Chapter 3: Small Business Issues

A trust fund tax is the money withheld from an employee’s wages (income, social security, and Medicare taxes) by an employer. These amounts are called trust fund taxes because the employer actually holds the employee’s money in trust until the employer makes a federal tax deposit in the required amount. Trust fund taxes also include other collected taxes (e.g., excise taxes). Trust fund taxes that are not paid to the IRS may be assessed personally against one or more “responsible persons.”

The trust fund recovery penalty (TFRP) is not a penalty in the usual sense. It is a means provided by IRC §6672 to facilitate the collection of trust fund taxes and enhance voluntary compliance. It is an alternative method of collecting unpaid trust fund taxes when the taxes are not fully collectible from the business that failed to pay the taxes. Congress enacted §6672 to encourage the prompt payment of tax withholdings and to ensure the ultimate collection of the taxes from a secondary source.1

Note. Employers may also be subject to penalties for failure to file and late payments, as well as interest on the unpaid balance.

IDENTIFYING TRUST FUND TAXES

TFRPs are based on liabilities reported on the following tax forms.2

- Form 720, Quarterly Federal Excise Tax Return
- Form 941, Employer’s Quarterly Federal Tax Return
- Form 943, Employer’s Annual Federal Tax Return for Agricultural Employees
- Form 944, Employer’s Annual Federal Tax Return
- Form 945, Annual Return of Withheld Federal Income Tax
- Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons
- Form 8288, U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests
- Form 8804, Annual Return for Partnership Withholding Tax (Section 1446)
- Form CT-1, Employer’s Annual Railroad Retirement Tax Return

2. IRM 8.25.1.3 (2012).
RESPONSIBLE PERSONS

The TFRP may be assessed against any person who: 3

1. Is responsible for:
   a. Collecting,
   b. Truthfully accounting for, and
   c. Paying over taxes held in trust, and

2. Willfully fails to collect or pay them.

In Slodov v. U.S., 4 the Supreme Court interpreted the statutory language to apply to all “persons responsible for collection of third-party taxes and not . . . [only] to those persons in a position to perform all three of the enumerated duties.” Thus, the Code deems anyone who is required to collect or account for or remit taxes a responsible person. 5

A responsible person may be one of the following: 6

• An officer or an employee of a corporation
• A member or employee of a partnership
• A corporate director or shareholder
• A member of a board of trustees of a nonprofit organization
• Another person with the authority and control over funds to direct their disbursement
• Another corporation or third-party payer
• Payroll service providers (PSP) or responsible parties within a PSP
• Professional employer organizations (PEO) or responsible parties within a PEO
• Responsible parties within the common law employer (client of PSP/PEO)

Responsibility is based on whether a person exercised independent judgment with respect to the business’s financial affairs. An employee is not a responsible person if the employee’s duty was solely to pay the bills as directed by a superior, rather than to determine which creditors would be paid.

Example 1. Clarissa is a non-owner employee who works as a secretary in the office of Merit Business Supply. She signs checks and tax returns at the direction of and for the convenience of the owner or a supervisor who is a non-owner. Clarissa is directed to pay certain vendors, even though payroll taxes are unpaid. She is not a responsible person for the TFRP because she works under the dominion and control of her superiors, and she is not permitted to exercise independent judgment. 7

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3. IRC §6672(a).
7. Adapted from an example in IRM 5.7.3.3.1.2 (2010).
The ability to select one creditor over another is not a prerequisite to being deemed a responsible person. Officers and higher-level employees of a company who are non-owners may be required to terminate their employment to avoid being responsible for the TFRP. For example, in *Howard v. U.S.*, a corporate officer was held to be the person responsible for paying trust fund taxes even though his superior ordered him not to pay the taxes and he informed the IRS of the matter. Despite the taxpayer’s claim that his actions were not voluntary, the court determined that his failure to pay taxes was willful because he could have refused to comply with his superior’s orders and risk dismissal from his job. The District Court had described the corporate CEO as “even more responsible” than the corporate officer. However, the CEO was apparently no longer within reach of the IRS. The Circuit Court observed that §6672 “looks only to ‘responsible persons,’ not to ‘the most responsible person,’ for satisfaction.”

*Commonwealth National Bank of Dallas, et al. v. U.S.*, was a case involving an employer, the employer’s bank, and the bank president, who were all liable for the TFRP. The liability was not confined to the employer and its officers but extended to those responsible for controlling corporate disbursements, which included the lender bank. The bank controlled how the funds were spent, including deciding which creditors were paid.

Persons serving as volunteers solely in an honorary capacity as directors and trustees of tax-exempt organizations are generally not considered responsible persons unless:

- They participated in the day-to-day operations of the organization, and
- They had actual knowledge of the failure to withhold or pay over the trust fund taxes.

This does not apply if it would result in no person being determined to be responsible for the TFRP.

The responsible person is *willful* if they:

- Must have been, or should have been, aware of the outstanding taxes, and
- Either intentionally disregarded the law or were plainly indifferent to its requirements.

Paying other creditors with available funds when the business is unable to pay the employment taxes is an indication of *willfulness*. In *Erwin v. U.S.*, the court noted that “when a responsible person learns that withholding taxes have gone unpaid in past quarters for which he was responsible, he has a duty to use all current and future unencumbered funds available to the corporation to pay back those taxes.”

**Note.** Form 4180, *Report of Interview with Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Taxes*, is an interview questionnaire used to determine responsible party status.

**Outsourcing Payroll**

Many employers outsource their payroll and associated tax duties to third-party payers such as PSPs and reporting agents (RA). Though most of these businesses are reputable, there have been many individuals and companies that have been prosecuted for stealing funds intended for the payment of payroll taxes.


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10. IRM 5.7.3.1.1 (2006).