

Congress of the United States

JOINT COMMITTEE ON TAXATION

Washington, D.C. 20515

May 6, 1981

MEMORANDUM

TO: Members of the Ways and Means and Finance Committees

FROM: Mark McConaghy

SUBJECT: Summary of GAO Report on Fictitious Employment
Tax Deposits

The U.S. General Accounting Office (GAO) recently issued a report concerning the failure by some employers to pay employment taxes (income tax withheld and social security tax). This report (copy enclosed), "Fictitious Tax Deposit Claims Plague IRS" (GAO Report No. GGD-81-45), concludes that employers' failure to pay employment taxes is one of the most serious delinquency problems facing the Internal Revenue Service. This report follows up on work done previously by the GAO. (See "IRS Can Improve Its Program To Collect Taxes Withheld by Employers." GGD-78-14, issued February 21, 1978.)

The following is a brief summary of GAO's findings and conclusions, its recommendation to the Commissioner of Internal Revenue, and the Commissioner's comments on the recommendation.

GAO FINDINGS AND CONCLUSIONS

During the fiscal year 1976, IRS began collection actions against employers who held back \$2.4 billion in employment trust fund taxes. In fiscal year 1979, these taxes accounted for \$298 billion of the \$460 billion collected by IRS. An employer who properly files a quarterly employment tax return but fails to pay the entire liability is subject to the following assessments: (1) a failure-to-deposit penalty (5 percent of the amount not deposited on time), (2) a failure-to-pay penalty (0.5 percent per month of the amount not paid by the due date of the return), and (3) interest at the rate of 12 percent per annum.

According to the GAO, employers who claim fictitious tax deposits are flagrantly abusing the concept of voluntary compliance with the tax law because: (1) they have converted to their own use the income tax and social security

payments withheld from their employees' wages, and (2) by preparing employment tax returns showing deposits which were not actually made, they have delayed IRS collection actions.

Based upon an analysis of delinquent tax accounts in five IRS district offices, GAO estimated that 31 percent of the delinquent employers' accounts involved fictitious deposit claims. These fictitious claims delayed IRS collection action by an average of 64 days.

The GAO concluded that present, as well as proposed, IRS procedures are insufficient to resolve the problem of fictitious deposit claims.

GAO RECOMMENDATION TO THE COMMISSIONER OF INTERNAL REVENUE

The GAO has recommended that the Commissioner of Internal Revenue pursue the enactment of legislation to provide a civil penalty for employers who claim fictitious deposits on their employment tax return. The GAO believes that the penalty should be severe enough to act as a deterrent, and suggests that this penalty could be as much as 25 percent of the underpayment.

COMMENTS OF THE COMMISSIONER OF INTERNAL REVENUE

The Commissioner of Internal Revenue agreed with the need for a new civil penalty to deter taxpayers from claiming fictitious tax deposits. Moreover, the Commissioner stated that the IRS will recommend legislation to the Department of the Treasury.

AVAILABILITY OF GAO REPORT

Additional copies of GAO's report are available from the U.S. General Accounting Office, Distribution Section, Room 1518, 441 G Street, N.W., Washington, D. C. 20548.

Enclosure