

# Payroll Tax Evasion Notice Suggests FinCEN's New Focus

By **Andrew Weiner and Jay Nanavati** (September 6, 2023)

On Aug. 15, the Financial Crimes Enforcement Network within the U.S. Department of the Treasury issued Notice FIN-2023-NTC1 to advise U.S. financial institutions of the need to report payroll tax evasion and workers' compensation fraud involving shell companies prevalent in the construction industry.

While FinCEN's role safeguarding and increasing domestic and international financial transparency often overlaps with tax enforcement priorities, FinCEN does not generally issue notices on tax evasion. The release of Notice FIN-2023-NTC1 raises questions about whether FinCEN is taking an increased interest in tax enforcement and plans to work more closely with the Internal Revenue Service on these issues.

Given FinCEN's existing portfolio and budgetary constraints, that remains to be seen, but the notice clearly demonstrates that employment tax violations remain a top priority and foreshadows increased enforcement in the construction industry.

## FinCEN

FinCEN was created in 1990 to maintain and analyze data reported by financial institutions pursuant to the Financial Record Keeping and Reporting of Currency and Foreign Transactions Act, or Bank Secrecy Act, and to support law enforcement efforts targeting financial crimes.

According to its website, FinCEN's stated mission "is to safeguard the financial system from illicit use, combat money laundering and its related crimes including terrorism, and promote national security through the strategic use of financial authorities and the collection, analysis, and dissemination of financial intelligence."

In addition, over the past decade, FinCEN's role in federal tax enforcement has increased substantially.

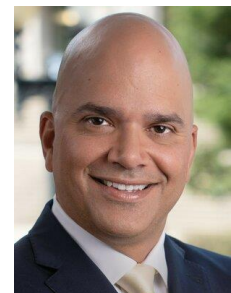
The Foreign Account Tax Compliance Act, or FATCA, enacted in 2010, generally requires that foreign financial institutions and certain foreign entities report information related to foreign assets held by U.S. persons. Information received pursuant to FATCA has been collected, reviewed and utilized by the IRS, pursuant to delegation from FinCEN, to pursue substantial penalties against U.S. persons with undisclosed foreign financial accounts, and by U.S. law enforcement agencies to identify and investigate financial crimes involving foreign financial assets and transactions.

FinCEN is poised to play a further role in tax enforcement through implementation of the Corporate Transparency Act, which takes effect Jan. 1, 2024, and requires disclosure of beneficial ownership information to curb the practice of hiding behind the corporate form for illicit purposes including tax evasion.

## The Notice



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Like the Corporate Transparency Act, Notice FIN-2023-NTC1 targets the use of shell companies. The notice stands out, however, for its focus on domestic payroll tax evasion.

At issue are transactions involving a shell company that purports to be a legitimate construction contractor. The shell company obtains a workers' compensation insurance policy for a minimal number of workers, resulting in very low premiums. Having a workers' compensation policy allows the shell company to obtain a business license.

The shell company then rents its business license to a construction contractor with numerous employees. This allows the construction contractor to falsely represent that it is properly licensed and maintains workers' compensation insurance on its many employees.

In contrast, a compliant construction contractor with a similarly large number of employees would have to take out a much larger and more expensive workers' compensation policy. Of course, the noncompliant construction contractor's rent payments to the shell company are far lower than the premiums that a compliant construction contractor would have to pay.

The shell company typically ceases doing business just before an annual workers' compensation audit one year into the policy, a new shell company is formed, and the cycle begins anew.

To avoid payroll taxes, a construction contractor writes checks to a shell company, which uses the funds to pay the contractor's workers or returns the funds to the contractor in cash, which the contractor then uses to pay its workers off the books. According to FinCEN, these schemes cost state and federal tax authorities hundreds of millions of dollars and put legitimate construction businesses at a competitive disadvantage.

In collaboration with the IRS' Criminal Investigation division, or IRS-CI, and the U.S. Department of Homeland Security's Homeland Security Investigations division, FinCEN identifies red flags to assist financial institutions in detecting, preventing and reporting these flavors of payroll tax evasion and workers' compensation fraud.

The notice seeks to leverage existing information-gathering tools, most notably, the requirement to file a suspicious activity report, or SAR, if a financial institution knows or suspects a transaction lacks an apparent lawful purpose or is intended to facilitate criminal activity.

The notice further encourages information sharing among financial institutions. While the reporting obligations of financial institutions are nothing new, FinCEN is raising awareness of schemes within the construction industry to elicit information through these channels.

IRS-CI's most recent annual report states that "upwards of 200 special agents and investigative analysts" work on SAR review teams and financial crimes task forces to combat nontax crimes. FinCEN and IRS-CI are bringing the same approach to identifying and investigating payroll tax evasion.

The IRS and the U.S. Department of Justice have long treated payroll tax evasion as a top enforcement priority and are aggressive in pursuit of civil examinations, injunctions, and criminal investigations and prosecutions.[1] With the issuance of Notice FIN-2023-NTC1, FinCEN and IRS-CI signal a creative and collaborative approach to this continuing problem.

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[1] News Release, Internal Revenue Service, IR-2019-71, IRS highlights importance of payroll tax compliance in two-week campaign focused on legal actions, education visits (April 11, 2019), available at <https://www.irs.gov/newsroom/irs-highlights-importance-of-payroll-tax-compliance-in-two-week-campaign-focused-on-legal-actions-education-visits>. U.S. Department of Justice, Tax Division, Programs & Initiatives: Employment Tax Enforcement (updated Apr. 12, 2023), available at <https://www.justice.gov/tax/employment-tax-enforcement-0#:~>.