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**Hearing On**

***Payroll Tax Abuse: Businesses Owe Billions  
And What Needs To Be Done About It***

**July 29, 2008**

Good morning and welcome to today's hearing. This morning, we turn to a problem that should be deeply troubling to every hardworking American taxpayer – the fact that more than one million businesses are cheating on their payroll taxes to the tune of \$58 billion. What's even worse, the problem appears to be growing by leaps and bounds.

Payroll taxes are a central part of our tax system. Basically, employers withhold taxes from their employees' paychecks and are required to forward that money to the IRS. These funds include income taxes, as well as other taxes that go directly to fund Social Security and Medicare. The employers are integral to this process because they handle these tax-dollars in trust for their employees.

According to the new GAO study, however, more than 1.6 million of those businesses are breaching that trust and are simply keeping their employees' taxes. Over the past ten years, those businesses have failed to pay a whopping \$58 billion of their employees' payroll taxes.

But these deadbeats aren't just breaching their employees' trust; they are also shortchanging honest American taxpayers. By cheating on their taxes, they are forcing even more weight on the sagging shoulders of hardworking Americans. This is no theoretical exercise: every year, as a direct result of unpaid payroll taxes, the government must transfer up to \$4 billion in taxes to fund Medicare and Social Security. The IRS estimates that, over the past ten years, 44 billion dollars have been transferred from general tax revenues to Social Security and Medicare.

That's billions upon billions of dollars taken from honest Americans that could be invested in crucial areas like healthcare, homeland security, and education, or – better yet – left in their pockets. Because of these deadbeats, those billions of tax-dollars must be used to cover shortfalls in other important programs because of widespread payroll tax abuse.

The effects of this misconduct go far beyond taxes. Not only are these tax-cheats shifting the tax burden onto honest Americans, they are also gaining an unfair advantage over honest businesses. By not paying these taxes, their costs are substantially lower than their law-abiding competitors. GAO cites a couple of case studies in which the tax-cheats won contracts because they could underbid their competitors and use the stolen payroll taxes to offset the losses.

As if that weren't enough, these tax-cheats use their employees' payroll taxes to lead lavish lifestyles. Some of the egregious cases should make your blood boil – we have cases in which business owners failed to pay payroll taxes, while purchasing luxury cars, planes, mansions, and properties in tropical islands and other far-flung countries. In several case studies, the owners made massive cash withdrawals from the business's accounts, pocketing \$20,000, \$50,000, and even hundreds of thousands of dollars in cash. It is clear that these tax-cheats are living the high life at the expense of hardworking American taxpayers.

The report identifies case after case in which the businesses owe millions upon millions in payroll taxes. Even worse, these tax-cheats appear to be stringing the IRS along, refusing to submit their taxes for eight, nine, and even ten years. Some play a shell game to avoid paying their taxes, moving money between multiple entities, shifting assets to family members, and even claiming bankruptcy to avoid their obligations.

Let's step back and put this in perspective: our tax gap, which is the difference between the taxes that are owed and the amount that is actually paid, approaches \$300 billion. And that actually understates the magnitude of the problem, as it does not include unreported income or underpaid taxes. Unpaid payroll taxes are the single largest business component of that gap, making up more than 20 percent of the tax gap by itself. To make matters worse, the problem is growing and growing – over the past few years, the amount of unpaid payroll taxes has increased just under 20 percent.

While the problem is expanding, our ability to address the problem is shrinking. The IRS's backlog of payroll tax cases dwarfs the number of cases actually being pursued. As cases languish in the backlog and the statutes of limitations expire, billions of dollars in unpaid payroll taxes are written off every year. More than \$4 billion in unpaid tax debt will be completely written off this year alone. By 2012, the write-off of unpaid tax debt is expected to reach \$5 billion each year, and within a couple of years, the write-offs will grow another 20 percent to \$6 billion every year.

What is clear is that we have a problem and we have to fix it now. In short, we have a \$58 billion problem, the problem is getting worse, and the government's efforts to fix the problem are not getting the job done.

So how do we move forward? The report identifies a number of concerns with the IRS's current collection procedures and offers numerous recommendations to improve its enforcement regime. If we are going to make any inroads in collecting unpaid payroll taxes, we have to consider substantial changes to IRS's collection policies and procedures.

One specific concern is that, when it has dealt with scofflaws and egregious cases, the IRS may have over-emphasized getting taxpayers to comply with the law voluntarily. Getting voluntary compliance is certainly a desirable goal, and it would appear to be the right strategy in most circumstances.

But GAO cites examples in which the tax-cheats are simply stringing the IRS along for years and years, even though they show no inclination to comply voluntarily. In those egregious, beyond-the-pale cases, the time for talk and voluntary compliance has passed; it is time for action.

The report is chock full of case studies in which the IRS revenue officers appear to treat the worst-of-the-worst with kid gloves. Perhaps we should reconsider the broad discretion given to those revenue officers when dealing with the worst tax-cheats and encourage the use of more stringent enforcement tools for those extreme cases. As a former prosecutor, I know the threat of prosecution and aggressive enforcement are powerful deterrents. I call on the IRS to ratchet up its efforts to recover these billions in back-taxes and hold these tax-cheats accountable.

The good news is that there is hope. The states have been developing creative and effective mechanisms for collecting taxes, such as identifying tax cheats on the internet. The IRS has also acknowledged the problem and has indicated a positive attitude and a willingness to take necessary steps to address these issues.

I look forward to exploring these issues with our witnesses today.

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