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TRUST FUND RECOVERY PENALTY ADVANCED LEVEL

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I. <u>Overview – Trust Fund Recovery Penalty</u>

1. Need for Revenue Officer Involvement**.**

   Know who you are dealing with. **<u>Only Revenue Officer's possess the ability to carry out and complete a trust fund investigation</u>**. **<u>If notices are coming from ACS, consider the time left on the statute of limitations on assessment of the trust fund recovery penalty before taking any action</u>**. Be careful waking a sleeping dog and exposing your client to liability.

   See Internal Revenue Manual 5.19.14.3, "Revenue Officers (RO) investigate and determine against whom to assess the TFRP."

2. **<u>Internal Revenue Code 7501</u>** provides that whenever any person is required to collect or withhold any internal revenue taxes from any other person and to pay over such tax to the United States, the amount of the tax shall be held in a special trust fund for the United States.

3. **<u>Internal Revenue Code 6672(a)</u>** provides as follows: "Any person required to collect, truthfully account for, and pay over any tax imposed by this title who **<u>willfully fails to collect such tax</u>**, or truthfully account for and pay over such tax, or **<u>willfully attempts in any manner to evade or defeat any such tax on the payment thereof</u>**, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over."

4**.** Assessments of the trust fund recovery penalty can come from the following tax forms:

   - 941, Employer's Quarterly Federal Tax Return
   - 720, Quarterly Federal Excise Tax Return
   - CT-1, Employer's Annual Railroad Retirement Tax Return
   - 942, Employer's Quarterly Tax Return for Household Employees
   - 943, Employer's Annual Tax Return for Agricultural Employees
   - 944, Employer's Annual Federal Tax Return
   - 945, Annual Return of Withheld Federal Income Tax
   - 1042, Annual Withholding Tax Return for U. S. Source Income of Foreign Persons
   - TFRP assessments are not based on Form 940 Unemployment Taxes.

5. Trust fund recovery penalty is calculated as the following amounts withheld from employee paychecks:

    a. The Federal income taxes that were withheld from an employee's paycheck but not paid over to the government;

    b. The Social Security and Medicare taxes that were withheld from employee's paycheck but not paid over to the government.

    c. The TFRP **does not include the employer's contributions to the employee's Social Security and Medicare accounts**.

6. Joint and Several Liability.

    The TFRP may be assessed against several individuals, but the total liability is collected (ultimately retained) only once from either:

    - The business,
    - One or more responsible individuals, or
    - The business and one or more responsible individuals.

    See Internal Revenue Manual 5.19.14.2

    The individuals who are responsible for the trust fund recovery penalty are jointly and severally liable. The IRS can collect the tax from them in any portion at their discretion.

7. A person is liable for the TFRP if the two statutory requirements below are met:

    a. The person against whom the penalty is assessed must be **"responsible"** (Internal Revenue Manual 5.7.3.3.1).

    b. The responsible person must have "**willfully**" failed to collect or pay over trust fund taxes to the government (Internal Revenue Manual 5.7.3.3.2). See also Internal Revenue Manual 5.17.7.1.

8. IRS Policy Statement 5-14 (Found in Internal Revenue Manual 1.2.14.1.3).

    "Trust Fund Recovery Penalty Assessments: The trust fund recovery penalty, applicable to withheld income and employment (social security and railroad retirement) taxes or collected excise taxes, will be used to facilitate the collection of tax and enhance voluntary compliance. If a business has failed to collect or pay over income and employment taxes, or has failed to pay over collected excise taxes, the trust fund recovery penalty may be asserted against those determined to have been responsible and willful in failing to pay over the tax. **Responsibility and willfulness must both be established**. The withheld income and employment taxes or collected excise taxes will be collected only once, whether from the business, or from one or more of its responsible persons."

9. Internal Revenue Manual on trust fund recovery penalty.

   a. IRM 5.7, Trust Fund Compliance Handbook

   b. IRM 5.19.14, Trust Fund Recovery Penalty (Liability Collection).

   c. IRM 5.17.7, Liability of Third Parties for Unpaid Employment Taxes (Legal Reference Guide for Revenue Officers).

   Go to irs.gov; search: "Internal Revenue Manual.'

II. Responsibility.

A. Overview.

1. Responsibility is a matter of status, duty, and authority.

   Per Internal Revenue Manual 5.17.7.1.2, Responsibility, "The crucial test is whether the person has the "**effective power to pay the taxes owed**." Purcell v. United States, 1 F.3d 932, 937 (9th Cir. 1993). **A person is deemed to have such power if he/she possesses the authority to exercise significant control over the company's financial affairs whether or not such control is in fact exercised**. Purcell at 937. Significant control generally relates to the person's status, duty, and authority in the business that failed to carry out one of the three statutory duties. Davis. v. United States, 961 F.2d 867 (9th Cir. 1992).

   Think of control over decision-making on the use of the employee's tax withholdings to pay operating expenses of the business.

2. A responsible person has a:

   - Duty to perform
   - Power to direct the act of collecting trust fund taxes
   - Accountability for and authority to pay trust fund taxes
   - Authority to determine which creditors will or will not be paid

   See IRM 5.7.3.3.1

3. Indicators of Responsibility, Internal Revenue Manual 5.17.7.1.2.

A determination of "responsibility" depends upon the facts and circumstances of each case. Common factors considered by the court include:

- identification of the person as an **officer, director, or shareholder** of the corporation;
- **duties of the officer as set forth in the by-laws**;
- **authority to sign checks**;
- identification of the person as the one in **control of the financial affairs of the business**;
- identification of the person as the one who had **authority to determine which creditors would be paid and those who exercised that authority**;
- identification of the person as the one who **controlled payroll disbursements**;
- identification of the person as the one who had **control of the voting stock of the corporation**; and
- identification of the person as the one who **made the federal tax deposit**. Datlof v. United States, 370 F.2d 655 (3d Cir. 1966), cert. denied, 387 U.S. 906 (1966).

See IRM 5.7.3.3.1

4. The Usual Suspects.

Potential responsible persons include:

Officer of a corporation

Employee of a corporation

Corporate director

Corporate shareholder

Partner or employee of a partnership

Employee of a sole proprietorship

Surety lender with sufficient control over funds to direct disbursement of the funds

Other person or entity outside the delinquent business organization

In some cases, a person assuming control after accrual of the liability (Slodov). See IRM 8.25.1.3.1

See Internal Revenue Manual 5.17.7.1.1, Persons Subject to the Trust Fund Recovery Penalty

B. Responsibility - Specific Situations (IRM).

1. Signature Authority.

If a person has the authority to sign checks, the exercise of that authority does not, in and of itself, establish responsibility. IRM 5.7.3.3.1.1.

Note: Prove that signatory authority was merely a convenience.

2. Employees.

a. Ministerial Acts.

Those performing ministerial duties without exercising independent judgment will not be deemed responsible.

IRS Policy Statement 5-14(5) (Formerly P-5-60), Found at IRM 1.2.14.1.3 and IRM 5.17.7.1.2(6) (reincorporating the Policy Statement)

b. Lack of Control/Bill Paying Function Only.

In general, non-owner employees who act solely under the dominion and control of others, and who are not in a position to make independent decisions on behalf of the business entity, will not be assessed the trust fund recovery penalty. Non-owner employees are those who do not own any stock, interest, or other entrepreneurial stake in the company that employs them. IRM 5.7.3.3.1.2(1)

A person is "responsible" for purposes of the TFRP if that person has "significant control" over the company's finances. **"Significant control" means more than having the mere mechanical duty of signing checks or preparing tax returns or having a title that**

<u>appears to have authority</u>. However, a responsible person need not have the final word in the company regarding the payment of creditors. IRM 5.7.3.3.1.2(3)

A non-owner employee is generally not a "responsible person" **<u>if the employee's function was solely to pay the bills as directed by a superior, rather than to determine which creditors would or would not be paid</u>**.

Example #1 from IRM 5.7:

The bookkeeper of a company is not an owner and is not related to an owner. She has check signing authority and she pays all of the bills that the treasurer gives her. She is not permitted to pay any other bills, and when there are not sufficient funds in the bank account to pay all of the bills, she must ask the treasurer which bills to pay. The bookkeeper is performing a ministerial act and should generally not be held responsible for the TFRP.

Example #2 from IRM 5.7:

A non-owner employee works as a clerical secretary in the office. She signs checks and tax returns at the direction of and for the convenience of the owner or a supervisor who is a non-owner. She is directed to pay other vendors, even though payroll taxes are unpaid. The secretary is not a responsible person for the TFRP because she works under the dominion and control of the owner or of a supervisor who is a non-owner and she is not permitted to exercise independent judgment.

c. Hobson’s Choice: Quit Your Job, or Owe the IRS

<u>Officers and higher level employees of a company who are non-owners may still be required to sacrifice their jobs</u> (i.e., quit) to avoid being responsible for the TFRP, **<u>rather than obey the orders of an owner to pay other creditors but not to pay current federal trust fund taxes</u>** as they become due. See <u>Brounstein v. United States</u>, 979 F.2d 952, 956 (3rd Cir. 1992). IRM 5.7.3.3.1.2(3). IRM 5.6.3.3.1.2(3)

<u>An employee with contol, such as an officer or controller, cannot avoid being responsible for the TFRP by merely showing that an owner or a lender limited his discretion on the specific matter of paying taxes that the company owed</u>. See the examples below.

Example #1 from IRM 5.7.3.3.1.2:

An experienced businessman was the general manager of a new company during a seven month period. He was not an officer or owner. **As general manager, he signed most of the company's checks to creditors, as well as signing net payroll checks to employees, and there was no monetary limit placed on his check signing authority**. He told the bookkeeper which bills to pay. **When the company was experiencing cash flow problems, he spoke to one of the owners about the company's delinquent payroll taxes. The owner told the general manager that these unpaid taxes were none of the general manager's business and he should not worry about paying the company's net payroll and missing its tax payments**. Both the general manager and the owner believed that the general manager could not be held liable for the TFRP because he was not an owner or officer of the company; the general manager turned down an offer to become the company's president specifically because he was worried about the company's tax situation. The general manager could be a responsible person for the TFRP. See

Example #2 from IRM 5.7.3.3.1.2:

The long-time **controller** of a company was never a shareholder, director, or officer of the company, but he **was responsible for overseeing the finances of the company, including the preparation of the payroll and filing the company's federal employment tax returns**. **He had the authority to sign checks in any amount and he dealt with the company's lender on a regular basis when the company experienced financial troubles**, though he did not arrange or sign the lending agreement on the company's behalf. When the lender directed the company to pursue an orderly liquidation of its assets, the controller requested funds from the lender to make full payroll and pay the taxes due on the remaining employees, but **the lender forwarded only enough funds for the company to make net payrolls**. The controller made out net payroll checks to the remaining employees and paid none of the taxes due, rather than prorate the funds available to the company between payroll and taxes. The controller could be a responsible person for the TFRP. See Hochstein v. United States, 900 F.2d 543 (2nd Cir. 1990).

3. Delegating Responsibility (The "He Did It" Defense).

Persons with ultimate authority over financial affairs may generally not avoid responsibility by delegating that authority to someone else. If a potentially responsible person asserts that the duty to pay taxes or otherwise handle the financial affairs of the business was delegated to an employee: Evaluate the facts and circumstances of the case and determine whether the delegation rendered the person (delegator) powerless to disburse funds or dictate fiscal policy. IRM 5.7.3.3.1.1.

4. Corporate Officers.

Regardless of a person's corporate title, a person will not be held liable for TFRP unless he or she has the duty to account for, collect, and pay over the trust fund taxes to the government. **<u>Even an officer of the business will not be a responsible person if they are an officer in title only and have no substantive duties with the business</u>**. <u>O'Connor v. U.S.</u>, 956 F.2d 48 (4th Cir. 1992). On the other hand, even if a person has no corporate title but has control of financial affairs or controls payment of funds by the business, that person could be held responsible for the TFRP. IRM 5.17.7.1.1(2)

The full scope of authority and responsibility <u>is contingent upon whether the person had the ability to exercise independent judgment with respect to the financial affairs of the business.</u>

5. Corporate Directors.

A director who is not an officer or employee of the corporation may be responsible for trust fund recovery penalty if he was responsible for the corporation's failure to pay taxes that were due and owing. <u>Commonwealth Nat'l Bank of Dallas v. U.S.</u>, 665 F.2d 743 (5th Cir. 1982). IRM 5.17.1.1.2

6. Stock Ownership.

<u>If a person is an officer or owns stock in the corporation, this cannot be the sole basis for a responsibility determination</u>. IRM 5.7.3.3.1.1.

7. Sole Proprietors.

<u>The trust fund recovery penalty is not needed to assert liability against the owner of a sole proprietorship</u> because the individual owner is personally liable for employment taxes under IRC §§ 3101, 3402, and 3403. However, the TFRP may be needed to assert liability against an employee or other non-owner of the sole proprietor who exercises control over the finances. IRM 5.17.7.1.1.

Note: **<u>Sole proprietors get hit with liability for the trust fund and non-trust fund portion of the liability</u>. <u>There is no corporate shield to the non-trust fund.</u>**

8. Limited Liability Companies.

The TFRP is available and may be appropriately asserted when the taxpayer is organized as a Limited Liability Company (LLC). **The need for a TFRP investigation is based on how the LLC is classified for tax purposes**.

a. **When the LLC is a disregarded entity, the TFRP is not needed to establish liability against the single member owner** as the single member owner is already the taxpayer for employment tax purposes **and is fully liable for all employment taxes, not just the trust fund portion**.

Note: The TFRP may be asserted against other responsible persons involved in the operations of the disregarded LLC, such as bookkeepers and managers.

b. **When the LLC is classified as a corporation or partnership for tax purposes, the usual procedures for determining responsibility and willfulness apply**.

Note: The TFRP determination must be made on an LLC classified as a partnership. Under state law the members of an LLC classified as a partnership are not liable for the debts of the partnership.

See IRM 5.7.3.3.1(5) as to LLC's.

9. Partners.

a. IRC § 6671(b) defines a "person" who may be responsible for assessable penalties as a member or employee of a partnership.

a. Because partners are individually liable for the debts of the partnership (the assessment is made in the name of the partnership and the names of the general partners), there is generally no reason to make a separate TFRP assessment against the various partners. United States v. Galletti, 541 U.S. 114 (2004). IRM 5.17.7.1.1.2

10. Volunteer Board Members of Tax Exempt Organizations.

a. Per IRS Policy Statement IRS Policy Statement 5-14(6 (Formerly P-5-60), the trust fund recovery penalty "**shall not be imposed on unpaid, volunteer members of any board of trustees or directors of an organization referred to in section 501 of the Internal Revenue Code to the extent such members are solely**

serving in an honorary capacity, do not participate in the day-to-day or financial operations of the organization, and/or do not have knowledge of the failure on which such penalty is imposed.

b. See also IRC 6672(e), stating "No penalty shall be imposed by subsection (a) on any unpaid, volunteer member of any board of trustees or directors of an organization exempt if such member (1) is solely serving in an honorary capacity, (2) does not participate in the day-to-day or financial operations of the organization, and (3) does not have actual knowledge of the failure on which such penalty is imposed.

c. Exception: IRC 6672(e) makes it clear that **this exception does not apply if it results in no person being liable for the TFRP**. See also IRM 5.7.3.3.1.1(5)

11. After Acquired Funds Doctrine - Slodov v. United States, 436 U.S. 238 (1978).

a. A person who becomes a "responsible person" when the business does not have the funds to pay an employment tax liability that arose under previous management and who uses funds acquired after he became a "responsible person" to pay the operating expenses of the business rather than to pay the withholding tax delinquency is not personally liable for the delinquency under section 6672. Slodov at 254.

b. If funds are available to pay delinquent taxes at the time a responsible person assumes control of the business and the responsible person fails to use those funds to pay the delinquent taxes, that person will be liable under IRC § 6672 to the extent of the funds available to pay the trust fund taxes. Slodov at 255.

Note: **The Slodov holding is commonly used by the IRS to hold otherwise non-liable parties responsible**. See IRM 5.17.7.1.2.

See also IRM 8.25.1.3.1, stating "When evaluating responsibility, consider the Supreme Court decision in Slodov v. United States, 436 U.S. 238, 78-1, USTC 9447 (1978)."

III. Willfulness.

A. Overview.

1. Under IRC § 6672(a), if a person is responsible, then failure of that person to collect or pay over trust fund taxes must also be **willful**. **However, if a person is responsible, it is very difficult to show that significant control did not come with a degree of implied willfulness**.

2. Definition of willful — intentional, deliberate, voluntary, reckless, knowing (not accidental). No evil intent or bad motive is required. Domanus v. United States, 961 F.2d 1323 (7th Cir. 1992). IRM 5.17.7.1.3(2).

3. Per IRM 5.17.7.1.3(3), government directive for “willfulness" is a showing that the responsible party **was aware of the outstanding taxes (or should have been aware) and either deliberately chose not to pay the taxes or recklessly disregarded an obvious risk that the taxes would not be paid**. Phillips v. United States, 73 F.3d 939, 947 (9th Cir. 1996).

   How do you show someone that has all the trappings of being responsible **should not have been aware**?

B. Willfulness – Specific Situations (IRM).

1. Willfulness is case law intensive, with a majority of the decisions holding in favor of the government. IRM 8.25.1.3.2 directs appeals officers to research the “large body” of Court decisions on willfulness, although most are in their favor. Many are contrary to the IRM guidance. Best cases are those in the District Court or Appeals Court where the taxpayer resides.

2. Failure to Investigate.

   A responsible person's failure to investigate or correct mismanagement after being notified that withholding taxes have not been paid satisfies the IRC § 6672 "willfulness" requirement. Finley v. United States, 123 F.3d 1342 (10th Cir. 1997). IRM 5.17.7.1.3(4) and IRM 5.7.3.3.2(2)

3. Reasonable Cause.

   Generally, a responsible person’s willfulness is not negated where the failure to pay was due to reasonable cause. Olsen v. United States, 952 F.2d 236 (8th Cir. 1991). IRM 5.17.7.1.3(6).

4. Mistaken Belief.

   A mistaken belief that trust fund taxes do not have to be paid does not make the failure to pay non-willful. Thomsen v. United States, 887 F.2d 12, 17 (1st Cir. 1989). IRM 5.17.7.1.3(7).

5. Negligence.

   Negligence alone is insufficient for willfulness. Standard is knew or should have known.

IV. Revenue Officer Investigation - Corporate Records. (IRM 5.17.7.1.4)

1. In the majority of cases, most of the evidence that can be secured to support recommendations of trust fund recovery penalty will be either corporate records or bank records.

   The documentation, including bank records, will be requested from the corporation whenever possible. If the corporation does not provide the requested records, a summons will be served on either the corporation, the bank, or both to secure the required documents (See IRM 25.5 and IRM 5.17.6.8.1.1 for summons procedures). IRM 5.7.4.2(1) and (2)

2. Bank Records.

   a. The bank records that are sought include:

      Cancelled checks and bank statements

      Signature cards and correspondence to the bank relative to changes affecting the signature cards

      Cancelled checks and signature cards would identify the persons authorized to sign corporate checks with a presumption of control.

      Loan applications and records of loans

      Any other records that may be relevant to determining which individuals were involved in the financial affairs of the business.

See IRM 5.4.4.2.4(8)

Even if the Revenue Officer knows who is responsible, bank records will be obtained to provide a record in case of appeal.

IRM 5.7.4.2.4(3) states "There must be sufficient documentation in the file to support each recommendation for assertion. **Bank records and copies of the applicable tax returns will be secured on almost every case**. If they are not secured, the case file must be documented with the reason(s) why they were not secured and why they are not necessary to support the recommendation.

b. Purpose and Use of the Bank Records.

The bank records will be reviewed to determine control and responsibility:

1. **Authority of persons to sign checks and deposit funds (a few or a lot?)**
2. **Authority of persons to obligate the corporation by borrowing**
3. Diversion of funds to officers, members, etc.
4. Deposits and withdrawals of alleged loans to corporation by officers, members, directors, etc.
5. Excessive salaries, expenses, etc.
6. Payment of other obligations
7. Deposit records for monies received for sale of assets
8. Deposit records of payments for stock in the corporation

See IRM 5.7.4.2.4(9)

3. Corporate records.

a. Corporate records that can be examined to further determine **control and responsibility** include:

1. Articles of Incorporation – could contain the names and duties of the officers and directors
2. Minute Books – could disclose the names of persons with authority to sign checks, deposit money, conduct business or authorize loans.
3. Forms 941 and 1120 or 1065 tax returns – the name of the person responsible for payroll decision making/signing authority

4. By-laws of the corporation – disclose authority to transact business for the company (creates presumption of control over funds).
5. Financial statements provided to the bank in connection with a bank loan may provide additional information regarding responsibility and financial solvency of the corporation.

b. Purpose and Use of Corporate Records.

1. Duties (and changes to duties) of officers, directors, etc.

2. Appointments and resignations of officers, directors, etc.

3. Responsibilities of individuals to file and pay tax returns

4. Issuance of stock to officers

5. Loans made to officers

6. Borrowing of funds not used to pay taxes

IRM 5.7.4.2.4(4) and (5)

V. <u>The Taxpayer Interview</u>.

1. Revenue Officer will attempt to interview any potential responsible persons identified from bank records and corporate records. See IRM 5.7.4.2 and 5.17.7.1.5.

2. The Interview – Form 4180.

a. IRM 5.7.4.2.1(1) states that the purpose of 4180 is to "**<u>secure direct, detailed information regarding the individual's or other person's involvement in the business in order to determine if he or she meets the criteria for responsibility (IRM 5.7.3.3.1) and willfulness (IRM 5.7.3.3.2)</u>**."

b. Be Careful, Form 4180 is Evidence – **<u>Admissions by Your Client</u>**.

<u>If the Revenue Officer is filing in your client's answers, be sure the answer is properly noted in full as given</u>. Supplement profusely if necessary.

Many questions are "yes" or "no" absolutes and do not give a place for explanation. Review the interview form with your client before meeting the Revenue Officer. Think carefully about the answer and timelines.

Your client will be asked to essentially testify against others in the company by answering questions about who else had elements of control over the finances.

Appeals will rely on the 4180. Avoid different taxpayer's from same company giving different and inconsistent answers and improperly implicating others.

c. Revenue Officers are instructed not to give or mail the form to the taxpayer to complete, but by phone or in person. IRM 5.7.4.2.1(3).

d. **Use affidavits from other employees to clarify 4180 answers and add supporting evidence**. Interview other employees and prepare the affidavits for their signature – here, you are controlling the facts. Use others to develop that the bookkeeper had no say over what bills were paid, or that an officer had no authority and was an officer in name only.

3. The Request for a Financial Statement (433A) from the Potentially Responsible.

a. **Contemporaneous with the From 4180 Interview, Revenue Officers will usually request that a potentially responsible person complete a 433A financial statement**. IRM 5.7.4.5(1) states "a collectibility determination must be completed (IRM 5.7.5) for each potentially responsible person determined to be both responsible and willful."

b. Beware of this request. **The Revenue Officer is requesting a financial disclosure BEFORE assessment**.

Unless there are other assessments against your client already, the RO has no ability to force a financial disclosure or summons the information. See IRM 5.7.5.2 stating "If the taxpayer will not complete the CIS, determine if a summons can be issued (if there are other open existing assessments - IRM 25.5) or if the financial analysis can be completed using the sources in IRM 5.7.5.3(2).

c. Beware of Form 433B.

Section 2, page 1, “Business Personnel and Contacts” are to be listed with the question:

Responsible for Depositing Payroll Taxes? Yes No

Wow (and that’s not a typo).

VI. Appealing a Trust Fund Recovery Penalty.

A. The 60 Day Letter (1153).

Unless collection of trust fund recovery penalty is in jeopardy, **the taxpayer must be given a preliminary notice at least 60 days before the date of notice and demand for payment of the trust fund recovery penalty**. **This 60 Day letter is identified as Letter 1153**.

There can be no assessment of the trust fund recovery penalty without this 60 day letter. Internal Revenue Code 6672(b(3),

B. Appeal of the 60 Day Letter.

1. **Appeal rights to dispute the proposed penalty must be excercised within 60 days from the date of the letter**. If no appeal is filed, the assessment will become final and it provides for administrative Appeal rights. Appeals considers the taxpayers timely protest and will either sustain in full, sustain in part or concede the proposed penalty.

   See Internal Revenue Manual 5.7.6.1 “Taxpayer's Response to Letter 1153(DO).”

   LOOK AT EACH QUARTER SEPARATELY - RESPONSIBILITY OFTEN STOPS AT A CERTAIN POINT WHILE THE LIABILITY CONTINUES.

2. Assessment.

   The IRS has 90 days to make an assessment if no appeal is filed.

   If an appeal is filed, the IRS has 30 days after issuing their notice of determination to assess the trust fund recovery penalty.

3. The Appeal/Protest.

Although not required if the balance due is under $2.500, always file a formal written protest with the Revenue Officer. The protest can be short and to the point, and should include:

- The responsible party's name, address, and Social Security number
- A copy of the Letter 1153(DO) and reference the date and number of the letter
- A statement that an appeal conference is requested
- The tax periods involved (from Form 2751)
- A list of issues that are disputed with supporting facts and citations to the Internal Revenue Manual and case law
- A statement by the representative that "Under penalties of perjury, I declare that I have examined the facts presented in this statement and any accompanying information, and, to the best of my knowledge and belief, they are true, correct, and complete."

See Internal Revenue Manual 5.7.6.1.5

4. What to Expect in Appeals.

Appeals will have the bank statements, bank records, and interview forms from not only your client, but others as well. **Affidavits can be submitted elaborating on facts not developed or noted by the Revenue Officer or to distinguish incorrect facts**.

REMEMBER THE CASE WAS DEVELOPED BY A REVENUE OFFICER SEEKING TO JUSTIFY LIABILITY. THE APPEALS OFFICER HAS ONLY ONE SIDE TO THE STORY. YOU ARE STARTING FROM BEHIND.

Do you bring your client to the appeals conference or not? Affidavits only?

5. After Appeals – Claim for Refunds.

If your appeal is denied, you can pay the withholding for one employee and file a claim for refund on Form 843, Claim for Refund and Request for Abatement. A separate claim and payment should be filed for each quarter on each separate assessment. If the claim is denied or no action is taken within 6 months, a Refund Complaint may be filed in US District Court to dispute the liability. The District Court complaint must be filed within 2 years of the making the payment.

See Internal Revenue Manual 5.19.14.26 and 5.7.7.6

VII. In Business Installment Agreements as Defense to Trust Fund Recovery Penalty.

A. In-Business, Repayment, No Trust Fund Assertion.

1. Trust fund recovery penalties are usually asserted when the business is closed, closing or cannot repay the liability.

   Internal Revenue Manual 5.7.4.8(2) permits Revenue Officers to withhold assertion of the trust fund recovery penalty if the employer is attempting to resolve the liability through another method. **These situations could involve an in-business installment agreement** (IRM 5.7.4.8.1), offer-in compromise (IRM 5.7.4.8.2), or bankruptcy (IRM 5.7.4.8.3 and 5.7.4.8.4).

   Note: Chapter 7 bankruptcy does not eliminate trust fund taxes. Chapter 11 and Chapter 13 reorganizations require full payment of the trust fund amounts.

2. Criteria For In-Business Installment Agreement Stopping Trust Fund Penalty.

   A revenue officer can secure an in-business installment agreement rather than recommending immediate assertion of the TFRP, as long as:

   - **The taxpayer qualifies for an in-business installment agreement** (IRM 5.14.7) **and is in compliance**
   - **The TFRP assessment limitation period is appropriately extended (Form 2750 Waiver of Time to Assess Trust Fund Recovery Penalty)**
   - **The investigative aspects of the TFRP inquiry are documented and preserved**

   See IRM 8.7.4.8.1(1)

   IRS Policy Statement 5-14 (Formerly P–5–60), Internal Revenue Manual 1.2.14.1.3(8):

   "Absent statute considerations, **assertion recommendations normally will be withheld in cases of approved and adhered to business installment agreements and bankruptcy payment plans**. To the extent necessary, information will be gathered to support a possible assessment in the event the agreement is defaulted.

Exception: Repeat offenders/Pyramiders. For practical purposes, withholding trust fund penalty assessment during an installment agreement is best suited for 1st time offenders who have cured the problem, the length of the installment agreement is not burdensome, and they are current of Federal Tax Deposits. **This is discretionary with the Revenue Officer**.

3. **If the installment agreement will not fully pay all balances due at least one year prior to the earliest trust fund statute assessment expiration date and the trust fund recovery penalty is not being assessed**, IRM 8.7.4.8.1 instructs the following actions must be taken by the Revenue Officer:

    Complete interviews for all potentially responsible persons and any other interviews necessary to determine responsibility and willfulness.

    Secure the appropriate Collection Information Statement from all potentially responsible persons and complete the collectibility determination (IRM 5.7.5).

    Request a signature on Form 2750, Waiver Extending the Statutory Period For Assessment of Trust Fund Recovery Penalty, from all potentially responsible persons (see IRM 5.7.3.6.1 for the actions required when securing a waiver) to extend the statute to the expected end-date of the agreement plus one year.

    Assemble all documentation for completion of the penalty to the point of assessment (including securing approval of Form 4180).

4. **If the installment agreement will fully pay all balances due at least one year prior to the earliest trust fund assessment statute expiration date, the Internal Revenue Manual (5.7.4.8.1) gives the Revenue Officer discretion in how far to proceed with the TFRP investigation**.

VIII. Statute of Limitations on Assessment of the Trust Fund Recovery Penalty.

A. General Rule of Assessment.

The general rule is that an assessment of tax must be made within three years from the date a return is filed or the due date of the return, which ever is later.

B. <u>Assessment Expiration Date - Trust Fund Recovery Penalty</u>.

1. Timely Filed Form 941 Return.

   <u>The trust fund recovery penalty must be assessed within 3 years from the April 15 that follows the year in which the return was due</u>. Internal Revenue Code Section 6501(b)(2) and Internal Revenue Manual Sections 5.17.7.1.7, IRM 5.19.14.6 and IRM 5.7.3.5.

Examples:

<u>941 return timely filed for quarter ended April 15, 2007</u>. Assessment of trust fund recovery penalty must be made before April 15, 2011, which is 3 years from April 15, 2008, the succeeding date of April 15, 2007.

<u>941 return timely filed for quarter ended December 31, 2007</u>. Assessment of trust fund recovery penalty must be made before April 15, 2011, which is 3 years from April 15, 2008, the succeeding date of December 31, 2007.

2. Late Filed Form 941 Returns.

   Three years from the date the return was actually filed, if that date is later than the due date.

3. Substitute Returns.

   IRM 5.7.3.5 and IRM 5.17.7.1.7(1)(E) provides that the following returns do not start the limitations period:

   a. Substitutes for returns prepared by the Service under IRC 6020(b)(1)

   a. False return or fraudulent return (IRC 6501(c)(1))

   c. A filing made in connection with a willful attempt to evade tax (IRC 6501(c)(2))

4. Impact of Appeal of Trust Fund Recovery Penalty.

   <u>The IRS has 90 days to make an assessment if no appeal is filed</u>.

   <u>If an appeal is filed, the IRS has 30 days after issuing their notice of determination to assess the trust fund recovery penalty</u>.

   See Internal Revenue Code 6672(b(3), Statute of Limitations

C. Impact of Other Actions on Statute Date.

The following table is from Internal Revenue Manual 5.7.3.6 as to whether bankruptcy or an offer in compromise extends the trust fund assessment date:

If. . .	Then. . .
a responsible person filed a bankruptcy petition after October 21, 1994	the statutory period for assessment of the TFRP will **not** be automatically extended by the bankruptcy filing.
the corporation is in a bankruptcy proceeding	the statutory period for assessing the TFRP against potential responsible persons is **not** automatically extended.
an Offer in Compromise is submitted for the corporate tax liability	the corporate offer does **not** automatically extend the statute for assessing the TFRP against any responsible corporate officer, employee, or other responsible person.

D. Always Check Trust Fund Statute Assessment Dates.

Especially for cases where all is quiet and there is no Revenue Officer contact.

IX. Designated Payments and Trust Fund Payment Application.

A. Designated Payments.

1. Procedures for Remitting Payment Designation to Trust Fund Taxes.

Voluntary payments only. IRS will not accept designations of installment agreement and levy payments.

Insert on memo portion of check "Trust Fund Taxes Only" along with either/both the social security number/employer identification number, and the quarters to be paid.

Include a cover letter with payment stating as follows:

"I/We {Name(s)}, hereby tender payment of ${Amount} and specifically request that such funds be applied to the trust fund tax liability of {Business Name}, {Business E.I.N} for the period(s) ending {List Each Period}. See Internal Revenue Manual 5.7.4.3(3)

THE BEST PRACTICE IS TO GO TO AN IRS OFFICE AND HAND-DELIVER THE CHECK AND HAVE THE IRS STAMP A PHOTOCOPY FOR YOUR RECOREDS.

2. Determining the Trust Fund Amounts.

Secure the 941 returns, calculate 100% of the income tax withholding and half (.0765) of the Social Security and Medicare withholding.

Obtain IRS transcripts of account

B. <u>IRS Application of Non-Designated Payments</u>.

1. Best Interests of the Government.

Any voluntary payment that is not designated and all involuntary payments (installment agreements/levy) will be applied in the "Best Interests of the Government." Internal Revenue Manual 5.7.4.3(1).

<u>IRS Policy Statement 5-14 (Formerly P–5–60), Internal Revenue Manual 1.2.14.1.3(10):</u>

"**<u>Any payment made on the business account is deemed to represent payment of the nontrust fund portion of the tax liability (e.g., employer's share of FICA) unless designated otherwise by the taxpayer</u>**. The taxpayer, of course, **<u>has no right of designation of payments resulting from enforced collection measures</u>**. To the extent partial payments exceed the nontrust fund portion of the tax liability, they are deemed to be applied against the trust fund portion of the tax liability (e.g., withheld income tax, employee's share of FICA, collected excise taxes). Once the nontrust fund and trust fund taxes are paid, the remaining payments will be considered to be applied to assessed fees and collection costs, assessed penalty and interest, and accrued penalty and interest to the date of payment."

2. Application of Non-Designated Payments.

Internal Revenue Manual 5.19.14.5 provides as follows as to the application of non-designated payments on the business account (made after June 19, 2000):

- First, to the **<u>non-trust liability</u>** for the oldest quarter
- Second, the **<u>trust fund taxes</u>** for the oldest quarter
- Third, **<u>fees and collection costs</u>**
- Then, **<u>assessed penalty followed by assessed interest</u>**
- Lastly, **<u>accrued penalty followed by accrued interest</u>**

The payment will generally be applied to satisfy the liability for successive periods in descending order of priority until the payment is absorbed.

Any 1120 and 940 taxes will also paid before trust fund taxes.

3. Every voluntary payment should be designated to the trust fund recovery penalty whether it is remitted by the business or individual.

X. Additional Trust Fund Issues.

1. Uncollectibility and Assertion of the Trust Fund Penalty.

If your client is and will continue to be uncollectible, the Revenue Officer has discretion to not assess the trust fund recovery penalty.

IRM 5.7.5.1(2) provides that the TFRP will normally not be assessed when:

- The likelihood of successful collection is minimal or
- Neither the responsible person nor their assets can be located

See also IRM 5.7.5.3.1, Nonassertion Based on Collectibility, "**After reviewing and verifying the financial information, if the present and future collection potential is minimal, do not recommend assertion of the TFRP**."

Examples (Internal Revenue Manual 5.7.5.3(3)):

If. . .	Responsible person data shows. . .	Then. . .
TFRP is $32,000	—35 years old with degree in computer science —Employed as a software developer —Yearly Income $35,000	Assess the penalty and take the appropriate collection action based on an analysis of the taxpayer's financial condition.
TFRP is $45,000	—55 years old and a concrete finisher —Plans to remain an employee —Yearly Income	Do not assess the TFRP since the financial analysis shows there is little prospect that the taxpayer will receive any increase in income or

If. . .	Responsible person data shows. . .	Then. . .
	$28,000 —Non working spouse and two children —CIS shows only asset is an old car with little equity, tools of trade and furniture exempt from levy under IRC 6334	acquire assets that will enable the Service to collect any of the penalty (based on taxpayer's age and limited income potential).
TFRP is $80,000	—Unable to locate —RTVUE of last income tax return reveals income from interest dividends and IRA distribution	Assess the TFRP since there is a good possibility of some collection from the assets that were located.
TFRP is $18,000	—Employed as a supervisor of cleaning crews of business establishments —25 years old —Non working spouse and two children —CIS analysis reveals $2,000 equity in a residence, small amount of equity in a car with 2 years left to pay	Assess the TFRP based on future collection potential and possible refund offset (based on taxpayer's age, income potential, and future potential equity in real estate). Prepare a pre-assessed 53 and file lien.

2. Make Sure the Trust Fund Amounts are Correct.

a. Substitute Return Assessments.

Many times, the proposal can be based on substitute returns prepared by the IRS even after the company went out of business. **<u>This is important for the client coming in after the damage is done and the assessments have become final</u>**. The trust fund recovery penalty assessment could be significantly overstated.

b. Misapplication of Payments.

Get transcripts of account to ensure that any payments made as to the trust fund by corporation were properly applied to the individual trust fund account. Taxpayer Advocate's office can be helpful in opening a file to resolve this.

3. Acquiring Information on Others Who May Be Potentially Responsible.

Internal Revenue Code 6103(e)(9) – Names, Liability, Payments.

"(U)pon request in writing of such person, the Secretary shall disclose in writing to such person--

(A) **the name of any other person whom the Secretary has determined to be liable for such penalty with respect to such failure**, and

(B) **whether the Secretary has attempted to collect such penalty from such other person, the general nature of such collection activities, and the amount collected**.

Limitation: A person is determined to be liable for purposes of IRC section 6103(e)(9) when that person is assessed. **Therefore, no disclosure is permitted until after the person is assessed**. See IRM 5.1.1.6.4 and 8.25.1.2.1.

4. Right of Contribution from Others Who Are Liable**.**

Internal Revenue Code 6672(d)) – Right of Contribution.

If more than 1 person is liable for the penalty, **each person who paid such penalty shall be entitled to recover from other persons who are liable for such penalty an amount equal to the excess of the amount paid by such person over such person's proportionate share of the penalty**.

XI. Collection of Trust Fund Recovery Penalty.

1. Bankruptcy.

Trust fund taxes are not dischargeable in bankruptcy. They would survive a Chapter 7 and would need to be repaid in a Chapter 13.

2. Offer in Compromise.

In 2007, 11,000 offers were accepted, down from 47,000 in 2001. Nonrefundable upfront payments now required. Toughest tax to compromise is also trust fund due to the nature of it being money belonging to third parties.

3. Installment Agreement.

Usually the amount of the trust fund penalty prevents a meaningful installment agreement as does the taxpayer's financial condition rebounding from a failed business (owner liability) or lack of sufficient income (employee liability).

4. Uncollectible.

Ride out the 10 year statute of limitations on collection.

5. Wait until another liable party or corporation pays it.

XII. <u>Case Study</u>.

Your client, Steve Welsh is an outside minority investor in Express Courier, Inc. Steve has a full time job at Scranton Leasing as a sales representative leasing trucks and vans to the transportation industry. Steve met the owner of Express Courier, Randy Garber through his employment at Scranton.

Mr. Garber's background is in owning and operating courier companies. Mr. Garber approached Steve Welsh to invest in his company to finance growth into a new market. Steve provided the funds.

To protect his investment, Steve was a 49% minority owner in Express. He was given the title of Vice President as a result of the investment. It gave him no real authority over the operations of the company, which were out of his realm of knowledge and experience.

Steve had no prior experience in the operation and management of courier service companies.

Randy Garber and a company bookkeeper gave conflicting versions of Steve's authority in the company (by laziness, not by bad intent). Their answers on Form 4180 indicated that Steve had control and authority when he did not - sign checks, make loans, work with vendors, manage employees, etc.

The reality was that Steve did not hire and fire employees. He had no understanding of the business and lacked the background to establish qualifications to make hiring decisions and to issue performance reviews. He did not sign payroll checks or influence, prepare or sign any 941 returns. Steve never made or authorized a bank deposit. He did not maintain an office at the company and never drew a salary.

Steve Welsh signed, at most, six bank checks during a span of four years. The few isolated checks Steve signed were forwarded by Mr. Garber to him at his job at Scranton with the instruction that he sign the check as Garber was out of town. Garber had the effective control and power over the checkbook.