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### IRS Warns Businesses, Individuals to Watch for Questionable Employment Tax Employment Tax Practices

The Internal Revenue Service issued a consumer alert for eight schemes where federal employment taxes are not properly withheld or paid by employers from their employees' paychecks. The IRS alert to business owners and other taxpayers follows a string of recent convictions and court rulings involving employment tax schemes.

"Failure to pay employment taxes is stealing from the employees of the business," said IRS Commissioner Mark W. Everson. "The IRS pursues business owners who don't follow the law, and those who embrace these schemes face civil or criminal sanctions."

Employment taxes consist of federal income tax withholding along with Social Security and Medicare taxes and unemployment taxes. Also, many states have withholding requirements for various employment related taxes, such as contributions to a worker's compensation fund. Improper reporting or payment of employment taxes affects the ease with which employees can claim future benefits from these programs.

During the past three years, one hundred seventeen individuals have been sentenced to confinement in a federal prison, a halfway house or home detention from criminal violations related to employment taxes. Approximately seventy-seven percent of the persons sentenced for evading employment taxes served an average of seventeen months confinement and were ordered to make restitution to the government for the taxes evaded, plus interest and penalties.

Recent examples of employment tax prosecutions can be found at *IRS.gov* by typing "employment fraud" in the search box and clicking on "Significant Employment Tax Case Summaries."

- 1. Pyramiding.** "Pyramiding" of employment taxes is a fraudulent practice where a business withholds taxes from its employees but intentionally fails to remit them to the IRS.
- 2. Unreliable Third Party Payers.** There are two primary categories of third party payers—Payroll Service Providers and Professional Employer Organizations. Payroll Service Providers typically perform services for employers such as filing employment tax returns and making employment tax payments. Professional Employer Organizations offer employee leasing meaning that they handle administrative, personnel, and payroll accounting functions for employees who have been leased to other companies that use their services.
- 3. Frivolous Arguments.** Unscrupulous individuals and promoters have used a variety of false or misleading arguments for not paying employment taxes. These schemes are based on an incorrect interpretation of "Section 861" and other parts of the tax law and have been refuted in court.
- 4. Offshore Employee Leasing.** This scheme, which was designated as a Listed Transaction by the Service in 2003, misuses the otherwise legal business practice of

employee leasing. Under the typical promotion, an individual taxpayer supposedly resigns from his or her current employer or Professional Corporation and signs an employment contract with an offshore employee leasing company. Because it is a Listed Transaction, those who use the scheme are required to disclose their participation on current tax returns, and will be liable for the unpaid tax and subject to penalties and interest.

5. **Misclassifying worker status.** Sometimes employers incorrectly treat employees as independent contractors to avoid paying employment taxes. Generally if the payer has the right to control what work will be done and how it will be done, the worker is an employee.
6. **Paying Employees in Cash.** Paying employees in whole or partially in cash is a common method of evading income and employment taxes.
7. **Filing False Payroll Tax Returns or Failing to File Payroll Tax Returns.** Preparing false payroll tax returns intentionally understating the amount of wages on which taxes are owed or failing to file employment tax returns are methods commonly used to evade employment taxes.
8. **S Corporation Officers Compensation Treated as Corporate Distributions.** In an effort to avoid employment taxes, some S Corporations are improperly treating officer compensation as a corporate distribution instead of wages or salary. By law, officers are employees of the corporation for employment tax purposes and compensation they receive for their services is subject to employment taxes.

The IRS encourages employees to report any concerns that an employer is failing to properly withhold and pay federal income and employment taxes. Taxpayers can contact the IRS at 800-829-1040 or report suspected tax fraud by calling 800-829-0433.

Employers must report employment taxes withheld from their employees on Form 941, *Employer's Quarterly Federal Tax Return*. Employers are also responsible for filing Form 940, *Employer's Annual Federal Unemployment Tax Return*. Payment of employment taxes must be made to an unauthorized bank or financial institution according to federal tax deposit requirements. Employers may also pay these taxes electronically. Information on how to file or pay employment taxes electronically is found at <http://www.irs.gov/efile> and <http://www.eftps.gov>.