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PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
Committee on Homeland Security and Governmental Affairs

Carl Levin, Chairman

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Opening Statement of Senator Carl Levin
U.S. Senate Permanent Subcommittee on Investigations Hearing:
Payroll Tax Abuse:
Businesses Owe Billions and What Needs To Be Done About It
July 29, 2008

Today, over 1.6 million businesses owe more than \$58 billion to Uncle Sam for unpaid federal payroll taxes that have accumulated over the last 10 years. Over half of this debt is now uncollectible. That's the conclusion of a Government Accountability Office (GAO) study requested by this Subcommittee on the problem of unpaid payroll taxes.

Today's Subcommittee hearing will examine what's behind this staggering number, and what can be done about it. Of the many tax schemes this Subcommittee has investigated over the years, the blatant cheating on payroll tax is particularly galling, because delinquent businesses are stashing away not only the taxes they owe Uncle Sam, but also stealing funds withheld from employee paychecks. Employers are required to withhold from their employees' salaries amounts for individual federal income taxes and for Social Security and Medicare taxes. These businesses have a fiduciary responsibility to hold the funds they withhold from employees "in trust" for the government. The employer must also match the amounts withheld for Social Security and Medicare. The willful failure to remit any of these types of payroll taxes is a felony. The fact that this problem is so widespread is a disgrace.

Ten years ago, in 1998, GAO conducted another study on payroll taxes and found that unpaid payroll taxes then totaled \$49 billion. In the ten years since, the number of businesses with unpaid payroll taxes declined from 1.8 million to 1.6 million, but the size of the tax debt got nearly \$10 billion worse, not better. Part of the reason appears to be ineffective IRS payroll collection efforts, despite the fact that IRS has continued to deem collection of payroll taxes "one of its highest priorities." The GAO report identifies a host of problems with those efforts. I want to focus on three.

Repeat Offenders. The first is the fact that many payroll tax cheats have been allowed to repeatedly violate the law for years at a time, accumulating massive payroll tax debts that can't ultimately be collected.

GAO's report discloses that 70% of all unpaid payroll taxes are owed by businesses that have failed to remit payroll taxes for more than one year. This means the business has at least four violations, since payroll taxes are supposed to be remitted quarterly. Over 25% have failed

to remit their taxes for more than 3 years. Nine percent have payroll violations stretching back five to ten years. In addition, thousands of businesses are involved. GAO reports that the number of firms with more than 5 years of payroll tax debt has nearly tripled, from 5,000 in 1998, to 14,000 in 2007. Those with more than 10 years of payroll tax debt went from 68 in 1998, to 490 businesses in 2007, an increase of more than 500%.

One case study highlighted in GAO's report involves a business with payroll violations dating back to 1994. As of July 2007, that business had accumulated unpaid payroll taxes totaling almost \$1 million.

Also, IRS data shows that, as unpaid payroll taxes get older, the likelihood of collecting the amounts owed declines dramatically. The result, according to GAO, is that 52% of existing payroll tax debt is now uncollectable.

But that's not all. Tax delinquent businesses allowed to operate for years with impunity gain an unfair advantage over honest competitors. By shirking their taxes, these businesses incur lower operating costs and may drive out honest firms. In one case study in the GAO report, a business used \$2.5 million that should have gone for payroll taxes to subsidize its underbidding of contracts.

Inadequate Enforcement. How is it that payroll tax cheats are able to continue operating with impunity for years at a time? That gets us to the second major problem: the IRS' failure to make effective use of available enforcement tools.

Current law provides the IRS with several powerful collection tools, but too often the IRS has failed to make effective use of them. As GAO points out, "Having a reticence to use enforcement tools may, over time, actually diminish voluntary compliance and collections." In other words, when honest taxpayers see tax cheats getting away with blatant misconduct, it not only undermines confidence in the tax system as a whole, it encourages cheating.

The IRS has two primary enforcement tools to stop payroll tax cheats: filing liens against the business and filing personal claims against the business officers and owners. GAO found that tax liens were not filed against businesses with unpaid payroll taxes in over 30% of all payroll tax cases assigned to the field for collection effort. That's nearly one-third of the payroll cases being "worked on" by a revenue officer, or 140,000 delinquent businesses.

GAO also found that the IRS often failed to assess penalties against the individual officers and owners of the business charged with collecting payroll taxes. Current law states that these individuals can be held personally liable for the portions of the payroll tax withheld from an employee if they willfully failed to collect or pay the tax. GAO describes multiple cases of business owners with payroll tax debt using business funds to pay for their own lavish lifestyles.

To collect the missing money from individual business officers or owners, the IRS can file a Trust Fund Recovery Penalty, or TFRP. GAO determined that it took the IRS an average of 40 weeks to determine whether a TFRP should be assessed and then an additional 40 weeks to actually assess it. That adds up to nearly 2 years to start collection on a TFRP.

In addition, a 2005 study by the Treasury Inspector General for Tax Administration (“TIGTA”) revealed that 43% of people who received a TFRP never made a payment on it, and that the IRS only collected 8% of the amount for which the TFRPs were issued. In one example reported by the GAO, the IRS assessed a business owner with a TFRP, but failed to file an accompanying tax lien. Therefore, the owner was able to sell a vacation home in Florida and the IRS missed the opportunity to collect any of the unpaid taxes from the proceeds of the sale.

Still another problem is the IRS practice of assigning a new revenue officer to collect a TFRP in cases where another revenue officer has already initiated enforcement action against a business with unpaid taxes. GAO found that in 75% of cases it reviewed, the TFRP was either not assigned or was assigned to a different revenue officer than the one already taking action against the business for unpaid taxes. Doubling up revenue officers on a single business makes little sense when there are too few revenue officers to go around.

In addition to finding that the IRS made ineffective use of tax liens and TFRPs in many payroll cases, GAO determined that the IRS failed to take timely enforcement action in half of the cases in which tax debtors missed specific deadlines. That means one out of two tax cheats missed payments they were required to make with no immediate consequences. That shocking statistic has got to change.

Deadtime in the Queue. One final problem. GAO discovered that the majority of businesses with unpaid payroll taxes do not get immediate enforcement attention. Instead, following a 15-week notification process, many cases are assigned to a so-called “queue” where they languish until a revenue officer is assigned to them. Right now, of the \$28 billion in unpaid payroll taxes still deemed collectible, about \$9 billion is sitting in the queue awaiting assignment to a revenue officer. That so many cases sit unproductively before any enforcement action is taken is inexcusable.

Recommendations. Here are three actions that can be taken to strengthen enforcement action against payroll tax cheats.

Quicker Enforcement Action. First, the IRS should develop an expedited process for filing liens and assessing TFRPs against businesses and key personnel with unpaid payroll taxes. These tax liens and TFRPs should be automatically imposed after a business has missed a specified number of quarterly payroll tax payments, unless a revenue officer provides written justification why those actions should not be taken. Also, the business tax case and the TFRP assessment should, when possible, be treated as a single, unified and coordinated collection effort assigned to a single revenue officer, instead of the current practice, which most often has TFRP collections assigned to a different revenue officer, if they get assigned at all.

Modernized Tax Lien Filing System. Second, Congress should enact S. 1124, the Levin-Coleman “Tax Lien Simplification Act,” to streamline the tax lien system. Right now, tax liens have to be filed on paper in 4,000 locations across the country, each with its own forms and filing requirements. The process is wasteful, burdensome, and inefficient. Our bill would require Treasury to establish an electronic tax lien registry at the federal level, which would not only make filing liens easier and more transparent, but would also, according to the IRS’s own estimates, save \$570 million over ten years just from improved efficiencies.

Performance Measures. Finally, the IRS should develop payroll tax collection performance measures. It is baffling that, with respect to this “high priority” issue, the IRS currently does not have a single performance measure to assess its progress in combating payroll tax cheats. When we asked IRS how long the average payroll tax case is open, we were told they do not track this data. Moreover, neither IRS managers nor revenue officers are currently evaluated on their efforts to collect payroll taxes or prevent the accumulation of payroll tax debt. These types of agency-level and personnel performance measures should be developed on an urgent basis.

A final point. It is ridiculous that one of this Administration’s top tax enforcement efforts has been to go after the small dollar claims under the Earned Income Tax Credit (EITC) Program, a refundable tax credit available to workers with low incomes. We should be using our limited number of revenue agents to catch the biggest fish – including payroll tax cheats who are misusing billions of dollars of employee and taxpayer money to benefit themselves.

I commend Senator Coleman for initiating the Subcommittee’s request for the GAO study on this important problem, and turn to him now for his opening remarks.

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