

Dealing with Undocumented Workers

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Businesses with Undocumented Workers

- Restaurants
- Construction Companies
- Landscape Contractors
- Generally, manual labor/service industry jobs

How do Cases Typically Arise with IRS?

- Employer audits
- Check cashers
- SSN mismatches

Immigration, Employment & Taxes

- Undocumented resident aliens who receive income from performing personal services are subject to the same tax reporting and withholding obligations as U.S. citizens and legal residents
- IRS enforces tax laws, not immigration laws
- IRC § 6103 prohibits IRS disclosure of taxpayer information for immigration enforcement (but exceptions apply)

Employment Requirements

- Employees must be:
 - Citizens
 - Non-citizen nationals (e.g., American Samoa)
 - Lawful permanent residents; or
 - Aliens authorized to work in the U.S. (e.g., temporary or skilled workers with certain visas)

Employer Must Verify & Withhold

- 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.
 - Employers must file Form W-2 with the Social Security Administration for every *employee* who has income, Social Security or Medicare taxes withheld

Employer Due Diligence

- 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.

Civil Penalties for Employment Violations

- Civil Penalties*
 - Employers who employ undocumented workers and fail to follow I-9 rules face civil penalties. 8 CFR 274a.10
 - \$583-\$4667 for first offense per unauthorized alien, up to \$6999 - \$23,331 for third offense per unauthorized alien
 - \$234-\$2332 for I-9 violations

* Per OMB Memorandum M-20-05, Implementation of Penalty Inflation Adjustments for 2020, Pursuant to the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015, Dec. 16, 2019

IRS Guidance on ITIN for Returns + SSN for Work

- 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)

Individual Taxpayer Identification Numbers

- 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; processing times are very long currently (in the past 6 to 10 weeks).

Social Security Numbers vs. ITINs

- SSN and ITIN holders *generally* subject to same rules, deductions, and credits
- ITIN holders are NOT eligible for Earned Income Tax Credit
- ITIN holders are eligible for the Child Tax Credit (CTC) and the Additional Child Tax Credit (ACTC) for child with SSN
- ITIN holders eligible for Other Dependent Credit

Benefits of the ITIN

- Facilitates tax compliance
- Ensures all workers report income and pay taxes
- Ensures all workers receive tax benefits
- Supports immigration petitions/applications
 - Tax compliance shows “good moral character” required for green card and citizenship applications

Providing False ID for Employment is a Crime

- An 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)
- 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).
- 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)

Is Employer Liable for Worker with Fake SSN?

- Mistake, deliberate ignorance or a pattern?

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 than 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, and again if second penalty notice arrives.
- After two re-solicitations, no need to solicit further.

Steps for Employer upon Learning of Investigation

- Should the employer fire all undocumented workers?
 - Potential Department of Labor implications
 - Discrimination based on national origin
- How should an employer proceed?
- Potential for ICE raid?

Voluntary Disclosure?

- What if employer is not yet under investigation?
- Voluntary disclosure is more complex in payroll tax cases
 - Consider assessment statute vs. potential criminal tax and immigration violations

Misclassification: 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, when 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 business aspects of the worker's job controlled by the payer? Examples: how worker is paid, reimbursed expenses, provider of tools and equipment.
- IRS can make a determination – IRS Form SS-8

Taxes - Income

Employee

- Payroll Withholding – Amount based
 - (1) the amount you 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 part of taxes.

Suing the Dishonest Employer under Section 7434

- 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)

Proving a Section 7434 Claim

- To succeed on 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. Case Salsa, 2013 WL 6184969 at *7 (S.D.Fla. 2013)

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. IRS § 7434(d).
- When the court awards damages, it must provide a finding of the correct amount of tax that should have been reported. IRS § 7434(e).

“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 2012-6434; *Jacobs v. Ocwen Fed. Bank*, FSB 311 F. Supp.2d 766, 769 (N.D. Ind. 20044).
 - *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).

Questions?

