Internal Revenue Service Criminal Investigation

Tax Fraud Alert

Employment Tax

www.irs.gov IRS Keyword: Fraud Fiscal Year 2003

Background

Employers are required by law to withhold employment taxes from their employees. Employment taxes include:

- Federal Income tax withholding
- Social Security and Medicare Taxes

The federal income tax is a "pay as you go tax." You must pay the tax as you earn or receive income during the year. For most employees this takes the form of income taxes withheld from their pay. Self-employed persons are also required to make estimated tax payments during the year. The pay as you go system was designed to ensure that taxpayers meet their tax obligations timely.

Social Security and Medicare taxes pay for benefits workers and their families receive under the Federal Insurance Contributions Act (FICA). Social security taxes pay for benefits under the old age, survivors, and disability insurance part of FICA. Medicare taxes pay for hospital benefits. Each employee contributes part of these taxes and the employer pays a matching amount. Self-employed taxpayers must also pay social security and Medicare taxes in the form of self-employment taxes. The programs funded by employment taxes provide essential benefits to many citizens. The importance of the programs will continue to grow as more citizens reach retirement age. The Federal Unemployment Tax Act (FUTA) tax, together with state unemployment systems, provides for payments of unemployment compensation to workers who have lost their jobs.

Employer and Employee Responsibilities

Both employer and employee hold the responsibility for collecting and remitting withholding taxes to the Internal Revenue Service (IRS). For the most part, the employer withholds these taxes on behalf of their employees, but in cases where an employer does not do this, or where an employee is self-employed, it is the responsibility of the employee to collect and pay withholding taxes.

Employer's Responsibility

Employers must report income and employment taxes withheld from their employees on an Employer's Quarterly Federal Tax Return (Form 941) and deposit these taxes in full to an authorized bank or financial institution pursuant to Federal Tax Deposit Requirements. Employers are also responsible for filing a FUTA return annually, and depositing those taxes.

Employers who do not comply with the employment tax laws may be subject to criminal and civil sanctions for willfully failing to pay employment taxes.

Employees' Responsibility

Employees who do not have taxes withheld nor remit them personally, are still liable for these taxes and may not qualify for Social Security, Medicare, or unemployment benefits.

Employees who are concerned that their employer is improperly withholding or failing to withhold federal income and employment taxes should report their employer by contacting the IRS at 1-800-829-1040. In cases where the employer withheld employment taxes but failed to deposit them, or failed to issue W-2s, the employee should contact the employer to request the W-2. If the employee is unable to secure a W-2 from the employer, the employee should complete and attach Form 4852, Substitute for W-2, to their tax return using the best information available to calculate the wages and the withholding. This information can often be secured from pay stubs.

In addition, if the employer refuses to withhold employment taxes from these wages and the IRS is unable to collect the employment taxes from the employer, the employee still has the responsibility to pay income tax and is ultimately responsible for his share of the FICA tax.

Evasion of Employment Taxes Carries a Price

Evading employment taxes can have serious consequences for employers and the employees. Employers may be subject to criminal and civil sanctions for willfully failing to pay employment taxes. Employees suffer because they may not qualify for social security, Medicare, or unemployment benefits when employers do not report or pay employment and unemployment taxes. Consequently, taxes withheld and paid by compliant employers are used to pay the refunds and social security benefits of employees whose employers did not pay the withheld taxes.

Where Do You Report Suspected Tax Fraud Activity?

If you suspect tax fraud or know of an abusive return preparer, you should report this activity to your nearest Internal Revenue Service office. This information can be communicated by phone or in writing to your local IRS office.
You can contact the IRS by phone at 1-800-829-0433.

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Employment Tax Evasion Schemes

Employment tax evasion schemes can take a variety of forms. Some of the more prevalent methods of evasion include pyramiding, employee leasing, paying employees in cash, filing false payroll tax returns or failing to file payroll tax returns.

Pyramiding
"Pyramiding" of employment taxes is a fraudulent practice where a business withholds taxes from its employees but intentionally fails to remit them to the IRS. Businesses involved in pyramiding frequently file for bankruptcy to discharge the liabilities accrued and then start a new business under a different name and begin a new scheme.

Employment Leasing
Employee leasing is another legal business practice, which is sometimes subject to abuse. Employee leasing is the practice of contracting with outside businesses to handle all administrative, personnel, and payroll concerns for employees. In some instances, employee-leasing companies fail to pay over to the IRS any portion of the collected employment taxes. These taxes are often spent by the owners on business or personal expenses. Often the company dissolves, leaving millions in employment taxes unpaid.

Paying Employees in Cash
Paying employees in whole or partially in cash is a common method of evading income and employment taxes resulting in lost tax revenue to the government and the loss or reduction of future social security or Medicare benefits for the employee.

Filing False Payroll Tax Returns or Failing to File Payroll Tax Returns
Preparing false payroll tax returns understating the amount of wages on which taxes are owed, or failing to file employment tax returns are methods commonly used to evade employment taxes.

Statistical Information

How to Interpret Criminal Investigation Data: Since actions on a specific investigation may cross fiscal years, the data shown in cases initiated may not always represent the same universe of cases shown in other actions within the same fiscal year.

	FY 2001	FY 2002	FY 2003
Case Initiations	64	92	104
Prosecution Recommendations	40	56	66
Indictments/Informations	33	55	66
Sentenced	31	41	45
Incarceration Rate*	74.2%	78.0%	75.6%
Average Months to Serve	15	15	20

* Incarceration includes confinement to federal prison, halfway house, home detention, or some combination thereof.

FY 2003 Archive Significant Case Summaries

The following case summaries are excerpts from public record documents on file in the courts in the judicial district in which the cases were prosecuted.

Operator of Convenience Stores Evaded $247,000 in Employment Taxes

On July 25, 2003, in New Haven, CT, Russell Mahler, Sr., who operated a chain of gasoline/convenience stores, was sentenced to 18 months imprisonment followed by three years supervised release. Mahler was also ordered to pay a fine of $40,000 and all back taxes, plus interest and penalties. Mahler pleaded guilty on March 11, 2003, to conspiring to impede the functions of the IRS. Mahler's son, Russell Mahler II, also pleaded guilty to the same charges in March and had been sentenced in May 2003 to one year and one day imprisonment followed by three years supervised release. The Mahlers admitted to paying a substantial portion of many of their employee's wages in cash and failing to pay over to the IRS the payroll taxes totaling an estimated $247,000. In addition, Russell Mahler, Sr. admitted evading about $46,000 of his personal income taxes.

Businessman Sentenced to 22 Months Imprisonment

On July 15, 2003, in Hartford, CT, William A. Trudeau, Jr., operator of Newtown Oil, was sentenced to 22 months imprisonment followed by 3 years supervised release and ordered to pay $458,312 in restitution to the victims of his financial fraud activities. Trudeau pleaded guilty in February 2001 to one count of tax fraud and one count of wire fraud. In the plea agreement, Trudeau admitted that he failed to account for and pay over $232,000 in employment taxes to the IRS for the tax years 1993 to 1997. Trudeau further admitted to engaging in ten fraudulent loan and lease transactions during 1999 in connection with the purchase of multiple real properties, cars and computer equipment.

Small Business Consultant Withdrew Over $1 Million from Client's Payroll Accounts

On July 14, 2002, in Kansas City, KS, Floyd McMillon, owner of Acculine Consulting Group, Inc., was sentenced to 63 months in prison and ordered to pay more than $621,000 in restitution to the small businesses he defraud. McMillon pleaded guilty on February 10, 2003, to one count of filing a false tax return and one count of failing to pay over taxes to the IRS. McMillon's business, Acculine Consulting Group, Inc., provided tax return preparation, bookkeeping and payroll services for small businesses. Acculine calculated employment taxes to be withheld from the paychecks of employees of the businesses, withdrew that amount from the businesses bank accounts, deposited the funds into Acculine's bank account, and submitted the required employment tax forms to the IRS. However, McMillon admitted that he withdrew more than $1 million from Acculine's bank account which was set up to pay the employment taxes.

Father and Son Sentenced to Tax Charges in School Construction Project

On June 26, 2003, in Manhattan, NY, Robert Carnival, Jr., was sentenced to 34 months in prison followed by 36 months probation, and ordered to repay $235,338. On May 8, 2003, Robert Carnival, III, was sentenced to 10 months imprisonment followed by 24 months probation, and ordered to pay $217,738. On January 30, 2003, Robert Carnival, Jr., and his son, Robert Carnival, III, pleaded guilty to tax evasion charges arising from their involvement in a scheme to pay cash wages to employees of various corporations that held contracts to install windows in New York City public schools and to evade federal taxes on those wages. Robert Carnival, Jr., is the former owner and operator of JRC Enterprises Limited (JRC) and JTJ Construction (JTJ). Robert Carnival, III, worked as a foreman for both JRC and JTJ and assisted in managing construction sites. As charged in the indictment, from May 1998 through June 2000, JRC and JTJ subcontracted work on window installation projects at public schools throughout five boroughs in New York City. During that time, they consistently defrauded the U.S. government and the IRS by, among other things, (a) failing to deposit checks received by JRC and JTJ into corporate bank accounts; (b) using the undeposited, unreported cash receipts for payment of workers' salaries off-the-books; and (c) failing to provide wage and earning statements (W-2s) to workers and to file the W-2s with the IRS.

Businessman Owes IRS $658,989 in Taxes

On May 16, 2003, in Boston, MA, Andrew A. Filippone was sentenced to two years in prison for engaging in a scheme to impede the due administration of the Internal Revenue Laws. Filippone pleaded guilty to the charges on February 11, 2003. In 1990 and 1991, Filippone and his corporations were assessed by the IRS employment taxes in an amount totaling over $150,000. From 1991 through 1998, Filippone endeavored to prevent and obstruct the IRS from collecting the tax due and owing by: concealing the nature and extent of his and his related entities' income and assets; filing false schedules and documents with tax returns; and making false statements to IRS agents. In total, Filippone owes the IRS $658,989.

Roofing Contractor Sentenced in Employment Tax Case

On May 14, 2003, in New Orleans, LA, Guy Huffine, owner and operator of Huffine Roofing and Construction Co., was sentenced to one year of home confinement, fives years probation, and ordered to pay over $90,000 in fines, as well as pay back taxes, interest, and penalties. Huffine pleaded guilty to one count of failing to properly account for and pay to the IRS taxes and one count of mail fraud on February 15, 2003. According to a superceding indictment, Huffine collected over $91,000 in employment taxes, which he failed to pay over to the IRS. The indictment also stated

"If it sounds too good to be true, it probably is!" *Seek expert advice before you subscribe to any scheme that offers instant wealth or exemption from your obligation as a United States Citizen to pay taxes. Buying into a tax evasion scheme can be very costly.*

that Huffine underreported his personal income by nearly $300,000.

Construction Contractor Pleads Guilty in $3.6 Million Employment Tax Fraud Case

On March 14, 2003, in Memphis, TN, David Cantu Jr., was sentenced to 48 months in prison, ordered to pay $860,435.13 in restitution to the IRS and pay a forfeiture amount of $10,000,000 to the United States. On December 17, 2002, David Cantu, Jr. and his company, Brother's Construction II, pleaded guilty to conspiracy to commit money laundering and willful failure to file proper payroll taxes, as well as conspiracy to harbor, encourage, or induce aliens to work at a variety of construction sites. The construction sites included the Adelphia Stadium, home of the Tennessee Titans NFL team, and the Federal Express World Headquarters. Cantu maintained the workers were 'independent contractors' therefore his company was not responsible for taxes. During a five quarter tax period covering January 1, 1999, and ending March 31, 2000, Cantu, doing business as Brother's Construction II, paid in excess of $3.6 million in gross wages to employees, which should have resulted in approximately $631,478 in payroll taxes and federal withholding taxes.

Plaza Hotel Owner Failed to Pay Over to the IRS $2.4 Million

On June 25, 2003, in Detroit, MI, Remo Polselli, owner of Plaza Hotel, was sentenced to 27 months imprisonment and was ordered to pay restitution in the amount of $2.9 million. On January 9, 2003, Polselli pleaded to one count of failure to account for and pay withholding and Social Security taxes and two counts of failure to file federal income tax returns for the years 1995 and 1996. Between 1993 and 1997, Polselli deducted and collected over $2,469,000 in withholding and Social Security taxes from his employees; however, he failed to pay the IRS the collected taxes. In addition, Polselli failed to file personal income tax returns after grossing approximately $602,000 in 1995 and $697,000 in 1996.

Former Owner of Defunct Security Agency Sentenced to 32 Months

On December 11, 2002, in Philadelphia, PA, Samuel Kuttab, former owner of the now defunct Central Security Agency and a Democratic Fund-Raiser, was sentenced to32 months in prison followed by 3 years supervised release. In addition, Kuttab was fined $10,000 and ordered to pay all back taxes, with interest and penalties. On June 26, 2002, Kuttab pleaded guilty to federal charges of conspiracy and tax fraud. Central Security Agency paid some employees in cash to avoid paying withholding taxes, thus causing the filing of false Forms 941. Kuttab also admitted to not filing federal tax returns for 1992 to 1999. The estimated taxes loss is $2 million for both personal and business returns.

Operator of Security Company Paid Employees "Under the Table"

On December 12, 2002, in Pittsburgh, PA, John M. O'Shea, operator of a security company and former police officer, was sentenced to seven months in prison and seven months home detention, ordered to pay a $5,000 fine, and ordered to continue paying back taxes to the IRS. O'Shea pled guilty on August 20, 2002, to making and subscribing to a false income tax return and failing to file income tax returns. O'Shea hired off-duty police officers and constables as security guards. He paid the majority of the guards with cash "under the table" and did not file Forms W-2 or withhold social security or federal income taxes. Under the plea agreement, O'Shea admitted to evading $230,000 in employee income tax payments from 1997-1998.

Office Manager Failed to Pay Over to IRS $125,217 in Payroll Taxes

On November 6, 2002, in Milwaukee, WI, Stacey L. Deprey was sentenced to 15 months in prison for filing a false personal income tax return and for failing to pay over $125,217 in employment taxes to the IRS. Deprey was also ordered to serve three years supervised release. According to court records, from December 1995 to May 1998, Deprey was employed as the office manager at The Comfort Company, and was responsible for all accounting duties for the business including signature authority for the corporate checking account. From January 1997 through about March 1998, Deprey paid wages to employees of The Comfort Company, withholding payroll taxes totaling approximately $125,217. Despite withholding taxes from those wages, Deprey failed to pay over any of these payroll taxes and did not file the appropriate quarterly payroll tax returns to the IRS. Furthermore, Deprey embezzled a portion of these funds for her own personal gain. Deprey pled guilty to failing to account and pay over payroll taxes of $25,935 for the third quarter of 1997 and to filing a false personal federal income tax return for 1997.

Doctor Sentenced for Tax Evasion

On November 1, 2002, in Reno, NV, Dr. Elliot Schmerler was sentenced to 15 months in prison, three years supervised release, and fined $15,000 for his guilty plea to tax evasion for the year 1995. Schmerler pled guilty on April 15, 2002. According to the plea agreement, during 1997 and 1998, Dr. Schmerler failed to pay over to the IRS more than $26,000 in federal employment taxes, consisting of income, social security, and Medicare taxes withheld from employees' salaries and related employer payroll and unemployment taxes. In addition, from 1994 through 1998, Schmerler used his medical practice, Lakeview Medical Associates, and a Bahamian corporation he controlled, to pay more than $500,000 in personal expenses, which he did not report on his tax returns.

Travel Advances and Bonuses Used to Disguise Salaries

On April 3, 2002, in Columbia, SC, Charles S. Porter, III, and his corporation, Southern Architectural Woodwork, Inc., pled guilty to income tax evasion. During the years 1995-1997, Porter, as the president and sole shareholder of Southern Architectural Woodwork, used various schemes to evade paying employment taxes, primarily social security and Medicaid withholdings on its employees. One scheme reduced employees' salaries and replaced the compensation with "per diem" or "travel advance" payments, so no taxes would be withheld or paid. Another scheme involved disguising salaries as "bonuses" and providing items to employees such as computers and home repairs instead of paying salaries. The total employment tax loss was over $61,000.

For more summaries, visit www.irs.gov and enter IRS Keyword Fraud.