# The IRS, Employers, And The Trust Fund Recovery Penalty

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Any person operating a business with employees should be aware of the Trust Fund Recovery Penalty that may be imposed by the Internal Revenue Service for the failure to collect and pay over the withholding taxes on an employee's earnings. This penalty is imposed on the employer and any person who is responsible for collecting and paying over withholding taxes on the earnings of an employee and who willfully fails to do so. The amount of this penalty is equal to 100% of the amount of taxes that were not withheld and paid over to the IRS by the responsible individual. Payment to the government of the withheld taxes satisfies the penalty. The penalty is typically imposed on persons who fail to collect and pay over withholding on employee earnings and the FICA taxes (social security and medicare) and FUTA taxes (unemployment contributions) on those earnings.

When the employer and the responsible person willfully fail to collect and pay over to the IRS the withholding on earnings, the government suffers a loss because the employee gets credit for the tax withheld even though the employer does not pay the tax to the government. The withheld taxes are deemed held "in trust" for the benefit of the employee until paid over to the government; but when the employer and the responsible person fail to do so, for example, by diverting them to other uses, they are held personally liable for their payment.

The Trust Fund Recovery Penalty is not a penalty that is imposed over and above the withheld taxes, but is a device for ensuring the taxes are properly paid to the government. Without this device for ensuring the collection and payment of the taxes to the government, the responsible persons charged with collecting the taxes could be easily seduced into using the funds for unauthorized purposes.

An individual is a "responsible person" if he or she has a duty, whether spelled out in the by-laws of a corporation or in a partnership agreement or operating agreement in a limited liability company, or even based on the facts and circumstances of each case, to collect and pay over the taxes. It may even be a third party who supplies funds to the employer to pay employees and who has knowledge that the employer will not be withholding taxes on the wages. The test for responsible person status is not holding a title or office but whether the person has actual management and control over the finances of the employer, such as the ability to write checks and decide which of various creditors is to be paid with available funds. Mere awareness of the unpaid withholding taxes, without more, is not sufficient to satisfy the criteria of responsibility, which is based on the totality of circumstances. Courts typically have relied upon a multi-factored test, focusing on duty, status and authority, to evaluate whether one or more individuals are responsible persons.

Determining that a person is "responsible" is not enough to make that person liable for the penalty. The responsible person must have acted "willfully" in failing to collect and pay over the withholding taxes. Willfully means a deliberate, voluntary, conscious choice to prefer another creditor over the United States government. The IRS has defined willful as intentional, deliberate, voluntary, reckless, know-
ing, as opposed to accidental. No evil intent or bad motive is required. Mere negligence is not sufficient to show willfulness.

After the responsible person, as identified by the IRS, receives notice of the proposed penalty, he or she should file a protest with the IRS Appeals Office within 60 days of receiving the notice. If the responsible person files no protest within the 60 days, the IRS may commence collection action by levying on bank or brokerage accounts, etc.

In Appeals, the best defense against the Trust Fund Recovery Penalty is to show that someone else bears ultimate responsibility for the failure to withhold and pay over the taxes, provided, of course, that you have documentation establishing that fact. Another possible defense to the penalty is to determine whether the penalty was incorrectly calculated, which sometimes happens with the IRS. You may need access to the IRS file to present this defense. If the Appeals Office is convinced by these or other defenses, Appeals will recommend non-assertion of the penalty. If the responsible person is not successful in Appeals, he or she may still make an offer of settlement based on the strength of the case. If no settlement follows, the IRS will assess the penalty but the responsible person will have no access to the U.S. Tax Court because no statutory notice of deficiency is issued.

Alternatively, instead of filing a protest, the responsible person may pay part of the withholding tax and file a claim for refund to contest the penalty.