October 18, 2002

REPRESENTING THE CLIENT WITH AN IRS COLLECTION PROBLEM

Robert M. Kane, Jr.
LeSourd & Patten, P.S.
2401 One Union Square
600 University Street
Seattle, Washington 98101
(206) 624-1040

Bob Kane's practice is devoted exclusively to resolving disputes with the Internal Revenue Service. He formerly represented the IRS in tax litigation as a trial attorney for the U.S. Department of Justice. Mr. Kane teaches a class on dealing with the IRS to accountants and lawyers at Golden Gate University. He is a Past-President of the Section of Taxation of the Washington State Bar Association and has an LL M in tax from New York University.

Revised October 10, 2002

REPRESENTING THE CLIENT WITH AN IRS COLLECTION PROBLEM

TABLE OF CONTENTS

REPRESENTING THE CLIENT WITH AN IRS COLLECTION PROBLEM

Bob Kane
LeSourd & Patten, P.S.

This outline covers situations commonly arising in connection with IRS attempts to collect tax. It is assumed that there is no dispute that the taxes are owed. The sole issue under consideration is how to take care of payment of taxes that are admittedly owed.

A. <u>Bill from IRS</u>.

<u>Situation</u>: Your client has just received a bill from the IRS.

1. When a bill is received from the IRS, your client has a number of options:

    a. Pay the bill in full and be done with it.

    b. Borrow money to pay the bill.

    c. Sell assets to pay the bill.

    d. Enter into an installment agreement.

    e. Have account put into uncollectible status.

    f. File an offer in compromise.

    g. File bankruptcy.

2. In deciding how to respond to a bill, it is important to know how the system works. When the IRS requests payment of an individual's tax, traditionally there have been four requests for payment sent from the Ogden Service Center over roughly a three-month period. Each notice is worded more strongly than the preceding notice. The fourth notice entitled "FINAL NOTICE–NOTICE OF INTENT TO LEVY AND NOTICE OF YOUR RIGHT TO A HEARING" notifies your client that if payment is not received within 30 days from the date of the letter, enforcement action, which might include the filing of liens and serving of levies, may be taken. This notice is very important because it gives your client the right to a collection due process hearing.

    After the notices come out of Ogden, the matter is referred to the Automated Collection System (ACS). This office handles delinquent accounts through an automated system before the case is assigned to a revenue officer. All dealings with ACS are over the telephone. ACS is fully capable of issuing levies (garnishments) on your client's wages and levying on your client's bank accounts.

If collection cannot be effected or worked out by ACS, the case will be assigned to a revenue officer. A revenue officer is a bill collector. The revenue officer's job is to collect the taxes as expeditiously as possible. The revenue officer has a wide assortment of powers available to aid in this task. Among these are the ability to file federal tax liens and to levy on property.

3. The IRS does not like to be ignored when it seeks to collect taxes. Your client gains nothing by ignoring the IRS. This serves only to provoke the IRS into taking more drastic collection measures and lessens chances of working out an acceptable plan for payment.

4. Dealing with the IRS Collection Division (now part of "Compliance") can be frustrating because typically the IRS, not your client, is holding all the cards. Nonetheless, IRS is bound by certain basic rules in collecting taxes. In any collection situation it is important to ascertain whether the IRS has jumped through the required procedural hoops. A valid assessment is a prerequisite to the IRS collection activity. An assessment is the formal recording of your client's tax liability on the IRS books. Therefore, it is important to determine, at a minimum, when applicable:

    a. Whether the 90-day letter was mailed to your client. Whether the 90-day letter was sent to your client's last known address. See IRC § 6212.

    b. Whether IRS made an assessment of the taxes. See IRC § 6203.

    c. Whether the assessment was made prior to expiration of the applicable statute of limitations (typically three years from filing of the return). See IRC § § 6501 and 6503.

    d. Whether notice of the assessment and demand for payment were properly given to your client. See IRC § 6303.

    In addition, it is important to keep in mind that IRS typically has ten years from the date of an assessment to administratively collect the tax. See IRC § § 6502 and 6503.

5. In dealing with a revenue officer (RO), there are a number of considerations to keep in mind:

    a. Money talks.

    b. It is to your advantage to demonstrate and convince the RO that your client wants to straighten out his predicament.

    c. Play it straight with the RO.

d. RO would prefer to have <u>you</u> collect the tax rather than for the RO to get heavily involved in collection activities.

e. RO's often are the target of abuse. Treat the RO with respect and the RO will be more inclined to work with you on resolving your client's problems.

f. Determine what your client can live with and sell this plan to the revenue officer. Be creative. For example, have relatives or controlled corporations give IRS a mortgage on their property; subordinate IRS lien if property can be made profitable by completion of a project.

6. If your client cannot pay the tax liability in full (and cannot sell assets or borrow the money), but has some ability to pay, an installment payment plan is likely. There are no hard and fast rules as to the amount of payment which will be required -- the terms depend upon your client's ability to pay. This ability is determined from an analysis of your client's monthly income and expenses as revealed on a financial statement which will be requested. (A form 433-B is used for a business. A Form 433-F can be used when the liability is less than $100,000.) At a minimum, the monthly amount required to be paid will be the difference between your client's gross income and allowable expenses. Keep in mind that one of the main purposes of the financial statement requested by the IRS is to find out about possible sources of collection (<u>e.g</u>., where your client's bank accounts are).

7. Installment Agreements

a. <u>When available</u>. If there are no assets for the taxpayer to sell or borrow against, installment agreements may be used for the payment of tax.

b. <u>Full payment necessary</u>. Installment agreements are arrangements that allow the taxpayer to pay liabilities over time. The IRS allows only agreements that provide for full payment. During an installment agreement, penalties and interest continue to accrue. The IRS does not levy during the term of an installment agreement.

c. <u>Lower dollar amounts</u>. IRC § 6159(c) guarantees a taxpayer with an individual income tax liability of $10,000 or less an installment agreement if 1) in the past five years the taxpayer (or the taxpayer's spouse if a joint return is involved) has not failed to file, pay or had an installment agreement, 2) the IRS determines the taxpayer is unable to pay in full, 3) the agreement requires full payment within three years, and 4) the taxpayer agrees to comply with the Code for the period such agreement is in effect. Taxpayers with liabilities of $25,000 or less may qualify for streamlined arrangements. The filling out of an IRS financial statement is not necessary when $25,000 or less is owed.

d. <u>Disposable income</u>. The basic approach is for the IRS to analyze the taxpayer's financial statement in order to determine how much the taxpayer can afford to pay on a monthly basis. Page six of the Form 433-A for individuals is the focal point. The idea is to determine a taxpayer's disposable income (gross income less allowable expenses), which is the amount available to apply against the tax liability.

e. <u>Current year liability</u>. The taxpayer's current tax year liability can be included in the installment agreement if it appears that taxpayer will have a balance due at the end of the year.

f. <u>Waivers</u>. An installment agreement must fully pay the liability involved before the statute of limitations on collection expires. The IRS may request that the taxpayer sign a Form 900 to extend the statute in connection with an installment agreement. It is IRS policy that such extensions be limited to an additional five years beyond the original statutory period for each tax assessment. It is also the policy of the IRS that the period of collection may be extended only once for each tax period.

g. <u>Review</u>. Taxpayers are entitled to an independent administrative review of rejected requests for an installment agreement. Rejection of a request is not conveyed to the taxpayer until after such review.

h. <u>Appeals</u>. If an installment agreement is rejected, a taxpayer has a right to appeal the rejection to the IRS Appeals Office.

i. <u>Allowable expenses</u>. In looking at the possibility of an installment agreement, there are two types of allowable expenses in connection with the determination of how much a taxpayer can pay on a monthly basis -- necessary expenses and conditional expenses.

j. <u>Necessary expenses</u>. Necessary expenses are those affecting the health and welfare of the taxpayer or the taxpayer's family and/or the production of income. Necessary expenses must be reasonable in amount unless the taxpayer will be paying in full within five years. Necessary expenses are the minimum that a taxpayer and family need to live.

k. <u>Conditional expenses</u>. Conditional expenses are those that do not meet the necessary expense test. These expenses are allowed if the entire IRS liability can be paid in full within five years. Conditional expenses include private school tuition and life insurance used as an investment.

l. “Five-year rule.” Excessive necessary and conditional expenses may be allowed if the tax liability including projected accruals can be paid within five years.

m. “One-year rule.” A taxpayer may have up to one year to modify or eliminate excessive necessary or not allowable conditional expenses if the tax liability cannot be paid within five years.

n. National Standard Expenses. One of the categories of necessary expenses is “national standard expenses.” It includes housekeeping supplies, clothing and clothing services, personal care products and services, food and miscellaneous. The taxpayer’s monthly allowance depends on gross income and the number of members in the household.

o. **PRACTICE TIP**: A taxpayer who claims more than the total allowed by the national standards must substantiate and justify as necessary each separate expense of the total.

p. **PRACTICE TIP**: A taxpayer is allowed the national standard expense amount whether or not the taxpayer actually incurs the expense. If a taxpayer can cut down on expenses in this category, there can be some cushion which might allow payment of what would not otherwise be considered a necessary expense (for example, credit card debt, charitable contributions, cable t.v., private school tuition and the like).

q. Housing and utilities. Local standards have been generated. (All standards can be found at IRS.gov website). Note that the figure includes both the mortgage or rent payment, home insurance, and all utilities (including telephone).

r. **PRACTICE TIP**: In some cases a taxpayer may be able to justify spending more than the normal housing allowance. If limiting the expense to the maximum amount, for example, would force a taxpayer to sell his home, there will be a loss of a tax deduction. As a result of the loss of deductions, the taxpayer would pay more in taxes, which in turn reduces the monthly installment payment to the IRS. If such a “wash” situation results, the IRS should not insist on a taxpayer changing the place of residence.

s. Car expenses. There are national standards for car payments. There are local expense numbers which serve as the maximum amount for operating costs and public transportation. These include lease or purchase payments, fuel, maintenance, and car insurance, registration fees, parking and tolls.

t. Credit Cards. Credit card expense is not considered a necessary living expense.

u. Private school. Private school tuition is not considered a necessary living expense.

v. **PRACTICE TIP**: The IRS will allow a student to finish the school year once the school year has started, rather than forcing a change in school.

w. Charitable contributions. Charitable contributions generally are not considered a necessary living expense.

x. **PRACTICE TIP**: If taking away the charitable contribution would hurt the health and welfare of the family in some way, the IRS may allow some contribution as a necessary expense. It is helpful if there is a documented history of giving.

y. Fees to tax practitioners. A monthly payment of a reasonable amount to a practitioner who is assisting with Collection Division negotiations is considered necessary. The amount is discretionary with the revenue officer. In contrast, amounts paid, for example, for a divorce attorney are conditional expenses.

B. Notice of Levy.

Situation: Your client has just received word that the IRS has levied on property to collect his tax liability. Typical examples are an IRS levy on a bank account or an employer (on wages).

1. The first step is to determine from where the levy came. It may have been served by the Automated Collection System, by a revenue officer, or even by the Ogden Service Center. Usually the levy form will specify where it was issued.

2. By the time a levy is served, IRS generally has sent a number of notices and tried to make contact with your client. The levy is a very effective tool to effect collection or, at a minimum, to get your client's attention.

3. After obtaining a power of attorney from your client, contact must be made with IRS. If the levy was not served by a revenue officer, one approach is to attempt to get your client's case assigned to a revenue officer. Otherwise, no specific person is assigned the case and you are forced to try to work out an arrangement through correspondence or over the telephone.

4. In an emergency, an appeal could be made to the Taxpayer Advocates Office. A taxpayer assistance order may be requested when the taxpayer is about to suffer a

significant hardship. IRC § 7811. There is a Form 911 which can be used by the taxpayer to make such a request.

5. Filing a collection appeal request through the Collection Appeals Program ("CAP") is another alternative. This approach can be used in connection with the appeal of an IRS decision to file a lien, serve a levy, effect a seizure or terminate or deny an installment agreement.

6. When a levy has been served it is important to be sure that the procedural requirements are met. At a minimum, the following should be determined:

    a. Is the assessment upon which the levy was based valid?

    b. Was a 30-Day Notice of Intent to Levy properly given by IRS, providing the taxpayer with collection due process appeal rights?

    c. Is the statute of limitations on collection still open?

7. Assuming the procedural requirements are met, arrangements must be made to defuse what is already a tense situation. By this stage there may very well be "bad blood" between your client and the RO. You can help by setting forth a clear plan of action as to how the taxes will be paid. Obtain a financial statement (Form 433-A) from your client to be submitted to the RO. Based on your client's financial condition, an attempt can be made to pay the liability over time.

8. Keep in mind that just as a levy gets your client's attention, money gets the attention of the IRS. If possible, when working out a payment plan with IRS, offer a check in partial payment as evidence of your client's good faith in working something out.

9. <u>Due Process Appeals</u> The 1998 Tax Act gave taxpayers significant rights in contesting levies and liens. The rights include the ability to appeal an RO's decisions on liens and levies to the IRS Appeals Office, and the right for judicial review if matters cannot be worked out in Appeals. These new rights are contained in IRC § § 6320 (liens) and 6330 (levies).

    a. <u>Hearing before levy</u>.

        1) The IRS generally must give written notice of its intent to collect taxes by levy at least 30 days before issuing the levy.

        2) The taxpayer may then request a hearing before the Appeals Office within 30 days. If the request is not mailed within 30 days after the date of the IRS written notice, the taxpayer nevertheless will be allowed a hearing ("equivalent hearing") but there will be no automatic statutory suspension of collection action and the

taxpayer will not have the right to go to court if the taxpayer disagrees with Appeals' determination.

3) The Appeals Officer conducting the hearing must be someone with no prior involvement in the matter, unless the taxpayer waives this requirement.

4) The Appeals Officer must first verify that required IRS procedures were followed, including:

   i) Revenue officer verified tax liability;

   ii) Estimated expenses will not exceed value of property to be levied on;

   iii) Revenue officer determined that there is sufficient equity in the property to yield net proceeds.

5) Any relevant issue relating to the unpaid tax or to the proposed levy can be raised, including:

   i) Spousal defenses (e.g., innocent spouse issues);

   ii) Appropriateness of collection actions;

   iii) Alternative collection methods;

   iv) Challenges to the existence or amount of the underlying tax liability; provided, that the taxpayer did not receive a statutory notice or otherwise have the opportunity to contest the liability.

6) Issues previously raised in an administrative or judicial proceeding cannot be raised again if the taxpayer participated meaningfully in those proceedings.

7) IRC § 6330(c)(3) provides that in reaching a determination, the Appeals Officer must consider the verification made by the IRS, the issues raised by the taxpayer, and whether the proposed collection action balances the need for efficient tax collection with legitimate concerns that any collection action be no more intrusive than necessary. The Appeals Officer must prepare a written determination.

8) The Appeals Office retains jurisdiction over its determination, and further hearings may be requested, as for example when the

taxpayer disputes whether the IRS is correctly interpreting the determination, or when circumstances change.

9) The determination may be appealed by the taxpayer within 30 days to the Tax Court if it is a matter subject to Tax Court jurisdiction, or otherwise to the U.S. District Court.

10) In general, collection action will be suspended during the Appeals hearing and any ensuing court appeal; however, the running of any statute of limitations (i.e., collection or criminal) is also suspended.

b. <u>Hearing regarding filing of notice of federal tax lien</u>.

1) Under the new law, the IRS must give written notice of its intent to file a notice of federal tax lien not more than five days after it files such notice of federal tax lien.

2) The taxpayer will be entitled to a hearing regarding the notice of federal tax lien under rules similar to those governing the hearing before a levy. If both types of hearings are requested, they will, to the extent practicable, be held together.

3) Notice that the taxpayer has certain rights to appeal a decision to file a federal tax lien *prior to* the filing of the lien pursuant to the Collection Appeal Program.

c. **PRACTICE TIPS**

1) Preserving the ability of your client to take a disputed collection action to court can be important. The taxpayer has 30 days to request a Collection Due Process Hearing with the IRS. The 30 days is triggered by a "1058 Letter" which a revenue officer sends and an LT11 if the Automated Collection System is involved.

2) Although not required, the appeal should be filed on a Form 12153. The taxpayer must explain why the taxpayer disagrees with the IRS Collection action.

3) The request should be sent by certified mail, return receipt requested, so that there is no question about jurisdiction if the matter is taken to court.

4) Unlike the Collection Appeal Program in which the IRS goal is to resolve the matter within five business days, there are no time limitations on how long Appeals can deal with the issues. This is not normally a problem for a taxpayer with a collection problem as the taxpayer generally wants more time to resolve the issues.

C. Offer in Compromise.

Situation: Your client was flying high in the late 90's working in the high tech industry. She exercised stock options in February of 2000. At the time, she thought she would be retiring soon. She owned $800,000 of stock as a result of the exercise. At the time, the tax liability that was generated was no big deal. However, in April of 2000, the value of her stock plunged. Soon thereafter she had tax liabilities greatly exceeding the value of the stock that was obtained through the exercise of the options. Although she has a new job, she is making much less than she used to. She has little in the way of assets with the exception of $40,000 in equity in a $300,000 home. So much is owed that she realizes there is little chance she will ever be able to pay the Form 1040 tax liability for 2000.

1. Doubt as to collectibility. An offer in compromise is a possibility. Although offers based on doubt as to liability are possible, most offers are submitted based on doubt as to collectibility.

2. Move forward. The IRS realizes that it is sometimes better off taking what the taxpayer offers, forgetting about the rest, and moving on to the collection of other delinquent accounts.

3. IRS objectives. The objectives of the program are to resolve accounts in which the liability cannot be collected in full, to effect collection of what could reasonably be collected at the earliest time possible and at the least cost to the government, to give taxpayers a fresh start to enable them to voluntarily comply with the tax laws, and to collect funds which might not be collectible through other means.

4. Amount of Offer. The amount of the offer, at a minimum, must exceed what the RO determines to be the realizable value from your client's assets. Generally, this means quick sale value, often thought of as 80% of fair market value. In other words, if the IRS could seize and sell assets and get more than what your client is offering, the offer will be rejected. The offer must also include provision for your client's "future income." For example, if your client can pay the IRS $100 per month, and there are five years left on the collection statute of limitations, then the IRS will want the offer to include the present value of that income stream that it would receive if there were a five-year installment agreement in effect.

5. Borrowed money. There is no clear dividing line between an offer that is acceptable and an offer that is unacceptable. It depends on the particular circumstances involved. The IRS must be convinced that it is receiving now the reasonable collection potential for the future. If the IRS thinks it can get more over time by waiting, it will reject the offer. Typically, an offer involves borrowing money -- giving the IRS something that it could not otherwise get. For example, a taxpayer might borrow a sum of money from relatives, thereby offering the IRS more than the IRS could reasonably expect to obtain by seizing assets and getting monthly payments over time.

6. Effective Tax Administration. Recent legislation in 1998 resulted in a new kind of offer--effective tax administration (ETA). There is no doubt that the tax liability is correct and there is no doubt the amount owed could be collected, but an exceptional circumstance exists that allows the IRS to consider the offer. The taxpayer must demonstrate that collection of the tax would create an economic hardship or would be unfair and inequitable. Final IRS regulations were issued in July of 2002 which attempt to explain when this type of offer is appropriate. The IRS position is that it will be the rare case when this type of offer is accepted.

7. Delegation Order 11. It should be noted that there is also something called a Delegation Order 11 offer. It is similar to an ETA offer. It is available for the taxpayer who has special circumstances and from whom collection of the full amount (when both assets and future income are considered) is not an option. Note that this type of offer is described in the Internal Revenue manual but there is no mention of it in the IRS instructions explaining how to submit an offer. Special circumstances include

advanced age, serious illness from which recovery is unlikely, assets of a type the liquidation of which would render the taxpayer penniless, and assets of a type that cannot be converted for payment due to other condition (e.g., an elderly taxpayer with equity in his residence cannot borrow against it due to lack of income).

8. Payment. Payment of an offer can be made in a number of ways: 1) cash (paid in 90 days or less); 2) short-term deferred payment (more than 90 days, up to 24 months); or 3) deferred payment (payment terms over the remaining statutory period for collecting the tax).

9. Cash Offer. The taxpayer must offer the realizable value of his assets plus the total amount that the IRS could collect over 48 months of payments (or the remainder of the ten-year statutory period for collection, whichever is less).

10. Short-term deferred Offer. The offer amount must include the realizable value of assets plus the amount the IRS could collect over 60 months of payments (or the remainder of the ten-year statutory period for collection, whichever is less).

11. Deferred payment Offer. The offer amount must include the realizable value of assets plus the amount the IRS could collect through monthly payments during the remaining life of the collection statute. The taxpayer has the option of paying all or a portion of the realizable value of assets within 90 days from the date of acceptance of the offer, or paying the entire offer amount in monthly payments over the life of the collection statute.

12. Considerations. There are a number of considerations to keep in mind in deciding whether to make an offer in compromise and in submitting one:

    a. Aggravation. Submitting an offer is not a fun experience. A taxpayer has to be prepared to divulge all financial information in great detail. At a minimum, the taxpayer must send the IRS financial information for the previous six months. Many taxpayers find the offer process a drill they would rather not go through.

    b. Lengthy process. Consideration of an offer takes a long time. It can easily take nine months to one year, or more, from the time of submission to have an offer in compromise accepted or rejected.

    c. Statute of limitations. The statute of limitations on collection is suspended during the period of time the offer in compromise is pending (the time the offer is being processed and considered), for 30 days following rejection of the offer, and during any appeal.

d. Collection put on hold. Collection activity is usually withheld unless collection of the tax is in jeopardy.

e. Tax lien. The IRS may file a federal tax lien on liabilities compromised under short-term deferred payment offers or deferred payment offers.

f. ETA limitation. The IRS considers an effective tax administration offer only after it has determined the liability is correct and collectible.

g. Processability. The IRS will not consider an offer if the taxpayer has not filed all federal tax returns or is involved in a bankruptcy proceeding.

h. Prerequisites. For the IRS to consider the offer of an in-business taxpayer, all employment taxes for the two preceding quarters must have been timely paid and the employment tax returns timely filed plus all deposits for the current quarter must be timely.

i. IRS instructions. The IRS instructions for Form 656 (Offers) are helpful in dealing with the mechanics of an offer.

j. Lien pending decision on offer. The IRS employee evaluating the offer is supposed to make a determination regarding the need to file a federal tax lien.

k. Combination offers. It is possible to submit an offer based on doubt as to liability, doubt as to collectibility, and effective tax administration. Such combination offers are worked in Collection first.

l. Employment taxes. The amount offered to compromise a corporate employment tax liability must include an amount equal to what can be collected from the responsible person(s) in addition to what can be collected from the corporation.

m. Updated information. If during the consideration of the offer, the financial statement becomes older than 12 months, the IRS contacts the taxpayer to update the information.

n. One-year rule not applicable. The one-year time frame allowed for adjusting expenses in installment agreement cases is not allowed in calculating future ability to pay for offers in compromise.

o. <u>Bankruptcy threat</u>. If taxes are dischargeable and the taxpayer can file a petition in bankruptcy, the IRS is to consider reducing the future ability to pay to what would be recoverable in a proof of claim filed in the bankruptcy proceeding.

p. <u>Collateral agreements</u>. Collateral agreements are not to be routinely secured but used only when the IRS expects a significant recovery.

q. <u>Compliance</u>. One of the terms of acceptance of an offer is that the taxpayer must file all returns and pay all taxes for five years or until the offered amount is paid in full, whichever is longer. Otherwise, the offer is defaulted.

r. <u>Deposit</u>. There is no requirement that money be deposited with the offer. In fact, the IRS form seems to discourage deposits.

s. <u>Refunds</u>. The IRS keeps any refund due the taxpayer for tax periods extending through the calendar year for which the IRS accepts an offer.

D. <u>Assessment of the Trust Fund Recovery Penalty</u>.

<u>Situation</u>: Your client has a construction business. Unfortunately, the business has failed. Among other things, the corporation did not pay over to IRS amounts of income and social security taxes withheld from employees' wages. The IRS has contacted your client and states that it is considering assessing the 100% penalty against him.

1. Employers are required to withhold income and social security (FICA) taxes from their employees. The employer is also under a duty to file quarterly tax returns (Forms 941) and to make federal tax deposits. The amounts withheld from employees (income taxes and FICA) are considered amounts held in trust for the government. These amounts are commonly called trust fund taxes (or employment taxes). Employers are also responsible for the "non-trust fund portion" which is comprised of the employer's share of FICA taxes and the federal unemployment taxes (FUTA). An employee is given credit for amounts withheld from his wages, even though the employer fails to pay to the government the amounts withheld. Employers are often tempted, when their business is not doing so well, to borrow from the government the amount of income taxes and FICA required to be paid over. Often this is done with the intent to pay them over just as soon as the business gets back on its feet. The problem occurs when the business does not get back on its feet.

2. In order to protect the government in this situation, IRC § 6672 imposes a penalty equal to the tax required to have been paid over. This is the old "100% penalty" although today it is called the trust fund recovery penalty (TFRP). The TFRP covers only the trust fund portion of the taxes.

3. The penalty is imposed on any person who (1) was required "to collect, truthfully account for and pay over" the taxes and who (2) willfully failed to do so.

4. The first inquiry is usually phrased in terms of whether your client is a "responsible person." Key considerations in connection with this are authority and control over the corporation's finances. Typically the responsible person is a corporate officer, director or shareholder, but need not be so. Some of the factors examined in determining whether a person is responsible for the payment of employment taxes include:

   a. The identity of corporate officers, directors and shareholders.

   b. The authority to sign checks.

   c. The duties of directors and officers as set out in the bylaws.

   d. The identity of those preparing and signing payroll tax reports and payroll tax returns.

   e. The identity of the person responsible for hiring and firing.

   Essentially, the determination focuses on who has control of the finances of the corporation -- i.e., who has control over who gets paid.

5. A person is not liable for the TFRP unless the person "willfully" failed to perform the required acts. This has been defined to mean an act which is intentional. The person must either intentionally disregard the law or plainly be indifferent to the law's requirements. When a person knows the taxes are due and owing but pays other creditors instead, the person's conduct is willful.

6. When the RO is conducting an investigation to determine against whom the TFRP should be assessed, the RO will want to interview likely candidates, and attempt to locate certain records. The records sought will include the articles of incorporation, bylaws, minute books, canceled checks, bank signature cards, bank statements, payroll records, payroll tax returns, various bank records, and correspondence files.

7. The opportunity exists at this stage to convince the RO that the TFRP should not be assessed against your client. However, this is difficult because if there is any doubt, the RO likely will play it safe and recommend that an assessment be made against your client. The IRS prefers to involve as many potential responsible persons as possible, so that each person will point his finger at the other (in effect making the government's case), while the government sits back and waits for a final determination to be made.

8. If you have no luck with the RO, a Protest can be filed and a conference with the Appeals Office can be requested.

9. If there is no success at Appeals, the amount of tax withheld from one employee for one quarter can be paid, a claim for refund can be filed, and when the claim is disallowed, suit can be filed in federal district court or the U.S. Court of Federal Claims.

10. Miscellaneous considerations:

    a. More than one person can be held responsible for the taxes for any given quarter. Sometimes the best service you can perform for your client in a TFRP case is helping the IRS make its case against another responsible person (so that, at a minimum, the liability can be shared).

    b. The IRS has much leeway in collecting these taxes. It is difficult to make an argument that the IRS failed to take advantage of collecting the taxes from the corporation first. There is generally no duty imposed on the IRS to attempt to collect taxes from the corporation before asserting the TFRP.

    c. If your client makes a payment to the IRS in connection with a potential TFRP, consider designating the payment to be applied against the trust fund portion.

    d. The liability for the TFRP is not dischargeable in bankruptcy.

    e. In dealing with the Appeals Office, TFRP case law in the Federal Circuit generally is more favorable than in the Ninth Circuit.

E. <u>Bankruptcy</u>.

<u>Situation</u>: Your client has gotten in over his head on a number of debts, including his personal income taxes. Also, your client owes a substantial amount due to a TFRP assessment. Will bankruptcy help?

1. Personal income taxes are potentially dischargeable in bankruptcy so long as the due date of the return, including extensions, is more than three years prior to the petition date.

2. Taxes required to be collected or withheld and for which your client is liable as a responsible person are not dischargeable, no matter when the assessment was made or when the liability arose.

3. For taxes that arise as a result of a deficiency assessment, the IRS has 240 days from the date of assessment to try to collect the tax, before the taxes are dischargeable.

4. For taxes due and owing in connection with late-filed returns to be dischargeable, the returns must be filed at least two years prior to the filing of the bankruptcy petition.

5. Congress is considering passing bankruptcy legislation that, in general, will make it more difficult to avoid tax liabilities through bankruptcy.