

Tips for Employers Who Outsource Payroll Duties

Cross References

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Many employers outsource their payroll and related tax duties to third-party payers such as payroll service providers (PSPs) and reporting agents (RAs). Reputable third-party payers can help employers streamline their business operations by collecting and timely depositing payroll taxes on the employer's behalf and filing required payroll tax returns with state and federal authorities.

Though most of these businesses provide very good service, there are, unfortunately, some who do not have their clients' best interests at heart. Over the past few months, a number of these individuals and companies around the country have been prosecuted for stealing funds intended for the payment of payroll taxes. Examples of these successful prosecutions are found at the end of this article.

Like employers who handle their own payroll duties, employers who outsource this function are still legally responsible for any and all payroll taxes due. This includes any federal income taxes withheld as well as both the employer and employee's share of Social Security and Medicare taxes. This is true even if the employer forwards tax amounts to a PSP or RA to make the required deposits or payments. For an overview of how the duties and obligations of agents, reporting agents and payroll service providers differ from one another, see the Third Party Arrangement Chart below.

Here are some steps employers can take to protect themselves from unscrupulous third-party payers.

- Enroll in the Electronic Federal Tax Payment System (EFTPS) and make sure the PSP or RA uses EFTPS to make tax deposits. Available free from the Treasury Department, EFTPS gives employers safe and easy online access to their payment history when deposits are made under their employer identification number, enabling them to monitor whether their third-party payer is properly carrying out their tax deposit responsibilities. It also gives them the option of making any missed deposits themselves, as well as paying other individual and business taxes electronically, either online or by phone. To enroll or for more information, call toll-free 800-555-4477 or visit www.eftps.gov.
- Refrain from substituting the third-party's address for the employer's address. Though employers are allowed to and have the option of making or agreeing to such a change, the IRS recommends that employers continue to use their own address as the address on record with the tax agency. Doing so ensures that the employer will continue to receive bills, notices and other account-related correspondence from the IRS. It also gives employers a way to monitor the third-party payer and easily spot any improper diversion of funds.

- Contact the IRS about any bills or notices and do so as soon as possible. This is especially important if it involves a payment that the employer believes was made or should have been made by a third-party payer. Call the number on the bill, write to the IRS office that sent the bill, contact the IRS business tax hotline at 800-829-4933 or visit a local IRS office. See *Receiving a Bill from the IRS* on IRS.gov for more information.
- For employers who choose to use a reporting agent, be aware of the special rules that apply to RAs. Among other things, reporting agents are generally required to use EFTPS and file payroll tax returns electronically. They are also required to provide employers with a written statement detailing the employer's responsibilities including a reminder that the employer, not the reporting agent, is still legally required to timely file returns and pay any tax due. This statement must be provided upon entering into a contract with the employer and at least quarterly after that. See *Reporting Agents File* on IRS.gov for more information.
- Become familiar with the tax due dates that apply to employers.

Third Party Arrangement Chart

There are some differences between a payroll service provider (PSP), reporting agent (RA) authorized under Form 8655, *Reporting Agent Authorization*, and an agent appointed using Form 2678, *Employer/Payer Appointment of Agent*.

A Form 8655 reporting agent provides payroll services for one or more employers, using each client's (employer's) employer identification number (EIN) to file separate returns (generally e-file only) on the client's behalf. A reporting agent may also deposit and pay taxes on the client's behalf.

A Form 2678 agent acts as the employer, assuming liability along with the employer for the employer's Social Security, Medicare and federal income tax withholding responsibilities. An agent appointed under Form 2678 files aggregate returns (e-file or paper) using the agent's EIN.

The chart below illustrates the most significant differences.

Third-Party Arrangement Authority	Form 2678 Agent	Form 8655 Reporting Agent (RA)	Payroll Service Provider (PSP)
Can file certain employment tax returns?	Yes. The agent files an aggregate return for all employers/clients, using the <i>agent's EIN</i> . Agent can file those returns listed on Form 2678 appointment request.	Yes. The RA signs and is generally required to file electronically a separate return for each client, using the employer's client's EIN. The RA must e-file returns listed in Rev. Proc. 2007-38 and shown on the Form 8655 authorization request, if the forms are available for electronic filing. Only forms that are not able to be electronically filed can be filed using paper forms.	Yes. The PSP prepares a separate return for each client using the <i>client's EIN</i> . After employer/client signs the return, either the client or the PSP may file the return on paper.
Can make deposits and payments for employment taxes reported on certain returns?	Yes. The agent deposits and pays for tax liabilities the agent has aggregated and reported using the agent's EIN, according to the agent's deposit requirements. Agent can make deposits and payments for those employment taxes reported on returns listed on Form 2678 appointment request.	Yes. The RA deposits and pays tax liabilities on behalf of each client, using the client's separate EIN, according to each client's deposit requirements.	Yes. The PSP deposits and pays tax liabilities on behalf of each client, using the client's separate EIN, according to each client's deposit requirements.
Can file Form 940, <i>Employer's Annual Federal Unemployment (FUTA) Tax Return</i> ?	No.* Clients must file FUTA tax returns using their own EINs.	Yes. RA signs and generally files electronically separate returns using client's EIN.	Yes. After employer/client signs the return, client or PSP files separate returns using client's EIN.
Has employment tax liability?	Yes. Client and agent are both liable for paying the client's employment taxes, filing returns, and making deposits and payments for the taxes reported.	No. Employer/Client, not RA, remains liable for ensuring all tax returns are filed timely and all deposits and payments are made timely.	No. Employer/Client, not the PSP, remains liable for ensuring all tax returns are filed timely and all deposits and payments are made timely.
Specific guidance in addition to Code, regulations and Circular E.	Rev. Proc. 70-6; Notice 2003-70 (state and local government agents).	Rev. Proc. 2007-38.	

* Exceptions may apply for an agent where the employer is a disabled individual or other welfare recipient receiving in-home care through a state or local program. See Rev. Proc. 80-4 and Notice 2003-70 for special instructions.

Examples of Employment Tax Investigations—Fiscal Year 2013

South Carolina man sentenced for tax evasion and employing illegal aliens. On June 24, 2013 in Columbia, South Carolina, Ji Duan Fang, of Hanahan, South Carolina, was sentenced to 12 months in prison, six months in a community corrections center, and three years of supervised release for failure to pay employment taxes and harboring illegal aliens. According to court documents, Fang owned and operated Jade China Buffet, a restaurant in North

Charleston, and he knowingly hired at least 14 illegal aliens to work at the restaurant. From 2008 through 2011, Fang paid the illegal alien employees in cash and did not collect or pay employment taxes for these employees. Fang's failure to collect and pay the employment taxes for the illegal alien employees resulted in \$212,225 in unpaid taxes.

California resident sentenced for employment tax evasion scheme. On June 24, 2013, in Los Angeles, California, Jason M. Harvey, formerly of Yorba Linda, California, was sentenced to 24 months in prison, three years of supervised release and ordered to pay \$11,738,000 in restitution for aiding in the evasion of payment of federal payroll taxes.

According to his plea agreement, Harvey, was identified as the legal owner of several payroll processing companies including Advanced Business Payroll, Inc., Global Business Outsource Solutions, Inc., and Global Consulting, Inc. He was responsible for filing correct payroll tax returns, collecting payroll tax and remitting payroll tax withheld from employees of the client's businesses to the IRS and State of California. During the period January 1, 2004 through December 31, 2006, Harvey failed to pay over \$10 million in payroll taxes that were actually due by the global companies for the wages paid to employees, and failed to file some of the payroll tax returns required to be filed with the IRS.

On February 4, 2013 Michael Harvey, Jason Harvey's father, was sentenced to 30 months in prison, three years of supervised release and ordered to pay \$15,177,106 in restitution. Michael Harvey pleaded guilty to evading payment of over \$15 million to the IRS, admitting that he caused the companies to not honor the levies, and aided Jason Harvey to cause those companies to not honor the IRS levies. Another co-defendant Denise Browning was sentenced to 42 months in prison and one year of supervised release after being found guilty of two counts of aiding and assisting in the preparation of false payroll tax returns.

Payroll company owner sentenced in tax case. On June 21, 2013, in Cincinnati, Ohio, Robert Sacco was sentenced to 78 months in prison, three years of supervised release and ordered to pay \$26,729,098 in restitution jointly with another defendant. Sacco pleaded guilty on October 26, 2012 to one count each of conspiracy to defraud the United States by impeding the IRS, money laundering and tax evasion.

According to court documents, Sacco was the owner and chairman of the board of Payscale, a Dayton-based professional employer organization which provided services that enabled business owners to cost-effectively outsource the management of human resources, employee benefits, payroll and workers' compensation and other strategic services. Sacco and others conspired to avoid the payment of federal employment taxes owed by Payscale for 2007 through 2009 and concealed from the IRS the legitimate tax liabilities the company owed. Sacco directed co-conspirators to prepare fraudulent IRS forms claiming that the wages paid by the company and the resulting tax liabilities were significantly lower than the wages the company actually paid.

Tennessee man sentenced on tax evasion charges. On June 3, 2013, in Greeneville, Tennessee, Paul Adams, of Kingsport, Tennessee, was sentenced to 36 months in prison, three years of supervised release and ordered to pay \$2,535,745 in restitution. According to court documents, Adams formed a professional employer organization, employing 500 employees for 23 client companies. Adams performed clerical services for the

23 companies, including withholding federal payroll taxes and filing federal payroll tax returns. During a 17-month period, Adams calculated and collected the correct amount of withholding and payroll taxes, but reported and paid a much smaller number to the Internal Revenue Service and the Social Security Administration. Adams pocketed more than \$2.5 million paid by his client companies and the employees.

Oklahoma bookkeeper sentenced for embezzlement and tax evasion. On May 6, 2013, in Oklahoma City, Oklahoma, Carolyn Dawson was sentenced to 24 months in prison, three years of supervised release and ordered to pay \$1,843,674 in restitution for embezzlement and evading federal payroll taxes. According to court documents, Dawson worked as a bookkeeper for a wholesaler of greenhouse supplies where she maintained payroll, prepared payroll tax returns, and paid withheld taxes to the IRS. From January 2007 through November 2011, Dawson defrauded the business by paying personal credit card expenses from the business bank account. Dawson also evaded federal payroll taxes by failing to file a 2010 payroll tax return for the company, failing to make payroll withholding payments to the IRS, and altering the books and records of the company to conceal her failure to make withholding payments.

Comptroller of New York payroll services company sentenced for \$20 million fraud. On April 12, 2013, in Sacramento, California, Kerry Seaman, of Lake Ronkonkoma, New York, was sentenced to 44 months in prison and ordered to pay \$19,141,618 in restitution. Seaman pleaded guilty on November 19, 2010 to wire fraud. According to court documents, Seaman was the comptroller for Ingentra HR Services Inc., a payroll services corporation in Hauppauge, New York. Ingentra, then known as Humanic Solutions Inc, was hired by Sacramento County in late 2004 to process the payrolls for Sacramento County's Special Districts. As part of the payroll services, Ingentra calculated the tax payments for the clients and the clients' employees and then transmitted the payments to the state and federal tax authorities.

Ingentra was responsible for paying the income tax withholdings to the IRS and to file the Employer's Quarterly Federal Tax Form (Form 941) with the IRS on behalf of the clients. From 2005 until April 2010, Seaman and co-defendant Albert Cipoletti defrauded the County of Sacramento Special Districts and two other companies of the tax withholdings intended to be paid to the IRS. Ingentra collected the correct amount from the clients but underreported to the IRS the amount owed, and diverted the difference to Ingentra's operating account for Ingentra's own use. Cipoletti and Seaman sent funding letters to the clients that correctly calculated payroll and federal tax withholdings for the clients' employees, and the clients wire transferred funds to Ingentra to pay both the payroll and taxes. Cipoletti and Seaman then filed false Forms 941 with the IRS, understating the true employee tax withholdings for these clients.

Cipoletti and Seaman wrongfully diverted in excess of \$20 million in tax withholdings from the clients that should have been remitted to the IRS on behalf of the clients and the clients' employees. Cipoletti was sentenced in May 2011 to 78 months in prison and ordered to pay \$19,141,618 in restitution.

To read about more cases, go to:

www.irs.gov/uac/Examples-of-Employment-Tax-Investigations-Fiscal-Year-2013