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National Payroll Reporting Consortium
PO Box 850 ★ Henrietta, NY 14467-0850 ★ www.NPRC-Inc.org

2013 OCT 17 AM 10: 07
OFFICE OF THE
DEPUTY COMPTROLLER

October 14, 2013

Mr. David F. Roose
Deputy Comptroller of Maryland
Goldstein Treasury Building
80 Calvert St.
Annapolis, MD 21404

Dear Mr. Roose:

Thank you for your time and service on the Commission to Study the Regulation of Payroll Services ("Commission"). Your attention to this important matter is the first step in protecting Maryland employers from fraudulent payroll service providers. We would also like to thank you for the opportunity the National Payroll Reporting Consortium ("NPRC") was given to participate in these important policy discussions.

At this juncture, we believe it is appropriate for NPRC to clearly articulate the steps it believes the State of Maryland could take that, in some measure, prevent payroll service providers from committing fraud against Maryland employers. We also want to be on the record about those possible actions which we feel are not appropriate given the size and nature of the problems encountered in the past.

Below, please find those potential recommendations as well as a summary of the actions the NPRC does not support. We would also draw your attention to the separate consensus recommendations document, which represents the collective work of several industry associations, for more background on these topics. These represent a consensus of all the organizations comprising the NPRC. The NPRC is open to full discussion of these and recommendations from others with both the Commission and other stakeholders.

POSSIBLE RECOMMENDATIONS OF THE COMMISSION TO STUDY THE REGULATION OF PAYROLL SERVICE PROVIDERS

1. **Implement an electronic verification system for employers similar to the IRS' EFTPS**

The Internal Revenue Service (IRS) recently implemented a regulatory approach which we believe will effectively prevent such incidents in the future. Past incidents were made possible because perpetrators were able to divert tax funds for a considerable period of time -- a year or more -- without detection. To detect any such diversion, a person would need to know two things: (1) the amount of current tax liabilities; and (2) whether these amounts were actually being paid to the government. A critical point is that only the employer - - the business taxpayer itself - - can know the current tax liabilities of the business. Thus, only the business itself can review current tax payments and know whether they are sufficient. No regulatory agency could ever protect against losses as effectively as a business that periodically checks its own account. But to do that checking, the business needs real time access to its accounts within the government's financial system.

Fortunately, IRS technology has already been implemented to address the problem. The IRS Electronic Federal Tax Payment System (EFTPS) enables businesses to easily verify federal tax payments by simply viewing their IRS tax account online. Other State tax authorities offer similar ways to verify tax payments.

However, few employers have been made aware of this technology. If employers had been aware of it and had utilized it, every past incident would have been detected almost immediately and losses minimized. IRS regulations became effective in November 2012 which requires all payroll service firms to disclose to each client on a quarterly basis that they remain liable for taxes, and how to easily verify tax payments.

2. **Make employers aware of EFTPS and the Maryland Unemployment Insurance Online Verification System and the means to verify employer withholding tax payments.**

Publicity is needed to ensure that Maryland employers are aware of the risks inherent in using any third party to administer tax payments, and the means to easily verify tax payments made on their behalf. The Comptroller's office could perform a valuable service by drawing attention to this issue in employer newsletters and publications and on the Comptroller's website. The following standard disclosure is now required by the IRS, at the time of contracting between the payroll service providers and their employer customers, and quarterly thereafter:

> *"The employer is ultimately responsible for the deposit and payment of federal and state tax liabilities, even if a third party is making the deposits. The IRS recommends that employers enroll in and use EFTPS (Electronic Federal Tax Payment System) to confirm payments made on their behalf. Enroll online at www.eftps.gov or call 800-555-4477 for an enrollment form.*
>
> *State tax authorities generally offer similar means to verify tax deposits. Contact the applicable state offices directly for details."*

3. **Send notices of 'change of address' to employers.**

One problem that has contributed to the few cases of criminal fraud in this industry is that, in some instances, an employer may not be aware of tax delinquencies because only the employer's payroll service provider, and not the employer, has received notices of such delinquencies. This is because, as part of the fraud, the payroll service provider, without the knowledge or consent of the employer, has changed the address of the employer with the government authorities. This prevents the employer from receiving delinquency notices. While it is impractical to prohibit the payroll service provider from receiving correspondence related to client accounts directly, the Comptroller's office should notify employers when an address change occurs so that employers will be aware when such changes have been requested, and have opportunity to reverse unintended address changes.

The Comptroller's office should issue a notice of confirmation of any address change relating to an employer making employment tax payments. Such notice should be sent to both the employer's new and/or former address, upon an actual change and perhaps annually.

4. **Authorize the Comptroller to refer evidence of payroll service fraud to the local State's Attorney.**

Theft and embezzlement by a fiduciary are both already crimes in Maryland under Article Criminal Law § 7-104 and §7-113. The penalty under §7- 104 escalates based on the value of property to a top penalty of imprisonment not to exceed 25 years and a fine not to exceed $25,000 for thefts valued at $100,000 or more. All penalties in the statute regardless of value require restitution to be made. Even with this penalty, an

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affirmative duty on the Comptroller to refer evidence to the appropriate States' Attorney may provide an additional deterrent and allow the Comptroller to provide additional warnings to the payroll service industry.

NPRC WOULD NOT SUPPORT THE FOLLOWING ACTIONS:

1. **Bonding**

Bonding is an important component of any regulatory oversight measures, if established with meaningful levels which would serve to ensure that only qualified service providers could offer payroll services in Maryland. However, this approach is very difficult politically, as evidenced in Maine, because not all existing service providers can obtain a bond.

Additionally, bonding is widely misunderstood. The general perception is that bonds are equivalent to insurance, covering 100% of the risk. Thus, any public perception of bonding will lead employers to perceive less risk, which would reduce their efforts to be diligent. (See also the separate Applicability of Surety Bonds to the Payroll Services Industry document for more details.) A bond is not equivalent to insurance. It will not protect against 100% of an exposure an employer may suffer in entrusting their employment taxes to a third party. A surety bond provides compensation only up to a capped amount in case a principal fails to perform as promised. Businesses that believe such bonding protects them may become less diligent in selecting a service provider and monitoring their performance.

Surety firms also typically require owners and spouses to pledge personal assets to obtain a surety bond. Many service providers in other states have been unable or unwilling to pledge sufficient collateral to qualify for a bond. The inability of many existing and reputable payroll service providers to qualify for required bonds was a significant problem in Maine, the only state to affirmatively regulate the payroll service industry. It would also pose a significant problem in Maryland as well.

2. **State Licensing**

State licensing would raise public perceptions and expectations that the state will somehow take responsibility for the safety of licensed service providers. Even an apparently innocuous requirement to register as a payroll service firm in Maryland would raise such expectations, leading businesses/clients to be less diligent in selecting and monitoring a service provider.

We believe that these measures can be accomplished administratively. We look forward to continuing this discussion and are confident we will be able to take positive steps towards eliminating the occurrence of fraud by payroll reporting companies in Maryland. Should you have any questions, please feel free to contact me at (909) 971-7670 or pete_isberg@nprc-inc.org.

Sincerely,

Pete Isberg
President
National Payroll Reporting Consortium