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Celesq® Master Tax Series - Employment Taxes and the Trust Fund Recovery Penalty

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Employment Taxes & The Trust Fund Recovery Penalty

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Liability for Trust Fund Taxes

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Trust Fund Taxes

- The IRC requires payors to withhold for taxes amounts paid to certain individuals.
- The most commonly encountered example is where an employer must withhold from an employee’s wages the employee’s federal income taxes and the employee’s share of FICA taxes.

Trust Fund Taxes

- The withheld taxes are referred to as "trust fund" taxes.
- The theory is that the employer has "paid those amounts to the employee so that the employer is no longer entitled to the amounts and, by retaining the amounts, *holds them in trust for the government* until they are paid over to the government to be applied to the employee's tax accounts."

Trust Fund Taxes

- Even though the funds are designated “trust” funds, there is no requirement that after withholding and prior to remitting to the government, that the funds actually be held in some type of segregated trust fund or account.

Trust Fund Taxes

- Prior to being turned over to the government, the employer holds the funds and can use them for any purpose whatsoever, although the person or persons directing their use for purposes *other than payment of the trust fund tax* can be liable for this TFRP or even a collateral criminal penalty (S 7202).

Trust Fund Taxes

- The government must *credit* the employee with the amount withheld even if the employer does *not* remit the withheld amounts to the IRS.

Trust Fund Taxes

- The following is a good example of the courts' view of the trust fund tax and the employer's responsibility:
  - The withholding taxes "are part of the *wages* of the employee, held by the employer *in trust* for the government"; the employer, as a function of administrative convenience, extracts money from a worker's paycheck and *briefly* holds that money before forwarding it to the IRS. **** A delinquency in trust fund taxes thus is not simply a matter between the IRS and an employer, but rather involves employee wages.

Trust Fund Taxes

– The significant responsibility *** is summed up by then-Judge Cardozo's famous statement that "[a] trustee is held to something stricter than the morals of the market place. Not honestly alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."

Trust Fund Taxes

- Here is an example:
  - Employer owes Employee $ 500 for wages and, based upon the withholding requirements, must withhold $ 50 for the employee’s income taxes (based on the employee’s W-4 and the related withholding tables) and $37.50 for the employee’s share of FICA. Employer writes a check to Employee for $ 412.50 ($ 500 - $ 87.50). Employer is deemed to have withheld the $ 87.50 from the payment and is required to turn that over to the IRS. It does not matter whether or not Employer in fact withheld. Indeed, Employer may have only had $ 412.50 to pay the employee and that’s all he paid. Nevertheless, Employer is deemed to have withheld the $ 87.50.

Trust Fund Taxes

- The employer is liable for the $ 87.50. Failure to pay over the $ 87.50 to the IRS subjects the person or persons within the employer's organization responsible for the failure to do so to the trust fund recovery penalty (TFRP). When the employer fails to pay the trust fund taxes, it will usually also fail to pay the employer's related taxes – specifically, the employer's portion of FICA. However, the employer's portion is not a trust fund tax. In other words, it's not *another* person's liability which is satisfied through withholding.

Trust Fund Taxes

- In this example, even if the withheld taxes are not paid, the employee will be credited against his income tax and credit for payments into the social security system for FICA. Essentially, the employer is the withholding agent for the government.

Trust Fund Taxes

- Not surprisingly, given the amount of dollars in the system for trust fund taxes, the IRS has a vested interest in encouraging compliance with requirements for withholding and paying over to the IRS.
- As such, the IRS has major compliance functions in place to deal with potentially delinquent withholders.

Trust Fund Recovery Penalty

- Section 6672 imposes civil liability upon certain persons *other* than the employer for unpaid trust fund taxes.
- The Code refers to the liability as a “penalty,” but it is merely a tool to enforce collection of the trust fund taxes.

Trust Fund Recovery Penalty

- Although the liability is related to the underlying trust fund taxes, it is still a liability separate and apart from them.
- The liability is frequently referred to as the Trust Fund Recovery Penalty (TFRP).

Trust Fund Recovery Penalty

- The circumstances giving rise to the penalty is that the employer is late in turning over the trust fund taxes to the IRS and then is unable to pay them.
- When a business falls on hard times and is experiencing cash flow problems, the principal person or persons managing the business may attempt to keep the business afloat by using the trust fund taxes to satisfy what he perceives to be a far more *urgent* need.

Trust Fund Recovery Penalty

- The expectation is that the cash flow problem will disappear and that the trust fund tax will be paid later.

Trust Fund Recovery Penalty

- The withholding taxpayer often views his intervening use of the trust fund tax proceeds as a temporary fix to get through a “rough time,” with every intention of eventually paying it.
- If the business succeeds or the withholding TP otherwise pays the delinquent taxes (with interest on the delinquent payments), everybody lives happily ever after.

Trust Fund Recovery Penalty

- But if the business goes belly up with the IRS holding the bag, as is too often the case, things go south fast.
- Section 6672 imposes civil liability – the TFRP – for the unpaid trust fund taxes upon those individuals who had the responsibility to ensure that the withheld taxes were paid over to the government for the trust fund taxes instead of being used for other purposes.

Trust Fund Recovery Penalty

- An individual is subject to the TFRP if he:
  - Was “required to collect, truthfully account for, and pay over,” and
  - Willfully failed to do so.
- The statute refers to the liability as a penalty but it is actually just a secondary tax collection mechanism for employers who fail to remit the withheld taxes to the IRS.

Trust Fund Recovery Penalty

- A person who is subject to the TFRP may have direct liability for the trust fund tax, as well as other taxes of the employer.
- Under most states' general partnership laws, a partner in a partnership is generally liable for the trust fund taxes as general partners separate and apart from the TFRP and assessing the TFRP might be unnecessary.

Trust Fund Recovery Penalty

- By contrast, an owner in a limited liability entity, such as an LLC, will only be liable under the TFRP.

Trust Fund Recovery Penalty

- Distinguishing between trust fund and non-trust fund taxes is critical.
- In the employment context, withholding from the employee for *income tax* and *FICA tax* are trust fund taxes.
- The employer's *direct* liability for the employer's *portion* of the FICA tax is *not* a trust fund tax and therefore, is *not* subject to the TFRP.

Trust Fund Recovery Penalty

- In addition, delinquency penalties and accrued interest for unpaid trust fund taxes are not consolidated in the liability.
- The TFRP is merely the amount withheld, *not* including the *employer's* penalties or interest.
- However, once the TFRP is assessed, it bears interest.

Trust Fund Recovery Penalty

- More than one person can be – and often are – liable for the TFRP. Thus, the IRS can make multiple assessments.
- A responsible person liable for the tax is not relieved of the responsibility to pay the TFRP even if another responsible person is “at large” and is more culpable vis-à-vis the default.

Trust Fund Recovery Penalty

- As unfair as this may seem, the IRS need not make the TFRP assessment against a person otherwise liable, even if that person is “dead to rights” and significantly more culpable.

Elements of Liability

- Section 6672 imposes liability upon:
  - Any persons 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 …

Elements of Liability

- Before the Supreme Court weighed in, individuals who were assessed the TFRP used to argue that they were not liable because their role with the employer did not consist of each of the *three* stated elements: collect, account and pay.

Elements of Liability

- The Supreme Court rejected that argument, holding that “and” actually meant “or.”
- Even with this holding, the key element for liability to attach is the term, “responsible person.”

Key Element - Control of Financial Decisions

- The key to civil liability is:
  - Control of finances within the employer corporation: the power to control the decision-making process by which the employer-corporation allocates funds to other creditors in preference to its withholding obligations.

Key Element - Control of Financial Decisions

- IRS Policy Statement P-5-60, sheds some light on who bears the “distinction” of being a responsible person
  - (3) Determination of Responsible Persons: Responsibility is a matter of status, duty, and authority. Those performing ministerial acts without exercising independent judgment will not be deemed responsible.

Key Element - Control of Financial Decisions

– (4) *** In general, non-owner employees, who act solely under the dominion and control of others, and who are not in a position to make independent decisions on behalf of the business entity, will not be asserted the trust fund recovery penalty.

Key Element - Control of Financial Decisions

- The over-arching issue is: “Who made the decisions that caused the company to default on paying the trust fund taxes?”
- Courts look to certain objective factors to identify the role of a person.

Key Element - Control of Financial Decisions

- The following is a list of a few salient factors:
  - (1) is an officer or member of the board of directors;
  - (2) owns shares or possesses an entrepreneurial stakes in the company;
  - (3) is active in management of day-to-day affairs of the company;
  - (4) has the ability to hire and fire employees;
  - (5) makes decisions regarding which, when and in what order outstanding debts or taxes will be paid;

Key Element - Control of Financial Decisions

– (6) exercises control over daily bank accounts and disbursement records; and
– (7) has check-signing authority.

Key Element - Control of Financial Decisions

- Note well: None of these factors alone are dispositive. They are simply factors to be considered in determining who had the *financial decision-making power*.

Key Element - Control of Financial Decisions

- The test for responsible person is very broad.
- Not only does it cover key officers whose job responsibilities bestowed upon them a material role in making financial decisions, but it may also cover directors and shareholders of a corporate employer who are *not* officers or employees of the corporation.

Key Element - Control of Financial Decisions

- Even more counter-intuitive, it may cover persons who are not officers, employees, directors or shareholders. However, it is the rare occasion that such a person would have decision-making authority, much less an incentive to participate in such decisions.
- It does not cover persons with titles that raise an inference of decision-making authority but who did not actually possess such authority.

Key Element - Control of Financial Decisions

- One court attributed liability to a person who "could have impeded the flow of business to the extent necessary to prevent the corporation from squandering the taxes."

Key Element - Control of Financial Decisions

- Courts seem to agree that a person need not have final or absolute control of the financial decision so long as they participated in a significant and meaningful way.
- Because authority and power is fluid, has no rigid structure, and may change regularly, it is critical to focus on a person's role *during* the quarters at issue (i.e., during which the TFRP is assessed).

Willfulness

- Liability attaches to a person only if the failure to pay the trust fund taxes was willful.
- It is impossible to discuss willfulness in the context of tax law without referring to the criminal sections of the Code, which often equate it with *mens rea*, a fancy Latin term for one's mental state.

Willfulness

- In the criminal tax context, willfulness is defined as violating a known legal duty.
- Outside the criminal tax realm, the concept is more broadly interpreted.
- For purposes of its application to the TFRP, willfulness means that the taxpayer possessing the responsibility "knew that the employer was required to withhold and pay over the TFRP taxes, but did not."

Willfulness

- Willful blindness, also known as “deliberate ignorance,” is the bane of most taxpayers’ existence.
- This is because it is a watered-down version of the heightened definition of willfulness and courts sometimes allow the government to use it to prove willfulness even in the criminal context where an individual’s very liberty is at stake.

Willfulness

- Not surprisingly, the IRS interprets willfulness in the TFRP context to include more than just a deliberate intent to fail to withhold and pay over.
- The IRM says:
  - Willfulness is construed to be the attitude of a person who … either *intentionally* disregards the law *or* is plainly *indifferent* to its requirements.

Willfulness

- In other words, even if a specific intent to not pay the taxes does not exist, willfulness will be inferred whenever a person’s actions are deemed to be “grossly negligent.”

Willfulness

- Does willfulness exist if an employer receives funds that by law or by contract are committed to uses *other* than payment of the delinquent trust fund tax?

Willfulness

– Obviously, an employer who receives and holds assets in trust for a *third party* cannot use those assets to pay the trust fund taxes.
– However, courts seem to take a nuanced approach, distinguishing between assets held by an employer subject to a *legal restriction* (analogous to a trust fund) and assets held by an employer subject to a *contractual term* that the assets be used for purposes other than trust fund taxes.

Willfulness

- A responsible person whose employer holds assets under a legal restriction (analogous to a trust fund) is ***not*** willful for failing to use those assets to pay delinquent trust fund taxes.
- However, a responsible person whose employer holds assets subject to a mere contractual restriction that they be used for other purposes ***is willful*** if he doesn't use those assets to pay delinquent trust fund taxes.

Willfulness

- One court recently held:
  - Funds are encumbered [and thus not available to pay trust fund taxes] only when certain legal obligations, such as *statutes, regulations, and ordinances*, impede the freedom of a company to use its funds to fulfill its trust fund tax debts. Voluntary contractual obligations, such as the lock-box arrangement at issue here, do not encumber funds so as to prevent a willful failure to pay trust fund taxes.

Reasonable Cause

- The statute does not provide a reasonable cause exception to TFRP liability.
- Some circuits, however, recognize a reasonable cause exception.
- Other circuits, such as the Fifth, state that the factors that might bear upon a reasonable cause inquiry are merely considerations to be used in determining whether a responsible person acted willfully.

Exceptions for Unpaid Volunteers to Charities

- Persons serving as volunteers for tax-exempt organizations are exempted from the TFRP if:
  - They serve solely in an honorary capacity;
  - They do not participate in the day-to-day business or financial operations of the charity; and
  - They do not have actual knowledge of the trust fund tax delinquency.
- This exception does not apply, however, "if it results is no person being liable" for the TFRP. This exception seems to swallow up the rule.

Administrative Procedures

- Audits and Appeals
- Assessments and Predicates
- Statute of Limitations
- IRS Policy to Collect Only Once
- Collection Due Process

Audits and Appeals

- When trust funds taxes are delinquent, the IRS's first course of action is against the employer. If the IRS is unable to shake the employer down for payment, it will conduct an *investigation* to determine whether the TFRP applies and who is liable.

Audits and Appeals

- Unlike income and estate and gift tax examinations, the TFRP is investigated by a Revenue Officer who is already involved in the failed effort to disgorge money from the corporation.
- The investigation involves review of corporate records (e.g., corporate documents such as articles of incorporation, by-laws to see who has authority and checks to see who had check-signing authority) and interviews of people in a position to observe acts that would give rise to liability.

Audits and Appeals

- Upon conclusion of the investigation, the IRS usually will have identified at least one person potentially liable for the TFRP.
- The IRS will issue a notice of proposed assessment to each person so identified.
- However, as a practical matter, the IRS generally does not assert the TFRP if the person against whom the assessment would be made has *no assets from which to collect*.

Audits and Appeals

- This notice gives the person an opportunity to seek administrative appeal to IRS Appeals.
- This appeal is similar to the appeal that can be taken from a “30-day letter” in the context of income and estate and gift taxes.
- If a person fails to appeal or if the IRS Appeals Office sustains the examining agent, then the IRS will assess the tax.

Audits and Appeals

- Upon assessment, the IRS will initiate collection.
- The responsible person may avoid IRS collection procedures by posting a bond and pursuing refund procedures.
- The collection statute of limitations is suspended during this period, but the IRS may make a *jeopardy* collection.

Audits and Appeals

- Much to the chagrin of the responsible person, standard collection procedures are available to the IRS for TFRP assessments.
- In other words, the IRS can:
  - Use IRS summonses to locate assets,
  - Levy on assets,
  - File a tax lien to protect its' interests in the taxpayer's assets,
  - File nominee liens.

Audits and Appeals

- Also, the IRS may enter installment agreements or Offers in Compromise (OICs with either the employer or the person who has been assessed the TFRP.
- However, if the IRS receives an OIC from the employer, in assessing the viability of an offer based on *doubt as to collectability*, the IRS will consider its collection alternatives from persons liable for the TFRP.

Audits and Appeals

- Moreover, if the IRS compromises the underlying liability, it is unlikely that the TFRP would apply to the amount abated pursuant to the compromise.

Assessments and Predicates

- The TFRP is an "assessable penalty" under S 6671(a).
- Unlike income and estate and gift taxes, TFRP is not required to give the taxpayer notice of his or her rights to pre-payment litigation in the U.S. Tax Court.
- Instead, the IRS need only notify the responsible person of the proposed assessment by mail to the last known address or deliver it by hand to that person *at least 60 days prior to the assessment*.

Statute of Limitations

- The SOL on assessment of the TFRP is tied to the employer's SOL on assessment of the underlying trust fund taxes.
- The statute is three years if the employer filed a return and time and memorial if the employer failed to file a return.

Statute of Limitations

- If the employer files a return and agrees to *extend* the SOL on assessment or collection of the trust fund tax liability, the TFRP is *not* also extended.
- In addition, if the employer obtains an *installment agreement* with respect to the trust fund taxes, the SOL for *assessing* the TFRP or *collecting* from the person assessed is *not* also extended.

Statute of Limitations

- If the SOL on the TFRP is in *jeopardy*, the IRS may ask the allegedly responsible person to *consent* to extending the SOL on assessment of the TFRP.

Statute of Limitations

- The SOL is suspended upon mailing of the notice required before assessment from the date of the notice through the *later* of:
  - 90 days *after* the date of the notice, or
  - If the TP makes a t*imely* protest, 30 days *after* the IRS makes its final administrative decision.
- NOTE: There is an exception for *jeopardy*.

IRS Policy to Collect Only Once

- The IRS's policy is to collect the underlying trust fund tax that should have been paid only *once*.
- Viewed from this perspective, the TFRP is a collection mechanism for the unpaid trust fund taxes and *not* an actual penalty imposed to punish each responsible person.

IRS Policy to Collect Only Once

- A literal reading of S 6672 seems to suggest that the IRS could impose the delinquent trust fund tax upon *each* responsible person so that the IRS could, in theory, collect the trust fund tax amount multiple times.
- Obviously, imposition of the TFRP on each responsible person would have the maximum deterrent effect.
- But, as interpreted, the IRS only collects the trust fund tax delinquency *once*.

IRS Policy to Collect Only Once

- Practically speaking, this means that if the employer itself pays the delinquent trust fund tax, the IRS will not pursue the responsible persons who were technically liable under S 6672 when the tax became delinquent.
- Individuals deemed liable under S 6672 for using the trust fund tax for other purposes usually attempt to pressure the employer to pay the trust fund taxes before going under. Sadly, as is more often the case, there is usually nothing left over to pay these trust fund taxes.

IRS Policy to Collect Only Once

- When the IRS is having trouble collecting from the employer (which is more often the case), a tactic employed by a disgruntled person against whom the IRS has asserted the TFRP is to “point the finger” at other persons within the organization with the fervent hope that the IRS will pursue these other people instead. The disgruntled person becomes a “whistleblower.”

IRS Policy to Collect Only Once

- The disgruntled person may even assist the IRS in locating assets of other allegedly responsible persons in the hope that the IRS will levy against them first.
- As underhanded as this strategy may seem, if the IRS succeeds in collecting the trust fund tax from one of these other persons that the disgruntled person “dimed in,” the disgruntled person will have avoided the inevitable: being liable for and having to pay the TFRP!

IRS Policy to Collect Only Once

- The IRS's policy to collect only once requires that it scrupulously adheres to administrative issues in the implementation of the policy, so that it only collects once.
- For example, the IRS may negotiate an installment agreement with the employer to pay the unpaid trust fund taxes over a period of time that spans beyond the expiration of the SOL for assessment of the TFRP.

IRS Policy to Collect Only Once

- According to the IRS policy, normally it will not pursue the TFRP during the period that the installment agreement is in effect and being honored by the employer.
- However, if the installment period extends beyond the SOL, the IRS may proactively assert the TFRP in order to protect itself against the possibility that the employer defaults on the installment agreement.

IRS Policy to Collect Only Once

- The SOL may require that the IRS take other precautionary measures.

IRS Policy to Collect Only Once

- Example: Suppose that within the three year limitations period for assessment, the IRS determines that Adam and Bob are liable for the TFRP.
- Adam has resources that may easily be tapped into by the IRS to pay the full trust fund tax delinquency.

IRS Policy to Collect Only Once

- Bob has *some* resources, but they are not easily accessible (e.g., a large equity cushion in his home).

IRS Policy to Collect Only Once

- Since the IRS can, if it chooses, pursue *only* one of them even though both are equally "liable," will the IRS assert the TFRP only against Adam and collect from Adam?
- Examining this from the perspective of the IRS, it might make better sense to pursue Adam exclusively in order to avoid the unnecessary expenditure of scarce resources on Bob.

IRS Policy to Collect Only Once

- But the best laid plans of mice and men often go awry. What if Adam files a *refund suit* within the applicable period of limitations (two years from the date of payment)?
- This would be a doomsday scenario. Why?

IRS Policy to Collect Only Once

- If the assessment against Adam was made at the end of the three-year SOL and Adam initiated his refund suit *after* the three-year SOL on assessment had expired, the IRS would be at risk that Adam would prevail in the refund remedy and the IRS would be unable to assess against Bob.

IRS Policy to Collect Only Once

- To eliminate this risk, the IRS will proactively assess against Bob, although it may – but need *not* – refrain from collecting from Bob *until*:
  - Adam's refund SOL has expired, or
  - If Adam pursues a refund, Adam's potential for recovery has been denied with prejudice.

IRS Policy to Collect Only Once

- What if the IRS assesses against both Adam *and* Bob and afterwards collects the *entire* amount from Adam or even collects from the employer under an installment plan?
- Under the collection only once policy, the unpaid assessments against Bob or against Adam and Bob, respectively, should be abated.

IRS Policy to Collect Only Once

- Of course, if the employer paid, he would not be entitled to a refund.
- So, upon payment or even partial payments by the *employer*, the assessments against Adam and Bob could be abated.

IRS Policy to Collect Only Once

- But, assuming the IRS collects *only* from Adam, it must postpone any abatement of Bob's assessment until such time as Adam is foreclosed from pursuing a refund due to the closing of the SOL or if Adam has pursued a refund, until such time as his recovery has been denied.

IRS Policy to Collect Only Once

- The foregoing examples demonstrate that the SOL may force the IRS to proceed against a responsible person when it is possible that, given a little more time, the IRS may be able to collect against the employer or even against another potentially responsible person.

IRS Policy to Collect Only Once

- A responsible person may prefer to attempt to negotiate with the IRS by agreeing to an extension of the limitations period for assessment in the hopes that the IRS's need to asses the tax against him will be satisfied as a result of payment by someone else.

IRS Policy to Collect Only Once

- Because of the policy to collect only once, a TP against whom the TFRP has been asserted may request and receive from the IRS the following information despite the general rule that taxpayer return information not be disclosed:
  - The name of any person against whom the TFRP has been asserted; and
  - The nature of the IRS's collection efforts, if any, against such other person(s) and the amount collected.

IRS Policy to Collect Only Once

- A person who has been assessed the TFRP may find this information helpful in assessing his financial exposure and taking certain action.

IRS Policy to Collect Only Once

- For example, assume that Adam and Brian have been assessed the TFRP, that both are clearly liable for the tax, and that after making the assessments, the IRS has fully collected against Adam.
- Armed with this information, Brian may be able to thwart collection efforts by the IRS, subject to any action the IRS deems necessary to ensure that Adam does not successfully pursue a refund claim.

IRS Policy to Collect Only Once

- Even if the IRS were to proactively initiate collection action against Brian, Brian might consider his ultimate exposure in light of the IRS's one collection policy which generally allows the IRS to issue a refund to the person whose payment created the excess payment.

Collection Due Process

- CDP offers a possible judicial remedy for *some* TFRP determinations.
- The CDP procedure is not available until the IRS:
  - Makes an assessment, and
  - Files a lien or levies on the taxpayer's assets.

Collection Due Process

- Can the Tax Court consider the *merits* of the TFRP liability?
- This depends on whether the responsible person had an *earlier* opportunity to dispute such tax liability.

Collection Due Process

- This limitation on the Tax Court’s jurisdiction is designed to motivate the party to pursue earlier available remedies for contesting the merits.
- The classic case where an earlier remedy for contesting the merits of an underlying tax liability exists is in the wake of receiving a notice of deficiency. This is the TP’s ticket to Tax Court.

Collection Due Process

- But the responsible person is not issued a notice of deficiency before the TFRP is assessed because one is not required.
- Thus, the argument can be made that the responsible person has no judicial remedy *prior* to assessment.

Collection Due Process

- But once there is an assessment and the TP pays the relatively small amount to pursue a refund remedy, the TP has a judicial remedy.
- The question becomes, “Does the availability of that post-assessment remedy foreclose Tax Court jurisdiction over the merits?”

Collection Due Process

- At the time of this presentation, there has been no such holding.
- However, one can infer from cases previously decided that there would be jurisdiction.

Collection Due Process

- Ironically, opportunity to dispute may not even require a judicial remedy.
- Keep in mind that the responsible person does receive some type of notice (albeit paltry compared to a notice of deficiency) entitling him to administrative review with IRS Appeals. And this alone, assuming it was received, may be enough.

Collection Due Process

- Assuming the CDP remedy is available, the *downsides* of using the CDP procedure to contest the *merits* are:
  - The lack of a jury or a generalist judge, and
  - The lack of robust discovery in Tax Court.

Collection Due Process

- The *upside* will be the government's *inability* to force the other responsible persons into the litigation, with the net result being:
  - Reduced costs due to the absence of multiple parties, and
  - Avoiding having to deal with those missing persons' claims that the party invoking the CDP remedy is actually the responsible person (i.e., cross-claims).

Collection Due Process

- When the employer invokes the CDP remedy, collection of the employer's liability for trust funds taxes is automatically suspended until the proceeding has ended.
- However, there is no bar against the IRS asserting or attempting to collect the TFRP from a responsible person while the employer's CDP remedy is pending.

Bankruptcy and the TFRP

- TFRP results from an employer who is experiencing financial difficulty. After all, if the employer paid the trust fund tax, there would be no TFRP.
- The employer needs cash to keep the business afloat and sticks his hand in the "cookie jar," using the trust fund taxes to weather the financial storm.

Bankruptcy and the TFRP

- Frequently, the employer will file bankruptcy and propose a plan of reorganization that includes a deferred payout of the trust fund taxes.
- The IRS, however, is *not* required to exhaust its remedies against the employer before it resorts to the nuclear option: asserting the TFRP against the responsible officer.

Bankruptcy and the TFRP

- Instead of accepting the deferred payout which is conditioned upon the success of the reorganization, the IRS can use the TFRP to collect the trust fund tax.
- The TFRP is *not* dischargeable in bankruptcy!

Planning for the TFRP

- The way to avoid the TFRP is to withhold from gross payroll the withholding amount and pay it over to the IRS.
- If a client has failed to pay over the withholding taxes and has had the foresight to engage you as his tax professional, you can give him the following advice.

Planning for the TFRP

- First, if your client expects the corporation to rebound from the downturn in its business, then work with the IRS to have the corporation pay the taxes. Keep in mind that the employer will be assessed penalties for failing to pay over. But, if the employer can get an installment agreement, he may be able to work it out.

Planning for the TFRP

- Second, if the corporation has free and unencumbered assets, use them to pay the IRS the trust fund tax rather than paying third-party creditors, carefully designating *in writing* that all payments be applied to the principal *only* of the trust fund taxes.

Planning for the TFRP

– Why? If the corporation fails, the IRS will have recourse against the individuals involved only for *trust fund taxes* via the TFRP or potential transferee tax liability.
– Thus, if the corporation owes income taxes from past quarters that can’t be covered by NOL carrybacks, pay the trust fund taxes first!

Contribution Among Responsible Persons

- Responsible persons who pay disproportionately on the TFRP relative to other responsible persons may recover from the others “an amount equal to the excess of the amount paid by such person over such person’s proportionate share of the penalty.”

Contribution Among Responsible Persons

- The suit must be brought independently of a case in which the U.S. is asserting the TFRP against one or more of the parties.
- The liability determined in the refund/collection suit is *joint and several*.

Contribution Among Responsible Persons

- Responsible persons paying joint and several liability in disproportionate amounts may only seek contribution in a separate proceeding involving only the persons potentially liable for the TFRP.

Contribution Among Responsible Persons

- The statute quantifies the amount that may be recovered as “the excess of the amount paid by such person over such person’s proportionate share of the TFRP.”

Contribution Among Responsible Persons

- It is not yet clear how the proportionate determination is made.
- For example, is it based upon some assessment of the relative contributions of the failure of the responsible persons to withhold and pay over? How is that assessment made?