Nuts and Bolts of Employment Taxes, the Trust Fund Recovery Penalty and the Section 6721 Information Return Penalty

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1 Portions of this Outline compile and organize the Internal Revenue Manual and the publicly available information available from the Internal Revenue Service regarding the trust fund recovery penalty. Although we have edited and re-organized the sections, no representation is made that this is the original work of the editors.
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Part I - Employment Taxes and the Trust Fund Recovery Penalty

I. Introduction

Amounts withheld from employee wages account for 70% of all revenues collected by the U.S Department of the Treasury (“Treasury”). As of October 2018, more than $57 billion of tax reported as due on employment tax returns remained unpaid. Considerable revenue is also lost as a result of misclassified workers. The Treasury estimates that, based on 2011 figures, for every worker classified as an independent contractor rather than an employee, a service consumer (i.e., one who uses workers to perform services)\(^2\) “saves” $3,710 in employment taxes and $43,007 in income paid annually.\(^3\) It is in the light of these staggering statistics that the Internal Revenue Service (“IRS” or “Service”)) and the Tax Division of the Department of Justice (“Tax Division”) recently identified civil and criminal employment tax enforcement as among the agencies’ top priorities.

This Outline discusses: (1) employer’s federal employment tax filing and withholding obligations; (2) the trust fund recovery penalty (“TFRP”) under I.R.C. ’6672, including who is a responsible person and when a responsible person acts “willfully” to support the imposition of the TFRP; (3) how continued noncompliance with employment tax obligations can result in criminal investigation and prosecution; (4) the assessment and collection of the TFRP; (5) rights before IRS collection and IRS Appeals to challenge a TFRP pre-assessment; (6) strategies to challenge and prevent the assessment of the TFRP; (7) how to resolve multiple TFRP assessments against more than one responsible person(s); and (8) an introduction to TFRP litigation.

\(^2\) The term “service consumer” is used in this outline to mean an individual, business enterprise, organization, State, or other entity for which a worker has performed services. The term “employer” is used only when an employer-employee relationship has already been assumed or established for purposes of a particular discussion.

Employee (Mis)Classification and Employment Taxes

A. Employee Classification

1. Overview: There are numerous relationships that can exist between a service consumer and a worker, including:

   a. Employer-employee;
   b. Independent contractor;
   c. Statutory employee; and
   d. Non-statutory employee.

   The relationships are defined by common law (i.e., case law) and statute.

2. Employer-Employee

   a. Defined: An employer-employee relationship generally exists when the persons (or businesses) for whom the services are being performed:

      have a right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as to how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so.

      Rev. Rul. 87-41, 1987-1 C.B. 296 (emphasis added); Treas. Reg. § 31.3121(d)-1(c)(2).

   b. So long as this relationship exists, a worker is generally designated as an employee, regardless of whether the parties agreed otherwise; any title or designation claiming that the worker is anything other than an employee is inconsequential.

3. Independent Contractor

   a. Defined: An independent contractor relationship may exist where a worker follows an “independent trade, business or profession in which they offer their services to the public.” Rev. Rul. 87-41, 1987-1 C.B. 296.

   b. Examples: Service-providers, such as doctors, veterinarians, and auctioneers, are more easily classified as independent contractors because, as the IRS explains, “the person for whom the services
are performed[] ha[s] the right to control or direct only the result of
the work and not the means or method of accomplishing the

c. Balancing Test Applied: The IRS applies a detailed balancing test
to resolve the somewhat nebulous issue of whether an employer-
employee relationship exists. In Rev. Rul. 87-41, 1987-1 C.B. 296,
the IRS established a list of 20 factors, weighted in terms of
importance, depending upon the worker’s occupation and the
factual context, to determine whether sufficient control was present
to create an employer-employee relationship.

4. Statutory Employee

a. Statutorily Defined: In addition to the common law tests discussed
above, the Code also classifies the following workers as
employees:

i. Officers of corporations, as well as superintendents,
managers, and other supervisory personnel are generally
considered employees unless the officer performs few to no
services for the corporation and is not paid (or entitled) to
be paid.

ii. Statutory Employees: Specific categories of statutory
employees that the Code recognizes include:

1. Drivers engaged in distributing meat, vegetable,
fruit, or bakery products; beverages (other than
milk); or laundry or dry-cleaning services, see
I.R.C. ' 3121(d)(3)(A);

2. Fulltime life insurance salesmen, see I.R.C. ' 3121(d)(3)(B);

3. People who perform work from home according to
the service consumer’s specifications, using
materials or goods furnished by the service
consumer that are required to be returned, see I.R.C.
' 3121(d)(3)(C); and

iii. Fulltime traveling or city salespersons engaged in
solicitation and transmission to the service consumer of
orders of wholesalers, retailers, contractors, or operators of
hotels, restaurants, or other establishments for merchandise

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for resale or supplies for use in their business operations, see I.R.C. ' 3121(d)(3)(D).

b. Many States also have comparable statutes defining an employee. See, e.g., N.Y. LABOR LAW § 511.

5. Non-Statutory Employee

a. The Code also designates as nonemployees three categories of workers:

i. Licensed real estate agents for whom a substantial part of their income is paid on commission under a contract specifying that they are not an employee for tax purposes;

ii. “Direct sellers” (i.e., those who sell consumer products in a place other than a permanent retail establishment, are engaged in selling consumer products to any buyer on a buy-sell basis, deposit-commission basis, or any similar basis for resale, or are engaged in newspaper or shopping news delivery); or

iii. Companion sitters (i.e., babysitters or careworkers for the elderly or disabled) who are not employees of a companion-sitting placement service. I.R.C. " 3506, 3508; IRS Pub. 15-A (2014), at 6.

B. Employer-Employee Taxes

1. Individual Components: Federal employment taxes consist of five separate employment taxes and an income tax on self-employment income:

a. Federal Insurance Contributions Act (“FICA”), with operative provisions at I.R.C. " 3101 through 3128;

b. Railroad Retirement Tax Act (“RRTA”), with operative provisions at I.R.C. " 3201 through 3233;

c. Federal Unemployment Tax Act (“FUTA”), with operative provisions at I.R.C. " 3301 through 3311;

d. Railroad Unemployment Repayment Tax (“RURT”), with operative provisions at I.R.C. " 3321 and 3322;

e. Collection of Income Tax at Source on Wages (“ITW”), with operative provisions at I.R.C. " 3401 through 3406; and


3. Importance of Worker Classification to Employment Taxes: A worker’s status or classification (i.e., employee, independent contractor, or other non-employee) determines what taxes are paid and who is responsible for reporting and paying these taxes. I.R.M., pt. 4.23.8.2 (May 17, 2018).

   a. Types of Taxes That Apply to Employer-Employee: Generally, if an employer-employee relationship exists, the employer is liable for FICA, FUTA, and ITW under I.R.C. "3101, 3102, 3111, 3301, 3402, and 3403, respectively.

   b. Exceptions Abound: There are exceptions to these general rules that are outside the scope of this outline. For more information on determining employment tax liability, see I.R.M., pt. 4.23.8 (May 17, 2018).

4. Income tax/withholding

5. Social Security and Medicare (“FICA”) Tax

   a. Employer and Employee are jointly responsible (7.65%/7.65%)

   b. For more information on calculating employment tax on unreported tip income, see IRM 4.23.7 (01-13-2014).

6. Federal Unemployment (“FUTA”) Tax

   a. Employer pays 6.0%, but up to 5.4% credit possible if taxes timely paid and the state is not determined to be a credit reduction state.


C. SECA Tax for Independent Contractors: Independent Contractors must pay Self-Employment (“SECA”) Tax (15.3%), which covers both the worker’s and the employer’s contributions to the worker’s Social Security and Medicare.
III. Overview of the TFRP

A. Introduction

1. In General:

   a. Authorization of the Penalty: I.R.C. '6672(a) imposes personal liability on any person required to collect, truthfully account for, and pay over taxes held in trust who willfully fails to do so. This liability is known as the trust fund recovery penalty (again, "TFRP").

   i. Collection Device or Penalty? An issue that often arises is whether the I.R.C. '6672 TFRP is a collection device with respect to which interest does not accrue independent of the underlying employment tax liability or whether the TFRP is a separately assessable penalty with respect to which interest accrues independent of the underlying employment tax. Courts are split on this issue.


   iii. Penalty: Another set of courts, including the U.S. Courts of Appeals for the Second, Seventh, and Ninth Circuits, hold that the I.R.C. '6672 imposes a penalty and is not a mere collection device. See, e.g., Mortenson v. Nat’l Union Fire Ins. Co., 249 F.3d 667 (7th Cir. 2001); Duncan v. Commissioner, 68 F.3d 315, 317-319 (9th Cir. 1995), aff’g in part, rev’g in part, and remanding in part, T.C. Memo. 1993-370; Kalb v. United States, 505 F.2d 506, 510 (2d Cir. 1974).

   iv. Why This Matters: Whether the TFRP is a penalty or a collection device affects not only the accrual of interest, but also the procedure that must be complied with to assess the penalty; namely, I.R.C. '6751(b)(1) (discussed below).

   b. Amount of the Penalty: The amount of the liability is equal to the amount of the tax evaded, not collected, or not accounted for and paid over. I.R.C. '6672(a).
c. **Full Unpaid Trust Fund Amount Will Be Collected Only Once:**
The full unpaid trust fund amount will be collected only once in a particular case, whether it is collected from the employer/collecting agent, from one or more of its responsible persons, or from a combination of the employer/collecting agent and one or more of its responsible persons.

i. **Dixon v. Commissioner:** In Dixon v. Commissioner, 141 T.C. 173, 193 (Sept. 3, 2013), the United States Tax Court (“Tax Court”) summarized the “well-established IRS policy against double collection of trust fund taxes”. The Court went on to note that an employer’s payment of employment tax must be credited toward a responsible person’s potential liability for the I.R.C. § 6672 penalty to avoid double collection of the same tax. Id. at 194-194.

ii. **IRS’s Policy Statements:** The IRS’s policy statements also state that the TFRP, including interest and penalties, should be collected only once (either from the business or from one or more of its responsible persons). See I.R.M., pt. 1.2.14.1.3(2) (June 9, 2003) (Policy Statement 5-14); see also IRM, pt. 5.17.7.1.9(2) (Aug. 1, 2010) (“If, after the assertion of the TFRP, the corporation pays the delinquent tax, the TFRP assessment will be abated.”).

d. **Tax Forms to Which the TFRP Can Relate:** Assessments of the TFRP are possible based on liabilities for the following tax forms:

i. Form 941, Employer’s QUARTERLY Federal Tax Return;

ii. Form 720, Quarterly Federal Excise Tax Return;

iii. Form CT-1, Employer’s Annual Railroad Retirement and Unemployment Return;

iv. Form 943, Employer’s Annual Federal Tax Return for Agricultural Employees;

v. Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;

vi. Form 945, Annual Return of Withheld Federal Income Tax;

vii. Form 944, Employer’s ANNUAL Federal Tax Return;

viii. Form 8288, U.S. Withholding Tax Return for Dispositions
ix. Form 8804, Annual Return for Partnership Withholding Tax (Section 1446). See I.R.M., pt. 5.7.3.1.1(3) (Aug. 6, 2015).

** This outline focuses on the applicability of the TFRP in the employment tax context.

e. **Bad Acts to Which TFRP Can Apply:** The TFRP may be imposed, with respect to the taxes described above for:

i. Willful failure to collect tax;

ii. Willful failure to account for and pay over tax; and

iii. Willful attempt in any manner to evade or defeat tax or the payment thereof. See I.R.M., pt. 5.7.3.1.1(5) (Aug. 6, 2015).

f. **Applicability to Excise Taxes:** The TFRP is normally applied to employment tax returns for withheld income tax, withheld Social Security tax, and withheld Railroad Retirement Tax, but the TFRP also applies to those excise taxes which are commonly referred to as “collected excise taxes”. Collected excise taxes are those which are imposed on persons other than the person who is required by law to collect the tax and pay it over to the Government (a collecting agent). See I.R.M., pt. 5.7.3.1.1(6) (Aug. 6, 2015).

2. **As Applied to Employment Taxes:**

a. **Employer’s Withholding Obligation:** The Code requires employers to withhold Social Security and Federal excise taxes from their employees’ wages.

b. **Amounts Withheld in Trust for the United States:** The employer is required to hold these monies in trust for the United States and pay such funds over to the United States. I.R.C. ' 7501(a).

c. **Interest Accruals on the TFRP:** Interest on the TFRP begins to accrue on the date notice and demand for payment is given to the responsible person. I.R.C. ' 6601(e)(2)(A).

i. **Interest Accruals on Employment Taxes by Contrast:** Interest on unpaid employment taxes generally begins to accrue on the first date upon which such taxes are due and
not paid (\textit{i.e.}, on the due date of the return). I.R.C. '6601. As a result of this timing difference, there is a potential for mismatch with respect to the accrual of interest on an underlying employment tax liability and related TFRP.

ii. \textbf{Practice Note:} For this reason, it is important to check the IRS’s calculations of interest with respect to the employment tax and the TFRP.

3. \textbf{What Are Trust Fund Taxes?} Trust fund taxes are the amounts that an employer withholds from an employee’s wages for the employee’s federal income taxes, social security, Medicare, and unemployment taxes.

4. \textbf{Filing Obligations:} The employer is required to file quarterly tax returns (Form 941, \textit{Employer’s Quarterly Federal Tax Return}, to report taxes withheld and to make federal tax deposits (FTD) with commercial banks designated as depositories by regulations.

   a. \textbf{Employee’s Share:} The employer withholds the trust fund taxes in trust for the Government until they are paid over to the Government to be applied to the employee’s tax accounts.

      i. Withholding taxes are actually part of the wages of the employee, held by the employer in trust for the government; it is a function of administrative convenience; the employer withholds money from a worker’s paycheck and briefly holds that money before forwarding it to the IRS. \textit{See Bell v. United States,} 355 F. 3d 387 (6th Cir. 2004).

   b. \textbf{Employer’s Share:} The employer is also required to report and pay its own portion of the Social Security and Medicare taxes as well as the federal unemployment tax.

5. \textbf{Practical Issues That Arise:} The TFRP becomes an issue for business owners who, due to business cash-flow problems, fail to remit employment taxes and instead use those monies to try to keep their business afloat.

   a. When the business goes under, the IRS will not be able to collect the employment taxes from the business.

   b. The Trust Fund Recovery Penalty (TFRP) is a civil penalty imposed upon persons for the unpaid trust fund taxes. \textit{See} I.R.C. § 6672.
c. While the TFRP is a “penalty” and not a “tax” for purposes of the Code, it is more accurately described as a device to enforce collection of the unpaid trust fund taxes from persons other than the business.

d. Thus, the IRS will seek to impose the Trust Fund Recovery Penalty (TFRP) on the business owners who failed to pay the employment taxes.

i. The Trust Fund includes only the employee’s portion of income tax, Social Security and Medicare.

ii. The following is not included in the TFRP: Penalties and interest for failure to pay employment tax.

iii. Once the TRFP is assessed, interest will start to accrue and the employer will be responsible for the TFRP and interest.

e. No TFRP Assessment is required for disregarded LLCs, sole proprietors, or general partners of a partnership.

B. Relevant Statute:

1. I.R.C. § 6672 - 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.

* *

(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).

C. IRS Policy Statements Concerning the TFRP

1. In General: The IRS’s policy on assertion of the TFRP is in Policy Statement 5-14 (Formerly P-5-60), Trust Fund Recovery Penalty Assessments (“Policy Statement”). It contains numerous subparts, which are set forth below.

2. Appropriate use of TFRP 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.


3. Goal is to Collect the Correct Amount of Tax, Not to Necessarily Impose a Penalty: The Policy Statement provides:

Collection of the withheld income and employment taxes or collected excise taxes is achieved when the Service’s right to retain the amount collected is established.


4. TFRP Assessments Generally Wait for the Resolution of In-Business Installment Agreements and Bankruptcy Payments Plans:
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.

IV. General Rules Related to Assessment

A. Appropriateness of TFRP Assessments:

1. Any person required to collect, truthfully account for, and pay over any “trust fund tax” 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. I.R.C. § 6672.

2. Based on the statutory language, two conditions must be satisfied in order for a person to be assessed:
   
a. The person was “responsible;” and
   
b. The person was “willful.”

3. The amount of the penalty is equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. I.R.C. § 6672.

B. Statute of Limitations: The IRS has three years beginning on the date that the employment or excise tax return that gave rise to the proposed TFRP assessment to issue Letter 1153 (the statutory notice required pursuant to I.R.C. § 6672(b)) to the person who the IRS proposes to assess with the TFRP. The statute of limitations does not expire before the later of:

1. the date 90 days after the date on which Letter 1153 was mailed or delivered in person, or

2. 30 days after the final determination in response to a protest timely-filed in response to Letter 1153.

C. Trust Fund Taxes: As noted, the taxes for which the penalty applies are those reportable on the following forms:

1. 941, Employer’s QUARTERLY Federal Tax Return;
2. 720, Quarterly Federal Excise Tax Return;
3. CT-1, Employer’s Annual Railroad Retirement and Unemployment Return;
4. 943, Employer’s Annual Federal Tax Return for Agricultural Employees;
5. 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;
6. 945, Annual Return of Withheld Federal Income Tax;
7. 944, Employer’s ANNUAL Federal Tax Return;
8. 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests; and
9. 8804, Annual Return for Partnership Withholding Tax (Section 1446).
D. **Responsible Person**: Responsibility is a matter of status, duty, and authority. Those performing ministerial acts without exercising independent judgment will not be deemed responsible. A “responsible person” is one who has the duty to perform or the power to direct the act of collecting, accounting for, or paying over trust fund taxes.

1. **Responsible Person Defined**: A “responsible person” is one who has the duty to perform or the power to direct the act of collecting, accounting for, or paying over trust fund taxes.

   a. **Must Be Duty to Account For, Collect, and Remit Trust Fund Taxes**: Regardless of a person’s corporate title, a person will not be held liable for the TFRP unless he or she has the duty to account for, collect, and pay over the trust fund taxes to the government. I.R.M., pt. 5.17.7.1.2 (Aug. 1, 2010).

   b. **Title Inconsequential**: Even an officer of the business will not be a responsible person if he or she is an officer in title only and has no substantive duties with the business. *O’Connor v. United States*, 956 F.2d 48 (4th Cir. 1992). On the other hand, a person who has no corporate title but has control of financial affairs or controls payment of funds by the business, may be held responsible for the TFRP. I.R.M., pt. 5.17.7.1.1 (July 18, 2012).

   c. **A responsible person has:**
      i. Duty to perform;
      ii. Power to direct the act of collecting trust fund taxes;
      iii. Accountability for and authority to pay trust fund taxes; and
      iv. Authority to determine which creditors will or will not be paid.

   d. **When Does Responsibility Begin**: 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 prior withholding tax delinquency is not personally liable for the delinquency under I.R.C. § 6672. *Slodov v. United States*, 436 U.S. 238 (1978).

      i. **Using Funds for Improper Purposes**: If funds are available to pay delinquent trust fund 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 for the delinquent taxes to the extent of the funds available to pay the trust fund taxes. Slodov v. United States, 436 U.S. 238, 255 (1978).

2. **Typical Responsible Persons:** The IRS may look to one or more of the following directors, officers, employees or owners for potential TFRP assessment:

   a. Officer or employee of a corporation;
   b. Partner or employee of a partnership;
   c. Member or employee of an LLC;
   d. Corporate director or shareholder;
   e. Another corporation; and
   f. Surety or lender.
   g. Payroll Service Provider (PSP)
   h. Responsible parties within a PSP
   i. Professional Employer Organization (PEO)
   j. Responsible parties within a PEO
   k. Responsible parties within the common law employer (client of PSP/PEO)

3. **Liability Not Mutually Exclusive:** Any of the individuals listed above may be held liable if that person fails to collect, truthfully account for or pay over the taxes. Slodov v. United States, 436 U.S. 238 (1978). One or more persons may be responsible persons within the meaning of I.R.C. § 6672 for the same quarter. Thomas v. United States, 41 F.3d 1109 (7th Cir. 1994).

4. **Facts and Circumstances Test:** A determination of “responsibility” depends upon the facts and circumstances of each case. Common factors considered by the court include the following:

   a. Identification of the person as an officer, director, or principal shareholder of the corporation, a partner in a partnership, or a member of an LLC;
   b. Duties of the officer as set forth in the by-laws;
   c. Authority to sign checks;
   d. Identification of the person as the one in control of the financial affairs of the business;

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4 The use of a third-party payer such as a PSP or a PEO does not relieve the common law employer and employees of the common law employer who are responsible for collecting, accounting for, and paying over the common law employers’ employment taxes from the responsibility of ensuring that all of the common law employers’ Federal employment tax obligations are met.
e. Identification of the person as the one who had authority to
determine which creditors would be paid and those who exercised
that authority;
f. Identification of the person as the one who controlled payroll
disbursements;
g. Identification of the person as the one who had control of the
voting stock of the corporation; and
h. Identification of the person as the one who signed the employment
tax returns.

** 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 or she possesses the
authority to exercise significant control over the company’s financial
affairs whether or not such control is in fact exercised. Id. 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).

** Signature authority may be mere convenience and does not necessarily
mean that a person was responsible.

5. Factors Considered: Responsibility is a matter of status, duty, and
authority. Those performing ministerial acts without exercising
independent judgment will not be deemed responsible. I.R.M., pt.
8.25.1.4.1 (Dec. 7, 2012). The holding of corporate office, control over
financial affairs, the authority to disburse corporate funds, stock
ownership, and the ability to hire and fire employees are important factors
to consider in determining responsibility. Thibodeau v. United States, 828
F.2d 1499 (11th Cir. 1987).

6. Superior Order Defense Indefensible: A person may be liable for failure to
pay over withheld funds to the United States, even if ordered by the
 corporation’s chief executive officer not to pay the taxes. Roth v. United
States, 779 F.2d 1567 (11th Cir. 1987). An employee who is otherwise a
responsible person may not be relieved of liability merely because he was
instructed to not pay the taxes. Brounstein v. United States, 979 F.2d 952
(3d Cir. 1992).

7. Non-officers and Non-employees May Be Held Liable: A director who is
not an officer or employee of the corporation may be responsible for the
TFRP if he or she was responsible for the corporation’s failure to pay
taxes that were due and owing. Commonwealth Nat’l Bank of Dallas v.
United States, 665 F.2d 743 (5th Cir. 1982).
8. An officer of the business will not be a responsible person if he or she is an officer in title only and has no substantive duties with the business. O’Connor v. United States, 956 F.2d 48 (4th Cir. 1992).

9. Penalty Will Generally Not Be Applied Against Unpaid Volunteers or Members of the Board of Trustees: The penalty will not be imposed against any unpaid, volunteer member of any board of trustees or directors of an organization exempt when the member:

   a. is solely serving in an honorary capacity,

   b. does not participate in the day-to-day or financial operations of the organization, and

   c. does not have actual knowledge of the failure on which such penalty is imposed. This exclusion does not apply when it results in no person being liable for the TFRP.

10. Multiple Responsible Persons Can Exist: More than one person may be held responsible, not just the most responsible person. Howard v. United States, 711 F.2d 729 (5th Cir. 1983).

11. TFRP Not Required in Sole Proprietorships or Disregarded Entities: The TFRP is not needed to assert liability against the owner of a sole proprietorship or a disregarded entity because the individual owner is personally liable for employment taxes under I.R.C. §§ 3101, 3402, and 3403.

12. General Partners Fully Liable: Similarly, general partners will be fully liable for entire employment tax, and not just the trust fund portion. See United States v. Galletti, 541 U.S. 114 (2004). This is because general partners are individually liable under State law for the debts of a partnership; therefore, assessments are made in the name of the partnership and the names of the general partners. Accordingly, there is usually no reason to make a separate TFRP assessment against the various partners. Id.

13. Partners and Members Generally: In accordance with I.R.C. § 6671(b), a member of a partnership, limited liability company, or limited liability partnership may be liable for the TFRP. I.R.M., pt. 5.17.7.1.1.3 (Aug. 1, 2010).

14. Employers Potentially Liable: An employee may be liable for the TFRP if he or she made the decision not to pay the taxes due. Gephart v. United States, 818 F.2d 469 (6th Cir. 1987). As noted, employees are generally under the dominion and control of an employer; however, instructions
from a supervisor not to pay taxes do not relieve an employee who is an otherwise “responsible person” from I.R.C. § 6672 liability. Brounstein v. United States, 979 F.2d 952 (3d Cir. 1992).

E. Willfulness: A “responsible person” must be willful in the failure to comply in order to be assessed with the TFRP.

1. Defined: Willfulness indicates intentional, deliberate, voluntary, reckless, or knowing (not accidental) conduct. No evil intent or bad motive is required. Domanus v. United States, 961 F.2d 1323 (7th Cir. 1992). “Willfulness” is the attitude of a responsible person who with free will or choice either intentionally disregards the law or is plainly indifferent to its requirements. Some factors to consider when determining willfulness are:

   a. Whether the responsible person had knowledge of a pattern of noncompliance at the time the delinquencies were accruing;

   b. Whether the responsible person had received prior IRS notices indicating that employment tax returns have not been filed, or are inaccurate, or that employment taxes have not been paid;

   c. The actions the responsible party has taken to ensure its Federal employment tax obligations have been met after becoming aware of the tax delinquencies; and

   d. Whether fraud or deception was used to conceal the nonpayment of tax from detection by the responsible person.

2. Aware of Taxes and Chose Not to Pay: Willfulness exists when the person was aware of the outstanding taxes 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, 942 (9th Cir. 1996).

3. Willful Blindness: Willful blindness to the failure to pay which can be demonstrated by a failure to investigate or correct mismanagement satisfies the willfulness factor. Finley v. United States, 123 F.3d 1342 (10th Cir. 1997).

4. Payment of Net Wages: The payment of net wages (wages minus trust fund taxes) constitutes willfulness. Hochstein v. United States, 900 F.2d 543, 548 (2d Cir. 1990). If funds are not available to cover both wages and withholding taxes, a responsible person has a duty to prorate the available funds between the United States and the employees so that the taxes are fully paid on the amount of wages paid. For purposes of determining willfulness, an employee owed wages is merely another
creditor of the business, and preferences to employees over the government constitute willfulness. Id.

5. **Mistaken Belief:** A mistaken belief that payments to other creditors were required to be made in preference to trust fund taxes does not make the failure to pay non-willful. *Thomsen v. United States*, 887 F.2d 12, 17-18 (1st Cir. 1989).

6. **Duty Not Absolute:** The statute does not impose upon the responsible person an absolute duty to pay over amounts that should have been collected and withheld by prior responsible persons. *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 prior withholding tax delinquency is not personally liable for the delinquency under I.R.C. '6672.
   
b. If funds are available to pay delinquent trust fund 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 for the delinquent taxes to the extent of the funds available to pay the trust fund taxes.

7. **Failure to Act Following Notice That Taxes Not Paid:** A responsible person’s failure to investigate or correct mismanagement after being notified that withholding taxes have not been paid satisfies the I.R.C. § 6672 “willfulness” requirement. *Finley v. United States*, 123 F.3d 1342 (10th Cir. 1997).

8. **Criminal Cases Compared:** The TFRP is a civil penalty; so the degree of willfulness in failing to collect or pay over any tax leading to liability for this penalty is not as great as that necessary for criminal proceedings.

F. **Extent of Liability, Voluntary Payments, and Involuntary Payments**

1. **In General:** I.R.C. § 6672 is limited to the trust fund portion of the tax; that is, to the tax that the “responsible person” is required to collect or withhold from the wages of employees.

2. **Designation of Voluntary Payments of Paramount Importance:** It is important when submitting voluntary payments that the payments be designated to the trust fund portion first. To determine the application of
payments and other credits for purposes of determining the TFRP, follow the guidelines in I.R.M., pt. 5.7.7, Payment Application and Refund Claims.

a. **Rule to Designate Voluntary Payments:** In order to meet the requirements for a proper designation, two prerequisites must be met:

i. The payment must be voluntary.

ii. The request or designation for the application of the payment must be specific, in writing, and made at the time of the payment.

b. **Designations in Connection With Installment Agreements:** While under an approved installment agreement, a business may not designate that its monthly installment payment be applied to the trust fund portion of the tax liability.

c. **Designations in Connection With Offers in Compromise:** Payments made on a corporate Offer in Compromise may be designated for trust fund if the designation is made in writing at the time of the payment.

3. **Involuntary Payments Compared:**


b. **Involuntary Payments Defined:** Involuntary payments are those received by the Government as the result of an action other than that of the taxpayer. I.R.M., pt. 8.25.2.4.4.4 (Aug. 5, 2018). Typically, this would be a levy.

i. **Refund Offsets and Payments Through an Installment Agreement:** Refund offsets are considered involuntary, as are payments made through an approved Installment Agreement.

4. **Basis of TFRP After Designation of Payments:** After the application of payments has been made, the TFRP is based on the remaining outstanding amount of withheld income tax and employee’s FICA tax. I.R.M., pt. 5.17.7.1.6 (Aug. 1, 2010).
5. **Limits of the TFRP:** The TFRP does not apply to direct taxes such as the employer’s portion of FICA or FUTA. Neither does it apply to non-collected excise taxes.

6. **Allocation of Non-Designated Payments:** Any payment made on the business account is deemed to represent payment of the non trust fund portion of the tax liability (e.g., employer’s share of FICA) unless designated otherwise by the taxpayer. The taxpayer, of course, has no right of designation of payments resulting from enforced collection measures. To the extent partial payments exceed the non trust 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 non trust 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. I.R.M., pt. 1.2.14.1.3 (June 9, 2003).

**G. Interest Accruals**

1. **Computation of Interest:** I.R.C. § 6601(e) (2) provides that “Interest shall be imposed under subsection (a) in respect of any assessable penalty, additional amount, or addition to the tax (other than an addition to tax imposed under section 6651 (a)(1) or 6653 or under part II of subchapter A of chapter 68) only if such assessable penalty, additional amount, or addition to the tax is not paid within 21 calendar days from the date of notice and demand therefor (10 business days if the amount for which such notice and demand is made equals or exceeds $100,000), and in such case interest shall be imposed only for the period from the date of the notice and demand to the date of payment.” Stated simply, interest accrues on the TFRP, but does not start until the penalty is assessed against the responsible person and notice and demand for payment is sent to the last known address.

**H. Defenses to the TFRP:**

1. Not a Responsible person (fact specific, be sure to focus on the factors considered).
2. Not willful.
3. Reasonable cause, depending upon the State in which the taxpayer lives. See discussion immediately below.
4. Misapplication of designated payments
5. Expiration of the period of limitations on assessment
6. Expiration of the period of limitations on collection
7. Failure to follow proper procedure with respect to the assessment of the TFRP, including noncompliance with I.R.C. ’ 6751(b) (discussed above)
8. Minimal likelihood of collection
9. Sue other responsible persons for contribution
10. Sue business to pay

I. Reasonable Cause Defense to Willfulness:

1. In General: The circuits are split on the issue of allowing a reasonable cause defense to negate willfulness.

2. Reasonable Cause Not a Defense: The Eighth and First Circuits have determined that reasonable cause is not a defense. Olsen v. United States, 952 F.2d 236 (8th Cir. 1991); Harrington v. United States, 504 F.2d 1306 (1st Cir. 1974).

3. Reasonable Cause Maybe a Defense: The Ninth Circuit has not stated specifically that the reasonable cause defense does not apply; however, it has determined that “conduct motivated by a reasonable cause may, nonetheless, be willful.” Phillips v. United States, 73 F.3d 939, 942 (9th Cir. 1996).

4. Reasonable Cause a Defense: The Tenth, Eleventh, Second, and Fifth Circuits have determined that the reasonable cause defense could apply to willfulness determinations under I.R.C. '6672, but under extremely limited circumstances. Smith v. United States, 555 F.3d 1158, 1170 (10th Cir. 2009) (reasonable cause defense must be narrowly construed with respect to I.R.C. '6672); Thosteson v. United States, 331 F.3d 1294, 1301 (11th Cir. 2003) (court does not decide whether reasonable cause applies, but notes that this defense is exceedingly limited); United States v. Winter, 196 F.3d 339, 354 (2d Cir. 1999) (reasonable cause defense negated willfulness only if the responsible person reasonably believed that taxes were being paid); Logal v. United States, 195 F.3d 229, 233 (5th Cir. 1999) (reasonable cause defense is exceedingly limited.).
V. IRS Procedures for Assessment of the TFRP

A. IRS Assessment Policy:

1. “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.” Policy Statement 5-14 (Formerly P-5-60)

2. “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.” IRM 1.2.14.1.3(8) (June, 9, 2003).

3. The goal of the trust fund recovery penalty is to recover the trust fund taxes that have not been paid. Accordingly, if the business enters into an in-business installment agreement, the IRS policy is generally to withhold assessment provided that the statute of limitations is not at risk. Therefore, the potential responsible person(s) will be required to submit a IRS Form 2750 to extend the statute of limitations for assessment. If the business defaults, the IRS will proceed with assessment against the responsible person(s).

B. Trust Fund Investigation

1. The IRS will want to question the individuals that may be “responsible”, including with those who have signatures on bank checks and owners, investors, and officers of the business.

2. The Revenue Officer will use IRS Form 4180 to ask the potential “responsible person(s) questions to determine if they should be assessed.

C. Best Practices During the TFRP Investigation

1. Practitioner Best Practices for the 4180 Interview:
   
a. Review the bank statements and canceled checks
   b. Interview with the client.
c. Interview third parties
d. Complete the Form 4180 in advance of the interview

2. For in-business installment agreement, negotiate non-assertion of the TFRP against the potential responsible person(s).
   a. Offer extension of time for assessment of the TFRP (IRS Form 2750).
   b. Demonstrate that the in-business installment agreement will serve to repay the unpaid taxes.
   c. While review of the proposed installment agreement is pending, make voluntary payments towards the liability. All voluntary payments should be designated to the unpaid trust fund liability amount. Once the installment agreement is granted, the taxpayer will not be able to designate how payments are applied. The IRS will apply those payments and all undesignated payments in the “best interest of the government.”

   (1) The payment designation must be specific, in writing and made at the time that the payment is submitted. Example: “Payment designated to the ‘trust fund’ portion of the Form 941 taxes owed for the tax period ending on March 31, 2015.”

3. For out-of-business employers, negotiate placement of the business into currently-not-collectible status. The IRS will expect the business to liquidate its assets and use proceeds from liquidation to pay towards its outstanding liability.
   a. Payments from the proceeds obtained from the liquidation of the business assets should be submitted as voluntary payments designated to the trust fund taxes that are owed.

4. For insolvent, potential responsible person(s), consider negotiation of non-assertion of the TFRP based on the IRS Non-Assertion Policy for insolvent taxpayers.
   a. The IRS will normally not assess when:

   (1) There is no present or future collection potential.

   (2) Neither the responsible person nor their assets/income sources can be located.
(3) There is no collection potential.

(4) The aggregate trust fund balance is below the amount in IRM 5.7.4.1(2), and

(5) There is no potential the taxpayer will accrue additional liabilities. IRM 5.7.5.1.1 (11-12-2014).

D. TFRP Assessment and Protest Procedures

1. Revenue Officers (ROs) are responsible for determining collection potential as well as investigating who they believe was responsible and willful for non-payment.

2. Before a TFRP is assessed, taxpayers must be mailed or hand delivered a 60-Day Notice of Proposed Assessment, Letter 1153 (i.e., the notice required by I.R.C. § 6672(b)(1)); Mason v. Commissioner, 132 T.C. 301, 317 (2009).

3. I.R.C. 6751(b) requires that penalty assessments be approved in writing by the examiner’s immediate supervisor. The examiner is not required to provide a copy of the written approval to the taxpayer. However, the IRS may wish to provide the taxpayer with a courtesy copy of the document showing that a manager approved the penalties. Taxpayers are entitled to request these documents under the Freedom of Information Act. To provide for proper notice of the assessment of trust fund penalties, I.R.C. § 6672 refers to the I.R.C. § 6212(b) instructions that provide for a properly mailed notice of deficiency. I.R.C. § 6672(b); see Mason v. Commissioner, 132 T.C. at 317.

4. Alternatively, I.R.C. § 6672 allows the IRS to personally serve the notice upon the responsible person. I.R.C. § 6672(b)(1).

5. Accordingly, in order for the IRS to properly assess trust fund recovery penalties, the Letter 1153 must be either mailed to the responsible person in the same manner as a notice of deficiency that determines taxes due under subtitle A or B or personally delivered to the responsible person.

6. Letter 1153 advises taxpayers of the proposed penalty and of their appeal rights. Issuance of the Letter 1153 prior to the ASED is required on all TFRP assessments.

7. Procedures when the Responsible Person Agrees with Assessment
a. Responsible person signs Form 2751 “Proposed Assessment of Trust Fund Recovery Penalty” and returns the form to the Revenue Officer.

8. Procedures when the Responsible Person Disagrees with Assessment

a. Submit a timely protest to the Revenue Officer. The Revenue Officer can rescind the Letter 1153 by issuing Letter 1153W “Proposed Trust Fund Recovery Penalty Rescission Notification” but is more likely to forward the case to Appeals.

b. A timely mailed protest is still timely for purposes of I.R.C. 6672(b)(3)(B) even if the protest is inadequate.

c. If the case cannot be resolved in appeals, the next step would be litigation in U.S. District Court.

9. Requirements for Written Protest

a. Send a letter requesting an Appeals conference to the attention of the Person to Contact at the address shown on the top of Letter 1153 (DO).

b. List the taxpayer’s name, address and social security number on the letter.

c. Enclose a copy of the Letter 1153 (DO) or list the date and number of the letter received.

d. List the tax periods being protested.

e. Enclose a list of the disputed issues and the reasons for the disagreement.

f. Identify the dates and amount of any payments in dispute.

g. Include specific dates, names, amounts and locations which support his or her position.

h. Include a clear explanation of the taxpayer’s duties and responsibilities, specifically the duty and authority to collect, account for and pay the trust fund taxes.

i. Sign the written protest under penalties of perjury by making the following statement (the jurat): “Under the penalties of perjury, I declare that I have examined the facts stated in this protest,
including any accompanying documents, and to the best of my knowledge and belief, they are true, correct and complete.”

j. If the taxpayer’s representative prepares and signs the protest for the taxpayer, the representative must substitute a declaration stating:

(1) He or she submitted the protest and accompanying documents

(2) Whether he or she knows personally that the facts stated in the protest and accompanying documents are true and correct.

E. Collectability Determinations

1. A collectibility determination must be made in order to determine if the TFRP should be assessed.

2. When TFRP Will Not Be Assessed: The TFRP will normally not be assessed when:

   a. There is no present or future collection potential.
   b. Neither the responsible person nor their assets/income sources can be located.
   c. When investigation has determined: (i) there is no collection potential, (ii) the aggregate trust fund balance is de minimis, and (iii) there is no potential the taxpayer will accrue additional liabilities.

3. Procedure: The IRS will:

   a. Secure Form 433–A, Collection Information Statement for Wage Earners and Self-Employed Individuals, in order to determine collectibility.
      
      i. Form 433-F, Collection Information Statement, may be used instead of Form 433-A if the individual is a wage earner and the potential TFRP liability is less than $100,000.
      
      ii. A Collection Information Statement (CIS) is not required if one was obtained within the past twelve months, but current research of the taxpayer’s information is still required.
b. The following factors will be considered when determining collectability of the TFRP:

i. Current financial condition;
ii. Involvement in a bankruptcy proceeding;
iii. Income history and future income potential; and
iv. Asset potential (likelihood of increase in equity in assets and taxpayer’s potential to acquire assets in the future).

c. Pursuant to I.R.M., pt. 5.7.5.3(3) (June 28, 2011), below are guidelines to assist in determining whether to assert the penalty based on collectibility:

<table>
<thead>
<tr>
<th>If responsible person financial analysis shows. . .</th>
<th>Then. . .</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any present or future ability to pay</td>
<td>Assess the penalty and take the appropriate collection action based on an analysis of the taxpayer’s financial condition.</td>
</tr>
<tr>
<td>No present, but future ability to pay</td>
<td>Assess the TFRP based on future income potential and possible refund offset. Prepare a pre-assessed Form 53 and file lien if appropriate.</td>
</tr>
<tr>
<td>The responsible person cannot be located or contacted but internal research identifies assets or income sources</td>
<td>Assess the TFRP since there is a good possibility of some collection from the assets/income sources that were located.</td>
</tr>
<tr>
<td>No present or future income potential exists over the collection statute period</td>
<td>Do not assess the TFRP since the financial analysis shows there is little prospect that the taxpayer will receive any increase in income or acquire assets that will enable the IRS to collect any of the penalty.</td>
</tr>
</tbody>
</table>
VI. Strategies for Completing the Form 4180

A. Importance of the Form 4180:

1. In General: The revenue officer conducting the interview will use Form 4180, Report of Interview with Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Taxes.

2. Questions Asked: The form asks the following questions:
   a. Did you determine the financial policy for the business?
   b. Did you direct or authorize payment of bills?
   c. Did you open or close bank accounts for the business?
   d. Did you guarantee or co-sign loans?
   e. Did you sign or countersign checks?
   f. Did you authorize or sign payroll checks?
   g. Did you authorize or make federal tax deposits?
   h. Did you prepare, review, sign, or transmit payroll tax returns?

3. Use Attachments: Each question on the Form 4180 requires a “yes” or “no” response. The short response format sometimes results in inaccurate, misleading, and inconsistent statements. The taxpayer’s need to make the IRS aware of exculpatory facts. Stated simply, in many instances the answer is not as simple as yes or no.

B. Best Practices for Completing the Form 4180:

1. In General: Below are best practices for completing the Form 4180.

2. Review the bank statements and canceled checks: As the bank checks are a primary source in directing the IRS to those with liability, it is important to recognize how many checks the witness signed. Knowing when the checks were signed can be important. If the checks were only signed during one quarter, but the business had a payroll tax problem for three quarters, there may be limits to the taxpayer’s liability to just that one quarter. Knowing how many checks your witness/taxpayer wrote can also be important. The authority to write a few checks a month for deliveries to the office is not the same as control over company finances.
3. **Interview the Client:** As explained above the Form 4180 can leave out important facts out. Thus, in most cases, it is essential to send the IRS a supplement that clarifies the issues the form does not take into account. The statements should be direct and to the point and no more than two typewritten pages, if possible. They should concentrate on the distinguishing facts, such as the process of how an officer manager had to submit invoices to a chief financial officer for review before payment.

4. **Interview Third Parties:** Third parties with exculpatory knowledge should also be interviewed. Third-party statements provide additional credibility to your witness/taxpayer and another point of view.

5. **Complete the Form 4180 in Advance of the Interview:** Complete the Form 4180 in advance of the interview and send it to the Revenue Officer. Although IRS guidelines require the revenue officer to take an in-person consultation, many revenue officers will waive the interview and accept the Form 4180 by mail.

C. **The 4180 Interview:**

1. **In General:** The IRS will ask to interview the potentially responsible person. Depending upon the facts, you may want to decline this interview and let the Form 4180 speak for itself.

2. **Naming Other Potentially Responsible Persons:** The Form 4180 interview also request the interviewee to turn in others—colleagues, investors, family members—who may have been involved in the occupation. The question asked is: “Who else performed this duty?” “Performing the duty” is not always the same as the control and authority over financial matters. Other individuals can be wrongly implicated if the interviewee lacks a proper understanding of the question.

3. **When to Decline the Interview:** IRS guidelines require the revenue officer to take an in-person interview, but many revenue officers will waive the interview and accept the Form 4180 by mail. This may be advisable in a number of situations, especially where the client may be criminally liable.
Part 2 - The Section 6721 Information Return Penalty

I. The Internal Revenue Code (“IRC” or “Code”) Section 6721 penalty relates to information returns. The key objective is to determine when the penalty is assessed and how it is abated.

A. Section 6721 states that a penalty is assessed for:
   1. Any failure to file an information return with the Secretary on or before the required filing date, and
   2. Any failure to include all of the information required to be shown on the return or the inclusion of incorrect information. I.R.C. § 6721(a)(2)(A) - (B).
   3. The penalty imposed by Section 6721(a)(1) for failure of either of the above is $250 for each return containing one such failure, but the total penalty amount imposed in any calendar year shall not exceed $3,000,000. I.R.C. § 6721(a)(1).
   4. Note: a majority of the penalties and penalty abatements discussed are subject to inflation adjustments. See I.R.C. § 6721(f).
II. Section 6721 provides several limitations and means of mitigating the penalties it imposes. These limitations do not, however, apply where the failure to file or properly report is due to “intentional disregard.” I.R.C. § 6721(e)(1).

A. Penalty Reductions Generally
1. Section 6721(b)(1) provides a penalty reduction where a failure is corrected within 30 days after the required filing date. I.R.C. § 6721(b)(1).
   a. The penalty is reduced to $50 in lieu of $250. The maximum penalty in a calendar year in this scenario is $500,000. Id.
2. Section 6721(b)(2) provides an additional means for penalty reduction, that is, when a failure is corrected after 30 days from the required filing date but no later than August 1 of the calendar year in which the required filing date occurs. I.R.C. § 6721(b)(2).
3. The penalty imposed here is $100 in lieu of $250. The maximum penalty in a calendar year is $1,500,000. Id.

B. Gross Receipts Limitation
1. The gross receipts limitation minimizes the penalty imposed on taxpayers in section 6721(a) by imposing a gross receipts floor. Therefore, the penalty is reduced for taxpayers who have gross receipts of no more than the floor imposed.
2. IRC 6721(d) provides that “[a] person meets the gross receipts test . . . for any calendar year if the average annual gross receipts of such person for the most recent 3 taxable years ending before such calendar year do not exceed $5,000,000.” I.R.C. § 6721(d)(1).
   a. Section 414’s aggregation rules applied to employees of entities under common control apply to the gross receipts test. See generally I.R.C. § 6721(d)(2)(B).
   b. Additionally, Section 448 provides accounting rules in applying the gross receipts test. Id.
3. Where a person meets the gross receipts test, apply the following:
   a. A penalty limit of $1,000,000 is substituted for the $3,000,000 calendar year penalty listed in I.R.C. § 6721(a)(1).
   b. A penalty limit of $175,000 is substituted for the $500,000 calendar year limit listed in I.R.C. § 6721(b)(1)(B).
   c. A penalty limit of $500,000 is substituted for the $1,500,000 calendar year limit listed in I.R.C. § 6721(b)(2)(B).

C. Penalty Exceptions for Failure to Include Information – De Minimis Failures
1. Section 6721(c) provides a de minimis exception where there’s a failure to include information. The exception applies where:
   a. An information return is filed with the Secretary;
   b. There is either a failure to include all required information or incorrect information is included pursuant to I.R.C. § 6721(a)(2)(B), provided that the failure is due to “reasonable cause and not [a result of] willful neglect,” I.R.C. § 6724(a); and
c. The failure is corrected no later than August 1 of the calendar year in which the required filing date occurs I.R.C. § 6721(c).

2. If the foregoing is satisfied, then the return is treated as correctly filed. Id.

3. The de minimis exception is limited by the calendar year. I.R.C. § 6721 only applies to:
   a. 10 informational returns or
   b. one-half of 1 percent of the total number of information returns required to be filed by the person during the calendar year. Id.

4. The following are examples of de minimis safe harbor errors with respect to a failure to disclose information:
   a. Errors regarding dollar amounts;
   b. Dollar discrepancies of no more than $100; and
   c. Withholding discrepancies of no more than $25.

5. A correction is not required in the foregoing examples, and the return is treated as correctly filed. Id.

6. If a taxpayer elects out of the safe harbor in a manner prescribed by the Secretary, then the safe harbors’ listed do not apply. Additionally, the Secretary may issue regulations in order to prevent abuse of the safe harbors. See id.
III. Substantial Completeness in Avoiding a Penalty for Late Filing

A. The IRS has distinguished income tax returns and informational returns with regard to establishing substantial completeness of the document. As for informational returns, the key factor is whether the information impedes the IRS from performing its duties. See IRS Pub. Int. Practice Units (2017), available at https://www.irs.gov/pub/int_practice_units/iga_c_17_03_01_02.pdf.

1. Substantial compliance will be the standard where a “requirement does not go to the essence of [a] statute.” Id.

2. In contrast, where a requirement does go to the essence of a statute, “strict compliance” is the standard. Id.

3. Generally, substantial compliance will be the standard for regulatory requirements, and strict compliance the standard for statutory requirements. Id.
IV. “Reasonable Cause” and IRC Section 6724 Defenses

A. A taxpayer can request that the IRS not impose a penalty on the grounds of “reasonable cause.” The IRS will contact a taxpayer claiming reasonable cause if it needs additional information to establish the defense. The IRS provides examples of situations that may properly be deemed “reasonable cause:” See IRM 20.1.7.12.1 (10-12-2017).

B. Reasonable cause for the information return penalties generally exists when:
   1. The filer acted in a responsible manner, both before and after the failure occurred; and
   2. There are significant mitigating factors; or
   3. The failure was the result of circumstances beyond the filer’s control. Id.

C. Acting in a responsible manner also includes taking steps to avoid the failure, for example:
   1. Requesting appropriate extensions of time to file when practical to avoid the failure;
   2. Attempting to prevent a failure if it was foreseeable;
   3. Acting to remove an impediment or the cause of the failure; and
   4. Correcting the failure as promptly as possible, generally within 30 days. Id.

D. A taxpayer may claim ignorance of the law where the taxpayer acted responsibly in all other manners. See id.

E. A taxpayer may also attempt a defense of “significant mitigating factors.” For the taxpayer to do so, however, he must establish reasonable cause.
   1. Events generally considered to be significant mitigating factors include, but are not limited to:
      a. First time filer - prior to the failure, the filer had not previously been required to file this particular form or statement.
      b. The filer has a history of complying with the information return reporting requirements. The filer’s history of compliance should be considered whether or not the filer specifically requests abatement on this basis.
   2. A good compliance history may benefit a filer who can show that they acted in a responsible manner, but cannot show that an event beyond the filer’s control caused the failure.
   3. Significant consideration is given to if the filer was previously penalized under IRC 6721, IRC 6722, or IRC 6723. Id.
V. Events Beyond Taxpayer’s Control

A. A taxpayer can attempt to prove that despite prudence on her part, events beyond her control intervened. The following are examples where a taxpayer may successfully claim reasonable cause regarding an event beyond her control:

1. Action by the IRS prevented compliance. To succeed, a taxpayer must show that she relied “on erroneous written information provided by the IRS.” The taxpayer must prove that reliance was reasonable and in good faith. Id.

2. The filer must provide:
   a. A copy of the written information provided by the IRS including the name of the IRS employee and the date the erroneous advice was received.
   b. A copy of the request for information, including the steps taken and the specific facts given to the IRS, and the answer received.
   c. This information should be used in determining whether the taxpayer has shown reasonable cause for taking a position on the return giving rise to the penalty. Id.

3. Action by an agent created an event beyond taxpayer’s control. To claim so successfully, the filer must show that:
   a. The filer exercised reasonable business judgment when contacting the agent, allowed the agent to timely file correct returns, or furnished correct payee statements.
   b. The filer provided the agent with proper information well in advance of the due date of the return or statement, and the agent satisfied the significant mitigating factors, or an event beyond the agent’s control occurred that could establish reasonable cause.
   c. A filer who contracted with an agent and cannot establish reasonable cause based on the actions of the agent as described above, may be able to demonstrate reasonable cause on his/her own merit by having an established history of complying with the information reporting requirements, and otherwise acting in a responsible manner both before and after the failure occurred. Id.

4. Actions by a payee or other person caused an event beyond taxpayer’s control. For reasonable cause to be established here, the filer must show that:
   a. The payee, or other person, failed to provide the necessary information to the filer; or
   b. The payee or other person failed to provide correct information to the filer.
   c. The filer made available to the payee all necessary information to complete the filing.
   d. The filer must provide documentary evidence when requested by the IRS showing that the failure was attributable to the payee. Id.

5. Taxpayers may seek to introduce as reasonable cause the unavailability of business records. However, the business records must have been unavailable as a result of unforeseen conditions, and in a manner which would prevent timely compliance (ordinarily at least a two week period prior to the due date or extended due date) of the information return, and the unavailability was caused by a supervening event. Id.
6. Some examples for a “supervening event” provided by the IRS are:
   a. Fires or other casualty that destroy the record or the device maintaining such records;
   b. A change in the law that relates to processing the information return’s data; and
   c. A death or serious illness of the person charged with filing. Id.
   d. For a corporation or trust, death or serious illness refers to the person with authority to file. See id.

7. A return delivered by the USPS after the due date despite the taxpayer correctly addressing and mailing the return prior to the deadline. See id.

8. An erroneously addressed return is not reasonable cause per se for late filing. However, additional documentation may be provided to show the reason for such “misdirection.” See id.

9. Documentation must include all of the following:
   a. An excellent filing compliance record;
   b. Dated or certified mail documents showing filing made to the state or local taxing agency on or before the return due date; and
   c. Evidence that the act of misdirecting the return was due to extenuating circumstances, and not to carelessness or intentional disregard. Id.

10. A taxpayer required to file by electronic media under IRC 6011(e), can show economic hardship with respect to her obligation if she shows that she:
    a. Attempted to contract out the electronic media filing, and the cost was prohibitive as determined 45 days before the due date of the return.
    b. The filer supports the prohibitive costs with two estimates from unrelated service bureaus or computer software/hardware companies.
    c. The filer filed the returns on paper.
    d. The undue economic hardship criterion does not prevent the filer from establishing reasonable cause based on other criteria that would be applicable to the electronic media penalty. However, caution should be used to ensure that other reasonable cause criteria would be appropriate to the filer’s failure to file on electronic media. Id.

11. Provided that certain evidentiary documentation is provided, major hardware or software malfunction can be an additional item deemed beyond a taxpayer’s control with respect to electronic media. See id.

12. IRC 7508 and “Ordinary Business Care and Prudence” Defenses. A taxpayer can be deemed to have taken sufficient steps to establish ordinary business care and prudence if the taxpayer establishes that she took preemptive measures in preparation for “reasonably foreseeable events.” See IRM 20.1.1.3.2.2 (02-22-2008).

13. Death, serious illness, or an unavoidable absence in the taxpayer’s family can potentially establish reasonable cause for late filing. In the case of a corporation or a trust, the above would apply to the person solely responsible for executing the return. See IRM 20.1.1.3.2.1 (11-25-2011).

14. Fire, casualty, natural disaster, or other disturbance can all establish reasonable cause for “affected persons.” See IRM 20.1.1.3.2.2.2 (11-21-2017).
15. An “affected taxpayer” may be an individual, any business entity or sole proprietor or, any shareholder in an S Corporation. Affected taxpayers include:
   a. Any individual whose principal residence, for purposes of IRC 1033(h)(4), is located in a covered disaster area;
   b. Any business entity or sole proprietor whose principal place of business is located in a covered disaster area;
   c. Any individual who is a relief worker affiliated with a recognized government or philanthropic organization and is assisting in a covered disaster area;
   d. Any individual whose principal residence, for purposes of IRC 1033(h)(4), or any business entity or sole proprietor whose principal place of business is not located in a covered disaster area but, whose records necessary to meet a tax deadline due within the disaster period are maintained in a covered disaster area;
   e. Any estate or trust that has tax records that are necessary to meet a tax deadline for an act due within the disaster period, and that are maintained in a covered disaster area;
   f. The spouse of an affected taxpayer, solely with regard to a joint return of the husband and wife;
   g. Any individual visiting the covered disaster area who was killed or injured as a result of the disaster; or
   h. Any other person determined by the IRS to be affected by a federally declared disaster, within the meaning of IRC 1033(h)(3). IRM 25.16.1.3 (06-26-2018).

16. A taxpayer’s inability to obtain records can potentially establish reasonable cause where the taxpayer “exercised ordinary business care and prudence.” IRM 20.1.1.3.2.2.3 (12-11-2009).

17. Occasionally, a mistake can establish reasonable cause. However, with sufficient support establishing the reason for the mistake, a mistake may suffice. See generally IRM 20.1.1.3.2.2.4 (12-11-2009).

18. Where a taxpayer relied on another person and received erroneous advice, the taxpayer may be able to establish reasonable cause. See generally IRM 20.1.1.3.2.2.5 (11-21-2017).

19. Ignorance of the law may establish reasonable cause. Factors to consider in conjunction with such ignorance are:
   a. The taxpayer’s education;
   b. If the taxpayer has previously been subject to the tax;
   c. If the taxpayer has been penalized before; and
   d. If there were recent changes in the tax forms or law which a taxpayer could not reasonably be expected to know. IRM 20.1.1.3.2.2.6 (11-25-2011).

20. Forgetfulness generally does not comport with ordinary business care and prudence. See generally IRM 20.1.1.3.2.2.7 (08-05-2014).
VI. Intentional Disregard

A. The IRS provides some guidance on determining when there’s been intentional disregard. First, “the facts and circumstances [need to] show that the filer knowingly or willfully failed to comply with the requirements of IRC 6721.” IRM 20.1.7.8.2 (10-12-2017).

1. The facts should show the filer:
   a. Was required to file;
   b. Knew or should have known of the requirement to file; and
   c. Consciously chose not to file or recklessly disregarded (i.e., ignored) the duty to file a timely and correct information return. Id.

2. Indicative of intentional disregard is the number of failures. An increased number of failures indicates intentional disregard. See id. (citing 26 CFR 301.6721-1(f)(3)(i)).

3. Additional indications of the existence of intentional disregard are:
   a. Did the filer correct the failure promptly after the discovery of the failure;
   b. Did the filer correct the failure within thirty days after notification of the failure by the IRS; and
   c. Did the filer avoid an administrative inconvenience or was the cost of compliance greater than an IRC 6721 penalty? Id.

4. In this vein, there may be intentional disregard where the cost of paying the penalty is less than the cost of compliance. See id. (citing 26 CFR 301.6721-1(f)(3)(iv)).

B. If failure to meet the filing and reporting requirements are due to intentional disregard, then:

1. The penalty exceptions and abatements do not apply;
2. The $250 penalty imposed for each failure is raised to $500; “or, if greater,
   a. in the case of a return other than a return required under section 6045(a) [broker returns], 6041A(b) [returns for direct sales of $5,000 or more], 6050H [returns for mortgage interest earned in trade or business], 6050I [returns for cash earned in a trade or business], 6050J [returns for foreclosure and security abandonment], 6050K [returns for exchanges in partnership interests, or 6050L [returns for donated property], 10 percent of the aggregate amount of the items required to be reported correctly,
   b. in the case of a return required to be filed by section 6045(a), 6050K, or 6050L, 5 percent of the aggregate amount of the items required to be reported correctly,
   c. in the case of a return required to be filed under section 6050L(a) [cash receipts of more than $10,000] with respect to any transaction (or related transactions), the greater of—
      i. $25,000, or
      ii. the amount of cash (within the meaning of section 6050L(d)) [foreign currency or a monetary instrument with a maximum face value of $10,000] received in such transaction (or related transactions) to the extent the amount of such cash does not exceed $100,000, or
d. in the case of a return required to be filed under section 6050V [returns for insurance contracts in which exempt organizations hold an interest], 10 percent of the value of the benefit of any contract with respect to which information is required to be included on the return.” I.R.C. § 6721(e)(1)-(2).

3. Where the penalty is determined under section (1)(ii)(a)-(d) above, then the $3,000,000 limitation normally imposed does not apply, and the penalty should not be considered in accounting for any of the other limitation. See I.R.C. § 6721(e)(3).

C. Cash Payroll Issue
1. If an employer pays an employee in cash, does the employer still have to report?

D. Issuing an Informational Return to Persons without Social Security
1. Generally
   a. Where an employee does not have a social security number, an employer can report an employee’s wages to the Social Security Administration (SSA) without a number. At the point, SSA will contact the employee at the address provided to it on the wage report. If an address is not provided or is incomplete, then SSA will contact the employer to fill in the information.
   b. If SSA is not provided with updated information after its follow-up, then wages or self-employment income cannot be credited to the appropriate person’s earning record. Consequently, the information is placed in a “Suspense File” of uncredited earnings. If the “suspense” is removed at a later date, then SSA will credit the earnings to the appropriate individual.
   c. When a wage report is filed without a social security number, SSA notifies the IRS so that it may decide whether penalties under IRC 6721 are appropriate.
   d. Additionally, if 90% or more of an employer’s wage reports are unidentified or incorrectly identified, the SSA may return the report to the filer. The filer then has 45 days to correct the wage reports without being subject to possible IRS penalties. SSA may grant an employer an additional 15 days upon request for such extension. See Treas. Reg. §422.120.

2. Undocumented Workers
   a. Taxpayers required to file a tax return must identify themselves pursuant to I.R.C. section 6109(a). Cynthia Blum, Rethinking Tax Compliance of Unauthorized Workers after Immigration Reform, 21 Geo. Immigr. L.J. 595, 597 (2007). For a U.S. citizen, a Social Security Number (SSN) will typically be the means of identification. Id. However, for the undocumented worker who does not have a SSN,
the Individual Taxpayer Identification Number (ITIN) serves as both a means of identification and a tax processing number. Id. at 598.

b. Among the people who qualify for an ITIN number are:
   i. “Unauthorized immigrants;
   ii. Lawfully present individuals; and

c. The Internal Revenue Code implicitly encourages tax compliance for undocumented workers. Under IRC section 6103, “IRS [officials] are forbidden to disclose information from a taxpayer’s tax return . . . except in limited circumstances.” Cynthia Blum, Rethinking Tax Compliance of Unauthorized Workers after Immigration Reform, 21 Geo. Immigr. L.J. 595, 598-99 (2007). Therefore, filing tax records with and ITIN should generally not lead to immigration enforcement or deportation. See id.

d. The ITIN also seems to resolve the scenario presented earlier in which 90% or more of employee’s don’t have a social security number. As mentioned earlier, a wage report with 90% unidentified employees may be returned to the employer. Without an ITIN, it would seem quite difficult for the employer to remedy the issue for undocumented employees without a SSN. However, with the ITIN, there should be no need to submit incomplete wage reports in the first place. Instead, the employer should be able to fill out the information returns by using the employee’s ITIN.

E. Penalties for Not Filing, Filing Late or Filing Incorrect Forms 1099 and W-2

1. The IRS imposes penalties for cases referred to it by the Social Security Administration (SSA). SSA refers a case to the IRS where there is a discrepancy in the amount of wages reported on the Form W-2 and Forms 941 and 944. See IRM 20.1.7.8.4.3 (10-12-2017).
   a. Before referring the case to the IRS, SSA will make two attempts to contact the employer to resolve the discrepancy. Id.
   b. The IRS will impose a penalty if the discrepancy is not resolved by filing missing Form W-2, filing Form W-2c, reporting adjustments to Form 94X (Form 941-X process), or providing an explanation of the discrepancy. Id.

2. The penalties imposed in 2018 for not filing correct information returns are as follows:
   a. Pursuant to IRM 20.1.7.12.2.8, Exhibit 20.1.7-1 (10-12-2017), Large Businesses with Gross Receipts of More Than $5 Million and Government Entities:

<table>
<thead>
<tr>
<th>Time returns filed/furnished</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not more than 30 days late (by March 30 if the due date is February 28)</td>
<td>$50 per return/</td>
</tr>
<tr>
<td></td>
<td>$536,000 maximum</td>
</tr>
<tr>
<td>Time returns filed/furnished</td>
<td>Penalty</td>
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<tr>
<td>-----------------------------</td>
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</tr>
<tr>
<td>Not more than 30 days late</td>
<td></td>
</tr>
<tr>
<td>(by March 30 if the due date is February 28)</td>
<td>$50 per return/ $187,500 maximum</td>
</tr>
<tr>
<td>31 days late – August 1</td>
<td>$100 per return/ $536,000 maximum</td>
</tr>
<tr>
<td>After August 1 or Not At All</td>
<td>$260 per return/ $1,072,500 maximum</td>
</tr>
<tr>
<td>Intentional Disregard</td>
<td>$530 per return/ No limitation</td>
</tr>
</tbody>
</table>

b. Pursuant to IRM 20.1.7.12.2.8, Exhibit 20.1.7-2 (10-12-2017), Small Businesses with Gross Receipts $5 Million or Less:
VII. Case Law Where the Taxpayer Prevails


1. Facts
The taxpayer successfully argued against the assessment of an “intentional disregard” penalty pursuant to section 6721(e). The taxpayer was a single-member LLC managed by Mr. Scott Borre (“Mr. Borre”). Id. at 1. The taxpayer was a disregarded entity under the “check-the-box” regulations. Id. Mr. Borre, therefore, reported the taxpayer’s profits and losses on results on Schedule C, Profit or Loss From Business of his tax return. Id. On its Forms 941 filed for 2005, 2006, and the first quarter of 2007, the taxpayer offset employment taxes due on its employees’ wages by the advance earned income credits (AEIC). Id. The Commissioner discovered that the wages and AEIC payments that the taxpayer reported on its Forms 941 for 2005 and 2006 were greater than the wages and AEIC payments it reported on its Forms W–2 for those years. Id. According to an IRS statement, the taxpayer did not file Forms W–2 for the first quarter of 2007. Id. Among other things, the IRS sought to impose intentional disregard penalties under section 6721(e)(2)(A). The IRS claimed that the penalties were appropriate because the taxpayer “filed ‘incorrect Forms W–2.’” Id. at 18. The taxpayer, however, claimed that there were no grounds for imposing the penalty for any of the periods at issue because the IRS failed to issue a notice and demand before the limitation period ran. Id. at 1.

2. Held
The tax court sided with the taxpayer for all three years in question. The court held that the taxpayer LLC did not have notice prior to the limitation period. Id. at 19. Here, the address of the taxpayer LLC and its manager differed. Id. The original notice and demand sent by the IRS was to the address of Mr. Borre, not the taxpayer LLC. Id. The taxpayer successfully argued that it was unaware of its employment tax underpayments until it received a notice of intent to levy, more than four years after the first quarter of 2007. Id. Although the court acknowledged that it normally would not conclude that an Appeals Officer “abused his or her discretion by relying on IRS computer records to verify that timely notice and demand had been mailed to the taxpayer’s last known address,” here, at a CDP hearing, the taxpayer LLC’s representative notified the Appeals officer “that the computer-generated address . . . to which any computer-generated notice and demand most likely would have been sent was never [the taxpayer’s] address and . . . that the first notice that either [the taxpayer] or Mr. Borre received was the notice of levy.” Id. at 9. Consequently, after applying an abuse of discretion standard of review, the court concluded that the Appeals Officer abused her discretion by concluding that the computer generated transcripts provided notice and demand to the taxpayer at its last known address within 60 days of the assessments for 2005 through 2007. Id. The court also considered Mr. Borre’s testimony that “his normal practice was to have his accountant, or members of his accountant’s firm, meet with [the taxpayer’s] bookkeeper to make sure that
[the taxpayer] would comply with all legal requirements.” Id. at 14. The court thus concluded that the Commissioner failed to show that the taxpayer acted with intentional disregard.


1. Facts
   The taxpayer, American Vending Group, Inc. (the “Company”), was incorporated in 1998 by Mr. John Blick (“Mr. Blick”) and another individual. Id. Because he lacked accounting knowledge, Mr. Blick hired outside help for the Company’s payroll matters. Id. After realizing that he needed to provide the Company’s employees with Forms W-2, he instructed the payroll service provider to provide the Company employees with the form. Id. at 2. Mr. Blick was unaware of Form W-3 in 1998. Id. Although Mr. Blick’s payroll service provider recalled placing the 1998 W–3’s on Mr. Blick’s desk along with the 1998 W–2’s, she also testified that Mr. Blick’s desk was “horribly messy.” Id. at 4.

2. Held
   The court began by reviewing the regulation on section 6721(e) in determining whether there’s been intentional disregard. The regulation provides that:
   
   The facts and circumstances that are considered in determining whether a failure is due to intentional disregard include, but are not limited to—
   
   (i) Whether the failure to file timely or the failure to include correct information is part of a pattern of conduct by the person who filed the return of repeatedly failing to file timely or repeatedly failing to include correct information;
   
   (ii) Whether correction was promptly made upon discovery of the failure;
   
   (iii) Whether the filer corrects a failure to file or a failure to include correct information within 30 days after the date of any written request from the Internal Revenue Service to file or to correct; and
   
   (iv) Whether the amount of the information reporting penalties is less than the cost of complying with the requirement to file timely or to include correct information on an information return. Id. at 6 (quoting Treas. Reg. § 301.6721–1(f)(3)).

   Applying the regulation, the court found the following: (1) the taxpayer’s failure to file the 1998 W–3’s was not part of a pattern of conduct; (2) the taxpayer never independently realized that it failed to file the 1998 W–3 transmittal return; (3) the taxpayer did not take corrective action within 30 days of receiving a Notice of Penalty Charge; (4) the taxpayer, as a rational taxpayer, would have complied with its reporting requirements and avoid the risk of the penalty imposed. See id.
By hiring outside payroll help, the court concluded, the taxpayer intended to comply with its reporting requirements. \textit{Id}. The taxpayer’s actions were thus accidental and not intentional, and the fines assessed under section 6721(e) were unwarranted. \textit{Id}.


1. \textbf{Facts}
   The taxpayer, John C. Hom & Associates, Inc., was a California corporation. John C. Hom ("Mr. Hom") was the owner and president of the corporation. \textit{Id.} at 1. In years 2004 and 2006, the taxpayer “issued Forms W–2, \textit{Wage and Tax Statement}, to employees but failed to file those forms and the Forms W–3, \textit{Transmittal of Wage and Tax Statements}, with the Social Security Administration (SSA). Mr. Hom generally followed a procedure for issuing Forms W–2 to employees and filing Forms W–2 and W–3 with the SSA. After mailing the forms to the SSA, Mr. Hom would save copies of the Forms W–2 and W–3 on his computer. Because Mr. Hom retained copies of the 2004 and 2006 Forms W–2 and W–3 on his computer, he believed that he had completed the previous step of filing those forms with the SSA.” \textit{Id.} Pursuant to section 6721(e), the Commissioner assessed penalties against the taxpayer for “intentional disregard” of its Form W–2 and W–3 filing requirements. \textit{Id.}

2. \textbf{Held}
   The tax court held in favor of the taxpayer. In its determination, the court, cited Gerald B. Lefcourt, P.C. v. United States, 125 F.3d 79, 83 (2d Cir.1997), a case in which the Second Circuit Defined “intentional disregard.” There, the court defined intentional disregard “as voluntary, conscious, and intentional conduct. \textit{Id.} at 4. In other words, the penalty applies when the failure was not accidental, unconscious, or inadvertent.” \textit{Id.} The tax court in this case provided two examples of other cases in which the taxpayer was deemed not to have acted with intentional disregard. First, the court cited to the previous case – \textit{American Vending Group} – in which the taxpayer prepared Forms W–2 and W–3, however, due to a “messy desk,” failed to file the forms. \textit{Id.} In a second case, the taxpayer testified that he mailed the Forms W–2 and W–3; therefore, if the Service did not receive the forms, it was not as a result of intentional disregard. \textit{Id.} In both cases, the district and bankruptcy courts respectively sided with the taxpayer on the issue of “intentional disregard.”

In light of these cases and applying the standard in the regulation defining intentional disregard, the tax court held that there was insufficient evidence to establish a pattern of behavior. \textit{Id.} Although the IRS tried to argue that a pattern had been established through the taxpayer’s failure to file Forms 940 and 941 in previous years, the court held that the evidence was insufficient to establish that the taxpayer was in fact required to file those forms in the years suggested. \textit{Id.} Moreover, the court held that, even “if petitioner was required to file Forms 940 and 941 and failed to file them for some periods, we are not
convinced that this failure would establish a pattern of conduct that includes the failure to file the 2004 and 2006 Forms W–2 and W–3.” Id. Additionally, the court noted that there was no evidence that the IRS ever prompted the taxpayer “to correct [its] failure to file the 2004 and 2006 Forms W–2 and W–3. Id. at 5. Without such prompting, the court concluded, “Mr. Hom would have no reason to know that the [taxpayer] needed to correct the failure to file.” Id.

Finally, in reviewing the cost of compliance versus non-compliance, the court emphasized that there is no cost, absent postage and time to prepare the forms, to file the Forms W–2 and W–3. Thus, when compared to the $2,070.30 and $8,018.75 section 6721(e) penalties for 2004 and 2006 respectively, “[a]ny rational taxpayer would comply with the reporting requirement.” Id. Note: Pursuant to section 7463(b), this decision has no precedential value.
VIII. Case Law Where the Government Prevails

   1. Facts
      In this case, the taxpayer company unsuccessfully made a “reasonable cause” argument for failure to file employment tax returns. Sarah Stevens (“Stevens”) incorporated Stevens Technologies, Inc. (the “Company”) in 2004. Stevens was the Company’s president from the time of incorporation through 2010. Id. at 1. The Company provided services to federal agencies, including the National Aeronautics and Space Administration and the Tennessee Valley Authority (“TVA”) from 2005 through 2010. Id. The basis for the reasonable cause argument was twofold:

      First, from 2005 through 2008, Stevens experienced several health and family issues. In 2005, Stevens suffered from heart problems. Because of her condition, she experienced a complicated pregnancy and ultimately gave birth in a hospital’s ICU. Moreover, Stevens’ daughter was born with a cancerous tumor. In 2006, Stevens’ daughter had an operation to remove the tumor. See id. at 4. Later that year, Stevens’s mother was diagnosed with cancer. Stevens began caring for her mother at her parents’ house in Pennsylvania. During this time she commuted to Charlotte, where the company was based. Id. In 2007, Stevens’ heart problems persisted and required surgery. Also in mid-2007, Stevens moved from Pennsylvania back to her home in Charlotte with her mother, where she continued to care for her mom until shortly before her mom’s death in November 2008. See id. After her mom’s death, Stevens became more involved in the Company again and began addressing its tax problems. Id.

      A second argument for Stevens’ reasonable cause argument was based on two business engagements the Company entered into with the TVA in 2009 and 2010. See id. The Company contracted to provide services to the TVA in 2009, however, the TVA did not schedule some work during the fourth quarter of 2009. Id. The Company entered into a second contract with the TVA in 2010. As part of that agreement, the Company would inspect several of the TVA premises; however, the Company was unable to perform because the TVA did not allow the Company employees on its facilities. The Company lost money on the contract as a result. See id. at 5.

      The Company taxpayer argued that Stevens’ personal issues between 2005 and 2008 prevented her from timely filing the Forms 941 and depositing and paying the taxes shown on those forms. During this period the company did not timely file its Forms 941; it was also delinquent in its payments and deposits of its quarterly employment taxes. Id. at 11. The Company also argued that the TVA’s failure to pay the company prevented it from paying and depositing its quarterly employment taxes for the last quarter of 2009 and the first two quarters of 2010. Id.
2. Held
The tax court, however, rejected the reasonable cause argument for the Company’s failure to timely file its tax returns, pay its employment taxes, and make its deposits. Id. The court reasoned that although the Company did not comply with its tax obligations, it was nevertheless “able to continue its operations, market its services to clients and potential clients, increase its workforce, and hire an accounting firm to prepare its Forms 941.” Id. Consequently, the court held that the Company’s tax failures were a “deliberate choice to focus on business matters rather than on tax compliance.” Id.

Regarding the company’s difficulties with the TVA and its subsequent failure to pay employment taxes and make deposits during the last quarter of 2009 and the first two quarters of 2010, the court noted that, despite apparent disruptions in revenue from the TVA in late 2009, the record was unclear. Id. Thus, the court could not determine how much work the contract required the TVA to give the company, the schedule on which the work was to be done by the company, or the schedule on which payments were to be made by the TVA. Id. The court was thus “not convinced that the disruptions [were] reasonable cause for the company’s failure to make the required payments and deposits.” Id.

3. Takeaway
Reasonable cause is determined based on the “ordinary business care and prudence” of the taxpayer. Id. at 10. Ordinary business care and prudence is viewed in light of “all the facts and circumstances of the taxpayer’s financial situation.” Id. (citation omitted). Additionally, “[d]eath or serious illness can constitute reasonable cause.” Id. (citation omitted). Further, a “majority of Courts of Appeals (that have considered the issue) recognize that financial difficulties can constitute reasonable cause, even for the failure to pay and deposit employment taxes.” Id. (citation omitted).

Although the above standard for reasonable cause set out by the tax court seems to favor the taxpayer, in light of the facts, the court held against the taxpayer. Despite both “death and illness” suffered by Stevens in 2005 through 2008, the court magnified the fact that the rest of the Company was operational. In a counterfactual scenario, one might imply that the outcome might be different.

The importance of providing the court with enough evidence for it to determine whether ordinary business care and prudence was used by a taxpayer is another point of emphasis in this case. The court highlighted that the record was spare on the alleged cause and effect of the TVA’s failure to pay and the Company’s tax failures. With additional evidence, a taxpayer might prevail.

1. Facts
The taxpayer, Bale Chevrolet Co., was audited by the IRS in 2000. The audit showed that, in violation of IRC § 6050I, Bale Chevrolet failed to file four Forms 8300. See id. Pursuant to IRC section 6721(e), the IRS assessed “intentional disregard” penalties against the taxpayer. The taxpayer paid the penalties, and thereafter filed a civil action for a refund. Id. The parties settled out of court, and Bale Chevrolet received a refund. Id. In this case, the taxpayer sought administrative and litigation costs refunded on the grounds that the penalties imposed were not “substantially justified” under IRC section 7430. Id.

2. Held
The district court held that the “United States was substantially justified in its application of the intentional disregard penalties” against the taxpayer. Id. at 3. The court gave credence to the argument by the government that there was little case law providing guidance on the section 6721(e) penalty at the time the penalty was imposed. See Id. at 3. Therefore, looking at whether the taxpayer exhibited a pattern of violations, a factor provided for by the regulation on section 6721(e), the government determined that a pattern had been established through taxpayer’s history of lack of internal controls. See Id. at 4.

The conclusion was based on prior audits against the taxpayer in 1991 and 1996. Id. Although the 1991 audit did not produce any violations, the IRS assessed did assess a violation against the taxpayer for failure to file one Form 8300 in 1996. Id. In this case, based on an audit conducted in 2000, the IRS found four separate instances in which the taxpayer failed to file Forms 8300. Id. After the taxpayer’s CFO and Comptroller filed a protest with the IRS, the IRS Appeals Officer determined that the taxpayer “‘intentionally disregarded’ its duty to file Forms 8300.” Id. at 5.

The court gave great deference to the IRS in this case and relied significantly on a single factor listed in the regulation, that is, a pattern of failure to comply. Indeed, the court acknowledged that “an argument exists that a prior singular violation does not create a pattern,” nevertheless the court concluded “that the United States reasonably believed that the previous violation coupled with the violation before them created a pattern sufficient to assess the intentional disregard penalty.” Id.

3. Takeaway
A distinction can be made between the reasoning of this court and the reasoning by the court in John C. Hom & Associates, Inc.. In this case, both the 1996 and 2000 failures involved Form 8300. In contrast, the government in John C. Hom & Associates, Inc. sought to establish a pattern from an alleged failure to file Forms 940 and 941 to Forms W-2 and W-3. However, the court chose not to establish a pattern from separate “form violations.” Another factor that the court in John C. Hom & Associates, Inc. mentioned was the government’s
failure to “prompt” the taxpayer. By contrast, here, the taxpayer was prompted by the government after the 1996 audit. Indeed, the taxpayer’s CFO and Comptroller signed an Acknowledgment of Requirement to File Form 8300 in 1996. Bale Chevrolet Co. at 4. At that time, she also acknowledged that several procedures were being implemented to detect transactions that require filing Form 8300. Id. Therefore, although this case might appear harsh standing alone, viewed in light of John C. Hom & Associates, Inc., the facts and thus the outcomes are distinguishable.
IX. Chief Counsel Memoranda

A. Divisibility of I.R.C. Section 6721 and Section 6722 Penalties
   1. The issue presented to the Chief Counsel was whether the current versions of section 6721 and section 6722 are divisible for the purpose of establishing refund suit jurisdiction or whether a taxpayer must pay amounts in full in order to establish refund suit jurisdiction.

   As a general rule, a taxpayer can only institute a refund suit if the taxpayer pays the tax liability in full prior to the commencement of the suit. Flora v. United States, 362 U.S. 145 (1960). Courts have recognized a limited exception to this so called “full payment rule” when the taxes are deemed divisible. In that case, the taxpayer need only pay a divisible portion of the tax to satisfy the payment prerequisite to jurisdiction. A divisible assessment is one where the tax or penalty is comprised of several independent assessments created by separate transactions. Therefore, in determining whether section 6721 and section 6722 are divisible penalties, the key factor is whether the penalties can be divided into separate transactions. According to the Chief Counsel, the penalties under section 6721 and section 6722 can be divided into separate transactions and are thus divisible.

   The reason for the Chief Counsel’s conclusion is the following: First, the assessments imposed under both 6721 and 6722 are done with respect to distinct failures and are thus separate “transactions” for penalty purposes. Second, not only are both penalties applied on a per-failure basis, but the amount of the penalty applicable to each failure is adjusted based on the circumstances surrounding the individual failure. Third, section 6724 provides a reasonable cause waiver applicable to sections 6721 and 6722. Like the penalty amount, the waiver is determined on a per-transaction basis.


B. I.R.C. 6721 Electronic Media Intentional Disregard Calculation
   1. The issue presented to the Chief Counsel was the proper procedure for computing the applicable percentage aggregate amount for a penalty imposed on a person who intentionally disregards the 6011(e) electronic media filing requirement. Treasury Regulation section 301.6011–2 requires magnetic media filing for persons filing more than 250 returns in a year. If a person fails to file a return on magnetic media when required to do so, he or she is deemed to have failed to file the return and is subject to penalties. IRC section 6724(c) provides that a penalty may be imposed under section 6721 only because a person failed to comply with the magnetic media filing requirement. Treasury Regulation 301.6721–1 explains that the penalties are imposed only on each return filed above 250. However, the IRC, Treasury Regulations, and Internal Revenue Manual are silent regarding the
procedure to be used for computing the applicable percentage aggregate amount of the penalty.

The Chief Counsel concludes that the computation of the percentage aggregate amount is a policy decision best left to the discretion of the IRS Office of Service wide Penalties (OSP). Nevertheless, the Chief Counsel offered several calculation means for the OSP. For example, a person who intentionally disregards the filing requirement in one calendar year by filing 300 paper returns, will have the applicable percentage of the aggregate amount of the items required to be correctly reported based on returns 251-300. The OSO can determine whether it should use the 50 returns with the highest amount reported; the 50 returns with the lowest amount reported; 50 randomly selected returns; or on the average amount reported on all 300 returns, multiplied by 50. The Chief Counsel noted that the OSP may want to consider that Congress has increased the section 6721 penalty amount multiple times in the past ten years, suggesting that a calculation resulting in the highest penalty amount should be imposed.