

7-2003

Secondary Liability for Federal Trust Fund Taxes

Steve R. Johnson

Florida State University College of Law

Follow this and additional works at: <http://ir.law.fsu.edu/articles>



Part of the [Taxation-Federal Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Steve R. Johnson, *Secondary Liability for Federal Trust Fund Taxes*, 11 *NEV. LAW.* 24 (2003),
Available at: <http://ir.law.fsu.edu/articles/270>

This Article is brought to you for free and open access by Scholarship Repository. It has been accepted for inclusion in Scholarly Publications by an authorized administrator of Scholarship Repository. For more information, please contact bkaplan@law.fsu.edu.



Secondary Liability for Federal Trust Fund Taxes

By Steve Johnson



When collection of unpaid taxes cannot be effected from the person primarily liable for them, the Internal Revenue Code creates for the IRS a number of mechanisms for collection from secondary parties. To satisfy the requirements of fairness and due process, secondary liability is imposed only when the party has some nexus to the liability, that is, when that person's actions helped create the liability or frustrated its collection from the primary taxpayer.

This article discusses I.R.C. § 6672, one of the most widely used and important of the secondary liability mechanisms in tax. There are numerous § 6672 assessments each year. Attorneys representing small business and their owners can expect to have some clients who have § 6672 problems.

CONTEXT

Employers are required to deduct from wages paid to an employee both withholding as prepayment of income tax and the employee's share of FICA (Social Security) tax.¹ These are called "trust fund taxes" because each is deemed to be a "special fund in trust for the United States."² Employers are supposed to pay them over to the IRS. Unfortunately, more than a few employers don't.

Of course, the IRS can proceed against the delinquent employer, but this typically is unavailing -- the very reason that the trust fund taxes aren't paid is that the business is in financial trouble. Thus, the IRS needs remedies against potentially solvent secondary parties connected with the underpayment. Section 6672 is the most frequently asserted such remedy.³

SUBSTANTIVE ISSUES

The § 6672 mechanism is variously known as the Trust Fund Recovery Tax (or Penalty), the 100% Penalty, or the Responsible Person (or Officer) Penalty. Section 6672(a) provides: "Any person required to collect, truthfully account for, and pay over any tax . . . who willfully fails to [do so] shall, in addition to other penalties provided by law, be liable for a penalty equal to the total amount of the tax." There are two principal substantive issues in § 6672 cases: (1) capacity (whether the target is a person under the collection or payment obligation) and (2) willfulness (whether that person acted willfully in not meeting that obligation).

Capacity: "Person," for this purpose, includes a corporate officer, a partner, or an employee of the business who is "under a duty" to collect, account for, and pay over the tax,⁴ but that enumeration is not exclusive. The capacity designation is functional and does not depend on formalities of office or title. Directors, prospective purchasers, sureties, creditors, trustees and other fiduciaries, and attorneys all have been held to be responsible persons on particular facts. One has the capacity requisite for liability if one has decision-making power within the business, the ability to choose to "allocate[] funds to other creditors in preference to [the tax] obligation."⁵

The standard often has been phrased imprecisely in the case law, with references like "final word" or "full authority."⁶ This

has given rise to considerable confusion and inconsistency in the decided cases.⁷ Whatever the linguistic formulations may connote, courts usually hold that "I was just following the orders of my boss, who told me to pay the other creditors first" is not a valid defense.⁸

Willfulness: Willfulness is the requisite standard under many civil and criminal sections, and usually is understood to mean "a voluntary, intentional violation of a known legal duty."⁹ Thus, most § 6672 decisions describe it as a voluntary and intentional, as opposed to a merely negligent, failure. However, once again, there are many inconsistent formulations in the cases and rulings.

A common situation involves a new owner of a business with unpaid trust fund taxes. If the new owner, without paying the taxes, willfully expends funds that had been amassed before her accession to control, she can (to that extent) be held liable under § 6672 for those prior unpaid taxes. However, she cannot be held liable for expending funds acquired after she assumed control.¹⁰

MULTIPLE LIABLE PERSONS

As seen above, *responsible person* is defined broadly. As a result, in any particular case, there may well be several officers, employees, or others who are potentially liable under § 6672 for the unpaid trust fund taxes of the business. This fact has several repercussions.

First, when a § 6672 case is litigated, there often are multiple parties against the Government. The IRS is permitted to directly assess § 6672 liabilities, but assessed persons may seek judicial review (typically in federal district court). If one assessed party sues the IRS, the Government often joins the other persons against whom § 6672 assessments for the same unpaid taxes have been made.¹¹ The Government often is in a comfortable

position. The mutual finger-pointing among the various assessed parties often insures that the Government will be successful against one or some of them.

Second, § 6672 liability is joint and several.¹² Thus, the IRS may, and often does, effect disproportionate collection from the various responsible persons. For instance, assume \$60,000 of unpaid taxes and three responsible persons. The IRS need not limit itself to \$20,000 from each. Nor need it apportion liabilities among the three in accord with their respective degrees of "fault." Instead, the IRS may collect from one, some, or all of the three in whatever amounts it can -- including, for instance, collecting all \$60,000 from one and leaving the other two alone.

In 1996, Congress created a federal remedy to alleviate the obviously harsh result just described. Section 6672(d) creates a federal right to contribution. A responsible person against whom the IRS has effected disproportionate collection may seek contribution from his luckier fellows by suing them in federal district court. However, so that prompt tax collection is not impeded, the contribution action must be separate from any action involving the IRS in which § 6672 liability is at issue.

Finally, although the language of § 6672(a) refers to a "penalty," the IRS views § 6672 as a collection device, not as a penalty to be imposed on the multiple responsible persons on top collected taxes.¹³ Thus, it is the IRS's policy to refund amounts collected (and to abate amounts assessed but not yet collected) in excess of the tax liability. It waits to do so, however, until its right to retain enough to fully cover the liability has been fixed, whether by litigation, binding agreement, or expiration of the statute of limitations on refund claims.¹⁴ ■

[Ed. Note: *Nevada Lawyer* regularly provides space for a submission from a faculty member of the UNLV Boyd School of Law. These articles are run without editing or censorship. The editorial content of *Nevada Lawyer* reflects the opinions of its authors and does not represent or reflect the policies of the State Bar of Nevada, the Editor, or the Publications Committee.]

The author is the E.L. Wiegand Professor at the William S. Boyd School of Law, University of Nevada, Las Vegas. A 1981 graduate of New York University School of Law, he practiced tax law in private practice, with the IRS Chief Counsel's Office, and as a Special Assistant United States Attorney. The author invites comments and questions at steve.johnson@ccmail.nevada.edu.

ENDNOTES

1. I.R.C. §§ 3102 & 3402.
2. I.R.C. § 7501(a).
3. It is not the only one. For example, under I.R.C. §§ 3505(a) and (b), the IRS may, under certain circumstances, impress liability for the unpaid trust fund taxes upon lenders, sureties, or others who assumed responsibility for the payroll or who advanced funds to the business for the payment of wages when they knew that associated trust fund taxes would not be paid.
4. I.R.C. § 6671(b).
5. *Haffa v. United States*, 516 F.2d 931, 936 (7th Cir. 1975).
6. *Wilson v. United States*, 250 F.2d 312, 316 (9th Cir. 1957); *Melillo v. United States*, 244 F. Supp. 323, 326 (E.D.N.Y. 1965).
7. For a case setting right some of the confusion on the capacity issue, see *United States v. Chapman*, 7 Fed. Appx. 804 (9th Cir. 2001)(per curiam; not selected for publication).
8. E.g., *Roth v. United States*, 779 F.2d 1567, 1571-72 (11th Cir. 1986).
9. E.g., *United States v. Pomponio*, 429 U.S. 10, 12 (1976)(per curiam).
10. *Slodov v. United States*, 436 U.S. 238 (1978).
11. See Rev. Proc. 84-78, § 6.02-03, 1984-2 C.B. 754.
12. E.g., *USLIFE Title Insurance Co. v. Harbison*, 784 F.2d 1238, 1243 (5th Cir. 1986).
13. E.g., *Newsome v. United States*, 431 F.2d 742, 745 (5th Cir. 1970); *Botta v. Scanlon*, 314 F.2d 392, 393 (2d Cir. 1963).
14. See, e.g., *Gens v. United States*, 615 F.2d 1335 (Ct. Cl. 1980).