

Dealing with the Undocumented Worker

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Why do immigrants without status pay taxes?

- Obligated by law
- Opportunity to contribute
- Document compliance and residency

Taxpayer Basics

Type of Taxes

- Federal – Income, FICA
- State – Sales
- Local – County, City

Tax ID Number

- Social Security Number
- Individual Tax Identification Number (ITIN)

Immigration, Employment and Tax Laws

Policy tensions:

- IRS interest in enforcing IRC and tax laws
- Confidentiality rules protect against immigration enforcement
- IRC § 6103 prohibits IRS disclosure of taxpayer information (but exceptions apply)
- Policy tensions exist (TIGTA vs. IRS Commissioner and National Taxpayer Advocate)

Benefits of the ITIN

- Facilitate compliance
- Ensure all workers report income and pay taxes.
- Ensure all workers receive tax benefits.
- Support immigration petitions/applications

Social Security Numbers vs. ITINs

Tax Credits:

- SSN and ITIN holders *generally* subject to same rules, deductions and credits
- IRC dictates refundable tax credit eligibility requirements
- Refundable tax credits are not “federal public benefits”
- Welfare reform amended Earned Income Tax Credit eligibility to render ITIN holders ineligible
- ITIN holders are still eligible for the Child Tax Credit (CTC) and the Additional Child Tax Credit (ACTC)

Earned Income Tax Credit

- Refundable credit available to eligible individuals who meet the income requirements and other statutory requirements.
- The individual cannot be a nonresident alien in the year the credit is claimed.

Earned Income Tax Credit, cont

- Only a social security number can be used on the form to claim the credit. The credit is not available to individuals who file tax returns with an ITIN.
- IRS Position – Only individuals *authorized* to work in the U.S. should benefit from the EITC.

Qualifying Child Credit

- A taxpayer can claim a \$1,000 credit against taxes owed for each *qualifying child* for which a dependency exemption has been claimed.
- The qualifying child must be a citizen, national or resident of the United States.

Hope and Lifetime Learning Credits

- Credit available for certain taxpayers enrolled in higher education programs.
- Nonresident aliens must elect to be taxed as resident aliens in order to claim either credit.

Dependency Exemption

- Taxpayers can claim exemptions against adjusted gross income for themselves, their spouses and dependents. In 2019, the amount of each exemption is \$4,200.
- Dependent is a qualifying child or a qualifying relative.

Dependency Exemption, cont.

- A dependent includes only an individual who is a citizen, resident or national of the United States. It also includes a resident of a country contiguous to the United States.

Affordable Care Act

- Coverage for health benefits is available only to individuals who are citizens, nationals or lawfully present in the U.S.

Affordable Care Act

- ACA raises new issues for undocumented workers.

Compliance Requirements for Undocumented Workers

- Tax compliance casts a favorable light on an individual seeking a discretionary U.S. immigration benefit.

Undocumented Aliens

- Undocumented resident aliens who receive income from performing dependent personal services are subject to the same reporting and withholding obligations which apply to U.S. citizens receiving the same kind of income.
- IRS has said it is not the U.S. Department of Homeland Security. It believes that filing returns is a potential pathway to citizenship.

Compliance Requirements for

- Return filing requirements:
 - Resident aliens must report their worldwide income.
 - Nonresident aliens must report their income effectively connected with the U.S. and their U.S. sourced income.

Individual Taxpayer Identification

- Individuals who do not have or are not eligible for a social security number must apply for an ITIN.
- The application is made on IRS Form W-7 and requires approximately 6 to 10 weeks for processing.

Individual Taxpayer Identification

- Applications must include documentation to prove foreign status and identity.
- Documents include original passports, USCIS photo ID, U.S. driver's license, visa issued by the U.S., foreign military ID, birth certificate, medical records, birth records, etc.

ITIN Issues

- IRS requires original and/or certified copies of documents used to support information on Form W-7
- Taxpayers cannot use certifying acceptance agents to submit documents to apply for an ITIN.

More ITIN Issues

- New procedures increase the processing time for applications;
- The original document requirement affects the ability of students and business travelers to comply with visa time limits;
- New procedures impose high burdens on taxpayers who are required to obtain original or certified copies from foreign government agencies.

Taxpayer Identification Number

- Social Security Number: An individual can apply for a social security number if the individual has been lawfully admitted to the U.S. for permanent residence or has an immigration visa that authorizes the individual to work in the U.S.
- An applicant should file Form SS-5 with the Social Security Administration.

Taxpayer Identification Number

- IRS guidance provides:
 - “If the individual has used someone else’s SSN to obtain employment, that SSN should be reflected on the Form W-2 the employer issues to that individual. So long as the individual uses his or her ITIN to properly report the wages that are reflected on the Form W-2 and pay the tax associated with that income, the individual has not violated the internal revenue laws.”
 - Chief Counsel Memorandum POSTN-122111-10 (June 21, 2010).

Taxpayer Identification Number

- The same guidance further provides that the individual who provides the employer with false identification documents to obtain employment has violated 18 U.S.C. §1028(a)(1).

Deportable Offenses

- Any alien present in the U.S. in violation of immigration laws or *any other laws of the United States*, is deportable.
8 USC § 1227(a)(1)(B).

Deportable Offenses, cont.

- **Falsely Claiming Citizenship.** Any alien who presents or represents himself to be a U.S. citizen for the purpose of benefitting under any Federal or State law is deportable. 8 USC § 1227(a)(3)(D)(i).

Deportable Offenses, cont.

- An individual who presents false documents, including Form I-9 for the purpose of securing employment with a private employer is deportable. See e.g. Ferrans v. Holder, 612 F.3d 528 (6th Cir. 2010).

Cancellation of Removal

- The Attorney General can cancel the removal of a deportable alien when:
 - The alien has been physically in the U.S. for at least 10 years continually;
 - The alien has been a person of *good moral character* during that time;
 - The alien has not been convicted of certain offenses; and
 - The alien demonstrates that removal would result in an exceptional and extremely unusual hardship to himself, his spouse, parent or child who is a citizen of the U.S., 8 USC § 1229b(b)(1).

Good Moral Character

- Failure to file true and accurate income tax returns can suggest that an individual lacks the good moral character that is needed to qualify for cancellation of removal.

Good Moral Character

- The consistent filing of income tax returns is a positive factor considered when determining whether an individual has good moral character. See e.g. Dominguez-Capistran v. Gonzales, 413 F.3d 808 (8th Cir. 2005).

Naturalization

- An individual can apply to become a U.S. citizen when:
 - The individual was lawfully admitted for permanent residence;
 - The individual has been physically present in the U.S. for at least 5 years and during the five immediately preceding years the individual was present in the U.S. for at least half that time;

Naturalization, cont.

- The individual has resided in the State in which the application was filed for at least three months;
- The individual has resided continuously within the U.S. from the date the application was filed through the time of admission for citizenship; and
- During these periods the individual has been and still is a person of *good moral character*.

Naturalization (cont.)

- Applicants are frequently asked to show proof of tax filings for previous years in the U.S.
- Prudent practitioner should provide evidence of tax compliance for all years where the applicant has worked in the U.S.

Naturalization (cont.)

- Where there is tax due after returns are filed, immigration judges want to see that the taxpayer has entered into a formal agreement with the IRS to pay back taxes.

Scenario 1

- Undocumented worker who earned income comes in to your office. He does not have a social security number.
- **First question**: Is this taxpayer a U.S. resident for U.S. income tax purposes?

Residency

Resident

- U.S. Citizen
- “Green Card” – alien registration card for a lawful, permanent resident
- Substantial Presence – physically present in the country for a period of time.

Non-Resident

- Not a U.S. citizen
- Does not have a Green Card
- Does not have Substantial Presence

Nonresident Taxpayer

- When Required to File
 - Engaged in a trade or business in the U.S. during the year
 - Exception – if income is wages and the amount is less than the personal exemption amount. 2019 = \$4,200
- When Not Required to File – Reasons to File
 - Refund or Credit

Resident Taxpayer

- When Required to File
 - Receive income for a specific amount
 - Factors include:
 - Age
 - Filing Status (marital)
 - Type of Income
- When Not Required to File – Reasons to File
 - Record Work History
 - Refund or Credit

Scenario 1 (cont.)

- **Second Question**: What is this taxpayer's taxable income for the year(s) before me?
- Does the taxpayer have to report and pay self-employment tax?

Taxable Income

Earned Income

- Wages, salaries, tips, and other taxable employee pay
- Union strike benefits
- Long term disability benefits received prior to minimum retirement age
- Net earnings from self-employment if (1) you own or operate a business or a farm, (2) you are a minister or member of a religious order, or (3) you are a statutory employee and have income.

Not Earned Income

- Interest and Dividends
- Retirement Income
- Social Security
- Unemployment Benefits
- Rental Income
- Alimony
- Child Support
- Prizes
- Bartering

Not Taxable Income

- Health Insurance Benefits
- Health Savings Account
 - Contributions by Employer
 - Distributions to pay qualified medical expenses.
- Gifts.
 - Gift Tax. There is a gift tax for any amount above the annual exclusion to a single person. The person who receives that gift is not responsible for the tax. The person who gives the gift is responsible. In addition to the annual exclusion, there is also a lifetime exclusion.
- Life Insurance Proceeds.

2019 Income (No One Can Claim You as Dependent)

Filing Status	Age	Gross Income
Single	Under 65	\$12,000
Single	65 or older	\$13,600
Married Filing Jointly	Under 65 (both spouses)	\$24,000
Married Filing Jointly	65 or older (one spouse)	\$25,300
Married Filing Jointly	65 or older (both spouses)	\$26,600
Married Filing Separately	Any	\$5
Head of Household	Under 65	\$18,000
Head of Household	65 or older	\$19,600
Qualifying Widow(er)	Under 65	\$24,000
Qualifying Widow(er)	65 or older	\$25,300

Non-resident Alien Spouse

- Can choose to treat as a U.S. resident:
 - File declaration of non-resident alien spouse for first year choice applies
 - File joint return
 - Each spouse must report his/her entire worldwide income
 - Treat as residents for all years choice in effect
- May still be treated as non-resident alien for purposes of withholding FICA tax

Ending Joint Filing with Alien Spouse

- Must suspend choice to file jointly:
 - Revocation by either spouse
 - Death of either spouse
 - Legal separation
 - Inadequate records
- Cannot choose to file jointly in any later year after revocation
- If choose not to treat as resident, possible for resident/citizen spouse to file as Head of Household (if responsible for more than half)

Scenario 1 (cont.)

- The next step is to file true and accurate tax returns.
- Since the taxpayer does not have a SSN, you must apply for an ITIN by filing Form W-7.

Employment Considerations

- Employment Status Verification
 - Employers must file Form I-9 to verify that employees are authorized to work in the U.S. The Form requires the employee to submit a valid social security number.

Employment Considerations

- Employees must be:
 - Citizens
 - Non-citizen nationals (American Samoa)
 - Lawful permanent residents; or
 - Aliens authorized to work in the U.S.

- U.S. Citizens;
- Permanent Residents;
- Temporary Workers with E visas;
- Specialized Workers with H visas;
- Temporary professionals from Mexico or Canada with TN visa;
- Skilled workers with permanent work EB visa;
- Individuals with student visas who receive proper authorization from the school being attended;
- Temporary visitors for business.

Employment Considerations Employer Responsibilities

- Civil Penalties
 - Employers who fail to comply with these requirements face the following civil penalties:

Civil Penalties

Civil Violations	First Offense	Second Offense	Third Offense
Knowingly hiring or continuing to employ an individual not authorized to work in the U.S.	\$539 per worker; maximum of \$4,343 per worker.	\$4,313 per worker; maximum of \$10,781 per worker.	\$6,469 per worker; maximum of \$21,563 per worker
Failure to comply with Form I-9 requirements	\$216 per form; maximum of \$2,165 per form.	\$216 per form; maximum of \$2,165 per form.	\$216 per form; maximum of \$2,165 per form.

Civil Penalties

Civil Violations	First Offense	Second Offense	Third Offense
Committing or participating in document fraud	\$445 per worker; maximum of \$3,563 per worker.	\$3,563 per worker; maximum of \$8,908 per worker.	\$3,563 per worker; maximum of \$8,908 per worker.
Committing document abuse	\$178 per form; maximum of \$1,782 per form.	\$178 per form; maximum of \$1,782 per form.	\$178 per form; maximum of \$1,782 per form.

Civil Penalties

Civil Violations	First Offense	Second Offense	Third Offense
Unlawful discrimination against an individual authorized to work in the U.S.	\$445 per worker; maximum of \$3,563 per worker.	\$3,563 per worker; maximum of \$8,908 per worker.	\$5,345 per worker; maximum of \$17,816 per worker
Failing to notify DHS of a Final Non-confirmation (FNC) of an employee's employment eligibility	\$751 per violation; maximum of \$1,502 per violation	\$751 per violation; maximum of \$1,502 per violation.	\$751 per violation; maximum of \$1,502 per violation.
Asking for a money guarantee that the employee can work in the U.S., i.e., an indemnity bond	\$2,156 per indemnity bond and a full refund of the bond amount. If employee cannot be found, the refund must be paid to the U.S. Treasury.		

Criminal Penalties

Criminal Violations	First Offense	Second Offense	Third Offense
Engaging in the practice of hiring, recruiting or referring for a fee unauthorized workers.	Up to \$3,000 for each unauthorized worker; up to 6 months in prison.	Up to \$3,000 for each unauthorized worker; up to 6 months in prison.	Up to \$3,000 for each unauthorized worker; up to 6 months in prison.

Employment Considerations

Employer Responsibilities

- Ketchikan Drywall Services, Inc.: Paid \$173,250 fine for failure to comply with Form I-9 requirements. KDS did not retain unauthorized employees.
- Most DOJ cases involve investigations of alleged violations of the anti-discrimination policies. Penalties include monetary fines, required training and monitoring.

Employee vs. Independent Contractor

- General Rule = Key Factor is Right to Control the Details
 - Independent Contractor = if the payer has the right to control or direct only the result of the work, and not what will be done and how it will be done.
 - Employee = if the payer has the right to control the work with what will be done and how it will be done. This applies even if the worker is given freedom of action.
- Common Law Rules
 - Behavioral. Does the payer control or have the right to control what the worker does and how the worker does his or her job?
 - Financial. Are the business aspects of the worker's job controlled by the payer? Examples: how worker is paid, reimbursed expenses, provider of tools and equipment.
 - Types of Relationship. Are there written contracts or employee type benefits (retirement, insurance, vacation)? Will the relationship continue and is the work performed a key aspect of the business.
- IRS can make a determination – IRS Form SS-8

Taxes - Income

Employee

- Payroll Withholding – Amount based
 - (1) the amount your earn
 - (2) the information you provide on Form W-4, including marital status, how many withholding allowances you claim (each allowance reduces the amount withheld) and whether you want additional amount withheld

Independent Contractor

- Estimated Taxes – Required when owe tax of \$1,000 or more.
- Quarterly payments

Taxes – FICA

- FICA – Federal Insurance Contributions Act – payroll tax imposed on employers and employees to fund Social Security and Medicare.
- Social Security.
 - Rate: 6.2% for each employer and employee for a total of 12.4%
 - Wage Base Limit: \$117,000
- Medicare.
 - Rate: 1.45% for each employer and employee for a total of 2.9%
 - Additional Medicare Tax: 0.9% for wages in excess of \$200,000 for employee only
 - Wage Base Limit: None
- Independent Contractor. Responsible for both employer and employee.

Employee Withholding

- Employers must file Form W-2 with the Social Security Administration for every employee who has income, Social Security or Medicare taxes withheld.
- The employer must verify his/her social security number.

Employee Withholding

- IRS encourages employers to obtain a copy of an employee's social security card to verify employment status.
- A taxpayer ITIN cannot be used in lieu of a social security number. The ITIN does not verify that the employee is authorized to work in the U.S.

Employer-Employee Mismatch

- Social Security Administration (SSA) notifies employers with “Code V” mismatch letter when more than 10 SSNs/ITINs do not match SSA records, and names representing more that 0.5% of Forms W-2.
- Employer has 60 days to respond with correction.
- Raises fears of sanctions from Immigration and Customs Enforcement (ICE)—particularly if employer discovers lack of documentation in process of correcting.
- Defense: Reasonable Cause

Showing Reasonable Cause

- Employer can show reasonable cause for mismatch on W-2 if:
 - It can show initial solicitation of new employee's ITIN; and
 - Up to two additional annual solicitations of employee after it received an IRS penalty notice.

Showing Reasonable Cause, Step-by-Step

- Solicit new employee for correct ITIN via IRS Form W-4, Employee's Withholding Allowance Certificate.
 - Once received, employer has satisfied duty to solicit employee
- If notice of mismatch arrives, employer may seek a waiver by showing it initially solicited employee's ITIN, then used what employee provided (send W-4)
 - Re-solicit ITIN if IRS sends penalty notice for incorrect ITIN, and again if second penalty notice arrives.
 - After two re-solicitations, no need to solicit further.

Suing the Dishonest Employer, cont.

- Civil damages range from \$5,000 minimum to the sum of actual damages directly resulting from the fraudulent filing, plus the costs to bring the action, and “in the court’s discretion, reasonable attorneys’ fees.” IRC § 7434(b).
 - Worker may not seek punitive damages. *Pitcher v. Waldman*, 110 A.F.T.R.2d 2012-6437 (S.D. Ohio Oct. 23, 2012).

Winning a Section 7434 Claim

- To win a Section 7434 claim, worker must prove by “clear and convincing evidence”:
 - the employer issued an information return;
 - the information return was fraudulent; and
 - the employer willfully issued the fraudulent return.

Seijo v. Casa Salsa, 2013 WL 6184969 at *7 (S.D.Fla. 2013)

“Willfulness” Defined

- “Willful” requires “proof of deceitfulness or bad faith in connection with filing an information return.” *Cavoto v. Hayes*, 106 A.F.T.R.2d 2010-5140 (N.D. Ill. July 1, 2010)
- A mere “error or mistake” in filing an information return does not establish fraud. *Pitcher*, 110 A.F.T.R.2d 2012-6437; *Jacobs v. Ocwen Fed. Bank, FSB*, 311 F. Supp. 2d 766, 769 (N.D. Ind. 2004).
 - *Katzman v. Essex Waterfront Owners LLC*, 660 F.3d 565, 566 (2d Cir. 2011) (a mere failure to file return without evidence of willfulness is not fraudulent)
- Absence of good-faith belief that the correct return was filed or that correct payments were made is evidence of willfulness. *Shiner v. Turnoy*, 114 A.F.T.R.2d 2014-5179 (N.D. Ill. July 11, 2014).

Bringing a Section 7434 Claim

- Statute of limitations: 6 years from the date the fraudulent return was filed, or 1 year after the date the “fraudulent information return would have been discovered by exercise of reasonable care.” IRC § 7434(c).
- IRS must receive a copy of the complaint. IRC § 7434(d).
- When the court awards damages, it must provide a finding of the correct amount of tax that should have been reported. IRC § 7434(e).

What Are Trust Funds?

- Trust funds are the 7.65% of the Social Security and Medicare tax withheld from an employee's pay and any income tax withheld from the employee's pay.

Trust Fund Recovery Penalties - IRC 6672

- IRC § 6672 allows the IRS to recover “trust funds” withheld from an employee’s pay from “any person required to collect, truthfully account for, and pay over any tax imposed” and “who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof.”
- The employer is deemed to be holding these funds in trust for the U.S. Government.
- The penalty is referred to as a “100% penalty” which means that the entire amount can be recovered against anybody determined to be a “responsible person” who willfully fails to collect and pay over such tax.

Two Elements of IRC § 6672

- Any and all of the following may be found to be a “responsible person.”
 - Sole Proprietors
 - Partners
 - Bookkeepers
 - Accounting firms
 - Parent companies
 - Lenders/Creditors
 - Purchasing companies

Who is a responsible person?

- The term “responsible person” is broad, encompassing anyone responsible for collecting, for accounting and paying over taxes to the government.
- Focus is on degree of control that employee or shareholder had over company’s affairs and who had the ability to decide who gets paid when.
- Responsibility is a matter of status, duty, and authority.
- The test is a functional one.

Willfulness

- Though an individual may have failed to collect and pay over trust fund taxes, he or she will not be deemed a responsible person unless the IRS can show the failure to collect and pay over the trust funds was willful.
- The IRS' view is that willfulness exists where “money withheld from employees as taxes, in lieu of being paid over to the Government, was knowingly and intentionally used to pay the operating expenses of the business, or for other purposes.” Revenue Ruling 54-158.
- The fact that there are insufficient funds to pay both employees and taxes is not a defense.

Tax-Exempt Organizations

- No trust fund penalty liability if:
 - Unpaid, volunteer member of any board of trustees or directors of an organization;
 - Serves in an honorary capacity;
 - Does not participate in the day-to-day or the financial operations of the organization; and
 - Does not know of the organization's failure to remit the trust fund taxes.
- IRC § 6672(e)

Joint and Several Liability

- Anyone responsible is jointly and severally liable for the tax.
- Each responsible taxpayer has a right of contribution from the other responsible parties. IRC § 6672(d).
- IRC § 6103(e)(9) allows the IRS to disclose to anyone determined to be a responsible person who else is responsible, what collection action was taken and how much the IRS collected.
- There is no requirement to collect from the employer first!

Refund Claim for Trust Fund Penalties

- A taxpayer is generally required to pay the full amount of tax assessed for the period before filing a refund claim or initiating a refund suit.
 - Employment taxes and the trust fund recovery penalty are “divisible” taxes and therefore, not subject to the full payment rule. *See* IRC § 6331(i)(2).
 - A refund claim can be made after payment of the portion of a trust fund recovery penalty that equals the amount due for a single employee for the period at issue.

Pre-Sale of Business Due Diligence

Thank you, Frank Agostino!

- We would like to extend a big thanks to Frank Agostino, Esq. of Agostino & Associates, PC, Hackensack, NJ, for creating many of the slides on which this presentation is based.