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Tax Surprises Can Follow When Payroll Firms Implode

By ANGUS LOTEN



Stephen Voss for The Wall Street Journal

'It's just such a terrible feeling,' says Kerry Koletar, shown at her family's Baltimore flower shop, which might be left on the hook for unpaid taxes.

An estimated four in 10 business owners farm out management of their payrolls. But many, including Kerry Koletar of Baltimore, are coming face to face with a downside of that strategy.

The 44-year-old bookkeeper, whose family opened its flower shop five decades ago, figured the Internal Revenue Service had made a mistake when it informed her last year that the business owed \$22,000 in unpaid employment taxes. She says she shrugged it off because the contractor that handled paychecks for the shop's 13 employees had reliably collected and paid the shop's taxes for more than a decade.

But the tax notices kept coming, and in mid-March, the payroll firm, AccuPay of Bel Air, Md., filed for bankruptcy, saying it intended to liquidate. That same month, local police began investigating

AccuPay for possible fraud, and have since handed the case over to the IRS, according to Detective Sgt. Jim Lockard of the Bel Air Police Department.

Ms. Koletar says she fears the shop, which had \$750,000 in revenue last year, might be left on the hook for the unpaid taxes: "It's just such a terrible feeling," she says.

An IRS spokesman says federal law prohibits the agency from "discussing specific taxpayer cases or situations."

James Vidmar, a lawyer for AccuPay, says "no charges have been made or filed" against the firm or its operators, referring to the allegations that it had failed to pay clients' taxes. He says the bankruptcy process will determine if any payments are due to former clients: "It's way too early to say how much those might be," he adds.

AccuPay's bankruptcy filing lists several dozen local businesses as creditors, including the flower shop, veterinarians, dentists and construction firms.

An April survey of 1,500 business owners by the National Small Business Association, a Washington-based trade group, found that roughly 40% of small firms use outside payroll services for tasks ranging from issuing employee paychecks to paying state and federal employee taxes. One in three of the firms pay more than \$500 monthly for those services, and some pay more than \$1,000 a month.

Many business owners, including Ms. Koletar, view third-party payroll management as necessary because they don't have the time to keep up with all the changes in taxes and other laws, and because the requirements are "overwhelming for a business like ours," she adds.

The industry is dominated by a handful of large companies, such as [Automatic Data Processing Inc.](#), [Paychex Inc.](#) and [Intuit Inc.](#), but thousands of smaller payroll services have cropped up in recent years to meet growing demand.

Bankruptcies are relatively rare in the industry because larger firms typically buy the clients from a struggling rival. But bankruptcy isn't the only risk.

In the past five years federal officials have prosecuted at least two dozen mostly small payroll firms that together allegedly pocketed more than \$300 million in taxes from their clients, according to an IRS tally based on public records.

Last week, a 37-year-old woman on New York's Long Island was sentenced to three years in federal prison for her role in a \$20 million employment tax scam at a Hauppauge, N.Y., payroll firm, according to the Federal Bureau of Investigation. In January, the owner of a Boise, Idaho, payroll firm received a four-year sentence for skimming more than \$950,000 from clients' paychecks to pay off his personal credit-card debts, among other expenses, according to the IRS.

That same month a Greensboro, N.C., payroll-firm operator drew a 15-year sentence for tax fraud and other crimes after using \$4 million in stolen tax payments to buy jewelry, the agency says, citing court documents.

Michael Alter, founder and president of SurePayroll, a Chicago-based payroll firm, says that since the recession at least two or three payroll firms a year have been convicted of tax scams. "It's a really sad thing, and it gives our industry a bad name," he says. As the industry grows, he adds, tougher licensing laws are needed to weed out bad actors.

Setting up a new payroll firm generally doesn't require a special license. Moreover, certain types of payroll-service providers, including so-called professional employee organizations, aren't required to report tax payments to their clients.

Nina Olson, the national tax advocate, whose job at the IRS is to protect taxpayers' interests, has called for new laws that would require a third-party payroll service to post a bond for its clients that would cover any lost tax payments. She also has urged policy makers to force all payroll services to file a record of tax payments that is available for their clients to see.

"Although the payroll-tax industry has evolved in the more than 60 years that have passed since employment taxes were enacted, the law has not kept up with this evolution," Ms. Olson said in her agency's annual report to Congress in January.

Michael O'Toole, a senior director of government relations at the American Payroll Association, a San Antonio-based trade group, says small payroll firms couldn't afford to post bonds for their clients.

Two weeks ago at a bankruptcy hearing at a federal courthouse in Baltimore, Beverly Carden, AccuPay's former president, took the Fifth Amendment on the witness stand, refusing to testify about the company's operations or its assets.

In the past year at least a half-dozen of her former clients have filed separate lawsuits against the firm in Hartford County Circuit Court, including a Bel Air veterinarian and a nearby brewing company. Those claims, alleging that AccuPay had been pilfering tax payments for several years, are on hold, following the firm's bankruptcy filing in March.

Sen. Barbara Mikulski, a Maryland Democrat, has called on the IRS to suspend any penalties or interest owed by AccuPay's clients, who under the tax code are liable for any unpaid taxes.

Lavinia Poist-Eades, 75, a business manager at Carpet Authority Inc. in Bel Air, which hasn't sued the firm, says she didn't suspect anything was amiss until late February, when she says AccuPay suddenly stopped answering her calls. The day the payroll firm shut its doors, she says, her son drove to its office and found an angry crowd outside.

Ms. Poist-Eades estimates that the 17-year-old carpet cleaning and restoration business has lost at least \$30,000 in tax payments over the years. "It's awful. We've been growing pretty well, and now we get hit by something like this?" she says. She says she was interviewed about the case by an IRS criminal investigator as recently as Tuesday.

"They were always so pleasant. These were nice people," Mike Kasun, the owner of ClearTree LLC, said of AccuPay's owners. He says his tree removal and trimming company had been using the service since 2004 and now owes more than \$80,000 in unpaid taxes.

Still, Mr. Kasun says he has already signed on with a new payroll service. "With 15 employees, managing payroll is an ordeal. It's nuts," he adds. "I want to be in front of my customers, not in the backroom doing paperwork."

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