Did You Know That Payroll Taxes Non-Compliance Can Get You Into TROUBLE?

S Corps are corporate entities through which the income and or losses of the entity pass through to its owner's personal income tax return. It is estimated that 100% of the shares of approximately 70% of small businesses incorporated as S Corps are owned by only "one person". In years past, officer shareholders of S corps received "unreasonably" low salaries in order to "reduce" FICA and Medicare payroll taxes. Some shareholder/employees of S corps with significant earnings were receiving little or no salary until, in 2005, IRS stepped up enforcement of the issue. In 2008, IRS published Wage Compensation for S Corps that states that "S corporations must pay reasonable compensation to a shareholder-employee in return for services that the employee provides to the corporation before non-wage distributions may be made to the shareholder-employee. The amount of reasonable compensation will never exceed the amount received by the shareholder either directly or indirectly". Moreover, "Distributions and other payments by an S corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation." This is a vague statement skewed to benefit IRS. IRS agents have broad latitude to reclassify S Corporation distributions as payroll; resulting in IRS collecting additional government revenues through imposing penalties and related interest or payroll taxes calculated from reclassifying dividends as salaries.

Approximately 66% of federal taxes are collected thorough the payroll tax system in the US. The IRS stipulates that employers must withhold federal income, Social Security and Medicare taxes from employee wages ("trust funds") and remit them to the Government. Yet Employers facing liquidity difficulties may divert funds withheld from employees' pay to make payments for other purposes.

In December 2015, IRS launched the **Early Interaction Initiative** for quickly identifying employers falling behind on payroll or employment taxes, payments and reporting responsibilities and providing them with help catching up. The Early Detection Initiative program monitors deposit patterns and identifies employers whose payments decline or are late. An employer is identified under this initiative will receive a "reminder" letter of its payroll tax responsibility and be asked to contact IRS. Some employers could receive a more direct contact from an IRS revenue officer.

Failure to pay and late payment of payroll and employment taxes is a serious matter. According to the IRS, using money that belongs in the "trust fund" category for paying suppliers, or keeping a business open are not valid reasons for not remitting to IRS.

About 40% of all small businesses use a third party provider for reporting, collecting and depositing employment taxes with state and federal authorities and for staying on top of their payroll tax Government filings. Payroll services are an option because they allow a business owner to focus on running the business and reduce the temptation that the business owner has to use trust funds for paying suppliers, vendors or anything else. That said, the Treasury Inspector General revealed in a report on March 2015, that there have been instances in which the third party providers receive funds from employers, and fail to remit the taxes to IRS. Unfortunately, under Internal Revenue Code regulations, the employer remains responsible for employment taxes already removed from the employer's bank by the third party provider.

These are the possible consequences of a failure to timely remit payroll tax liabilities to the IRS:

- IRS will make assessments against all "responsible persons" who have ownership or signature authority over an employer's bank accounts,
- IRS can assess a Trust Fund Recovery Assessment (a/k/a 100% penalty against every "responsible person"),
- Employees will get notices,
- The employer might be liable even without knowledge that the taxes were not paid to IRS,
- If a person is a "responsible person", IRS can pursue the "responsible person" personally,
- The Government can shut down the business,
- The Government can seek an injunction and, or criminal penalties.

Don't be a victim of your own making. Please contact your tax specialist if you can't keep your employment taxes current or if you receive a notice regarding the payment of your taxes.