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Competence in Small Bites[©]

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Tax Problem Solvers

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Trust Fund Recovery Penalty Basics ©

Part 1 of 2



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FWT
FICA w/h
Medicare w/h



Trust Funds Defined



Withheld income tax and the employee's share of social security taxes—are collectively referred to as the *trust fund taxes*.



Excluded from this definition are the employer's share of social security taxes, unemployment taxes, penalties, and interest.

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IRC §6672 Trust Fund Recovery Penalty



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Any person who is required by law to collect, truthfully account for, and pay over any tax, and who willfully fails to do so or willfully attempts in any manner to evade or defeat payment, is liable for a *penalty* equal to the total amount of the tax. This provision is known as the **trust fund recovery** penalty (TFRP) because it equals the amount that should have been paid to the government.

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Responsible and Willful



Both are Required for IRS to Assess



A responsible person, for purposes of the TFRP, is any person who has the power to see that the taxes are paid.

The TFRP can even extend to outsiders (e.g., banks, creditors, contractors, suppliers, or mortgagees) who exercise control over the financial affairs of the business.



Responsibility and willfulness must both be established. The withheld income and employment taxes will be collected only once, whether from the business, or from one or more of its responsible persons”

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Increased Enforcement Initiative



Purpose of the TFRP

To collect taxes from persons who are not directly liable for such taxes but have the power to control:

- The finances of the entity with primary liability, and
- Determine which creditors are paid.

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Not A True Penalty



Nature of the TFRP...

- Assessment of tax
- Not an addition to tax.
- Similar to a penalty
 - Cannot be deducted
- §6672 assessments are tax, not a penalty,
 - Therefore, not dischargeable in bankruptcy

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60 Days to Protest



Assessable Penalty



IRC §6671(a)



Payable on notice and demand. Not subject to the deficiency procedures.



No Tax Court



Therefore, no right to challenge by petitioning the Tax Court.



IRC 6672(b)



Preliminary notice required at least 60 days prior to notice and demand



Form 1153



Allows 60 days to protest the determination. The case is then transferred to Appeals.

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IRC §6672 Trust Fund Recovery Penalty



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The entity that accrued the tax liability is liable for the entire payroll tax, as well as interest and penalties.

The TFRP can be asserted against other individuals or entities that satisfy the requirements for liability.

IRS can pursue multiple parties, but the liability will only be collected once.

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Limited Liability Entity



Liability of an LLC Depends on Election

1. If a multiple-member LLC elects to be taxed as a corporation, the LLC is liable for the tax but the members may be liable for the TFRP.
2. No corporate election, a multiple-member LLC is taxed as a partnership. Unlike the typical partnership situation, where the IRS asserts an employment tax liability against the partners (who are liable for the partnership's debts under state law), the IRS will not assert an employment tax liability against the members because they are not liable for debts of the LLC under state law. The members may be liable for the TFRP.
3. Single-member LLC elects to be taxed as a corporation, the LLC is liable for the tax but the single member owner (and others) may be liable for the TFRP. If no corporate election, a single-member LLC is not treated as a disregarded entity for employment tax purposes. The LLC owes the taxes on wages paid. To collect from the individual member of the LLC, the IRS has to assess the TFRP.

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Effect on Employees



The failure to pay over trust fund taxes will not harm the employee.

They are given full credit for the amounts that should have been turned over to the government.

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Early Intervention Program



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- In-business
- Behind on FTDs
- 2 or more trust fund modules in collection
- RO will attempt initial contact with repeaters within 45 days (IRM 5.7.8.5)

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IRM 5.7.8.5.3

TFRP and OIC

In-business t/ps attempting to settle a delinquent tax liability by submitting an OIC must be in compliance by timely filing and timely depositing taxes during OIC investigation or the offer will be returned.



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Criminal Penalties



IRC §7202 and IRC §6672



Wording in IRC §7202 and IRC §6672 are virtually identical.



As of 11/1/16, the U.S. Sentencing Commission Guidelines **no longer** refers to §7202 violations as “a felony that is infrequently prosecuted.”

Even if funds are spent as a result of the business financial hardship, there is still a crime being committed.

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Criminal Penalties



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Compare IRC §7202 and IRC §6672

IRC Sec. 6672 (Civil Penalty)

Any person required to collect . . . pay over any tax . . . who willfully fails to collect such tax, . . . shall be liable to a penalty equal to the total amount of the tax evaded, or not collected . . .

IRC Sec. 7202 (Criminal Penalty)

Any person required to collect . . . who willfully fails to collect . . . and pay over such tax shall be guilty of a felony and, upon conviction thereof, be fined not more than \$10,000, or imprisoned not more than five years, or both.

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Criminal Penalties



IRC §7202 and IRC §6672

Under **IRC Sec. 7202**, a person who is required to collect, account for, and pay over taxes and who willfully fails to do so is guilty of a felony and can be fined up to \$10,000, imprisoned for up to five years, or both.

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Criminal Penalties



IRC §7202

Clients with delinquent payroll taxes should be advised of their potential criminal exposure, especially when there is a large liability, a prior history of TFRP assessments, and/or continual pyramiding of trust fund taxes.

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**No Need to
Seek
Payment from
Employer
First**



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TFRP Not the Same as the Tax

The TFRP is separate and distinct from the employer's liability for the trust fund taxes.

Therefore, IRS need not seek payment from the employer before attempting to collect from a responsible person.

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How About a Liability for Non-Trust Fund Amounts?



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An individual was held liable for the trust fund *and* non-trust fund taxes owed by a failed business.

The government relied on 31 U.S.C. Sec. 3713 (which is not part of the Internal Revenue Code) to collect the non-trust fund portion against the individual as a representative of an "estate" who had committed an "act of bankruptcy."

This was based on evidence that the individual made financial decisions for the company and directed payments to other creditors and himself when the business was insolvent.

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Don't Forget to Log In and Watch Part 2 of Trust Fund Recovery Penalty Basics



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Topics in Part 2:

- Voluntary Payments
- Application of Payments
- Responsible Person Paying
- Penalties and Interest
- Applicability of §6672, §6673, §7202
- 4180 Interview
- Documentation needed to support TFRP assessment

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Also, Look for Related Topics Like Defending the TFRP



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More Information?

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Almost Work Time!!

Hope you enjoyed
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