

Trust Fund Recovery

Facing possible retributions such as civil liability for unpaid employment taxes, including penalties and interest, and possible criminal liability, employer delinquencies in the payment of employment taxes remain one of the most serious collection problems of the IRS.

Under the Internal Revenue Code certain persons, other than taxpayers, may be designated as agents or responsible persons for the collection of taxes due to the United States. The most common example of this type of provision is the requirement that employers collect and withhold income and social security (or more properly, Federal Insurance Contributions Act [FICA]) taxes, which are by far the most commonly collected from persons other than the taxpayers.

A corporation or partnership unable to obtain outside financing or having insufficient funds to pay all its obligations may attempt to continue in business by failing to pay employment taxes. Because the IRS does not immediately detect delinquencies or take enforced collection action, employers thus are tempted to treat the government as an ordinary creditor. In effect, they borrow from the government the amount of employment taxes required to be paid over.

In most cases, persons responsible for deciding how the funds of the employer's business will be spent do not intend to defraud the government. They decide to prefer creditors other than the government in hope that the business will "turn the corner" so that sufficient funds will then be available to pay all creditors, including the government. To compensate the government for part of the taxes due it upon the failure of a business, Section 6672 of the Internal Revenue Code (which is included at the end of this chapter) imposes a penalty equal to the tax required to have been paid over (hence the former term "100% Penalty") on any person who (1) was required "to collect, truthfully account for and pay over" employment taxes; and (2) willfully failed to do so.

Under the so-called "Trust Fund Recovery Penalty" or TFRP provision, the IRS may assess and collect a penalty in the amount equal to the unpaid corporate **trust fund** taxes from any person who was required, but failed, "to collect, truthfully account for, and pay over the tax."

In order to assert the trust fund recovery penalty assessment, the IRS must establish two elements. First, the person subject to penalty must be "responsible" for seeing that the corporation's withheld trust fund taxes were paid to the government. Generally, a finding of responsibility will attach to persons charged with "control over the corporation's business affairs (and) who participate in decisions concerning payment of creditors, or those who have "the final word as to what bills should or should not be paid, and when." Second, the IRS must prove that the person "willfully" failed to pay over the taxes.

In this context, willfulness means a voluntary, conscious, and intentional choice to pay other creditors instead of the government at the time the wages were paid and the withholding taxes were due for deposit. Mere negligence is insufficient to establish willfulness under this provision. A reckless disregard of the risk that the tax may not be paid over to the government may, however, constitute willfulness.

The following points should be noted regarding the trust fund recovery penalty under IRC section 6672;

1. The trust fund recovery penalty does not make the government whole in the event of the failure to pay over employment taxes. The penalty only returns to the government the amount of the taxes collected and not paid over—that is, the trust fund portion of employment taxes and not the portion of the taxes imposed on the employer.
2. The term penalty is somewhat misleading. The amount of the liability imposed by Section 6672 is equal to the amount of the delinquent trust fund taxes and is not in addition to those taxes. Consequently, the "penalty" is actually a collection device designed for the purpose of collecting the taxes the employer should have paid over.
3. There is a distinction between the amount of the liability and the existence of liability for the penalty. The amount of the liability is affected by the lack of payment of trust fund taxes by the corporation. However, liability for the penalty is a direct and primary obligation of the responsible person for failure to withhold and pay over the trust fund tax. This liability is separate and distinct from the liability of the employer under this wage withholding provisions.
4. The trust fund recovery penalty is not necessary in the case where a business is conducted as a proprietorship. The individual owners are personally and directly liable for employment taxes.

Accordingly, Section 6672 applies where a corporation or partnership is the “employer” and a “person” subject to the trust fund recovery penalty includes “an officer, or employee of a partnership, who ...is under a duty to perform the act in respect of which the violation occurs.” The statute states “any person” having the duty to collect and pay over may be liable for the penalty and, accordingly, the penalty may be, and frequently is, asserted against more than one person.”

5. No negligence or fraud penalty may be assessed against a person in the event that the trust fund recovery penalty is assessed.
6. In addition to collecting and paying over income taxes from employees, an Employer is required to report and pay his own portion of FICA taxes, as well as federal unemployment tax, or FUTA taxes. These amounts are referred to as the employer’s portions of employment taxes.
7. In the event that an employer fails to collect and pay over, he may be required, on notice, to create a special bank account in trust for the withheld taxes. If the employer fails to comply with these trust provisions, he may be prosecuted under Section 725 for committing a misdemeanor punishable by a fine of not more than \$ 5,000 or imprisonment for not more than one year, or both.
8. Civil penalties and interest may be imposed if the employer fails to file returns or to pay over the entire correct amount of employment taxes.
9. In aggravated cases of nonpayment, criminal prosecution may be instituted. A felony prosecution might also be brought under one of the criminal statutes described in Section 7204 for fraudulent withholding statements or willful failure to supply such statements to employees, Section 7207 for fraudulent written statements given to the Service, or on Section 7203 for willful failure to supply information.
10. In the event that the employer has no assets, then no taxes, penalties, or interest can be collected from the employer. Nevertheless, employees are entitled to credit for the amount of income and FICA taxes withheld whether or not the employer pays over the withheld taxes to the government.

The IRS’ practice is to assert 100% penalties against all executive officers. However, a person may be an officer (or a director) of a corporation without having real or effective control over financial affairs. This may be true even when an officer has authority to sign checks. Accordingly, the officer’s scope of authority in dealing with the payment of taxes should be described. If the person has no authority over tax matters, an employment agreement, resolution, or other official documents should say so.

Joint-and-Severall Liability and Contribution

A taxpayer who is jointly and severally liable for the payment of an unpaid tax along with other responsible persons cannot avoid collection on the basis that the government should first collect, or attempt to collect, the tax from the other persons. The obligation to collect and pay over is the individual and primary obligation of the responsible person. For this reason, some courts have also found that the IRS need not have first attempted to recover the tax from a corporation, although this may not be true if it can be established the corporation was solvent and had assets available at the time the Service should have collected the liability as joint and several. The amount of liability will not be apportioned or divided between or among alleged responsible persons.

Statute of Limitations

Except in cases of a failure to file a return, filing false returns, or willful attempted evasion, the statutory period of assessment is three years after a return is filed. This general rule applies to the assessment of the trust fund recovery penalty of Section 6672 against a responsible person. Tax returns for employment taxes are filed quarterly. Since the 100 percent penalty is a device for collection of the trust fund portion of these taxes, the penalty should be subject to the same period of limitations as

the tax itself—that is, the three-year period following the filing of the employment tax return. The statute of limitations of assessment can remain open more than three years after the date of the failure to act. If the return is filed after the due date, the limitations period is measured from the actual filing date, and if no return is filed, the limitations period remains open indefinitely. Once the tax is assessed, the Service may collect the tax by a levy or proceeding in court within ten years after the assessment. The assessment that is collectible within the ten-year period is the assessment under Section 6672, not the assessment against the employer. An action against a responsible person has nevertheless been held timely when brought within ten years of the date of the assessment against the employer.

Corporate officers or other persons who might be considered responsible for paying over trust fund taxes should instruct the IRS to apply payments to the trust fund portions of employment taxes accrued during their period of responsibility before making any other application of the payment. The elimination of any delinquency in trust fund taxes eliminates the trust fund recovery penalty as well. Specific designation of a payment is necessary because the IRS's procedure is to consider that any payment on a corporate account represents a payment of the employer portions of the liability (including assessed penalty and interest) unless there is some specific designation to the contrary. Only the balance of the payment, if any is applied to the trust fund portion of the liability. The IRS will not recognize any right of designation where enforced collection of the delinquency is made.

The IRS determines whether to pursue the Trust Fund Recovery Penalty:

After the initial contact of trust fund taxpayer

As soon as possible but no later than 120 calendar days after assignment of the balance due accounts in the Collection Field.

Note: Although this decision must be made within six month period, there's no requirement that the entire investigation be completed within a specific time period. However, when the Revenue Officer makes the decision to assert, the investigation will proceed as expeditiously as possible. If the business is no longer operating, the Trust Fund Recovery Penalty will generally be completed within 120 days of the determination date.

In the event that certain facts surface during the IRS investigation, which may indicate that transfers of corporate stock and/or capital assets have occurred, the IRS will, in addition to pursuing the Trust Fund Recovery Penalty, consider recovery of the unpaid corporate liability by recommending:

- Transferee assessment
- Suit to establish a transferee liability
- Suit to set aside a fraudulent transfer
- Examination referral

TFRP Interviews and Investigations (4180 Interview)

1. During the initial contact with the taxpayer the Revenue Officer will attempt to conduct interviews with all potentially responsible persons. The revenue officer should take the following actions during the interview:
 - a. Provide Publication 1, Your Rights as a Taxpayer, and document the history that the publication was delivered;
 - b. Explain the Trust Fund Recovery Penalty;
 - c. Advise all potentially responsible persons, to the extent possible, that they may be held personally liable for the Trust Fund Recovery Penalty;
 - d. Provide Notice 784, Could You Be Personally Liable for Certain Unpaid Federal Taxes?
 - e. Advise the person(s) being interviewed of the proper actions to take to avoid such liability;
 - f. Begin asking questions and gathering information and documents, such as bank statements and cancelled checks, in support of assertion of the penalty;

- g. Attempt to secure at least one Form 4180, Report of Interview with Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Tax, from a potentially responsible person;
- h. Secure additional Forms 4180 from all potentially responsible persons to the extent possible;
- i. The Revenue Officer will not give or mail the form to the potentially responsible person(s) or representative for completion by that person. **It will be completed in person or over the phone;**
- j. The Revenue Officer will always request the presence of the potentially responsible person when conducting an interview with a representative having a Power of Attorney;
- k. A summons may be necessary to require the potentially responsible person's presence at the interview;
- l. A statement can be updated at a later date with the changes, initiated by the Revenue Officer and the person interviewed.

Third Party Interviews and Third Party Contact Considerations

It may be necessary to contact a third party for the purpose of gathering information concerning other officers or employees.

The Revenue Officer will secure and include in the file documentation of sources of income and assets and all necessary supporting documents in order for the initiating revenue officer to make a recommendation for assertion or non-assertion of the Trust Fund Revenue Penalty, including non-assertion due to collectability.

Evidence That May Support Recommendations

In the majority of cases, the largest portion of evidence that is secured to support recommendations of Trust Fund Recovery Penalty is either corporate records or bank records.

Note: Determination of the amount of documentation required to support the recommendation to assert the penalty is done so on a case by case basis. 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.

Corporate records that can be reviewed include:

Articles of Incorporation

Minute Books

Forms 941 and 1120 or 1065

Payroll records

Any other records that may be relevant to determining the roles and responsibilities of individuals involved with the corporation

1. The corporate records should be reviewed to determine:
 - Duties (and changes to duties) of officers, directors, etc.
 - Appointments and resignations of officers, directors, etc.
 - Responsibilities of individuals to file and pay tax returns
 - Issuance of stock to officers
 - Assets transferred to officers
 - Loans made to officers

- Unreported payroll and other taxes
- Diversion of funds
- Borrowing of funds not used to pay taxes
- 2. Bank records that can be reviewed include:
 - Cancelled checks and bank statements
 - Signature cards and correspondence to the bank relative to changes affecting the signature cards
 - 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
- 2. The bank records should be reviewed to determine:
 - Authority of persons to sign checks and deposit funds
 - Authority of persons to obligate the corporation by borrowing
 - Diversion of funds to officers, members, etc.
 - Deposits and withdrawals of alleged loans to corporation by officers, members, directors, etc.
 - Excessive salaries, expenses, etc.
 - Payment of other obligations
 - Deposit records for monies received for sale of assets
 - Deposit records of payments for stock in the corporation
 - Any other relevant records

Calculating the TFRP

If a taxpayer submits a partial payment of a liability when there are assessments for more than one taxable period, and the taxpayer did not provide specific written instructions as to the application of the partial payment, the payment will be applied in a manner serving the best interests of the government. The payment will be applied to satisfy the liability for successive periods in descending order of priority until the payment is absorbed. If the amount applied to a period is less than the liability for the period, the amount will be applied to tax, penalty, and interest, in that order, until the amount is absorbed. When considering the best interest of the government and period of priority, in addition to statute and lien priority issues, consideration will be given to first applying payments to the non-trust funds.

Note: If returns were calculated under IRC 6020(b) and the liability is being included as part of the TFRP assessment, said returns must be submitted for processing and must be included as pre-assessed modules if the assessment has not yet posted.

Determining the TFRP balance applies:

On cases where the Letter 1153(DO) is issued on or after June 19, 2000

For all payments received on or after January 1, 2003 for cases where the Letter 1153(DO) was issued before June 19, 2000

All undesignated payments on a tax period are applied following the guidelines below:

SEQUENCE OF PAYMENT APPLICATION

Non-trust fund portion of tax (employer's share of FICA, or the non-trust fund reported on Form 720)

Trust fund portion of tax (withholding and employee's share of FICA, or the trust fund "collected" excise tax under IRC 6672 on communications or air transportation).

Assessed lien fees and collection costs

Assessed penalty

Assessed interest

Accrued penalty to date of payment

Accrued interest to date of payment

Special Payment Application Rules

Proceeds from an offset or a levy on a contract are applied to the liability incurred during the period of the contract even though the application may not serve the best interests of the government.

Payments by Responsible Party on Behalf of the Employer

When efforts to collect the tax, penalty, and interest from the employer have been unsuccessful, it may be suggested to the responsible persons that they have two options:

Pay the withheld tax liability on behalf of the corporation.

Have the Trust Fund Recovery Penalty.

1. If a responsible person chooses to pay on behalf of the corporation then:

Payment will be made by cash, cashier's check, certified check, or other acceptable payment form.

The responsible person may provide the funds to the corporation and pay with a corporate check.

If the payment is not made with a corporate check, the responsible person(s) will provide a signed statement certifying that payment is being made on behalf of the corporation for the application to the trust fund liability.

The statement will read 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}."

This statement protects the government's position in cases where a responsible person later files a claim for refund of the TFRP, claiming that their personal tax payment was misapplied or applied against their wishes to the corporate liability.

Retain the signed statement along with a copy of Form 4183 as part of both the balance due and any TFRP case files.

Note: if statement accompanying unsolicited payments are to be accepted as adequate they must clearly indicate the intent to designate payments, along the lines of the statement in (d) above.

The TFRP investigation will continue while awaiting designated payments from a responsible person.

Form 4183 Penalty Assessment Recommendation

The Revenue Officer will review all of the documentation in the case file as well as all Forms 4180 in order to make a determination regarding responsibility and willfulness for each potentially responsible party.

A collectability determination must be completed for each potentially responsible person determined to be both responsible and willful.

Manager's Review of Trust Fund Recommendations

1. The group manager must complete a thorough review of the Trust Fund Recovery Penalty recommendation to determine the adequacy of the TFRP recommendation prior to the revenue officer issuing the assessment.
2. The manager's review of the recommendation must address the same issues that the revenue officer addressed. When the answer to any of the questions is "no", the manager should consider whether to return the recommendation to the revenue officer for corrective action and/or further development. Managers must ensure all required documents are in the case file and a collectability determination has been made on each potential responsible officer.

Notification of Proposed Assessment

Once Form 4183 is approved by the group manager, the Revenue Officer should prepare Form 3177, Notice of Action on the Master File, to request input of the TC 130 to freeze any potential refunds for all individuals determined to be responsible for the TFRP. The form may be prepared using the ATFR program. Form 3177 should then be submitted to the CP 44 Unit in Accounting Control/Services for input of the TC 130.

Letter 1153 and Form 2751 are then prepared, and along with Publication 1, they are delivered to the taxpayer. A copy of page 4 of Form 4183 showing the penalty computation may also be included with the documents delivered to the taxpayer so they are aware of how payments were applied to the account.

Letter 1153

Notifies the responsible party of the proposed assessment

Contains a description of the available appeal rights

Affords the responsible party the opportunity to agree to or to appeal the assessment

Should be modified if the responsible person has filed a bankruptcy proceeding and the automatic stay is still in effect, to delete any references to: the Service "collecting" the TFRP, any actions the taxpayer should take to delay collection activity by the Service, and any collections the Service may take in Jeopardy circumstances

Form 2751

Provides a report of the corporate liability

Provides a breakdown of the proposed TFRP assessment for each quarter for which the TFRP assessment is proposed

Allows the responsible party to agree to the proposed assessment

Waives the 60 day restriction on notice and demand if signed by the taxpayer

May be signed by the responsible party at any time during the TFRP investigation or after the Service has issued Letter 1153(DO)

Payroll Tax Withholding and the IRS

It is tempting to “borrow” the payroll taxes withheld from your employees-in order to take advantage of the time between payday and the day you’re supposed to pay those amounts over to the Internal Revenue Service.

Section 6672 of the tax code makes you liable’ “in addition to other penalties provided by law... to a penalty equal to the total amount of the tax” not accounted for and paid over. There is a civil penalty that may, at the government’s discretion be assessed. It may also be augmented by criminal prosecution. The Tax code (section 7202) makes it a felony to willfully fail “to accounts for; and pay over” taxes withheld from employees.

You are deemed to have withheld the taxes (withholding tax, as well as your employees’ share of Social Security and Medicare taxes) by paying your employees their wages net the deductions. The withheld amounts constitute a fund you hold in trust for the government. This “trust fund” is not the same as a debt such as accounts payable.

A debt is what you owe your creditors for goods or services, or for a loan you received. Even your personal income tax is your debt to the government. The taxes you withhold from your employees’ compensation are treated as the government’s money that you hold in trust as agent or trustee. IRS regulations stipulate that once you have withheld the tax, your employees are entitled to credit for it, regardless of when (or if) you pay it over to the government.

You will be held personally liable for the withheld taxes, if: (a) you are responsible for its collection and payment. Whether as the owner of the business or a person authorized to handle its funds; and (b) your failure to collect the tax and pay it over are “willful.” You have the burden of proving the absence of at least one of elements.

You do not have to be the owner of the business. The courts have made it clear that you can be held liable for the tax if you are in a position to exercise significant control even if you don’t have the final word over the disbursement of funds. Whether you are called the chief financial officer or the bookkeeper, if you authorized to determine which creditors are to be paid, and to issue checks, you can be held responsible even if some payments are subject to a superior’s approval.

The easier question has to do with the “willfulness,” since the courts have provided an answer that is very simple: Failure to pay withholding taxes is willful within the meaning of irc section 6672 if you pay other creditors when you don’t have sufficient funds to pay the taxes you know to be due. Even an employee to whom you owe wages is regarded as just another creditor.

If your company is teetering at the edge, you are generally better advised to close it down than to use the government’s money as working capital.

Section 6672¹

Failure to collect and pay over tax, or attempt to evade or defeat tax

(a) General rule

Any person required to collect, truthfully account for, and pay over any tax imposed by this title 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, 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. No penalty shall be imposed under section 6653 or part II of subchapter A of chapter 68 for any offense to which this section is applicable.

(b) Preliminary notice requirement

(1) In general

No penalty shall be imposed under subsection (a) unless the Secretary notifies the taxpayer in writing by mail to an address as determined under section 6212(b) or in person that the taxpayer shall be subject to an assessment of such penalty.

(2) Timing of notice

The mailing of the notice described in paragraph (1) (or, in the case of such a notice delivered in person, such delivery) shall precede any notice and demand of any penalty under subsection (a) by at least 60 days.

(3) Statute of limitations

If a notice described in paragraph (1) with respect to any penalty is mailed or delivered in person before the expiration of the period provided by section 6501 for the assessment of such penalty (determined without regard to this paragraph), the period provided by such section for the assessment of such penalty shall not expire before the later of –

- (A) the date 90 days after the date on which such notice was mailed or delivered in person, or
- (B) if there is a timely protest of the proposed assessment, the date 30 days after the Secretary makes a final administrative determination with respect to such protest.

(4) Exception for jeopardy

This subsection shall not apply if the Secretary finds that the collection of the penalty is in jeopardy.

(c) Extension of period of collection where bond is filed

(1) In general

If, within 30 days after the day on which notice and demand of any penalty under subsection (a) is made against any person, such person -

- (A) pays an amount which is not less than the minimum amount required to commence a proceeding in court with respect to his liability for such penalty,
- (B) files a claim for refund of the amount so paid, and
- (C) furnishes a bond which meets the requirements of paragraph (3), no levy or proceeding in court for the collection of the remainder of such penalty shall be made, begun, or prosecuted until a final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding the provisions of section 7421(a), the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court. Nothing in this paragraph shall be construed to prohibit any counterclaim for the remainder of such penalty in a proceeding begun as provided in paragraph (2).

(2) Suit must be brought to determine liability for penalty If,

within 30 days after the day on which his claim for refund with respect to any penalty under subsection (a) is denied, the person described in paragraph (1) fails to begin a proceeding in the appropriate United States district court (or in the Court of Claims) (FOOTNOTE 1) for the determination of his liability for such penalty, paragraph (1) shall cease to apply with respect to such penalty, effective on the day following the close of the 30-day period referred to in this paragraph.(FOOTNOTE 1) See References in Text note below.

(3) Bond

The bond referred to in paragraph (1) shall be in such form and with such sureties as the Secretary may by regulations prescribe and shall be in an amount equal to 1 1/2 times the amount of excess of the penalty assessed over the payment described in paragraph (1).

(4) Suspension of running of period of limitations on collection

The running of the period of limitations provided in section 6502 on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Secretary is prohibited from collecting by levy or a proceeding in court.

(5) Jeopardy collection

If the Secretary makes a finding that the collection of the penalty is in jeopardy, nothing in this subsection shall prevent the immediate collection of such penalty.

(d) Right of contribution where more than 1 person liable for penalty

If more than 1 person is liable for the penalty under subsection (a) with respect to any tax, 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. Any claim for such a recovery may be made only in a proceeding which is separate from, and is not joined or consolidated with -

- (1) an action for collection of such penalty brought by the United States, or
- (2) a proceeding in which the United States files a counterclaim or third-party complaint for the collection of such penalty.

(e) Exception for voluntary board members of tax-exempt organizations

No penalty shall be imposed by subsection (a) on any unpaid, volunteer member of any board of trustees or directors of an organization exempt from tax under subtitle A 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.

The preceding sentence shall not apply if it results in no person being liable for the penalty imposed by subsection (a).

ⁱ IRC section 6672