



Testimony

Before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Government Affairs, U.S. Senate

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TAX COMPLIANCE

Businesses Owe Billions in Federal Payroll Taxes

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**On December 19, 2008, the PDF file was revised to correct table 1 on page 8 and accompanying text on pages 8 and 11. The number of businesses with over 20 quarters of payroll tax debt as of September 30, 2007, changed from 14,681 to 10,083, and the percentage increase changed from 174 to 88. The number of businesses with over 40 quarters of payroll tax debt as of September 30, 2007, changed from 490 to 169, and the percentage increase changed from 470 to 97.**



G A O

Accountability \* Integrity \* Reliability



Highlights of [GAO-08-1034T](#), a testimony before the Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, U.S. Senate

### 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 and 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

In our report (GAO-08-617) being released today, 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 business owners and officers personally liable for not remitting withheld payroll taxes. IRS agreed to all six of our recommendations.

To view the full product, including the scope and methodology, click on [GAO-08-1034T](#). For more information, contact Steven J. Sebastian at (202) 512-3406 or [sebastians@gao.gov](mailto:sebastians@gao.gov).

## TAX COMPLIANCE

### Businesses Owe Billions in Federal Payroll Taxes

#### 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 non-payment 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 Owner owed over \$500,000 in personal taxes, put property in spouse's name, and sold property to children for less than market value
Dentist	Over \$500,000 over 10 years	

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

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Mr. Chairmen and Members of the Subcommittee:

Thank you for the opportunity to discuss unpaid federal payroll taxes. Our related report, released today and developed at the request of this subcommittee and the Senate Committee on Finance, describes issues we identified in the collection and prevention of unpaid payroll taxes. It builds on a large body of work over the last several years that identified tens of thousands of federal contractors with unpaid taxes, most often unpaid payroll taxes, who abused the federal tax system.<sup>1</sup> This testimony also builds on your concern regarding the almost \$300 billion annual tax gap.

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. When businesses do not remit payroll taxes, they are using employees' money to fund business operations or the personal lifestyle of the businesses' owners/officers, and causing shortfalls in funding for Social Security and Hospital Insurance. If left to accumulate unpaid payroll taxes, businesses can gain an unfair business advantage over their tax-paying competitors at the expense of the government. The Internal Revenue Service (IRS) acknowledges that unpaid payroll taxes are a major compliance problem. The willful failure to remit payroll taxes is a felony under federal law.<sup>2</sup>

Today's testimony focuses on (1) the magnitude and composition of unpaid payroll taxes, (2) factors affecting IRS's ability to enforce

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<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 System 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).

<sup>2</sup>26 U.S.C. § 7202.

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compliance or pursue collection of unpaid payroll taxes, and (3) businesses with unpaid payroll taxes that are engaged in abusive<sup>3</sup> or potentially criminal activities with regard to the federal tax system.

To determine the magnitude and composition of unpaid payroll taxes and to identify owners or officers who repeatedly abused the federal tax system by not remitting withheld payroll taxes, we analyzed IRS's database of unpaid taxes as of September 30, 2007. We also performed a macro-analysis of IRS's overall inventory of unpaid tax debts. 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 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 and whom IRS assessed a Trust Fund Recovery Penalty (TFRP)<sup>4</sup> to identify the timeliness of IRS's collection actions.<sup>5</sup> We also interviewed tax officials from several states concerning collection tools and techniques they used. Finally, to determine whether businesses with unpaid payroll taxes were engaged in abusive or potentially criminal activities involving 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

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<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, 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 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.

<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.

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revenue officers for 50 businesses selected as case studies. We performed a more in-depth review of 12 of those cases and presented the results in table 3.

The work supporting the report on which this testimony was based was performed 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.

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## Summary

Our analysis of IRS's records showed that, as of September 30, 2007, over 1.6 million businesses owed over \$58 billion in unpaid payroll taxes, including interest and penalties. As such, payroll taxes comprise over 20 percent of IRS's \$282 billion inventory of outstanding taxes, penalties, and interest owed by businesses and individuals at September 30, 2007, and over 50 percent of the total amount owed by businesses in IRS's inventory. Our analysis showed that 70 percent of all unpaid payroll taxes are owed by businesses with more than a year (4 tax quarters) of unpaid federal payroll taxes. In addition, over a quarter of payroll taxes are owed by businesses that have tax debt for more than 3 years (12 quarters). Because unpaid payroll taxes include amounts owed for Social Security and Hospital Insurance (Medicare 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 because employers failing to remit withheld taxes on employee wages.

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 with the large number of businesses that repeatedly

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

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do not remit payroll taxes. In reviewing IRS's collection actions for these egregious payroll tax offenders, we identified several issues that limit the effectiveness of IRS's current approach, including:

- 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 tax liens against the property of payroll tax debtors to protect the government's interest. For over a third of all businesses with unpaid payroll taxes assigned to the field for collection efforts, IRS had not filed a lien and over 80 percent of payroll cases in the queue awaiting assignment to a revenue officer did not have a lien filed.
- IRS is not timely assessing penalties to individuals responsible for not remitting business's payroll tax debts. 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 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 fund a personal lifestyle through the non-remittance of payroll taxes.
- IRS does not place as high a priority on collection efforts against the responsible owners/officers as it does the related 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, some states have additional tools that help prevent the further accumulation of unpaid payroll taxes. These include:

- 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.

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- 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 responsible for non-payment of payroll taxes at three or more businesses. Our analysis of 50 case study 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 owed almost \$2.5 million, was under reporting personal income, and was involved in possible check kiting and money laundering. Another had accumulated \$2.5 million in unpaid payroll taxes and made large cash withdrawals prior to filing bankruptcy multiple times. A third had accumulated \$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.

Our companion report, released today, contains six recommendations to IRS to address issues identified in the report, including (1) developing a process and performance measures to monitor collection actions taken by revenue officers against egregious payroll tax offenders and (2) developing procedures to more timely file liens against egregious businesses and assess penalties to hold responsible parties personally liable for not remitting withheld payroll taxes. In commenting on a draft of the report, IRS agreed to our recommendations.

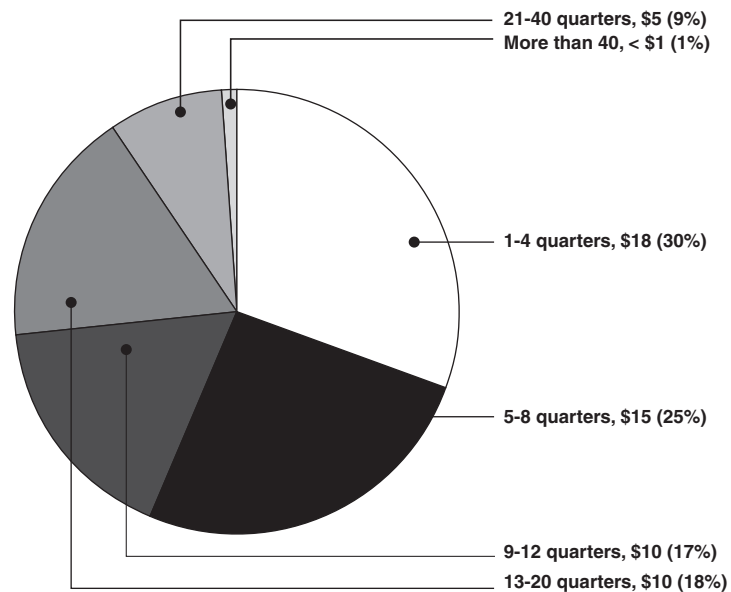
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## Magnitude and Composition of Unpaid Federal Payroll Taxes

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, and over 100,000 businesses currently owe for more than 2 years (8 quarters) of payroll taxes. This total includes amounts earned by employees that were withheld from their salaries to satisfy their tax obligations, as well as the employer's matching amounts, but which the business diverted for other purposes. 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 1 shows the total dollar amount of payroll tax debt summarized by the number of unpaid payroll tax quarters outstanding.

**Figure 1: 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.



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Using IRS's database of unpaid taxes, we were able to identify many of the industry types associated with businesses owing payroll taxes.<sup>7</sup> The top industries with unpaid payroll tax debt included construction (\$8.6 billion), professional services (\$4.4 billion), and healthcare (\$4 billion).

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### 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 less than the payroll taxes due, and the Social Security and Hospital Insurance Trust Funds have fewer 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 in payroll taxes from employers. 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. 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 payroll 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 because of the expiration of the statutory collection period.<sup>8</sup> Recent IRS data indicate that the cumulative shortfall increases by an additional \$2 billion to \$4 billion annually because of uncollected payroll taxes.<sup>9</sup>

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### Collection Status of 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

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<sup>7</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.

<sup>8</sup>26 U.S.C. § 6502. IRS has a statutory limitation on the length of time it can pursue unpaid taxes, generally 10 years from the date of the assessment. 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.

<sup>9</sup>Because of the statutory limitation, this amount represents an estimate of the subsidy provided over an approximately 10-year period.

performed our last in-depth review of payroll taxes,<sup>10</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) almost doubled between 1998 and 2007. The number of businesses that had not paid payroll taxes for over 40 quarters (10 years or more) also almost doubled, from 86 businesses to 169 businesses. These figures are shown in table 1.

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

	As of September 30, 1998	As of September 30, 2007	Percentage increase
Businesses with over 20 quarters of payroll tax debt	5,367	10,083	88
Businesses with over 40 quarters of payroll tax debt	86	169	97

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

Of the \$58 billion in unpaid payroll taxes as of September 30, 2007, IRS categorized about \$4 billion (7 percent) as going through IRS's initial 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 to a revenue officer in the field. About \$7 billion (12 percent) of the unpaid payroll tax amount was being worked on by IRS revenue officers for collection, and about \$9 billion (16 percent) was in a queue awaiting assignment for collection action. Most of the unpaid payroll tax inventory—\$30 billion (52 percent)—was classified as currently uncollectible by IRS. IRS classifies tax debt cases as currently not collectible for several reasons, including (1) the business owing the taxes is defunct,<sup>11</sup> (2) the business is insolvent after bankruptcy, or (3) the

<sup>10</sup>GAO, *Unpaid Payroll Taxes: Billions in Delinquent Taxes and Penalty Assessments Are Owed*, GAO/AIMD/GGD-99-211 (Washington, D.C., August 2, 1999).

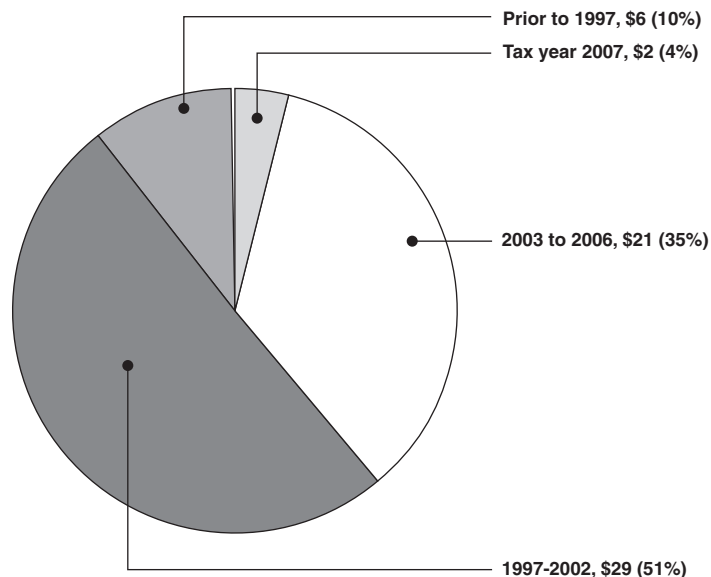
<sup>11</sup>IRS defines a defunct business as one that is inactive and with no leviable assets.

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business is experiencing financial hardship. Of those unpaid payroll tax cases IRS has classified as currently not collectible, almost 70 percent were as a result of a business being defunct.

Much of the unpaid payroll tax debt has been outstanding for several years. As reflected in figure 2, 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>12</sup>

**Figure 2: 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>13</sup> Further, the continued accrual of interest and penalties on the outstanding federal taxes can, over time, eclipse the

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<sup>12</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.

<sup>13</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).

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original tax obligation. Additionally, 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>14</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 because of the expiration of their statutory collection period.<sup>15</sup>

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## 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 that 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. Additionally, although unpaid payroll taxes is one of its top collection priorities, IRS did not have performance measures to evaluate the collection of unpaid payroll taxes or the related TFRP assessments. 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 that it has not yet developed.

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

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>16</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

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<sup>14</sup>26 U.S.C. § 6502.

<sup>15</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.

<sup>16</sup>GAO, *Financial Management: Some DOD Contractors Abuse the Federal Tax System with Little Consequence*, GAO-04-95 (Washington, D.C.: Feb. 12, 2004).

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payroll taxes. For example, our analysis of IRS's inventory of unpaid payroll taxes found that over 10,000 businesses owed payroll taxes for 20 or more quarters—5 years or more.

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 can gain an unfair business advantage over their competitors at the expense of the government. As we have found previously,<sup>17</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 in part because the business's reduced costs associated with its non-payment of payroll 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>18</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.

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 a study performed by the Treasury Inspector General for Tax Administration (TIGTA) 8 years ago. In that study, TIGTA found that revenue officers were focused on IRS's customer service goals and therefore were reluctant to take enforcement

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<sup>17</sup>GAO, *Financial Management: Thousands of GSA Contractors Abuse the Federal Tax System*, [GAO-06-492T](#) (Washington, D.C.: Mar. 14, 2006).

<sup>18</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).

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actions.<sup>19</sup> In another study performed 3 years ago, TIGTA reported that IRS allowed tax debtors to continue to delay taking action on their tax debt by failing to take aggressive collection actions.<sup>20</sup> TIGTA found that IRS did not take timely follow-up action in half of the cases for which tax debtors missed specific deadlines.

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. IRS has recently strengthened its procedures 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 such payroll taxes.

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## IRS Does Not Always File Tax Liens Timely

We found that for payroll tax debt, one of IRS's highest collection priorities, IRS does not always file tax liens to protect the government's interest in property, and when IRS 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>21</sup> A 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>22</sup>

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<sup>19</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.: Aug. 2000).

<sup>20</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>21</sup>The 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.

<sup>22</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).

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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 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 routes these cases to revenue officers for face-to-face collection action instead of being routed to the Automated Collection System (ACS)<sup>23</sup> for telephone contact. However, IRS generally places cases in a queue of cases awaiting assignment until a revenue officer is available to work the cases. Cases can be in the queue for extended periods of time awaiting assignment to a revenue officer. For the period that a case is in the queue, revenue officers are not assigned to file liens and take other collection actions.<sup>24</sup> Our analysis found that for all payroll tax cases in the queue awaiting assignment as of September 30, 2007, over 80 percent 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.

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

IRS has a powerful tool to hold responsible owners and officers personally liable for unpaid payroll taxes through assessing a TFRP. However, 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 a 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, to

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<sup>23</sup>The ACS is a telephone contact system through which telephone assistants collect unpaid taxes and secure tax returns from delinquent taxpayers who have not complied with previous notices.

<sup>24</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.

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assess a TFRP against the business owners/officers.<sup>25</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>26</sup> For 5 of the 76 sampled cases, we found that 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 revenue officers did not begin the TFRP process in over a quarter of the cases it reviewed.<sup>27</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 non-compliant 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 we reviewed 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

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<sup>25</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 percent of 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>26</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>27</sup>TIGTA's sample included 166 businesses for which a TFRP interview was applicable. TIGTA 2005-30-142.



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month of IRS's assessing the TFRP, the owner closed the business, which by then had accumulated about \$3 million in unpaid taxes.<sup>28</sup>

In September 2007, IRS implemented new requirements to address the timeliness of TFRP assessments. Under the new policy, IRS is now requiring revenue officers to make the determination on whether to pursue a TFRP within 120 days of the case's being assigned and to complete the assessment within 120 days of the determination. However, the revised policy maintains a provision that allows the revenue officer to delay the TFRP determination. Additionally, the policy does not include a requirement for IRS to monitor the new standards for assessing TFRPs.

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### 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 who 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>29</sup> Of those that had been assigned, over half of the TFRP assessments had not been assigned to the same revenue officer who 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

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<sup>28</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>29</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.

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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. 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 non-compliant business to prevent the further accumulation of unpaid payroll taxes.

IRS collection officials 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. 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 taxes that were not remitted to the government.<sup>30</sup> This view that the payroll tax debt and the TFRP assessment are essentially the same tax debt is reinforced by IRS's 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 2005 study of TFRP cases, 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.

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<sup>30</sup>Under the law, TFRP assessments, while equal to the total amount of the employee's withheld portion of the 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.

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

When a business repeatedly fails to comply after attempts to collect, IRS policies state 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 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>31</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. 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. These procedures will be used for the most egregious taxpayers when the revenue officer can establish that additional administrative procedures would be futile.

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<sup>31</sup>IRS's policies place a high standard for seeking an injunction against a business. The policies state that the revenue officer must be able to show irreparable harm and that IRS has no adequate remedy at law other than the injunction.

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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. These officials 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. 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.

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## 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. Performance measurement and monitoring, however, support 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. While IRS has caseload and other workload reports for local managers (to measure process and outputs), 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. These operational reports do contain information about unpaid payroll and TFRP case assignments, but they 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 that identify businesses that continue to accrue additional payroll tax debt, but these 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 section of its annual financial

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statement and in its IRS Data Book.<sup>32</sup> However, IRS does not specifically address unpaid payroll taxes as a part of this reporting. 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 serve as an early warning system to management or as a vehicle for improving IRS's approach or actions.

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## 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, the officers noted that having certain additional tools available to them could allow them to more effectively deal with recalcitrant businesses. In discussions with a number of state tax collection officials, 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.

For example, while the Internal Revenue Code prohibits IRS from publicly disclosing federal tax information without taxpayer consent,<sup>33</sup> an increasing number of states—at least 19, including New Jersey, Connecticut, Indiana, Louisiana, and California—are seeking to increase tax collections by publicizing the names of those with delinquent tax bills. In California, a recent law mandates the state to annually publish the names of the top 250 personal and corporate state tax debtors with at least \$100,000 in state tax debt.<sup>34</sup> 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. 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.

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<sup>32</sup>IRS *Data Book 2007*, Publication 55B (Washington, D.C.: March 2008).

<sup>33</sup>26 U.S.C. § 6103.

<sup>34</sup>Cal. Rev. & Tax. Code § 19195. The listing does not include those who are fighting the tax bills in courts, have sought bankruptcy protection, or have set up payment plans with the state.

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As another example, while 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>35</sup> IRS officials stated that they often have difficulty using levies to collect unpaid payroll taxes. They noted that the levy may be made against funds in a bank account at a certain point in time when little or no funds are available. They also noted, 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. However, several states use legal authorities to assist in identifying levy sources. States such as Kentucky, Maryland, Massachusetts, Indiana, and New 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 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.

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## 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. 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 lifestyle.

In addition to owing payroll taxes for multiple tax periods and accumulating tax debt for years, many of the owners and officers of these

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<sup>35</sup> 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.

businesses are repeat offenders. We identified owners who were involved in multiple businesses, all of which failed to remit payroll taxes as required. In total, IRS records indicate that 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 that 18 business owners/officers were 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 who IRS found acted willfully in the non-payment of the businesses' payroll taxes and who were assessed TFRPs—these figures 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**

Number of businesses associated with owner/officer	Number of individuals
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 50 case study businesses with tax debt found substantial evidence of abuse and potential criminal activity related to the tax system. 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. Table 3 shows the results of 12 of the case studies we performed.<sup>36</sup>

<sup>36</sup>IRS noted that in half of the 12 case studies presented here IRS was stayed from collection action for various lengths of time because of 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 trust fund recovery penalty.</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	Health care	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>• 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>



Case study	Nature of business	Unpaid payroll tax	Comments
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 filed a lien against the business for unpaid taxes.</li> <li>• IRS notes that owner has the ability to pay, but refuses.</li> </ul>
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 \$400,000 in personal taxes.</li> <li>• Owner has multiple businesses that have not filed returns 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 for this and another business and assessed a TFRP for this and another business.</li> </ul>

Case study	Nature of business	Unpaid payroll tax	Comments
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 for both this business and assessed a TFRP for both this business and at least two previous businesses.</li> </ul>
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 \$10,000.</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 be unable 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, but did not pursue, business for fraud charges.</li> <li>• Business/owners have received four civil judgments against it/them 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>

Case study	Nature of business	Unpaid payroll tax	Comments
10	Health care	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 out 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 the owner willful and responsible for not remitting taxes withheld from employees and assessed a TFRP.</li> </ul>
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 multimillion dollar tax debt for multiple businesses since the early 2000s, and IRS records indicate that the owners have also under reported 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 personal 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.

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## Concluding Comments

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's perception regarding the fairness of the tax system, a perception that 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 Social Security and Hospital Insurance Trust Fund payments, falls more heavily on taxpayers who willingly and fully pay their taxes. Third, the failure to remit payroll taxes can give 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 IRS's actions to collect and prevent the further accumulation of unpaid payroll taxes. 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 or 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 the use of 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, there is a

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significant concern as to whether IRS is 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 that include the appropriate use of the full range of available enforcement tools against egregious offenders to prevent their businesses from accumulating 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 IRS's 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.

Our companion report being released today contains six recommendations to IRS to address issues regarding its ability to prevent the further accumulation of unpaid payroll taxes and collect such taxes. The recommendations include (1) developing a process and performance measures to monitor collection actions taken by revenue officers against egregious payroll tax offenders and (2) developing procedures to more timely file notice of federal tax liens against egregious businesses and assess penalties to hold responsible parties personally liable for not remitting withheld payroll taxes.

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Mr. Chairmen and Members of the Subcommittee, this concludes my statement. I would be pleased to answer any questions that you or other members of the committee and subcommittee have at this time.

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## Contacts and Acknowledgment

For future contacts regarding this testimony, please contact Steven J. Sebastian 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 testimony.

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