The secret (illegal) business advantage that you may unknowingly support.

And how it bites the otherwise innocent employee.

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The tax referenced in this article is Income Tax and FICA, or “*Federal Insurance Contributions Act*” (Social Security & Medicare).

When you get your paycheck, you see a portion of your earnings have been withheld. The largest portion of withholding for tax will be for **Income Tax**. Your 1040 tax return at the end of the year shows how much income tax you owe and, if you had more Income Tax withheld than is owed, you get a refund. **FICA** is how we fund Social Security & Medicare. Employers are also required to pay a percentage of the employee's FICA.

The employer is then required to deposit these taxes and file a quarterly return declaring the taxes. If they made the correct deposits, the tax will be the same and they owe nothing. However, some employers don’t file that return or they file the return but don't pay the tax or make the tax deposits.

*There are many variables to the amounts & types of tax that we are not covering. For simplicity we will use the most common percentages and amounts. For this article we will use 10% for income tax.*

The way it works is you pay 7.65% of your wages and your employer matches that amount for a total of 15.3% of your wage amount.

So, if an employer offers you $500 per week, they are supposed to distribute a portion of your pay to the government for your taxes. That distribution is made as 7.65% for FICA & 10% for income tax. The rest of the pay (less any benefits, other taxes, or withdrawals, goes to you in your paycheck. The employer is required to also match 7.65% toward your FICA.

So, out of your $500, they withhold about $88 (FICA & income tax). They also owe their share at about $38. The total tax is $126.

The employer records expenses as follows:

|  |  |  |
| --- | --- | --- |
| Employee's share of SSA/Medicare | $ 38.00  |  |
| Employee's Income Tax |  $ 50.00  |  |
| Paycheck |  $ 412.00  |  |
| Employee's pay |  |  $ 500.00  |
| Employer's share of SSA/Medicare |  |  $ 38.00  |
| Employer's expense |  |  $ 538.00  |

Remember, the employer promised you $500 of which they would withhold $88 for your FICA. If the government does not get that $88, who is getting it? You’re not. It's in the employer's pocket. They took your money and kept it for themselves. Of course, this doesn’t include the $38 from employer’s portion.

It doesn’t sound like that much of an advantage until you apply it to a real-world example. Say each employer has 5 employees. That’s $126 ($88+38) for each employee, $630 each week and $32,760 per year. Quite an advantage!

To be clear, most times the employer isn't deviously trying to increase their profits this way, but instead thinks they can hold off on making the deposit until later and then catch up. The truth is, catching up is harder than it seems and almost never happens. And, regardless of the intention, the result is the same.

##  How is this a business advantage?

If you have Company A doing this and Company B paying the way they are supposed to, which company has more money for advertising, updating tools & equipment, expanding services, etc.? Well, it's Company A, because they fund those things with their employees’ wages.

## And how does it hurt innocent employees?

Eventually, the IRS will find out the employer has not paid the tax. If the employer can’t pay it immediately, they will set them up on a payment plan. However, they will also assess a penalty in the amount of the tax owed against anyone they determine was responsible for the tax getting paid.

How that works can get confusing, so we’ll explore it in another article.

For now, let’s look at the overview. (For more details on Trust Fund assessments, please read Internal Revenue Manual - 8.25.1.3 (09-11-2018) Requirements for Liability Under IRC 6672.)

To assess the Trust Fund Penalty, the IRS must show that the person they are assessing against is responsible, willful, & collectable.

Responsibility can be assumed by signing payroll checks, hiring & firing authority, a position of authority, signature authority on the company bank account, preparing, reviewing, or signing returns, making tax deposits, position within company.

Willfulness does not mean an intentional desire to deceive or do wrong. It simply means that the person chose not to do what they should have done. For example, the company bank account shows $1,000. There is a shut-off notice for the electricity bill of $600 and the tax bill is $900. Paying the electricity demonstrates willfulness as there was a choice to be made and the person chose to not pay the tax.

Quite often an office manager or bookkeeper could be held responsible and willful without them even realizing it.

Lastly is collectability. It’s straight forward in that it is meant to not assess against someone that will likely never be able to pay. For example, consider the bookkeeper. If the Trust Fund taxes are $1mm, what are the odds the bookkeeper will ever be able to pay that? It would not be in the government’s best interest to assess that.

When a business gets behind on payroll taxes it can feel like an insurmountable obstacle, but it isn’t. There are solutions that allow the business to continue operating and pay back the balance due. The first thing to do is to start doing it right – immediately. Then work on the past due balances. If you are not sure where to start or the best option, contact a professional Enrolled Agent or CPA for assistance.

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