PUBLICATION

Advice for Employers in This Difficult Economy, Part 2

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Part II: *Perils of Failing to Timely Report and Pay Employment Taxes*

Many employers in today's difficult economy are faced with cash-flow problems due to shrinking lines of credit and a lack of liquidity. These problems often leave employers without sufficient resources to timely pay all obligations, and employers must decide which obligations will receive priority and which will be postponed. One obligation that some employers often delay is the payment of employment taxes to the Internal Revenue Service. This Focus addresses the obligations of employers with respect to employment taxes as well as the consequences to both the employers and certain associated individuals, including directors, officers, managers and employees, for failing to timely meet those obligations.

Obligations

Employers are responsible for reporting and remitting three types of employment taxes: (1) social security and Medicare (FICA) taxes, (2) unemployment (FUTA) taxes and (3) wage and withholding (Withholding) taxes. With respect to FICA and Withholding taxes, employers are required to deposit the taxes either semi-weekly (employers with more than $50,000.00 in employment taxes annually) or monthly (employers with less than $50,000.00 in employment taxes annually). These deposit amounts include both the employer's and employee's share of the obligation. In addition to making the required deposits, employers are generally required to report the FICA and Withholding taxes to the IRS on a quarterly basis by filing Form 941.

With respect to FUTA taxes, employers are required to deposit such taxes quarterly. These deposits include both the employer's and employee's share of the obligation. Employers may not, however, have a FUTA obligation if the employer's state unemployment (SUTA) taxes include all taxable wages subject to FUTA. In addition to making the required deposits, employers are required to report FUTA taxes to the IRS on an annual basis by filing Form 940.

Penalties For Failing To Deposit And Report Employment Taxes

The Internal Revenue Code (Code) imposes both civil and criminal penalties at the employer level as well as at the individual level, including certain directors, officers, managers and employers, for failing to deposit and report employment taxes. Because of the broad scope of liability associated with employment taxes, employers must take extra precautions to ensure timely payment. The following is a summary of those penalties:

A. Civil Penalties Imposed On Employers

Employers who fail to timely deposit and report employment taxes are subject to a myriad of civil penalties that substantially increase the total amount owed. Often, the penalties substantially increase the total liability to the IRS and pose a significant threat to the life of a business. Those include the possibility of any one of the following: (1) penalty equal to a maximum of 25% of the tax owed for failing to timely file any tax return, (2) penalty equal to a maximum of 25% of the tax owed for failing to timely pay the amount owed, (3) penalty equal to a maximum of 15% of the underpayment for failing to timely deposit, (4) accuracy related penalty equal to 20% of any understatement of tax owed, and (5) penalty equal to 75% of any understatement of tax owed, if such understatement is attributable to fraud.

In addition to the above-referenced penalties, the IRS may also civilly sue an employer for failing to pay the tax owed or for failing to file a return properly and at the time required. The IRS also has levy and lien powers with respect to delinquent employment taxes; and, if such powers are fully exercised, employers can effectively be put out of business.

B. Criminal Penalties Imposed On Employers

Employers may also be subject to various criminal penalties if such actions are determined to be "willful." Willful is defined as the voluntary, intentional violation of a known legal duty. The criminal penalties include the possibility of any one of the following: (1) fine up to $100,000.00 ($500,000.00 for corporations) and imprisonment up to five years for willfully attempting to evade or defeat any tax; (2) fine up to $10,000.00 and imprisonment up to five years for willfully failing to collect or pay over the tax to the IRS; (3) fine up to $25,000.00 ($100,000 for corporations) and imprisonment up to one year for willfully failing to file a return; (4) fine up to $100,000.00 ($500,000.00 for corporations) and imprisonment up to three years for willfully giving any false statement; and (5) fine up to $10,000.00 ($50,000 for corporations) and imprisonment up to one year for willfully filing any fraudulent return.

C. Civil Penalties Imposed On Individuals

In addition to employers, certain individuals associated with the employer will be subject to a civil penalty if they are found to be a "responsible person." A responsible person is any individual who the IRS determines had authority over the employer's finances or had general decision making authority for the employer, and willfully failed to pay over the amount of taxes due. Responsible persons often include officers, directors, managers, and comptrollers. Further, the IRS may identify more than one person as a responsible person. Each person identified by the IRS as a responsible person is subject to a penalty equal to the amount of employment taxes that were required to be withheld from each employee's gross wages.

D. Criminal Penalties Imposed On Individuals

Individuals may also be held criminally liable and subject to the same criminal penalties discussed above for employers if their actions are found to be willful.

Summary

Employers must timely meet their employment tax obligations. Although the current economic climate may tempt some employers to give priority to other obligations, doing so may prove very costly in light of the far reaching civil and criminal penalties the IRS may impose.