

Collection

Employment Tax Collection Case

By *Patti Logan*

The Government Accountability Office (GAO) studied the IRS's handling of employment tax collection cases.¹ Overall, the GAO determined that employment tax cases were a huge percentage of the IRS collection inventory. The GAO determined that IRS actions often do not prevent additional taxes from being added when a taxpayer already owes employment taxes; the IRS takes too long to file Notices of Federal Tax Liens in these situations, and the trust fund recovery penalty is not utilized in a timely manner. Businesses that owe employment taxes often come to us to represent them before the IRS, so it is important that we understand what the IRS plan of action entails. There are several types of employment tax collection cases:

1. **Trust funds.** These are taxes that employers deduct from employee's paychecks. Once deducted, the employer holds them in trust until paying them over to the IRS. A penalty equal to the amount of tax collected from employees but not paid over may be assessed against persons who are willful and responsible for the payment of the tax.² After the penalty is properly assessed, the IRS may take collection action against those persons who owe the trust fund penalty.
2. **Repeater trust fund taxpayers.** These are taxpayers who are in-business, not current with their Federal Tax Deposits (FTDs) and have been repeatedly assigned to the IRS field collection units with outstanding liabilities. Note: Once taxpayers begin to make timely FTDs and are in compliance on filing, they are no longer considered repeaters.
3. **Pyramiding trust fund taxpayers.** These taxpayers are in-business, not current with their FTDs and owe two or more trust fund modules that are assigned to the collection field function.



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Patti Logan, EA, specializes in taxpayer representation before the Collection Division. As a former Revenue Officer, she brings a unique expertise to the inner workings of the Special Procedures Branch. She can be reached at patti@thetaxgroup.com.

Because of the GAO report as well as Congressional hearings, IRS has agreed to:

- file Notices of Federal Tax Liens as soon as is appropriate;
- recommend and assess trust fund recovery penalties as soon as is appropriate; and
- apply a strategic approach to employment tax cases.

In July 2008 as a result of the GAO report and the Congressional hearings, then-IRS Deputy Commissioner Linda Stiff directed the Service-wide Employment Tax Advisory Council (SETAC) to focus its efforts and concentrate solely on the more effective use of enforcement tools in employment tax cases.³ Two teams were established to conduct comprehensive reviews of the Federal Tax Lien (FTL) and Trust Fund Recovery Penalty (TFRP) programs.

On March 17, 2009, the Director, Collection issued a memorandum entitled *A Working Approach to Resolving Employment Tax Cases*. The comprehensive strategy identified a number of factors that influence the directions of an employment tax case:

- Type of entity and type of returns required
- Ownership of the entity
- Protection of the government's interest through timely lien determinations
- Early pursuit of the Trust Fund Recovery Penalty
- Pyramiding and repeater entities
- Multiple entities and successor entities
- Nominee, transferee/alter ego issues
- Third-party payors
- Issues requiring suit recommendations
- Employment tax fraud issues

In pursuing employment tax compliance, the IRS is focused on several actions:

- **Federal Tax Deposit alerts (“FTD alerts”).** FTD Alerts are not a new tool but had fallen out of favor in the past. The FTD Alert is issued to investigate a taxpayer who has not made timely deposits when they had in the past or has substantially reduced the deposit. After an initial analysis, if it is determine that the taxpayer has probably fallen behind on deposits, Collection then goes to the taxpayer's place of business and interviews the taxpayer. If the taxpayer is not in compliance, the Collection employee reviews the FTD requirements, discussing the consequences of noncompliance such as levy action and possible seizure actions. If the taxpayer still is not brought into compliance, the

account is monitored, the 941 for the period is secured, and, if full payment is not received, Collection may make an immediate assessment and begin collection on the case.⁴ In some cases, the taxpayer has a seasonal business or issues end of year bonuses. In such cases, the Collection employee may close the alert and notify the computer that future FTD alerts should be suppressed.

- **Develop and test streamline procedures for requesting injunctive relief.** The Internal Revenue Code requires that the IRS may not levy any property if the amount of the expenses that the Secretary estimates at the time of the levy exceeds the fair market value of such property at the time of the levy.⁵ After the law was passed, the IRS realized that when a business was pyramiding taxes, they could levy the bank accounts and receivables, but that did not always close the business. Without the ability to levy the real and personal property even when there was no equity, the taxpayer could stay in business and the IRS was hamstrung. The answer to the problem lay in the court system. The IRS began closing businesses with no equity by asking the courts to issue an injunction against the business.
- **Pursuit of criminal prosecution in appropriate instances.** When you are working with a revenue officer on an in-business tax case and your client continues to add more 941 quarters to those unpaid, be aware that the revenue officer may refer the case to Criminal Investigation. In one case I worked, the revenue officer told me that my client met all of the factors present for criminal prosecution.

Practice Pointer. When you enter into a situation where your client is pyramiding 941 taxes, adding more and more quarters to the revenue officer's inventory, if you are not versed in criminal prosecution, you may want to refer your client to an attorney who knows how to handle this type of case. For those of us who are enrolled agents or CPAs, there may come a time when it is appropriate to turn the case over to a tax attorney. Although your client may want you to stay involved with the case, if you are only covered under the attorney/client privilege, think hard before staying closely involved.

Filing the Notice of Federal Tax Lien

The GAO report found that the IRS did not timely file the Notice of Federal Tax Lien (FTL). A Notice of Federal Tax Lien protects the government's interest in the taxpayer's equity. When a revenue officer receives a case, they have 30 days to make contact with the taxpayer (in the case of a pyramiding taxpayer). Within 10 calendar days of the initial contact the collection employee must decide if it is appropriate to file a Notice of Federal Tax Lien. Before filing the lien the field collection employee *must* make a reasonable effort to contact the taxpayer. Although notices sent by the computer meet the minimum requirements of the law, when a lien has not been previously filed, the lien determination should be made in conjunction with an attempt to contact the taxpayer.

At the same time as making the lien determination, the collection employee may issue the Letter 1058, giving the taxpayer their Collection Due Process (CDP) rights. If the Letter 1058 is issued at the same time the lien is filed, Appeals may address both the filing of the lien and the proposed levy at the same CDP hearing.

The collection person who is considering whether or not to file a lien must consider if the filing of the lien may hamper collection. In that case, the filing of the lien may be deferred. But in making that decision, the compliance history of the taxpayer must be considered.

So, for example, if your client must sell his accounts receivable to a factor in order to make his installment agreement payments and other operating expenses, and the factor also requires the client to give a security interest in all current and future accounts receivable, the revenue officer may agree to defer the filing of the lien. In this case, you can clearly show the revenue officer that filing of the lien will end the factoring arrangement by providing a copy of the factoring contract. Expect the revenue officer to require your client to stay in full compliance while the installment agreement is being considered and of course, once the agreement is approved.

There are other situations other than hampering collection where the revenue officer is advised not to file a Notice of Federal Tax Lien:⁶

- When the taxpayer is a corporation that has gone through a liquidating bankruptcy

- When more than one party has been assessed a trust fund recovery penalty on the same periods and the assessment has been paid by one of those parties, it is not appropriate to file a lien on the nonpaying party.
- When there is an indication that the liability has been satisfied or there are credits available to satisfy the liability
- When the taxpayer is a financial institution under control of the Resolution Trust Corporation
- When the taxpayer is in bankruptcy and the lien relates to liabilities incurred before the taxpayer filed for bankruptcy
- When there is genuine doubt as to the validity of the liability
- When the taxpayer is deceased and there are no known assets in an estate
- When the taxpayer resides abroad and has no known assets in the United States

The revenue officer may defer the decision whether or not to file the lien; however, managerial approval is required on most employment tax cases. Territory manager approval is required for all revenue officer determinations to not file the lien or defer filing the lien where there are 10 or more employment tax quarters.

Trust Fund Recovery Penalty

The GAO also concluded that the IRS was failing to assess the trust fund recovery penalty in a timely manner and that the IRS, once the penalty is assessed, does not make collection of the penalty a priority. The IRS is now stressing the trust fund recovery penalty when dealing with employment tax cases.

Revenue officers are instructed to begin building the trust fund recovery penalty case upon initial case analysis and when first contacting the taxpayer. Note: Revenue officers are advised that if the taxpayer has a power of attorney on file, they should schedule the visit to the taxpayer's place of business.⁷

Initial analysis of the trust fund penalty includes the following:

- Checking the Articles of Incorporation for a list of corporate officers
- Securing a Form 4180, *Report of Interview with Individual Relative to Trust Fund Recovery Penalty of Personal Liability for Excise Taxes*
- Securing financial information on the company and potentially responsible officers (Form 433A,

Collection Information Statement for Wage Earners and Self-Employed Individuals, and Form 433B, *Collection Information Statement for Businesses*)

- Completing a business and personal compliance check assuring that returns have been filed and required deposits have been made. If the required 941s have not been filed, the revenue officer is instructed to get the information necessary to prepare the return under authority of Code Sec. 6020(b).
- Identifying potentially responsible persons
- Getting copies of signed Forms 941 and bank signature cards, and interviewing all potentially responsible persons

Revenue officers are advised that the taxpayer is more likely to be cooperative and submit information when they are seeking something such as an installment agreement.

Once the revenue officer has determined the persons who are willful and responsible for nonpayment of the employment taxes, they must take action to propose the trust fund recovery penalty against the person(s).

Although the trust fund recovery penalty cannot be separated from any article regarding collection of employment taxes, in-depth information regarding the penalty and defending a person against the proposed assessment is outside of the scope of this column. It is important though to mention that there are two components to the determination of whether the penalty should be assessed against a person:

1. **Responsibility.** The determination of responsibility is based on the position the person holds in the business as well as their duty and authority. Each case should be looked at separately.
2. **Willfulness.** In the case of the trust fund recovery penalty, willfulness means intentional, deliberate, voluntary, reckless, knowing as opposed to accidental. Evil intent or bad motive is not required.

Monitoring Compliance

It is estimated that 70 percent of all unpaid employment taxes are owed by businesses that have pyramided more than four quarters of unpaid payroll taxes. The IRS has determined that preventing pyramiding is a significant goal of the revenue officer.

When we as representatives have clients required to make Federal Tax Deposits, it is just as important

for us to verify that they understand those requirements and are actually making the required deposits. There are two things that are an absolute must when dealing with collection:

1. That all tax returns have been filed as required
2. That, at least for the current period, all efforts are made to comply with the deposit or estimated tax payment requirements

Filing the tax returns is usually simple to handle. Making up for missing deposits or estimated tax payments for the current period may be more difficult. The revenue officer may consider it sufficient for the taxpayer to become current from the point of initial contact onward. However, if the taxpayer is unable to make their required FTDs and pay their ongoing operational expenses, the taxpayer will have few options available for resolving the tax problem. When clients cannot make employment tax deposits and pay their necessary operational expenses, the revenue officer will immediately consider closing the business.

While the revenue officer is working the case, they are instructed to require the taxpayer to prove that required FTDs are being made either at their bank or through the Electronic Federal Tax payment System (EFTPS).⁸

Successors

When the revenue officer monitors compliance, they are on the look-out for taxpayers who have accrued multiple employment tax periods on one company, closed that company and then opened another company doing essentially the same work, with the same assets and the same or similar business name as the original company. The IRS considers these as successor entities.

When the revenue officer identifies a successor entity, they have several options:

- The successor entity may be considered an alter ego of the original business or the transfer of the assets may be considered as a fraudulent transfer. In these cases, the revenue officer may refer the case for litigation to collect against the transferred assets or from the income and assets of the successor entity.
- If equity exists in the transferred assets or if the original business still has assets, the revenue officer may move swiftly to levy or seize them. Note: In some cases, representatives have worked with the revenue officer to arrange a

levy of assets at the time of a sale. The purchaser is discharged of their obligation to pay the seller.⁹ The IRS receives the value of the assets being sold, and the seller is protected as long as the sale is for fair market value of the property. Although this is not as technically correct as the discharge of federal tax lien, in many cases the value of the assets being sold are less than the cost of preparing the application for the discharge including valuation of the assets by two disinterested parties.

- If a lien has been filed on the original business, the successor corporation may apply for a discharge of federal tax lien and pay the fair market value of the property less any senior encumbrances.

Disqualified Employment Tax Levies

As we know, the Internal Revenue Code¹⁰ requires that a person be given notice before a levy is served and a right to a fair hearing (collection due process). In the case of employment taxes, if the person subject to the levy requested a collection due process hearing (CDP) in the most recent two years before the beginning of the taxable period included on the current levy, then the right to a hearing is granted *after* the levy rather than before. The prior hearing must be a CDP hearing and not an equivalent hearing. The two-year look-back period is measured from the beginning of the disqualified employment tax levy period. If the taxpayer requested a CDP hearing for employment taxes arising during a calendar quarter that ended during the two-year period, the module meets the criteria for a DETL.¹¹

Example 1. The taxpayer requests a timely CDP levy hearing for Form 941 taxes for quarter ended December 31, 2007. The taxpayer accrues an additional employment tax liability for the quarter ended June 30, 2008. This additional liability qualifies for DETL levy because the taxpayer requested a prior levy hearing for a quarter that ended (December 31, 2007) within the two-year look back period (April 1, 2006, through April 1, 2008).

Example 2. The taxpayer requests a timely CDP levy hearing for Form 941 taxes for quarter ended March 31, 2007. The taxpayer is assessed an additional employment tax liability for the

quarter ended December 31, 2005. This liability does NOT qualify for a DETL levy because the taxpayer requested a prior levy hearing for a quarter that ended (March 31, 2007) outside the two-year look back period (October 1, 2003, through October 1, 2005).

If the tax period currently owed meets the DETL criteria, then a Letter 1058-D, *Notice of Levy and Notice of Your Right to Hearing*, is sent to the taxpayer with a copy of the disqualified levy.

Third-Party Payors

More and more employers are using third-party payors, either a payroll service provider or a professional employer organization. The payroll service performs services for the employer such as filing returns and making employment tax payments. The professional employer organization offers employee leasing where the employee of the taxpayer is actually employed by the professional employer organization and leased to the taxpayer. Other third-party payors include employee leasing companies and reporting agents.

The problem comes when the third-party collects the money from the taxpayer to pay the employment taxes but fails to do so. The Treasury has proposed implementing standards clarifying when employee leasing companies can be held liable for the federal employment taxes of the actual employer.¹²

The IRS advises the actual employer to only use leasing companies who use EFTPS so that the taxpayer may verify that payments are being made. In flagrant cases where the third party has failed to pay over the taxes that were paid to them, revenue officers are instructed to consider injunctive relief and referral to Criminal Investigation for criminal prosecution.¹³

Installment Agreements

Many of our business clients want an installment agreement in order to pay their back taxes. As previously mentioned, it is imperative that all returns be filed before proposing an installment agreement. If the revenue officer determines that the taxpayer does not have adequate ability to fully pay the taxes, the next consideration is the installment agreement. The revenue officer is going to look at several options:

- Is the business able to get a loan to pay some or all of the taxes?

- If entering into an installment agreement, is it appropriate to assess the trust fund recovery penalty in conjunction with the installment agreement? The manual generally advises the revenue officer to assess the trust fund recovery penalty unless the entire liability will be paid within 90 days; the taxpayer agrees to liquidate assets to pay the tax in full within 90 days or the person responsible agrees to liquidate specified assets to pay the entire trust fund amount within 90 days.¹⁴ Is the responsible officer willing to sign a Form 2750 extending the statute for assessment of the penalty? Is the potentially responsible person able to make payments from their current assets or income?¹⁵
- After assessing the trust fund recovery penalty, and entering into an installment agreement with the taxpayer, when is it appropriate to withhold collection of the penalty? They must consider the potential success of the installment agreement. Is collection of the trust fund recovery penalty in jeopardy? Will a lien be filed against the trust fund recovery penalty?

Note. In the past, revenue officers have only wanted to enter into installment agreements for trust fund taxes if the taxes plus accruals can be paid in a short period of time. In current training, the maximum payment term for in-business trust fund installment agreement is indicated to be the length of time remaining on the collection statute of limitations.¹⁶

Trust Fund Compliance Tools

When a revenue officer is unable to convince a business taxpayer to make timely federal tax deposits, they have several tools to stop additional pyramiding. Obviously the revenue officer may levy or seize assets attempting to force the business to close or convince the owner to be current on their FTDs. However, sometimes the business has little or no assets. In these cases, the revenue officer may use compliance tools.

Letter 903 may be issued to the taxpayer. This letter puts them on notice that they must file and pay their taxes on a timely basis or be subject to certain requirements and restrictions such as filing the 941 monthly, having to make special deposits into a specific bank or being subject to civil actions or criminal prosecutions. Once this letter is issued, a code is input in the computer which accelerates subsequent delinquent periods to be assigned immediately to the field.

If taxpayers do not become compliant after issuance of the Letter 903, they may be required to file their 941 monthly on Form 941-M¹⁷ and make their deposits into a special bank account¹⁸ for a minimum of six months.

While issuing the Letter 903 or requiring monthly filing or special deposits, the revenue officer may be referring the case to Criminal Investigation.

As you can see, employment taxes have become an even greater priority for Collection.

ENDNOTES

¹ Tax Compliance: Business Owed Billions in Federal Payroll Taxes (GAO-08-0617).

² Code Sec. 6672.

³ Written Testimony of IRS Deputy Commissioner Services and Enforcement Linda Stiff Before the Senate Homeland Security and Government Affairs Permanent Subcommittee on Investigations on the Collection of Federal Employment Taxes, July 30, 2008.

⁴ IRM §5.7.1.

⁵ Code Sec. 6331(j)(2)(c).

⁶ IRM §5.12.2.4.2.

⁷ Revenue Officers FY 09 Continuing Professional Education, *Participant Guide*.

⁸ For information on how to sign up for EFTPS, see www.eftps.gov.

⁹ Reg. §301.6331-2(c)(1).

¹⁰ Code Sec. 6330.

¹¹ IRM §5.1.9.

¹² Treasury Department General Explanations of the Administration's Fiscal Year 2011

Revenue Proposals (GREEN BOOK), Feb. 2, 2010.

¹³ Revenue Officers FY 09 Continuing Professional Education, *Participant Guide*.

¹⁴ IRM §5.7.4.1(2).

¹⁵ Revenue Officers FY 09 Continuing Professional Education, *Participant Guide*.

¹⁶ Revenue Officers FY 09 Continuing Professional Education, *Participant Guide*.

¹⁷ Reg. §31.6011(a)-5.

¹⁸ Code Sec. 7512.

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