and food services               | Almost 40                                    | Over \$200,000 / under \$50,000                    | Yes                         | This business has tax debt dating back to the late 1990s. Business has closed and IRS did not file TFRPs within the statutory period, thus missing an opportunity to collect unpaid payroll taxes from the responsible officers.  |
| 38                | Accommodation and food services               | Almost 20                                    | Over \$100,000 / under \$50,000                    | No                          | Business owed tax debt back to the early 2000s, when officers made large cash withdrawals from the business. At the time of our review, business had been in the queue awaiting assignment since the mid-2000s. TFRPs were assessed on two officers. After the assessment but before IRS filed a federal tax lien, one officer sold property for almost \$150,000. IRS reached an installment agreement with one officer while another officer claimed inability to pay and filed bankruptcy. One officer was charged for concealing a weapon and driving under the influence, and has become a fugitive. |
| 39                | Construction                                  | Almost 20                                    | Under \$50,000 / under \$50,000                    | No                          | Business has accumulated payroll tax debt dating back to the late 1990s, but the tax debt has been in IRS's queue of cases awaiting assignment since July 2006. At the time of our review, IRS had neither filed a federal tax lien or assessed TFRPs.  |
| 40                | Construction                                  | Over 10                                      | Almost \$1 million / under \$50,000                | Yes                         | This business accumulated unpaid taxes for over 3 years. When IRS investigated, owner claimed employees were embezzling funds. At the time of our review, IRS was seeking to assess a TFRP, but the owner had filed an appeal of the action.  |
| 41                | Other services (except public administration) | Almost 30                                    | Almost \$100,000 / under \$50,000                  | No                          | This business has accumulated payroll tax debt dating back to the late 1990s and has multiple state and federal liens filed.  |

**Appendix II: Businesses with Unpaid Payroll Taxes**

| <b>Case study</b> | <b>Nature of business</b>  | <b>Number of unpaid payroll tax quarters</b> | <b>Unpaid payroll taxes/other federal tax debt</b> | <b>Did IRS file a lien?</b> | <b>Comments</b>  |
|-------------------|--|--|--|-----------------------------|--|
| 42                | Information services   | Almost 30                                    | Almost \$2.5 million / over \$100,000              | Yes                         | The owner of this business was involved with over 30 businesses, including several defunct businesses for which the owner owed TFRPs since the 1980s. The owner was also sentenced to prison for willful failure to pay payroll taxes. In addition, owner had been investigated for check kiting, arrested for fraud, and had several lawsuits pending. Same officer was involved in our case study #44.   |
| 43                | Accommodation and food services  | Almost 20                                    | Over \$12 million / almost \$2.5 million           | Yes                         | This business, with tax debt dating back to the mid-1990s, was under criminal investigation by IRS. The owner has a long criminal history of involvement in many businesses with tax debt. The owner diverted funds from businesses to pay for luxury cars, planes, and a mansion in a foreign country, and has been involved in over a dozen bankruptcies.  |
| 44                | Healthcare and social assistance   | Almost 20                                    | Almost \$5 million / almost \$100,000              | Yes                         | This business has refused to pay any payroll taxes for almost 5 years. Because of the nature of the business, IRS has been reluctant to close the business, but did convict the owner on criminal charges related to failure to pay payroll taxes. Same officer was involved in our case study #42.  |
| 45                | Administrative and support and waste management and remediation services | Over 40                                      | Over \$16 million / almost \$1.5 million           | Yes                         | Since the mid-1990s, business has not paid nor filed payroll taxes, neither has the owner paid or filed income taxes. When investigated by IRS, the business filed 30 quarters of payroll taxes at one time and went out of business. Business was being investigated for hiring illegal immigrants and the owner has a criminal history. IRS pursued a criminal investigation against the business and owner, and arrested the owner for income tax crimes. |

**Appendix II: Businesses with Unpaid Payroll Taxes**

| <b>Case study</b> | <b>Nature of business</b>                     | <b>Number of unpaid payroll tax quarters</b> | <b>Unpaid payroll taxes/other federal tax debt</b> | <b>Did IRS file a lien?</b> | <b>Comments</b>   |
|-------------------|---|--|--|-----------------------------|---|
| 46                | Construction                                  | Almost 30                                    | Almost \$500,000 / under \$50,000                  | Yes                         | This sole proprietor accumulated almost a half million dollars of payroll tax debt. IRS designated the owner as being in financial hardship and has not pursued collection action against the company. Business owner stated that it could not pay taxes because its contractors took too long to pay him. Owner of the business made an offer-in-compromise to pay 2 cents on the dollar to settle the debt, but IRS rejected the offer. |
| 47                | Manufacturing                                 | Over 10                                      | Almost \$100,000 / under \$50,000                  | Yes                         | This business was a sole proprietor that accumulated payroll tax debt for 4 years. IRS's investigation found the owner to be an extremely poor manager with no knowledge of how to handle payroll taxes. Once IRS contacted the owner regarding the debt, the owner agreed to close the business.   |
| 48                | Transportation and warehousing                | Almost 10                                    | Almost \$100,000 / under \$50,000                  | No                          | This business has periodically failed to pay payroll taxes since the early 2000s and has not filed returns in 2 years. IRS records indicated that the case has never been investigated for collections, has had no liens filed, and was recently "shelved" by IRS due to lack of resources to pursue collection of the tax debt.  |
| 49                | Other services (except public administration) | Almost 20                                    | Over \$200,000 / under \$50,000                    | Yes                         | This sole proprietor business has payroll tax debt dating back to the late 1990s. Although there were indications at the time of our review that the business was still operating, it has not filed a payroll tax return since the early 2000s; thus its tax debt may be much higher. IRS has designated the owner as being in financial hardship and has not investigated the case for collections.                                      |
| 50                | Other services (except public administration) | Almost 40                                    | Over \$500,000 / under \$50,000                    | Yes                         | This sole proprietor business has accumulated over 10 years of payroll tax debt. IRS has designated the owner as being in financial hardship and has not pursued collection action against the business, but the business continues to accumulate more unpaid payroll tax debt. Business assets were seized as part of a commercial foreclosure.  |

Source: GAO analysis of IRS data, including unpaid federal tax debt as of September 30, 2007.

# Appendix III: Comments from the Internal Revenue Service



DEPUTY COMMISSIONER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

July 18, 2008

Mr. Steven J. Sebastian  
Director  
Financial Management and Assurance  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. Sebastian:

I have reviewed the Government Accountability Office (GAO) draft report titled, *Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes (GAO-08-617)*. We agree preventing and collecting unpaid payroll taxes is an important responsibility of the Internal Revenue Service (IRS). All appropriate available tools must be used to bring payroll tax offenders into compliance.

In 2007, the IRS Collection program collected \$31.8 billion, of which approximately \$7.2 billion was related to payroll tax. Payroll tax liabilities are a top priority for assignment to our Collection Field function.

We have implemented numerous actions to improve our processes and procedures as well as to prioritize assignment of cases, and continue to explore other opportunities. These improvements include the following:

- We recently made refinements to our "potential in-business pyramider" indicator. This indicator was established to monitor the degree to which taxpayers in active Collection inventory remain in compliance with current filing and paying requirements. The taxpayer's ability to remain current is crucial to our collectibility determination.
- We are testing a number of recommendations made by our Corporate Approach to Collection Inventory team. These include increasing the dollar threshold to allow our Automated Collection System (ACS) to work more payroll tax liabilities and calculating risk scores to keep payroll tax cases in certain high risk categories longer.
- We have established special search abilities and reports to track and monitor taxpayers with multiple payroll tax liabilities.
- We are working to improve the effectiveness of available collection tools. For example, streamlined injunctive relief procedures are being piloted for possible use in delinquency cases that involve repeat, in-business taxpayers.

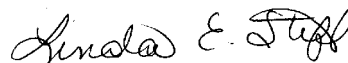
2

- We have taken steps to improve the timeliness of lien filing while recognizing the decision to file a lien is influenced by the impact lien filing will have on the taxpayer's ability to pay.
- We have added new timeframes to the Internal Revenue Manual to improve the timeliness of the Trust Fund Recovery Penalty determination and its ultimate assessment.
- We have fine-tuned the Federal Tax Deposit Alerts program. Reviews indicate our efforts to get the right alerts worked by revenue officers are resulting in more taxpayers benefiting from this compliance program.
- We continue to explore new ways to identify potential levy sources.

A separate enclosure specifically addresses each of your recommendations.

If you have any questions, or if you would like to discuss this response in more detail, please contact me or Frederick W. Schindler, Director, Collection Policy at (202) 283-7650.

Sincerely,



Linda E. Stiff

Enclosure

GAO Recommendations and IRS Responses to  
GAO Draft Report Tax Compliance: Businesses Owe  
Billions in Federal Payroll Taxes  
GAO-08-617

Recommendation: Develop a process to monitor collection actions taken by revenue officers against egregious payroll tax offenders to ensure collection actions appropriately utilize all available collection tools contained in the IRM.

Comments: We agree to explore the value of a regular extract from our ENTITY program of taxpayers by area with a number to be determined of unpaid payroll tax quarters to be shared with the Director, Collection for discussion with the area director. Our quality reviews already examine cases for the appropriateness and timeliness of enforcement action.

Recommendation: Review current case prioritization and assignment practices to determine if IRS's enforcement and collection procedures could be enhanced by requiring, to the maximum extent feasible, businesses with egregious payroll tax debt and the responsible owners/officers with a TFRP assessment be treated as a single unified and coordinated collection effort assigned to a single revenue officer.

Comments: We agree that, when feasible, egregious payroll tax assessments and TFRP assessments should be assigned to a single revenue officer. Treating payroll tax and TFRP assessments as a single unified and coordinated collection effort may achieve the advantages outlined in the report. Timely determinations, recommendations and assessment of the TFRP will accelerate the statutory notice requirements and may enable the revenue officer to more effectively leverage the assessments to gain compliance and/or prevent accumulation of additional unpaid payroll taxes.

Recommendation: Develop and implement procedures to allow liens to be filed against property as soon as possible after payroll tax debt is identified (including cases in the queue awaiting assignment) to ensure liens are placed on businesses with unpaid payroll taxes and owners/officers assessed a TFRP.

Comments: We agree to evaluate our existing practices and determine if a change should be made to our current case routing criteria in order to allow liens to be filed as soon as a payroll tax liability is identified.



2

Recommendation: Develop and implement procedures to monitor and report on revenue officers' compliance with the new TFRP assessment timeframes to ensure revenue officers are making TFRP determinations and assessments in a timely manner.

Comments: We agree to consider ways to use the reports available on the timeliness of TFRP assessment.

Recommendation: Develop performance goals and measures that specifically evaluate the accumulation of unpaid payroll taxes by businesses (especially egregious businesses with over 20 quarters of payroll tax debt), the extent and timeliness of TRFP assessment, and the effectiveness of actions taken to collect unpaid payroll taxes and TFRP assessments.

Comments: We agree to evaluate the effectiveness and feasibility of establishing performance goals and measures based on the information in the reports tracking the timeliness of TFRP assessments.

Recommendation: Work with states that have developed procedures for matching financial accounts to tax debts to evaluate the potential for IRS to either develop and implement similar measures or to partner with states that currently have that tool to leverage their effort to assist revenue officers in identifying a business' leviable assets.

Comments: We agree with this recommendation. We will work with the states that have developed a program to match financial accounts with tax debts to determine the program's effectiveness and whether a similar program in IRS would be cost effective and consistent with privacy laws.

---

# Appendix IV: GAO Contact and Staff Acknowledgments

---

## GAO Contact

Steven J. Sebastian, (202) 512-3406 or [sebastians@gao.gov](mailto:sebastians@gao.gov)

---

## Acknowledgments

The following individuals made major contributions to this report: William J. Cordrey, Sean Bell, Russell Brown, Ray Bush, Kenneth Hill, Delores Lee, David Shoemaker, Lisa Warde, Tina Wu, and J. Mark Yoder.

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to [www.gao.gov](http://www.gao.gov) and select "E-mail Updates."

---

## Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office  
441 G Street NW, Room LM  
Washington, DC 20548

To order by Phone: Voice: (202) 512-6000  
TDD: (202) 512-2537  
Fax: (202) 512-6061

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Ralph Dawn, Managing Director, [dawnr@gao.gov](mailto:dawnr@gao.gov), (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, DC 20548

---

## Public Affairs

Chuck Young, Managing Director, [youngc1@gao.gov](mailto:youngc1@gao.gov), (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, DC 20548