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PAYROLL TAXES

Billions in Delinquent Taxes and Penalties Due But Unlikely to Be Collected

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the results of our work on payroll taxes owed to the federal government and the associated trust fund recovery penalties assessed against individuals responsible for the nonpayment of these taxes. This work was performed in response to your request for information on unpaid payroll taxes and associated tax penalties. We are issuing our report on the results of this work today.[1]

In your request, you asked that we determine

- the extent to which payroll taxes are not remitted to the federal government,
- the magnitude of the trust fund recovery penalties (TFRP) assessed against individuals who withheld federal payroll taxes from employees' salaries but did not forward them,
- the extent to which individuals who have not remitted payroll taxes are responsible for not paying these taxes at multiple businesses,
- the extent to which businesses and individuals who failed to pay payroll taxes are also receiving federal benefits or other federal payments, and
- the factors that affect the Internal Revenue Service's (IRS) ability to enforce compliance or pursue collections in this area.

The report we are issuing today responds to each of these questions. This statement summarizes the major issues contained in our report.

In summary, at September 30, 1998, $49 billion in cumulative unpaid payroll taxes were owed by nearly 2 million businesses, and $15 billion in TFRPs had been assessed against, and remained owed by, 185,000 individuals responsible for the nonpayment of payroll taxes. The majority of these unpaid payroll taxes and associated TFRPs will unlikely be collected. Nearly 25,000 individuals with outstanding TFRPs were responsible for withholding but not forwarding payroll taxes to the government at more than one business. A significant number of both businesses with unpaid payroll taxes and individuals with outstanding TFRPs are also receiving billions of dollars in federal benefits and payments. Several factors, including financial management system deficiencies and internal control weaknesses, ineffective taxpayer education and early warning programs,

[1]See Unpaid Payroll Taxes: Billions in Delinquent Taxes and Penalty Assessments Owed (GAO/AIMD/GGD-99-211, August 2, 1999).

and federal and state laws, affect IRS' ability to enforce compliance and pursue collection of unpaid payroll taxes.

Payroll Taxes and the Process for Distributing Monies to the Trust Funds

Employers are required to withhold from their employees' salaries amounts for individual federal income taxes and Federal Insurance Contribution Act (FICA) taxes, which include taxes for Social Security and hospital insurance (Medicare). Employers are required to forward these withheld taxes, as well as the employers' matching FICA tax amounts, to the federal government. The Department of the Treasury, through IRS, is responsible for collecting these taxes.

The information IRS receives at the time it collects several types of tax payments, including those for Social Security and hospital insurance, is not sufficient to allow it to attribute these payments to specific trust funds. For this reason, initial distributions to the Social Security and hospital insurance trust funds are based on estimates prepared by the Social Security Administration's (SSA) Office of the Chief Actuary and Treasury's Office of Tax Analysis (OTA), with adjustments subsequently made as a result of certifications made by the Commissioner of SSA. This process is illustrated in detail in appendix I.

It is important to emphasize that the amounts distributed to the Social Security and hospital insurance trust funds are based on the wages an individual earns as required by law, not the amount the employer actually forwards to the government. This ensures that individuals who work and have taxes withheld to pay into the Social Security program—or their spouses and qualified dependents—receive the appropriate level of program benefits when they retire, become disabled, or die.

However, this also creates a situation in which the general revenue fund subsidizes the Social Security and hospital insurance trust funds to the extent that Social Security and hospital insurance taxes owed are not actually collected. While the vast majority of businesses pay the taxes withheld from employees' salaries as well as the employers' matching amounts, a significant number of businesses do not. Over time, the cumulative amounts of unpaid payroll taxes, and thus the amount of this subsidy, is significant. As of September 30, 1998, the estimated amount of unpaid taxes and interest in IRS' $222 billion unpaid assessments balance was approximately $38 billion for Social Security and hospital insurance taxes.[2]

Trust Fund Recovery Penalties

To the extent a business withholds money from an employee's salary for federal income taxes and the employee's FICA obligation but does not forward these monies to the federal government, that business is liable for these unpaid taxes, as well as its own matching FICA contribution. Under statute, if determined to be "willful and responsible," individuals can also be held personally liable and subject to a TFRP for federal income and FICA taxes withheld from employees but not forwarded to the federal government. It should be noted that IRS does not have to determine that there was a deliberate intent or desire to defraud the federal government as a prerequisite to assessing a TFRP.

More than one individual can be found willful and responsible for a business' failure to pay the federal government withheld payroll taxes and thus be assessed a TFRP. Additionally, the business itself is still liable for the entire amount of the unpaid payroll taxes. However, IRS policies require that it collect the unpaid tax only once.

Cumulative Unpaid Payroll Taxes Are Significant

According to IRS records, as of September 30, 1998, businesses owed the federal government about $49 billion in payroll taxes.[3] This represents about 22 percent of the $222 billion in IRS' inventory of unpaid tax assessments as of September 30, 1998. The $49 billion includes about $19 billion in unpaid tax assessments and another $30 billion in penalties and interest.

While consisting of less than a quarter of IRS' outstanding balance of unpaid assessments at September 30, 1998, unpaid payroll taxes make up

[2]This estimate includes both FICA and Self-Employment Contribution Act (SECA) taxes, but does not include federal income tax withholdings, which are a component of payroll taxes. SECA taxes are Social Security and hospital insurance taxes required to be paid by self-employed individuals. Accrued interest is also included in the estimate because assessments distributed to the trust funds earn interest at Treasury-based interest rates, similar to IRS' interest accruals.

[3]Differences between this amount and the estimated cumulative subsidy amount of $38 billion discussed previously are due to the following: (1) the $49 billion in unpaid payroll taxes includes federal income tax withholdings, which are not included in the estimate, and (2) the $38 billion estimated subsidy includes unpaid SECA taxes, which are not included in the $49 billion in unpaid payroll taxes.

over 50 percent of IRS revenue officers' caseloads in many regions of the country. Consequently, they represent one of IRS' most significant enforcement challenges.

The Number and Age of Delinquent Payroll Taxes Are Significant

IRS records show that over 1.8 million businesses owe the $49 billion in unpaid payroll taxes for more than 4.9 million separate tax periods or quarters (see table 1). Nearly 50 percent of the businesses with outstanding payroll taxes are delinquent for more than one quarter. Some of these businesses have in excess of 40 quarters of delinquent payroll taxes.

Table 1: Businesses With Multiple Quarters of Unpaid Payroll Taxes

	Unpaid payroll taxes	
Number of businesses	Number of quarters	Outstanding balance[a] (dollars in billions)
1,702,177	1 to 6	$26.4
158,106	7 to 20	21.0
5,281	21 to 40	1.5
86	Over 40	0.1
Total 1,865,650	**—**	**$49.0**

[a]Consists of taxes, penalties and interest.

Source: IRS Business master file.

As table 1 illustrates, a significant number of businesses have multiple tax periods of unpaid payroll taxes. Over 52 percent of the 4.9 million in delinquent quarters of payroll taxes predate 1994, as shown in table 2. Moreover, these multiple periods of unpaid payroll taxes can go back as much as 20 years or more. The outstanding balance of these delinquent quarters of payroll taxes totals over $34 billion, representing over 70 percent of the total balance of unpaid payroll taxes in IRS' inventory of unpaid assessments at September 30, 1998.

Table 2: Delinquent Quarters of Unpaid Payroll Taxes and Their Outstanding Balances by Age

	Unpaid payroll taxes	
Tax years	Number of quarters	Outstanding balance[a] (dollars in billions)
1994-1998	2,348,838	$14.4
1988-1993	2,198,493	25.4
1980-1987	407,619	9.0
Before 1980	3,491	0.2
Total	**4,958,441**	**$49.0**

[a]Consists of taxes, penalties and interest.

Source: IRS Business master file.

Potential Collectibility of Unpaid Payroll Taxes Is Low

Taxpayer account status codes maintained in IRS' systems indicate little potential for collection for many of the 4.9 million delinquent payroll tax accounts, as shown in table 3. In fact, these records would indicate that the majority of the unpaid payroll tax accounts are not likely to be collected.

Table 3: Delinquent Payroll Tax Accounts With Little Likelihood of Collection

Business status	Number of accounts	Percentage of 4.9M delinquent accounts
No longer in existence	1.4 million	28
Insolvent or IRS is unable to locate or contact	487,000	10
Does not have resources to pay amount owed	444,000	9
In bankruptcy or other litigation proceedings	189,000	4
Total		**51**

Our previous work on IRS' unpaid assessments[4] has shown that older delinquent taxes have little likelihood of collection. Additionally, our review of a statistical sample of 690 unpaid tax assessments selected as part of our audit of IRS' fiscal year 1998 financial statements reinforces this conclusion. Of the 690 unpaid tax assessment accounts selected for review, 191, with outstanding balances of about $121 million, were unpaid

[4]See Internal Revenue Service: Composition and Collectibility of Unpaid Assessments (GAO/AIMD-99-12, October 29, 1998).

payroll taxes or associated TFRPs.[5] In our review of these cases, both we and IRS determined that only about 9 percent of the outstanding balances would likely be collected.

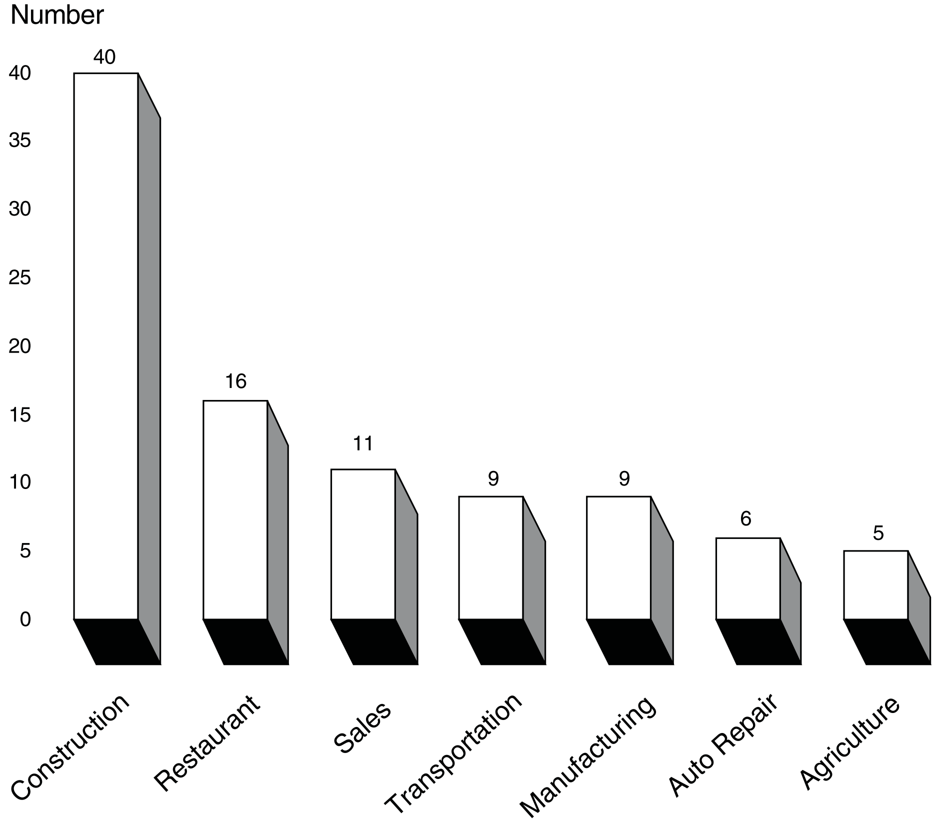
Types of Businesses With Unpaid Payroll Taxes

There are many types of businesses with delinquent payroll taxes. IRS records indicate that corporations represent about 56 percent of the total number of businesses with unpaid payroll taxes. Sole proprietorships represent the second most significant category, about 29 percent of the total, and partnerships represent the third most significant category, about 7 percent.

Our review of the 191 unpaid payroll tax cases and discussions with IRS revenue officers throughout the country identified additional characteristics of the businesses that have failed to forward payroll taxes to the federal government. These businesses are typically in wage-based industries, with few assets available as a potential collection source for the IRS. They are usually small, closely held businesses using a corporate structure, but this can vary by region of the country. As can be seen in figure 1, construction businesses make up the greatest percentage of industries with unpaid payroll taxes identified in our review of the 191 cases.

[5]While our sample of 690 unpaid assessment accounts is a representative sample, the 191 unpaid payroll tax and TFRP cases selected as part of this sample cannot be considered statistically representative of the entire population of such cases. Thus, any analysis of these 191 cases cannot be projected to the entire population of unpaid payroll taxes and TFRPs.

Figure 1: Most Common Businesses/Industries With Unpaid Payroll Taxes From Cases Reviewed



Other types of businesses noted in our review of the 191 unpaid payroll tax cases included (1) professional services, (2) consultants, (3) education and training, (4) computer software, and (5) child care.

Unpaid Penalties Assessed Against Individuals for Not Forwarding Payroll Taxes to the Government Are Significant

According to IRS records, as of September 30, 1998, outstanding TFRPs assessed against individuals were about $15 billion. This amount includes initial assessments of about $9 billion and accumulated interest of about $6 billion. IRS records indicate a total of about 237,000 separate TFRP assessments made against, and owed by, nearly 185,000 individuals.

As discussed earlier, a TFRP assessment is only for the federal tax withholding and FICA taxes withheld from employees' salaries; it does not include the business' or employer's matching FICA contributions. Additionally, a TFRP can be assessed against anyone found willful and responsible for the withholding and nonpayment of payroll taxes. If several individuals involved in a business are found willful and responsible, they can each be separately assessed a TFRP for the unpaid taxes. However, while TFRPs are assessed against one or more individuals and thus appear as separate unpaid assessments on IRS' records, the total payroll taxes owed by the business are to be collected only once. This means that if the business responsible for the unpaid payroll taxes pays some or all of its delinquent taxes, or if one of several individuals assessed a TFRP covering the same delinquent tax period pays some or all of the assessment, the tax liability for all related parties should be reduced or eliminated from IRS' records.

System Deficiencies Affect the Completeness and Accuracy of TFRP Information

In our October 1998 report[6] on internal control weaknesses at IRS, which was based on the results of our audit of IRS' fiscal year 1997 custodial financial statements,[7] we discussed serious financial management systems issues that affected IRS' ability to effectively manage and accurately report on its unpaid assessments. One of the most serious issues we discussed related to IRS's inability to link related taxpayer accounts to ensure that they all receive appropriate credit when a payment is made on one account. This is of particular concern for unpaid payroll taxes and related TFRPs. The unpaid payroll tax of a business and the TFRP assessed against an individual, or individuals, are maintained on IRS' business and individual master files—the detailed databases of taxpayer information for businesses and individuals, respectively. These are two separate and distinct

[6]See Internal Revenue Service: Immediate and Long-Term Actions Needed to Improve Financial Management (GAO/AIMD-99-16, October 30, 1998).

[7]See Financial Audit: Examination of IRS' Fiscal Year 1997 Custodial Financial Statements (GAO/AIMD-98-77, February 26, 1998).

databases that are not integrated. Consequently, if a payment is received from the business, there is no automated entry to record the reduction in the individual, or individuals', TFRP account or accounts. This has led to instances in which IRS has pursued collection against officers of a business for amounts that had already been paid.

IRS has attempted to correct this problem by manually entering a code on related taxpayer accounts to alert IRS personnel that related accounts exist and should be reviewed to ensure that all transactions are appropriately reflected on each account. However, as reflected in table 4, our audits of IRS' fiscal year 1997 and 1998 financial statements have shown that the use of these codes, referred to as cross-references, has not been effective in providing the compensating link between related taxpayer accounts. In fact, in over half of the unpaid payroll tax cases we reviewed during both years, payments were not properly reflected in each related account.

Table 4: Frequency of Payments Not Properly Recorded to Related Taxpayer Accounts Identified in Fiscal Years 1997 and 1998

Fiscal year	Number of unpaid payroll tax cases reviewed in which a TFRP was assessed	Cases reviewed in which payments were not reflected on all related taxpayer accounts: Number	Percent
1997	83	53	64
1998	104	54	52

In our fiscal year 1998 audit, we also determined that this problem was not caused solely by the lack of an automated link between IRS' business and individual master files. In 7 of the 54 cases we reviewed in which payments were not properly recorded, IRS failed to credit one individual's TFRP liability account for payments made by another individual who had also been assessed a TFRP for the same business' unpaid payroll taxes. Additionally, in 52 of the 104 unpaid payroll tax cases we reviewed in fiscal year 1998 in which a TFRP was assessed (50 percent), a cross-reference was not present in the master files to alert IRS personnel that the account was related to one or several other accounts. These problems create instances of unintentional taxpayer burden, such as that caused by inappropriate federal tax liens on taxpayers' property, and affect the accuracy of reported balances of both the unpaid payroll tax and the associated TFRPs.

Significant delays in recording payments also affect the completeness and accuracy of the reported amounts for both unpaid payroll taxes and TFRPs. In one instance, we found that payments were recorded to the individual's account over 8 years after they had been received. Additionally, we found that IRS did not always assess TFRPs against responsible individuals in a timely manner. Specifically, we found two cases in which IRS did not assess a TFRP against officers of businesses until 36 and 55 months, respectively, after the businesses filed their payroll tax returns and IRS would have become knowledgeable of the tax delinquencies. During this period, these officers received tax refunds. Had IRS assessed the TFRPs more promptly, it would have been able to retain, or offset, the refunds to recover a portion of the balance of unpaid payroll taxes.

Not All Individuals Responsible for Nonpayment of Payroll Taxes Are Assessed TFRPs

In addition to the serious financial management deficiencies and internal control issues that affect the integrity of IRS' data on unpaid payroll taxes and TFRPs, IRS does not track or otherwise systemically maintain information on the number and dollar value of potential TFRPs that are not assessed—the value of which could be significant. Several factors affect whether IRS assesses an individual a TFRP for unpaid payroll taxes.

First, IRS must be able to establish that an individual was, in fact, willful and responsible for the nonpayment of payroll taxes. Some businesses operate in a fashion that allows an individual without direct responsibility to nonetheless indirectly influence the nonpayment of payroll taxes. An example would be a corporate director who, by all established lines of authority, has no direct involvement in the day-to-day operations of the business but who, in practice, is heavily involved in the business' operations. Thus, establishing that an individual was both willful and responsible is not always easy.

In determining whether to assess a TFRP, IRS also considers the amounts involved and the cost associated with pursuing collection actions against the individual. If IRS concludes that the amounts involved do not warrant the cost of pursuing collection, it typically will not assess the TFRP. Additionally, IRS does not assess sole proprietors and partnerships TFRPs for unpaid payroll taxes, believing that it can best pursue collection against the individuals through their individual tax return filing. Finally, IRS also considers the potential to collect the assessment in determining whether to assess the TFRP.

Consequently, the numbers and dollar value of outstanding TFRPs discussed above likely significantly understate the extent to which individuals are responsible for not forwarding payroll taxes to the federal government.

Collectibility Potential on TFRPs Is Not Considered Great

IRS' records, our discussions with revenue officers, and our work on a sample of unpaid assessments performed as part of our audit of IRS' fiscal year 1998 financial statements indicate that the potential for significant collections on TFRPs is not great. Status codes in IRS' individual master files for about 76,000 (32 percent) of the 237,000 TFRPs assessed against individuals reflect conditions suggesting minimal likelihood of collection. These conditions include the following:

- the individual cannot be located or contacted,
- the individual is in bankruptcy proceedings or some other form of litigation,
- the individual does not have the ability to pay the assessment, and
- the individual is deceased.

Discussions with revenue officers throughout the country have reinforced the conclusion that TFRP assessments are not highly collectible. Many revenue officers we interviewed believe that less than 30 percent of amounts assessed as TFRPs are ultimately collected. Of the 104 unpaid payroll tax cases we reviewed in fiscal year 1998 in which TFRPs were assessed, we determined that only 8 cases had some potential for collectibility.

Significant Numbers of Individuals Are Responsible for Withholding But Not Paying Payroll Taxes at Multiple Businesses

IRS records indicate that as of September 30, 1998, nearly 25,000 individuals, or about 13 percent of the 185,000 individuals with TFRPs, have been assessed such penalties for unpaid payroll taxes at more than one business. As shown in table 5, about three-quarters of these individuals have TFRP assessments for two separate businesses, and about a quarter have TFRP assessments at three or more businesses.

Table 5: Number of Individuals With Trust Fund Recovery Penalties for Two or More Businesses

Number of businesses	Number of individuals
2	18,993
3	3,925
4	1,079
5	409
6	192
7-12	235
Over 12	29
Total	**24,862**

Source: IRS UNLCER files and individual master file.

In fact, IRS' records indicate that 7 individuals have been assessed TFRPs at 20 or more separate and distinct businesses. However, we must reiterate that these data may not provide a complete and accurate assessment of the degree to which such "multiple offenders" exist because of the significant deficiencies in IRS' financial management systems and internal controls and because IRS does not always assess an individual a TFRP. Additionally, these data cannot account for those individuals who establish new businesses under other names or otherwise conceal their identities.

Our review of the 191 unpaid payroll tax related cases and our discussions with revenue officers throughout the country confirm that a significant number of individuals are found liable for the nonpayment of payroll taxes at more than one business. Of the 104 unpaid payroll tax cases we reviewed in which TFRPs were assessed against individuals, we found that 30 (29 percent) involved individuals assessed TFRPs for more than one business. In one case, we found that an individual had TFRP assessments outstanding for four separate businesses and had been determined responsible for the nonpayment of payroll taxes at a fifth business. In all instances, the individual established and operated construction-related (electrical) companies, in which he was both owner and president. Each company accumulated unpaid payroll taxes and then went out of business. Shortly after each company went out of business, the individual opened a new company in the same line of business.

Reasons Individuals Continue to Have Unpaid Payroll Taxes at Multiple Businesses

Most of the revenue officers we interviewed believe the majority of the individuals responsible for not paying payroll taxes at multiple businesses do not flagrantly disregard their responsibility to forward such payments to the federal government. Most of the revenue officers stated that the individuals responsible for not paying these taxes lack the skills necessary to properly manage a business. We were told that many start up businesses with little capital and quickly find themselves experiencing cash flow problems. In their struggle to stay in business, these individuals prioritize and direct their payments to those recipients without which the businesses would quickly fail, such as employees' net salaries, rent, and utilities. Eventually the businesses are unable to sustain even these payments, and they fail. Revenue officers further stated that, unfortunately, these individuals do not learn from some of the mistakes they make, and are soon opening and operating new businesses in much the same manner.

However, the revenue officers acknowledged that some individuals intentionally disregard their responsibility to forward payroll taxes to the federal government. One revenue officer noted a case in which an individual was ultimately determined to be responsible for not paying the payroll taxes at three businesses. This individual used family members to conceal his involvement in two of the businesses. He was the president of the first business and had the business assets listed in his name. After this corporation had accrued but not paid substantial payroll tax liabilities, the corporation went out of business and he established a new corporation, listing his wife as president and placing the assets in her name. He subsequently established a third corporation, this time listing his daughter as the president and placing the assets in her name. Both of these subsequent corporations also accrued significant unpaid payroll tax liabilities.

Regardless of an individual's intent, the failure to pay withheld payroll taxes has the same effect on the federal government. In either case, the federal government incurs costs to pursue collection of the delinquent tax debt and loses revenue to the extent that such taxes are not ultimately collected. Additionally, as discussed previously, to the extent payroll taxes are not paid, the general revenue fund subsidizes the Social Security and hospital insurance trust funds. As a result, fewer funds are available to finance other federal programs.

Businesses and Individuals Responsible for Not Paying Payroll Taxes Receive Significant Federal Benefits and Other Federal Payments

We found that businesses and individuals responsible for withholding but not paying payroll taxes receive substantial payments from the federal government, either for federal benefits or for other payment purposes, such as federal contracts or loans.

Specifically, based on a matching of IRS records of individuals with outstanding TFRPs with certain Financial Management Service (FMS) payment records, we estimate that about 18,800 (10 percent) of these individuals were receiving about $212 million in annual federal benefit payments while owing almost $2 billion in delinquent payroll taxes, as shown in table 6.

Table 6: Delinquent Taxpayers Receiving Federal Benefits at September 30, 1998, and Their Tax Liability Balances (Dollars in millions)

Payment type	Taxpayers	Estimated annual payments	Tax liabilities at September 30, 1998
SSA	18,199	$200.4	$ 1,902.0
Civilian Retirement	271	3.9	21.5
Civilian Salary	215	6.3	14.1
Railroad Retirement	81	1.0	7.7
Total	**18,766**	**$211.6**	**$1,945.3**

Source: GAO analysis of FMS payments and IRS' records for trust fund recovery penalties.

Additionally, based on a matching of FMS records of payments made to civilian vendors over a 3-month period to IRS' records of businesses with unpaid payroll taxes and individuals with outstanding TFRPs, we found that about 16,700 taxpayers with payroll tax liabilities of about $507 million at September 30, 1998, received about $7 billion in federal payments over this 3-month period.

Finally, based on our matching of IRS records of businesses with unpaid payroll taxes with the Small Business Administration's (SBA) records of outstanding loans as of September 30, 1998, we estimate that about 12,700 taxpayers with unpaid payroll taxes estimated at more than $295 million had received loan disbursements totaling about $3.5 billion. Further analysis disclosed that 38 of these taxpayers, with outstanding TFRPs of about $1.6 million, received SBA loans estimated at $10.6 million after IRS had assessed the TFRPs. In addition, 1,719 taxpayers (businesses and individuals) with unpaid payroll taxes of about $31.6 million received

SBA loans estimated at $448.7 million after accumulating these tax delinquencies.

However, any conclusions drawn from this analysis must consider the potential problems with the reliability and completeness of IRS data due to the serious financial management system deficiencies and internal control weaknesses discussed previously.

Factors Affecting IRS' Ability to Enforce Compliance or Pursue Collection of Unpaid Payroll Taxes

Several factors affect IRS' ability to enforce compliance with respect to the payment of payroll taxes and to pursue collections of unpaid payroll taxes from businesses or responsible individuals. These factors are discussed briefly below.

Financial Management System Deficiencies and Internal Control Weaknesses Affect Accuracy of Taxpayer Account Status

As discussed previously, the lack of an automated link or interface between IRS' separate taxpayer databases for businesses and individuals leaves IRS no assurance that its records for an individual taxpayer or business are complete and accurate. IRS efforts to date to address this lack of linkage have not been fully effective in ensuring the accuracy of taxpayer accounts. In addition, delays in assessing individuals TFRPs result in missed opportunities to collect amounts through such means as retaining or offsetting refunds against unpaid payroll taxes.

Taxpayer Education and Early Warning Programs Are Not Considered Effective

IRS has two programs to prevent payroll tax delinquencies: the (1) Small Business Tax Education Program and (2) Federal Tax Deposit (FTD) Alert Program.

The Small Business Tax Education Program attempts to prevent payroll tax and income tax delinquencies by offering education programs and tax workshops to individuals wishing to start up businesses. Despite its purpose, many of the revenue officers we interviewed nationwide noted that this program has not been very effective in reducing or preventing delinquent payroll taxes. Others noted that the individuals in most need of attending these workshops did not appear to be present.

The FTD Alert Program is intended to identify and prevent potential payroll tax payment delinquencies through early identification of required deposits under the FTD system that have not been made. The Alert Program targets larger employers who deposit semiweekly (those who reported more than $50,000 in payroll taxes on their quarterly Tax Form 941 filings during the previous 12-month period). Information regarding taxpayers who failed to make their deposits is transferred to tapes, which are sent to the service centers for printing of alert notices and mailing to the respective district offices.

Some revenue officers noted that the alerts are not received in the field early enough to prevent employers from accumulating substantial delinquencies or to provide early warning of potential problems. Some of the revenue officers also noted that the alerts received were often invalid or unproductive. Often the taxpayer's case has already been designated as delinquent, or the taxpayer has actually gone out of business before the revenue officer makes contact. In other instances, the employer has already paid the delinquent payroll taxes between the time the FTD alert is issued and received in the field and the contact is made with the taxpayer. Some revenue officers also stated that the FTD alerts yield few collections compared to the effort expended in processing the alerts.

Certain IRS Procedures Limit Collection and Prevention Efforts

According to several IRS field office representatives, another factor that inhibits IRS' ability to collect delinquent payroll taxes and to prevent taxpayers from accumulating multiple payroll tax delinquencies is that IRS' Criminal Investigation Division (CID) and District Counsel do not prosecute taxpayers for failing to pay payroll taxes unless fraud is clearly evident. Field office personnel noted that even in instances in which the taxpayers are multiple offenders, CID and District Counsel appear reluctant to pursue prosecution. A few field personnel noted that IRS could seek injunctions through the U.S. Attorney's Office to prevent taxpayers from accumulating multiple payroll tax delinquencies and that the District Counsel prefer not to seek such injunctions due to the time and expense required to prosecute such cases.

Federal and State Laws Also Inhibit Compliance and Collection Efforts

Federal and state laws also affect IRS' ability to enforce compliance with respect to payment of payroll taxes or to pursue collections on delinquent payroll taxes. Under section 6103 of the Internal Revenue Code, IRS is precluded from sharing tax information with state licensing authorities that have the power to grant or deny business licenses for new and existing businesses. Therefore, IRS is inhibited in its ability to prevent individuals responsible for the nonpayment of payroll taxes from starting up new businesses and repeating the practice. Some Collection Division field representatives noted that due to the same disclosure prohibitions, IRS is unable to publish the names of delinquent taxpayers to increase compliance and generate collections, a process that has been used with some success by a number of states and local taxing authorities.

One IRS field representative we spoke with also mentioned that in California, the posting of bonds by a new business for state payroll taxes is required as a prerequisite to the granting of a new business license. In this manner, the state is protected to some degree in the event of nonpayment of state payroll taxes. This avenue is currently not available to the federal government for federal payroll taxes.

According to some IRS field representatives, the agency's ability to pursue collections of delinquent payroll taxes and associated TFRPs is also inhibited by the property laws of some states, as well as varying interpretations of bankruptcy laws. According to some representatives, in a number of states, IRS is unable to enforce collection of delinquent taxes and penalties because state laws preclude attaching liens to, and seizing, personal property. States in which Tenancy by the Entirety[8] or Marital Joint Property laws exist limit the assets available for IRS to attach or seize. Also, according to an IRS official, a business under Chapter 11[9] Bankruptcy Reorganization can continue to operate at the bankruptcy judge's discretion. This can result in the business incurring additional tax delinquencies.

Other Factors IRS Employees Cite as Affecting Enforcement and Collection of Unpaid Payroll Taxes

In addition to the factors discussed above, Collection Division field representatives cited other factors that, they believe, affect their ability to enforce compliance and pursue collections on delinquent payroll taxes and TFRP assessments. Several field representatives stated that the current level of collection staff is not sufficient to effectively prevent, collect, and monitor delinquent payroll taxes and TFRPs, and that revenue officers are increasingly being required to spend time supporting IRS' Customer

[8]Tenancy by the Entirety is one form of jointly held property in which the property is co-owned with a spouse. Each spouse owns 100 percent of the property at all times.

[9]In general, Chapter 11 is a reorganization proceeding for an individual or a business or other entity in which creditors are paid under a plan.

Service and other functional areas instead of working on collection issues. Field representatives also said that certain provisions of the Restructuring and Reform Act of 1998, which was enacted to provide fairness to taxpayers, could lengthen the time it takes revenue officers to work cases and result in fewer cases being resolved, and expressed uncertainty about how to operate under certain provisions that contain penalties for IRS personnel if the rules are not followed.

Ability to Offset Federal Benefits and Other Federal Payments Has Yet to Be Achieved

Federal law does not prevent businesses or individuals from receiving federal payments or loans when they are delinquent in paying payroll taxes. While IRS can retain, or offset, refunds otherwise due businesses or individuals to recover some or all of the delinquent taxes owed, up to this point it has not been able to systematically pursue other federal payments made to these taxpayers to recover delinquent taxes.

The Debt Collection Improvement Act of 1996, enacted under the leadership of this Subcommittee, called for the centralization and aggressive pursuit of delinquent nontax federal receivables, including delinquent loans and other forms of payments owed the federal government. Treasury also intends to include the collection of federal tax debts as part of the mechanism it is developing to pursue collection of nontax federal receivables as mandated under the act. In doing so, Treasury is using as its legal authority a subsequently passed provision in the Taxpayer Relief Act of 1997. This provision grants IRS the authority to place a continuous levy on a delinquent taxpayer’s federal benefits to assist in recovering overdue taxes. Implementation of the continuous levy provision is expected to begin in July 2000.

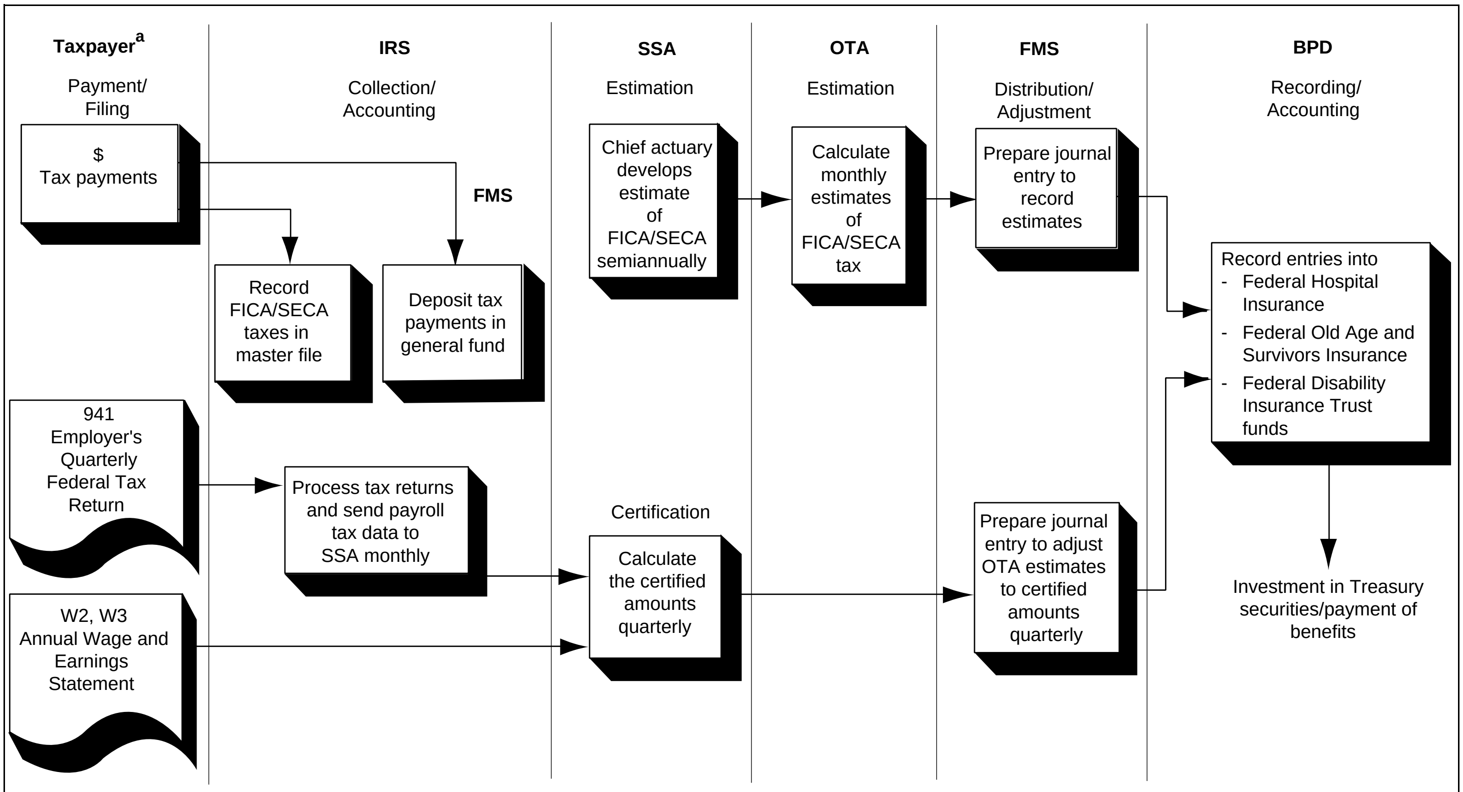
Treasury’s plan has been revised on several occasions, as it and other affected agencies try to address complex implementation issues to avoid undue harm to individuals. This will be of particular concern with respect to Treasury’s plan to include unpaid tax assessments as part of its federal debt collection efforts. There will be a critical need to address IRS’ significant financial management systems deficiencies and internal control weaknesses to ensure that taxpayers are not unduly harmed through the levying of federal benefits and other payments to repay amounts that have already been collected.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions you or other members of the Subcommittee may have.

Contact and Acknowledgment

For future contacts regarding this testimony, please contact Gregory D. Kutz at (202) 512-3406 or Cornelia Ashby at (202) 512-9110. Individuals making key contributions to this testimony included Steven J. Sebastian, Ralph Block, Paul Caban, and Patrick McCray.

Overview of the Process for Distribution of FICA and SECA Tax Revenue to Trust Funds



[a] Employers and self-employed individuals

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