IN WHOM WE TRUST

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ABSTRACT

The Internal Revenue Service ("IRS") collects the majority of taxes through business entities that are required to withhold taxes from wages or collect excise taxes at the time of providing services. These business entities hold the taxes they collect in trust for the IRS. The vast majority of business entities pay over the taxes held in trust in a timely and appropriate manner; however, a sizeable amount, in dollar terms, does not get paid. Aside from passing criminal laws at or near the passage of the 1954 code, Congress has done little to create a structure that provides incentives for business entities acting as trustees to pay over these collected taxes.

This Article explores the literature that has primarily developed with respect to the tax gap seeking to find structural answers to the problem. Most of the literature addresses issues concerned with underreporting taxes rather than the underpayment of taxes but certain ideas on how to influence taxpayer behavior are transferable to underpayment. Applying appropriate structural principles to the problem, the Article explores some of the solutions adopted by states to see if importing those solutions could assist the federal government in collecting these taxes.

Five specific recommendations follow from the study and these recommendations range from information gathering to monetary incentives for timely compliance to requiring bonds. The range of proposed solutions is intended to address the range of reasons for the non-compliance. Through the implementation of these solutions or similar ideas that create the proper structure for taxpayers serving as trustees, this corner of the tax gap should be reduced.

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I. INTRODUCTION

Congress chose to use business entities as the primary tax collectors in the United States.\(^1\) Employers collect federal income taxes and social security taxes from their employees. Telephone, airline, and oil companies collect federal excise taxes from their customers. As they collect these taxes, the business entities become trustees for the United States for the money they hold.\(^2\) Most business entities acting as trustees timely pay over the amounts they have collected; however, some business entities fail to remit the monies they hold in trust. Currently, the tax gap for unpaid “collected taxes”\(^3\) exceeds $58 bil-

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1. See Written Testimony of IRS Deputy Commissioner Linda Stiff Before the Senate Committee on Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations of the Collection of Federal Employment Taxes, 2 (July 29, 2008) (“Today employment taxes represent the largest portion of total tax dollars collected by the IRS. In FY2007 for example, of the $2.7 trillion in taxes collected by the IRS, $1.7 trillion was payroll taxes. This means that approximately two out of every three dollars collected by the IRS are from required withholding on employment tax returns. Of this $1.7 trillion collected in withholding and FICA taxes, approximately $778 billion was collected for Social Security and Medicare and approximately $922 billion was collected for individual withholding taxes.”).

2. See I.R.C. § 7501 (2009) (establishing treatment of taxes required to be withheld or collected on behalf of the United States and personal liability for failing to pay over such taxes).

3. The term “collected taxes” will be used in this article to describe taxes that an individual or entity must collect on behalf of the United States and hold for payment...
This Article proposes some actions that can address that segment of the tax gap with a goal of creating a structural system that leads businesses collecting taxes for the Internal Revenue Service ("IRS") toward better compliance while reducing the requirement for collection action by the IRS.

While almost every business entity has the prospect of becoming a trustee for the IRS, the IRS does not know much about its trustees and the individuals who manage these business entities. As with income taxes, it relies on a system of self reporting by the business entities that owe the tax. The IRS only becomes engaged when it perceives a problem, which is often much too late to effectively recover the unpaid tax.

The process of allowing anyone to serve as a trustee for collected taxes leads to having many unqualified trustees. The entities serving as trustees and their corporate officers are often unaware that the collected taxes constitute a trust that the entity holds for the benefit of the IRS. The entities become trustees almost from the moment of formation, meaning that this obligation lands on them at their most financially vulnerable time. As these entities and the officers responsible for these entities do not understand that the funds collected from others for the payment of their taxes constitute a trust, and because the IRS does not know who the trustees and their responsible officers are in many instances, too much of the money ostensibly held in trust in this manner simply does not get paid.

This Article is the second addressing problems with the collection of taxes held in trust. The first article addressed a problem with the manner of charging interest under Internal Revenue Code ("IRC") sec-

tion 6672 and it proposed a statutory change to fix the problem by requiring the persons liable under section 6672 to pay interest back to the due date of the return reporting the collected taxes. This Article addresses structural problems in the system of collection from the parties responsible for the taxes held in trust. It contains recommendations that span both administrative and statutory problems. By providing better information to the corporate officers about their duties as trustees, obtaining better information from these individuals concerning who is responsible and revealing certain other structural incentives, this Article proposes a framework for reducing the shortfall in payment of the taxes collected for the United States but never paid over. As discussed further below, it is by providing the appropriate structural framework that the government can most effectively ensure the payment of taxes.

Five specific proposals receive attention in this Article. These proposals seek both to inform and cajole the individuals running the trust to timely perform their duties by: (1) requiring disclosure of all responsible officers of an entity at the time the entity forms and seeks an employer identification number (“EIN”) and providing those individuals with a detailed list of their duties in running the trust on behalf of the IRS as well as a detailed list of the consequences of failure; (2) providing financial incentives for timely compliance to small businesses; (3) requiring bonds of entities that fail to comply or which have as responsible officers individuals who have failed to comply in the past; (4) eliminating the crediting of withholding and social security taxes for individuals who are responsible for an entity failing to pay


6. Numerous articles exist on the liability imposed under section 6672 and particularly the willfulness issue. See Mary A. Bedikian, The Pernicious Reach of 26 U.S.C. Section 6672, 13 VA. TAX REV. 225 (1993) (discussing how the section 6672 liability should attach once the determination of liability has occurred); Doreen McCall, Who is a "Responsible Person" – The Overreaching Power of the Internal Revenue Service to Collect Employer Withholding Taxes, 18 OHIO N.U. L. REV. 905 (1992) (discussing whether someone meets the section 6672 statutory criteria for assessment); see also Gerald P. Moran, Willfulness: The Inner Sanctum or Unnecessary Element of Section 6672, 11 U. TOLEDO L. REV. 709 (1980) (discussing creating a structure that, if successful, would reduce the number of section 6672 cases by reducing the amount of collected taxes that are not paid over to the IRS).

7. To follow is an article addressing why the disclosure laws should be changed to allow publication of trust fund liabilities in order to remove the competitive advantage enjoyed by entities that fail to pay their collected taxes and to inform consumers whose decisions about the companies with whom they deal might be influenced.

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over the taxes to the United States in a timely manner; and (5) in
cases in which an entity has multiple responsible officers liable for
failure to pay the trust fund monies, providing an incentive to the re-
sponsible officers to be the first ones to pay.

Non-compliance with payment of collected taxes generally occurs
with small businesses and not with large ones. While large busi-
nesses tend to get much of the press, small businesses make up the
vast majority of firms in the United States. Over half of the United
States labor force works at small businesses. The failure rate of
these businesses is high; thirty percent of small businesses close
within two years of opening and fifty percent close within four years.
With these rates of failure, the importance of having small businesses
keep current on their tax obligations is critical. In the start up years
these businesses typically owe very little, if anything, in income taxes.
The federal tax obligation that impacts them most is the employment
tax liability, much of this liability is money these businesses collected
from their employees and hold in trust for the United States.

Before detailing the specific proposals, the Article will create
some context for the proposals by discussing applicable trust law prin-
ciples. These principles should guide the thinking on how to structure
a trust relationship between the IRS and those the IRS designates as

9. See U.S. Gov't Accounting Office, GAO-99-256, Payroll Taxes: Billions in De-
linquent Taxes and Penalties Due but Unlikely to Be Collected, 6-7 (1999) (discussing
unpaid payroll taxes in small businesses). Small businesses are run by entrepreneurs
who often place at risk all or almost all of their assets. The potential personal liability
pursuant to section 6672 may not serve as a significant deterrent to someone who al-
ready has everything on the table, although most of these individuals probably do not
realize the full bite that section 6672 takes because of its inability to be discharged in
bankruptcy. In contrast, the managers and executives of larger business have no desire
to place their personal assets on the line and have little or no incentive to fail to pay
over the collected taxes and incur personal liability.

10. See The Small Business Economy: A Report to the President 1999-2000 17
(finding small businesses make up ninety-nine percent of all businesses in the United
States); see also Rafael Efrat, The Tax Burden and the Propensity of Small Business
Entrepreneurs to File for Bankruptcy, 4 HASTINGS BUS. L.J. 175 (2008) (finding that tax
problems constitute an important reason for bankruptcy filings for a sizeable number of
entrepreneurs).

11. See The Small Business Economy, supra note 10, at 12-14 (giving statistics of
U.S. small business firms).

12. See Efrat, supra note 10, at 177.

13. See WRITTEN TESTIMONY OF OWNER AND PRINCIPAL OF LANDMARK ENGINEERING
AND SURVEY CORPORATION DAVID HURLEY BEFORE THE PRESIDENT'S ADVISORY PANEL ON
FEDERAL TAX REFORM, 131-41 (MARCH 8, 2005), http://govinfo.library.unt.edu/taxreform
panel/meetings/meeting-03082005.html. (last visited Oct. 6, 2009) (discussing the im-
 pact of federal employment tax liability on small business); see also NFIB: The Voice
of Small Business – National Small Business Poll, Coping With Business Regulation: De-
LID=0038 (providing insight into burdens experienced by small businesses).
its trustees. Another preliminary matter to be discussed, as well as one that will flavor specific proposals is the significant body of research on what makes an effective tax law, one that provides the proper incentives for compliance as well as the proper remedies for non-compliance. Almost no structural changes to the trust fund provisions of the IRC occurred since enactment. The wealth of research that has taken place over the years should serve to inform proposals for changing its structure. As a preliminary matter, this Article also looks at the meager prior efforts to change the structure of this system to determine how those efforts have worked to date.

II. TRUST PROVISIONS

In general terms, a trust is a mechanism for creating a fiduciary relationship with respect to property. A trust works by having one party (the trustee) hold property (the trust res) for the benefit of a second party (the beneficiary.) A trust typically places certain duties on the trustee with respect to the manner in which the trustee deals with the property.\(^{14}\)

The Internal Revenue Code ("IRC") established trusts with respect to the collection of taxes by third parties for the benefit of the Internal Revenue Service ("IRS").\(^{15}\) Third parties must, by statute, serve as trustees of the collected taxes for the IRS as beneficiary. The third parties hold the money in trust subject to certain duties placed

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15. I.R.C. § 7501(a) (2009) provides: "Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose." I.R.C. § 7501(a) (2009).

The leading case interpreting I.R.C. § 7501(a) is Begier v. IRS, 496 U.S. 53 (1990). In Begier the Court sought to determine what, if anything, comprised the trust res where payments were made to the I.R.S. from the taxpayer's general checking account rather than a special trust account. Because the payments from the general account of the trust fund liabilities occurred during the preference period and were made with respect to an antecedent debt, the bankruptcy trustee sought to bring them back into the bankruptcy estate. The Court determined that the "collection" of the payments giving rise to the trust res occurred at the time of the payment of wages (employment taxes) or the provision of services (airline excise tax in this case) and the placement of the monies collected into a special account was not necessary for the funds to exist. The Court then found that a trust was created "at the moment the relevant payments (from customers to AIA for excise taxes and from AIA to its employees for FICA and income taxes) were made. It then found that using money from the general account to pay the taxes identified the trust res making these funds not subject to the preference provisions. Beiger, 496 U.S. at 61-62.
on them by the IRC. These duties generally address how to report and pay over the taxes to the IRS after they have been collected.\textsuperscript{16}

In addition to the fundamental creation of a trust with the appointment of a trustee, the establishment of the trust res, and the existence of a beneficiary, other basic concepts of trust law exist, some of which carry over to the type of statutory trusts set up by the IRC and some of which do not.\textsuperscript{17} The trustee holds the property for the benefit of the beneficiary. The trustee holds legal and not equitable title to the property, which is why the payments in \textit{Begier v. I.R.S.}\textsuperscript{18} did not create a preference since they were not payments of the taxpayer's money (or at least payments in which the taxpayer held on bare legal title).\textsuperscript{19} The trustee holds the property as a fiduciary and is expected to act faithfully to protect and further the beneficiary's interest. Unlike a typical trust in which a trust instrument exists, here the statutory language takes its place.

Trustees have certain duties in common law, which have parallels in their duties under the IRC. The trustee has a duty of loyalty and impartiality. Pursuant to this duty, the trustee must act for the benefit of the beneficiary and not for the trustee's personal interest.\textsuperscript{20} Trustees have a duty to take steps to preserve and protect trust property.\textsuperscript{21} Trustees have a duty to keep trust property separate from

\begin{footnotes}
\item[16] Several code sections require entities to collect taxes for the federal government. For some of the most prominent see I.R.C. § 3102 (2009) (requiring employers to collect FICA taxes); I.R.C. § 3402 (2009) (requiring income tax withholding by employer); I.R.C. § 4251 (2009) (establishing excise tax for communication services); I.R.C. § 4261 (2009) (establishing excise tax for transportation by air), and I.R.C. § 4291 (2009) (creating the statutory mandate for collection of the tax by the provider of the goods or services subject to the excise tax).
\item[17] See GEORGE BOGERT & AMY MORRIS HESS, LAW OF TRUSTS AND TRUSTEES 111 (Thomson West 2d ed.1984) (1978) ("[u]nder common law principles, a trust is created \textit{in property}; a trust, therefore, does not come into existence until the settler identifies an ascertaintainable interest in property to be the trust res."); see also WILLIAM FRATCHER & MARK ASCHER, 6 A SCOTT ON TRUSTS 76 (WoltersKluwer 4th ed. 1987) (1886) (discussing common law trust principles). A section 7501 trust is radically different from the common law paradigm, however. That provision states that "the \textit{amount} of [trust fund] tax . . . collected or withheld shall be held to be a special fund in trust for the United States," I.R.C. § 7501 (2009)(emphasis added). Unlike a common-law trust, in which the settler sets aside particular property as the trust res, section 7501 creates a trust in an abstract "amount" – a dollar figure not tied to any particular assets – rather than in the actual dollars withheld." \textit{Begier}, 496 U.S. at 62.
\item[20] See Reutlinger, supra note 14, at 220 (discussing the duty of loyalty); see also Bogert, supra note 17, at 341 ("[t]he trustee owes a duty to the beneficiaries to administer the affairs of the trust solely in the interests of the beneficiaries, and to exclude from consideration his own advantages and the welfare of third persons").
\item[21] See Reutlinger, supra note 14, at 221 (discussing duties trustor owes trustee); Bogert, supra note 17, at 358 ("[a] trustee has a duty to perform such acts as a reasonably prudent businessman would find necessary for the protection and preservation of the trust property.").
\end{footnotes}
their own property and to clearly mark it as belonging to the trust.\textsuperscript{22} Trustees have a duty to provide information and accounting regarding the trust.\textsuperscript{23} Trustees are liable to beneficiaries of the trust for any breach of trust resulting from a violation of a trust duty.\textsuperscript{24}

In looking at the structure of the trust the IRC imposes on those charged with collecting and holding taxes for the benefit of the IRS, the principles of trusts and trust administration inform the manner in which an appropriate structure can be built. Some of the suggestions herein link directly to the general trust principles. Others aim at informing the individuals charged with administering this statutory trust of their duties as a trustee, which might not otherwise be known to them, since the role is not a natural one for most businesses.

III. PROPER COMPLIANCE INCENTIVES

Before addressing each proposal and the compliance incentives it provides, it is important to look at the research that exists on how to best influence compliant tax behavior to see how the current system fits with the thinking on this subject, and to see how these proposals might fit into that thinking. Academics wrote much on tax compliance in the past few decades while, as discussed in the next section, little has changed in the compliance regime of collected taxes. Most of the writing does not specifically address the issue of failure to pay collected taxes where the unpaid liability is not at issue and the obligation for the tax is straightforward. Nonetheless, the literature provides a basis for approaching methods to encourage compliant behavior in the area of collected taxes as well as in more widely discussed areas of non-compliance such as the reporting of taxes by self-employed individuals.

Recent scholarship identified structural systems as an important mechanism for reducing behavior that the Internal Revenue Service ("IRS") seeks to prohibit and as a better alternative to statutory commands.\textsuperscript{25} Professor Edward K. Cheng describes statutory commands, terming these "fiat," as a direct but not always effective method of reg-

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\textsuperscript{22} See id. at 221 (discussing duty not to comingle).

\textsuperscript{23} See id. at 225 (discussing duty of trustor to render complete accounts to trustee).

\textsuperscript{24} See id. at 226 ("[t]o assure payment in the event of breach, the trustee may be required to give a security bond, which obligates a third party (the 'bondsman') to pay the trustee's damages. Possible remedies include not only damages or a surcharge of the trustee for a loss to the trust but also specific performance of the duty owed . . . ").

\textsuperscript{25} See Cheng, supra note 8 ("[t]he use of structure to encourage tax compliance has been an unqualified success"); see also Leandra Lederman, Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance, 60 STAN. L. REV. 695 (2007) (arguing that substantive federal income tax law can, and often does, foster compliance by harnessing the structural incentives of third parties).
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ulating behavior. According to Professor Cheng, the alternative to fiat is an indirect method of regulation, terming this "structure," to "establish mechanisms or procedures that push citizens toward compliance by making the undesirable behavior less profitable or more troublesome."  

While direct regulation provides many benefits and is always an appealing option for legislatures, it relies principally on deterrence. Reliance on deterrence does not necessarily achieve the desired result when large numbers of people violate the law. At some point, the passage of unenforceable laws simply fails to provide the desired or necessary results, leaving structural laws as a potentially more effective alternative. Structural laws seek to regulate behavior by removing or minimizing the opportunities to violate the law rather than by punishing the violations. Two types of structural laws exist: (1) laws that create "a process that facilitates enforcement" and (2) laws that make it more difficult to achieve the undesirable activity.  

As discussed in the following section, Congress passed numerous statutory commands concerning the responsibilities of entities to collect certain taxes on behalf of the IRS and pay the taxes over to the IRS. These statutory commands created a system that works extremely well for collecting taxes from individuals who are employees. The system also works well to achieve payment from large corporations of the collected taxes where the leaders are managers


27. See Cheng, *supra* note 8, at 659 (discussing fiat and its problems); see also Erich Kirchler, *The Economic Psychology of Tax Behavior* (Cambridge 2007) (discussing why such structures may be needed given taxpayer perceptions and attitudes). Non-compliant taxpayers who owed VAT were younger, more egotistical, and less knowledgeable about VAT. Many thought money received from others in payment of VAT was coming from their own business and did not appreciate they were holding the money in trust. People put money in different boxes mentally and if they do so it effects how they are willing to spend it. Most people surveyed believed that VAT money was theirs. *Id.* at 164-65.  

28. See Cheng, *supra* note 8, at 662 (arguing that structural laws offer a more effective alternative for influencing everyday behavior than statutory prohibitions)  

29. *Id.* at 664.  

30. *Id.*  

31. Perhaps the greatest tax example of a structural law is the withholding provisions that underlie the collected tax issue that is the subject of this paper. The withholding tax laws require employees to have a portion of their salary taken each pay period resulting, usually, in full payment of their income taxes over the course of the year. Payment, and compliance, is achieved because of the structure of the withholding provisions. The withholding tax provisions make it difficult for employees to fail in their tax paying obligations and provide an incentive for them to file their taxes. See generally Piroska Soos, *Self-Employed Evasion and Tax Withholding: A Comparative Study and Analysis of the Issues*, 24 U.C. Davis L. Rev. 107 (Fall 1990) (discussing the non-compliance of withholding agents).
and executives rather than entrepreneurs. The system works much less well with small entities in which the entity and the individual essentially share an identity. These small entities fail to pay over the collected taxes at a rate that has created a $58 billion unpaid amount on the books of the IRS. While most people think of the tax gap as the result of underreporting of taxes, the failure to pay acknowledged tax obligations each year represents ten percent of the gap and amounted to $33 billion of the tax gap in 2001.

Congress created an effective system for tax administration using structural laws to withhold taxes, and only used statutory commands to move the collected taxes from the accounts of the entities doing the collecting into the hands of the IRS. States are using some structural laws to assist in obtaining their collected taxes. It is time for Congress to consider some of the techniques the states have used and try to close the payment gap with techniques that extend beyond the current ability to collect presented by statutory commands and enforced collection action. In selecting the appropriate structural laws to address the payment of collected taxes, Congress and the Tax Administrator should determine the incentives that influence those paying over collected taxes.

One issue that emerges repeatedly when analyzing the payment of collected taxes concerns the competing claims on the entities that owe these taxes. The competing claims force the responsible persons to choose whether to honor their personal commitments to trade creditors instead of impersonal creditors such as governmental entities. A second issue concerns the entrepreneurial spirit of the individuals who run the entities with collected tax problems and their belief that the business will turn the corner "at any moment," so they can make good on unpaid obligations such as the collected taxes. Both of these issues present "legitimate" societal reasons for the decisions that responsible officers make that cause them to fail to pay over the col-

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32. See U.S. Gov't Accountability Office, GAO-08-617, Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes 15 (2008) (finding a significant number of businesses are not paying payroll taxes).


34. See Robert B. Cialdini, Social Motivations to Comply: Norms, Values and Principles in 2 Taxpayer Compliance: Social Science Perspectives 200 (Jeffrey A. Roth & John T. Scholz, eds., University of Pennsylvania Press 1989) (1989) (establishing six sets of principles that most powerfully and regularly influence compliance decisions: 1) be consistent with prior commitments; 2) return an earlier fit, favor or service; 3) follow the lead of similar others; 4) conform to the directives of legitimate authority; 5) seize opportunities that are scarce or dwindling in availability; and 6) accede to the requests of those we like).
lected taxes. Neither issue presents a legal basis for the decisions of the responsible officers.\footnote{See U.S. Gov't Accounting Office, GAO-99-256, Payroll Taxes: Billions in Delinquent Taxes and Penalties Due but Unlikely to Be Collected, 13 (1999) (containing anecdotal comments from IRS revenue officers on why the collected taxes do not get paid).}

Nonetheless, the very real competing interests placed on the responsible officers of entities with outstanding collected tax obligations put incentives on these individuals that conflict with their best interest from a legal perspective and conflict with the societal goals of payment of taxes. The question is how to prioritize the payment of collected taxes so that it causes responsible officers to properly balance this requirement with their desires to pay their friends and their hopes to continue a flagging business because success lies just around the corner. Additionally, an appropriate structure must exist for those responsible officers who simply want to use the collected taxes for their own benefit knowing that their use is an evasion of the payment of tax obligations.

The proposals set out below seek to address these concerns by providing a mix of information to allow responsible officers to make better informed decisions. Hopefully, better informed decisions will lead to higher compliance with the tax law.\footnote{See Margaret McKerchar, Understanding Small Business Taxpayers: Their Sources of Information and Levels of Knowledge of Taxation, 12 Australian Tax Forum 25 (1995) (discussing the level of knowledge of small business taxpayers); see also Thaler, supra note 25, at 188 (discussing the importance of providing information as a basis for achieving desired outcomes).} The proposals also seek to address the situation by providing the IRS with better information about who the IRS needs to pursue because earlier pursuit of the proper individuals will result in the collection of a significantly higher amount of the unpaid collected taxes.\footnote{Numerous studies have shown that the longer the delay in collecting delinquent liabilities the less likely collection becomes. See, e.g., 2004 National Taxpayer Advocate’s Annual Report to Congress 233, available at http://www.irs.gov/advocate/article/0, id=133967, 00.html (showing success in collection based on the number of months since the assessment was made). But see U.S. Gov’t Accountability Office, GAO-08-617, Tax Compliance: Businesses Owe Billions in Federal Payroll Taxes, 32-33 (2008) (finding that determining the persons responsible for the payment of tax and assessing the liability against them typically took between two and three years); see also U.S. Gov’t Accountability Office, GAO-05-637, Financial Management: Thousands of Civilian Agency Contractors Abuse the Federal Tax System with Little Consequence, 2 (2005) (discussing civilian contractor tax abuse).} The proposals also seek to provide some benefits for compliant action and greater punishment for non-compliant action. The mixture of behaviors the proposals seek to influence mirrors the mixture of reasons for current non-compliance.

\footnote{35. See U.S. Gov’t Accounting Office, GAO-99-256, Payroll Taxes: Billions in Delinquent Taxes and Penalties Due but Unlikely to Be Collected, 13 (1999) (containing anecdotal comments from IRS revenue officers on why the collected taxes do not get paid).}
The variety of bases for the proposals fits with the research suggesting that “one size” enforcement activity does not fit all.\textsuperscript{38} Individuals and entities that fail to pay over the collected taxes will have unpaid taxes for different reasons.\textsuperscript{39} The path to non-payment may follow the same course as the path taken by those who seek to evade the payment of their taxes or it may follow a course driven by different considerations.\textsuperscript{40} Creation of a variety of responses that include information, incentives, and enforcement provides a much greater opportunity for success in reaching all of the individuals and entities within the target audience. Norms based appeals and enforced compliance action can both increase overall tax compliance, although each may impact a different group.\textsuperscript{41}


\textsuperscript{39} See Dan Kahan, \textit{Trust, Collective Action and Law}, 81 \textit{B. U. L. Rev.} 333 (2001) (noting that the level of tax compliance in a community depends on “individuals beliefs about the willingness of others to comply with tax laws: those individuals who believe that most other individuals are complying form the belief that paying taxes is an important moral duty, whereas those who believe cheating is widespread conclude that evading is not a particularly serious wrong”).

\textsuperscript{40} The group of individuals or entities that fails to pay its collected taxes is drawn from the same group that exhibits the highest non-compliance with reporting of taxes—the small businesses within the IRS SBSE classification. See Leandra Lederman, \textit{The Interplay Between Norms and Enforcement in Tax Compliance}, 64 \textit{Ohio St. L.J.} 1453, 1505 (2003). As Lederman discusses, the non-compliance among this group could result from a desire to remain competitive with others in the group who are also not fully paying their taxes or it could result because this group consists of entrepreneurs, a self selected group of risk takers who would almost always be among the least compliant taxpayers. The same factors causing this group to be non-compliant in reporting their taxes could also drive their failure to pay over collected taxes. At least one study suggests that non-compliance in one aspect of paying taxes has a carry over effect to other aspects of tax compliance. The one consideration that differs in the payment mode compared to the reporting one is the existence of third parties. While the general notion that third party competitors or peers may not be properly reporting their taxes could drive the behavior of a member of this group, the interplay with third parties exists more closely in the payment situation than the reporting one. When deciding whether to pay collected taxes over to the government, the individual or entity often faces a dilemma of whom to pay when insufficient funds exists. The resolution of that dilemma often results in payment of creditors with whom the individual or entity has a close or reciprocal relationship that does not exist between the individual or entity and the government. See Book, \textit{supra} note 38 (examining the scope of low income taxpayers' compliance problem and why the IRS vigorously directs its compliance effort toward low-income taxpayers).

\textsuperscript{41} See Lederman, \textit{supra} note 40, at 1500 (describing three types of taxpayers: 1) those committed to compliance; 2) those susceptible to influence (the largest group); and 3) those committed to non-compliance). The government wants to enact provisions with the greatest impact on the second group but it also wants compliance actions that will keep the third group in check.
IV. PAST AND CURRENT COMPLIANCE EFFORTS

The failure of entities to pay over collected taxes the entities held in trust has existed as a problem since the time these entities received the responsibility to collect taxes for the government. Many administrative and legislative responses have attempted to address the issue with varying degrees of success. As discussed in more detail below, attempts to address the problem through criminal tax provisions have proved especially ineffective.

Current Internal Revenue Code ("IRC") section 6672 has its origins in a criminal tax provision. When the 1954 IRC created section 6672 as the civil enforcement mechanism allowing the Internal Revenue Service ("IRS") to pierce the corporate veil and pursue individuals responsible for the failure to pay the collected taxes, IRC section 7202 came into existence as its criminal counterpart tracing its roots back to the same origins. Almost no one has been prosecuted under section 7202 despite the fact it dates back to 1954 and that $58 billion of unpaid collected taxes exist on the books of the IRS today.

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43. See Gerald P. Moran, Willfulness: The Inner Sanctum or Unnecessary Element of Section 6672, 11 U. Tol. L. Rev. 709, 723-751 (1980) (discussing the legislative history of section 6672); see also Fogg, supra note 5, at 11-14 (discussing the legislative history of section 6672).
44. 26 U.S.C. § 7202 (2010); This section provides "[a]ny person required under this title to collect, account for, and pay over any tax imposed by this title who willfully fails to collect or truthfully account for and pay over such tax shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution." I.R.C. § 7202 (2010). This section has existed in its current form since 1954 with no changes.
45. See Moran, supra note 41, at 750 (discussing the legislative history of section 6672); see also Fogg, supra note 5 at 11-12 (discussing the legislative purpose of section 6672).
7202 presents prosecutors with significant problems as they must prove that an individual willfully violated the act. The difficulty is grounded in the discomfort felt by fact finders, whether the bench or a jury, convicting someone trying to keep their business afloat. As section 7202 is almost never used as a basis for prosecution even though large amounts of collected taxes go unpaid, it represents a failure as an enforcement mechanism.

Not long after the passage of the 1954 Code, Congress recognized the need for more enforcement in the collected tax area and sought to


47. See Jeffrey A. Dubin, Criminal Investigation Enforcement Activities and Taxpayer Noncompliance, 35 PUB. FIN. R. 500 (2007) (discussing the effectiveness of criminal tax enforcement in raising overall compliance). Of course with so few prosecutions under I.R.C. section 7202 the effect of criminal enforcement in this area is extremely limited.

48. Department of Justice: Tax Division, Criminal Tax Manual 9.03 (2009), available at http://www.usdoj.gov/tax/readingroom/2001ctm/titlepg.htm; United States v. Poll, 521 F.2d 329 (9th Cir. 1975), overruled by United States v. Easterday, 539 F.3d 1176 (9th Cir. Cal. 2008). Poll is no longer good law. The court in Poll gave a jury instruction putting wrong limitations on willfulness based on the money in the corporate bank account. It is not cited for its legal correctness but rather to demonstrate an attitude that has pervaded regarding prosecutions for failure to pay over collected taxes – particularly employment taxes. That attitude may be shifting and there has been an uptick in the number of prosecutions for failure to pay collected taxes but the uptick is simply a circumstance of going from almost none to several each year in recent years. This number of prosecutions is still unlikely to generate significant compliance. For a discussion of the correct legal standard in a case that makes clear Poll has been overruled see United States v. Easterday, 564 F.3d 1004, 1007 (9th Cir. 2009) (“The statute under which Easterday was found guilty is 26 U.S.C. § 7202, a fairly rarely invoked provision that criminalizes a willful failure to pay over employees federal income tax withholding on wages”). See U.S. Gov’t Accounting Office, GAO-99-256, PAYROLL TAXES: BILLIONS IN DELINQUENT TAXES AND PENALTIES DUE BUT UNLIKELY TO BE COLLECTED, 16 (1999) (containing observations of IRS field collection personnel on the likelihood of criminal tax prosecutions for the failure to pay collected taxes).

49. Perhaps it could be argued that so few prosecutions occur under this statute because the statute has achieved its intended result of modifying behavior so that prosecution is unnecessary. That does not appear to be the case here given the discussion in the recent GAO report, the discussion in the Criminal Tax Manual, the amount of the unpaid collected tax liability and the passage of section 7215 in a later attempt to address the problem. More prosecution of employment tax issues, though not necessarily under section 7202 or section 7215, has occurred in recent years and the IRS is doing a good job of publicizing these prosecutions on its web site for those who go there to look. See I.R.S. Examples of Employment Tax Investigations FY2008, www.irs.gov/compliance/enforcement/article/0,,id=174631,00.html (last visited August 9, 2009) (providing examples of recent employment tax investigations).
IN WHOM WE TRUST

address that need through the creation of another criminal tax provi-

sion, IRC section 7215,\(^\text{50}\) in 1958.\(^\text{51}\) Section 7215 specifically refers to and is triggered by the IRS taking action pursuant to section 7512.\(^\text{52}\) This statutory scheme has now existed for over fifty years. During that time twelve reported decisions existed of individuals prosecuted pursuant to section 7215.\(^\text{53}\) As with section 7202 this criminal provi-

\(^{50}\) 26 U.S.C. § 7215 (2010).

\(^{51}\) This section provides:

\((a)\) Penalty – Any person who fails to comply with any provision of section 7512(b) shall, in addition to any other penalties provided by law, be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than $5,000, or imprisoned not more than one year, or both, together with the costs of prosecution.

\((b)\) Exception – This section shall not apply –

\((1)\) to any person, if such person shows that there was reasonable doubt as to

\((A)\) whether the law required collection of tax, or \((B)\) who was required by law to collect tax, and

\((2)\) to any person, if such person shows that the failure to comply with the pro-

visions of section 7512(b) was due to circumstances beyond his control.

For purposes of paragraph (2), a lack of funds existing immediately after the payment of wages (whether or not created by the payment of such wages) shall not be considered to be circumstances beyond the control of a person.”


\(^{52}\) This section provides:

\((a)\) General Rule – Whenever any person who is required to collect, account for, and pay over any tax imposed by subtitle C, or chapter 33 –

at the time and in the manner prescribed by law or regulations (A) fails to collect, truthfully account for, or pay over such tax, or (B) fails to make depos-

its, payments, or returns of such tax, and

is notified, by notice delivered in hand to such person, or any such failure, than all the requirements of subsection (b) shall be complied with. In the case of a
corporation, partnership, or trust, notice delivered in hand to an officer, part-

ner, or trustee, shall for purposes of this section, be deemed to be notice deliv-

ered in hand to such corporation, partnership, or trust and to all officers,
partners, trustees, and employees thereof.

\((b)\) Requirements – Any person who is required to collect, account for, and pay over any tax imposed by subtitle C, or chapter 33, if notice has been delivered to such person in accordance with subsection (a), shall collect the taxes imposed by subtitle C, or chapter 33 which become collectible after delivery of such no-

tice, shall (not later than the end of the second banking day after any amount

of such taxes is collected) deposit such amount in a separate account in a bank
(as defined in section 581), and shall keep the amount of such taxes in such
account until payment over to the United States. Any such account shall be
designated as a special fund in trust for the United States, payable to the
United States by such person as trustee.

\((c)\) Relief From Further Compliance with Subsection (b) – Whenever the Secre-
tary is satisfied with respect to any notification made under subsection (a), that all requirements of law and regulations with respect to the taxes imposed by
subtitle C, or chapter 33, as the case may be will be henceforth be complied with, he may cancel such notification. Such cancellation shall take effect at
such time as is specified in the notice of such cancellation.”


\(^{53}\) The twelve reported decisions are: United States v. Christopher, 1 Fed. Appx. 533 (7th Cir. Ill. 2001); United States v. Dreske, 536 F.2d 188 (7th Cir. 1976); United States v. Erne, 576 F.2d 212 (9th Cir. 1978); United States v. Gay, 576 F.2d 1134 (5th Cir. Fla. 1978); United States v. Gordon, 495 F.2d 308 (7th Cir. Ill. 1974); United States v. Hemphill, 544 F.2d 341 (8th Cir. Mo. 1976); United States v. Meriwether, 329 F.
sion had almost no impact on individuals and entities failing to pay over collected taxes.  

Subsequent to the passage of section 7215, Congress has not enacted any criminal laws addressing the issue of the failure to pay collected taxes.  

Congress addressed a shortcoming of section 6672 in 1966 with the passage of IRC section 3505.  

The reason for creating section 3505 was to close a loophole in section 6672. Although the number of cases brought under section 3505 is relatively small, the statute appears to have the intended effect of stopping entities from making net payroll lending.  

One reason this provision may have succeeded

54. Edward Cheng aptly described the reaction of Congress to the compliance problems with collected taxes, "When faced with undesirable behavior, legislatures almost invariably turn to the criminal law to regulate." Cheng, supra note 8, at 656. The system of regulation created by I.R.C. section 7202 and section 7215 sought to control the undesirable behavior of non-payment of collected taxes but it failed because the problem was not one which criminal prohibitions could fix.  

55. It should be noted that prosecution for evasion of collected taxes is also possible under I.R.C. section 7201 and prosecution for failure to file tax returns related to collected taxes is also possible under I.R.C. section 7203. These two provisions describe criminal sanctions that cast a broader net than just seeking to prosecute for failures with respect to collected taxes. Occasionally, a prosecution under one of these provisions will occur related to a collected tax.  

56. "(a) Direct Payment by Third Parties – For purposes of sections 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such an employee or group of employee, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.  

(b) Personal Liability Where Funds Are Supplied – If a lender, surety or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer, with actual notice or knowledge (within the meaning of section 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the wages, such lender, surety, or other persons shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.  

(c) Effect of Payment – Any amounts paid to the United States pursuant to this section shall be credited against the liability of the employer  


58. Net payroll lending refers to the practice of lending to permit an employer to pay the salaries of its employees as reduced by the withheld taxes while simultaneously refusing to lend the employer the funds to allow it to pay the government the tax amounts.
where the criminal provisions did not is that the target audience of this statute, banks and other lenders, represents an audience that pays careful attention to statutory obligations and receives competent advice on how to meet such obligations.

Some small changes to section 6672 were enacted by Congress in 1996 and 1998 as a part of taxpayer bill of rights provisions to expand rights and codify procedures. However, those provisions did nothing to address shortcomings in the ability of the IRS to recover collected taxes.59

In July 2008, the General Accounting Office ("GAO") issued a report concerning outstanding payroll taxes.60 In this report, GAO identified five problems caused by the failure of businesses to remit payroll taxes: (1) public perception; (2) compliant taxpayers must shoulder greater burden; (3) unfair competitive advantage to non-complying taxpayers; (4) prolonging the life of failed businesses through the non-compliance subsidy; and (5) unmet government financial needs in era of deficits.61 Next, GAO made six proposals to "fix" or improve the situation of non-payment of collected taxes: (1) develop a better process for monitoring collection actions taken by IRS collection officers; (2) review case assignment prioritization; (3) file notice of federal tax liens faster; (4) develop procedures for better monitoring how fast IRS collection officers cause assessment of section 6672 liability; (5) develop performance goals and measures; and (6) work with states to develop better measures and implementation of goals.62

Essentially all of GAO's recommendations to "fix" the problem of compliance in the collected tax area have fallen on the IRS and not on the non-compliant taxpayers. GAO sees the solution to the compliance problem as one which can be fixed by having the IRS work

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59. The Taxpayer Bill of Rights 2 in 1996 made the most changes to section 6672. Consistent with the title of the legislation, these changes did not seek to impose additional duties or obligations on responsible persons but rather to improve procedures for handling these cases in a manner that gave taxpayers more rights in the determination of their liability. New subparagraph (b) provided the requirement that a notice be issued prior to assessment and gave taxpayers a right to have a hearing in the Appeals Division prior to an assessment. New subparagraph (d) gave responsible officers the right to seek contribution from fellow responsible officers. New subparagraph (e) made it more difficult to hold volunteer members of the board of directors of a tax-exempt organization liable as responsible officers. The IRS Restructuring and Reform Act of 1998 (some parts of which are referred to as Taxpayer Bill of Rights 3) made minor changes to subparagraph (b) clarifying the method of delivery of the required notice. None of these changes to section 6672 had any impact, or were intended to have any impact, on the effectiveness of section 6672 as a tool to reduce the amount of unpaid collected taxes.


61. Id. at 50.

62. Id. at 52.
smarter, better, and faster rather than creating a structure in which
the non-compliant entities are led to a path of compliance by struc-
tures that move them down that path. The proposals below seek to
build a better path rather than simply to find solutions to the problem
in the efficiency of the IRS or by additional criminal or civil penalty
statutes that seek to treat the problem by fiat.

V. PROPOSALS FOR CHANGING THE SYSTEM OF
ADMINISTERING RECOVERY OF COLLECTED TAXES

A. SELF IDENTIFICATION OF RESPONSIBLE OFFICERS

As mentioned above, to become a trustee for the United States, an
individual or entity merely needs to start a business in which (a) em-
ployees exist causing withholding of employment taxes, or (b) collec-
tion of excise taxes occurs. This Article proposes that the Internal
Revenue Service ("IRS") should: (1) require identification of the indi-
viduals within an entity who have responsibility for the financial deci-
sions of that entity and who control the funds of the entity in such a
manner that they determine whether the taxes held in trust for the
IRS get paid on time; (2) require the identified individuals to person-
ally sign a document acknowledging responsibility as well as the du-
ties and consequences that flow from that status; (3) provide the
identified individual with detailed information concerning their du-
ties; (4) require that the list of responsible individuals be updated as
positions change; (5) impose actual penalties on persons found respon-
sible who were not on the list of responsible individuals for an entity
that fails to pay collected taxes; and (6) set up a system for contacting
the responsible individuals within thirty days following the end of a
quarter in which collected taxes were not timely paid by the entity.
Several states have decided to gather information about who is re-
sponsible for payment of collected taxes when a new business incorpo-
rates. The IRS has a similar opportunity to gather this data and to

63. See American Bar Association, Report and Recommendations on Taxpayer
Compliance, 41 Tax Law. 329 (1988) (identifying four types of non-compliance: 1) under-
reporting of income; 2) overstating deductions; 3) failure to file returns; and 4) failure to
pay established liabilities). The fourth type of non-compliance is the subject of concern
here. With respect to this type of non-compliance, the ABA states "there is a persistent
and difficult problem of unsuccessful businesses failing to pay over to the IRS the taxes
already withheld from their employees wages. The Commission recommends that more
effective procedures be developed to allow the Service to intervene quickly in such situa-
tions, before the tax becomes unmanageable." Id.

64. As might be expected, states vary widely in how and whether they gather this
information. Included below, as Appendix 1, is a listing of the information required by
all states regarding the identification of responsible officers at the time of incorporation.
Many states do not collect information concerning who is responsible for paying over
collected taxes. Those states that do collect the information do so in a variety of ways
use that information to create a structure that better fosters the payment of collected taxes. The IRS should do so.

When an individual or entity starts a business, it must request an employer identification number ("EIN") from the IRS and use the EIN on the return reporting the employment or excise taxes. Currently, the IRS does not ask entities seeking an EIN to provide any information concerning the individuals who have responsibility for ensuring that any trust funds held by the entity get paid. By failing to request information about responsible officers at this juncture in the life that offer several models for how this might best occur. Fourteen states require identification of persons responsible for payment of collected taxes at the time the entity seeks its business registration: Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Mississippi, New Jersey, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, and Virginia. Only Kansas appears to require the signatures of all responsible officers which means in other states seeking this information it is possible for someone to be listed as responsible without their knowledge. See infra Appendix 1 (detailing state requirements regarding identification of persons responsible for payment of collected taxes at the time the entity seeks its business registration).

An Employer Identification Number (EIN) is a nine-digit number that the IRS issues to certain business entities. Employers, sole proprietors, corporations, partnerships, non-profit associations, trusts, estates of decedents, government agencies, and certain individuals can apply for EINs. Applicants may apply by telephone, fax, mail, or online. If applying by fax or mail, applicants must complete Form SS-4 and submit it to the IRS. EINs are issued within four days for faxed applications and three weeks for mailed applications. The IRS prefers applicants apply online. Using the online application process, the IRS asks the applicant a series of questions (very similar to questions asked on Form SS-4), attempts to validate the information, and, if the information is validated, issues the applicant a permanent EIN. If the information is not validated, an EIN will not be issued; however, the applicant will have an opportunity to correct the information during the same session. The telephone application process is very similar to the online application process; applicants receive an EIN at the end of the conversation.

The Application for Employer Identification Number, Form SS-4, requires the applicant to disclose its legal name, trade name, and physical and mailing addresses. The applicant must designate an individual to contact regarding tax matters and identify a principal officer, general partner, grantor, owner, or trustee and that individual's social security number, taxpayer identification number (ITIN), or EIN. The applicant must disclose its type of organizational structure (sole proprietorship, partnership, corporation, etc.) and the reason the entity is applying for an EIN. The application asks approximately how many employees the entity plans to employ, if the entity expects its tax liability to be greater than $1,000, and if the entity has received an EIN previously. The applicant must also check one of twelve boxes describing the principal activity of the entity. Finally, the applicant must sign the application.

Form SS-4 has a Third Party Designee option whereby the applicant of the EIN authorizes a named individual to receive the entity's EIN and answer questions regarding Form SS-4. If the applicant uses a third party designee, the application requires identification of the third party designee and disclosure of the third party's telephone number, fax number, and address. A third party designee may also be used to obtain an EIN by telephone, but the applying entity will need to fax the Third Party Designee section to the telephone application center. See IRS Employer Identification Numbers, http://www.irs.gov/businesses/small/article/0,,id=98350,00.html (last visited October 11, 2009) (explaining EINs generally); IRS Application for Employer Identification Number (2009), available at http://www.roa.org/site/DocServer/irs_sss4.pdf?docID=10324 (setting forth procedure to apply for an EIN).
of an entity, the IRS misses the opportunity to obtain valuable information and simultaneously educate the individual on their duties as a trustee.

Understanding the process of obtaining collected taxes is necessary to understand why the IRS should want to know who is responsible at an entity for making sure that the trust fund taxes get paid. To illustrate the process, a typical employment tax liability will set the scene:

*ABC, Inc. (“ABC”) is a small manufacturing company that makes widgets. It has a payroll of twenty-five employees that it pays weekly. At the end of each week, ABC’s bookkeeper writes twenty-five payroll checks. In the first quarter of 2008 each of its employees makes $500 per week. The payroll checks made out to the employees each week are for $400 because $100 is taken from their weekly check to pay withholding taxes, social security, and other employee expenses. For purposes of this illustration, $50 each week is withheld for employment taxes and $25 each week is withheld for social security. After paying the payroll each week, ABC should hold $1,875 in trust for the United States. If there are thirteen weeks in the quarter, ABC should remit to the United States $24,375 at the end of the quarter to cover its obligation as a trustee for the withheld income and social security taxes. ABC will also have a corporate liability for half of the social security liability of its employees. However, that liability is not held in trust for the United States but rather represents a tax liability of the entity.

If ABC does not remit $24,375 to the IRS at the end of the quarter, it is liable for this unpaid collected tax liability. With respect to this liability, the individuals at ABC and any other individuals or entities having responsibility for paying over the collected taxes that willfully caused the taxes not to be paid are also individually liable for this amount. This liability arises under Internal Revenue Code (“IRC”) section 6672 that is variously known as the “one-hundred percent penalty” or the “trust fund recovery penalty.” The provisions of section 6672 allow the IRS to pierce the corporate veil and hold liable anyone who meets the tests of responsibility and willfulness. Assuming that ABC files its employment tax return for the quarter, the IRS will know at that point that ABC has an outstanding liability; however, the IRS does not currently know who the responsible people of ABC are. The IRS takes about two to three years to find out who is

To obtain the collected taxes that the entity did not pay over to the IRS, the IRS will seek to collect those taxes from the entity itself, using its administrative enforcement powers, such as lien and levy. In many cases in which the entity does not remit the employment taxes, the entity faces severe cash flow problems and the collection efforts of the IRS fail because no assets exist from which tax collection can occur. The failure to pay the employment taxes serves as a marker that the business failed. If this occurs, the only recourse for seeking the unpaid collected taxes that the entity held in trust lies in the pursuit of the individuals who had responsibility for running the entity. At this point, the IRS would benefit from knowing the names and other identifying information of these individuals. It does not currently know this information, and therefore must embark on a search to ascertain the identity of the individuals. This search, and the time it takes to begin this search, is a big part of the determination of who is liable. This proposal seeks to eliminate the search for who is responsible and simultaneously educate those individuals on their special responsibilities regarding collected taxes.

As discussed above, many states have already identified this issue and have administrative requirements that entities seeking to incorporate a business in their jurisdiction must identify the individuals responsible for the monies held in trust by the newly incorporating entity. Creating this requirement at the time an entity seeks an EIN would not require a legislative change but merely an administrative one. The IRS would side step much of its currently lengthy process of determining who to assess for the section 6672 liability if it knew the individuals responsible for paying over the monies held in trust by the entity. Armed with knowledge of the individuals respon-


68. See Report and Recommendations, supra note 59 (stating "[t]here is a tendency for the media to depict the Service in such cases as somehow victimizing the business and causing it to fail. But, in fact, the business had already failed; theft of employee withholdings only postpones the day of reckoning, at a substantial cost to the public treasury").

69. See U.S. Gov't Accountability Office, GAO-07-742T, Tax Compliance: Thousands of Federal Contractors Abuse the Federal Tax System (2007) (addressing noncompliance by entities who have contracts with the federal government). To address the issue of identifying these entities prior to entering into contracts, a new federal government rule has been adopted requiring companies seeking federal contracts to certify whether they have any outstanding federal tax debts over $3,000. See Dave Rifkin, A Primer on the 'Tax Gap' and Methodologies for Reducing It, 375 Quinnipiac L. Rev. 375, 416 (2009) (discussing shaming).

70. See supra note 60.
sible, the IRS could simply send them correspondence giving them a reasonable, but relatively short, period of time to explain why they were not willful in the failure to pay over the collected taxes. For individuals failing to respond to such an inquiry or responding acknowledging liability, assessment could take place immediately after the correspondence closing date. This might collapse the current two to three year waiting period for assessment to a period lasting two to three months after the return due date.

Obviously, some individuals identified as responsible for payment of the collected taxes would respond to such an inquiry with an explanation detailing why they were not willful in the failure to pay the collected taxes or an explanation of why they were no longer responsible at the time the collected taxes were not paid. Even an early response denying liability would allow the IRS to focus its collection efforts at a point much closer to the end of the quarter. This would be possible because of the known identity(ies) of the individual(s) who had claimed responsibility for the payment of the collected taxes.

For individuals who argued they were not willful in the failure to pay the collected taxes, their responses would provide an early focus on the specific issues in the case. A narrow range of defenses to the liability based on willfulness exists. The discussion concerning liability would focus on that narrow range within which the admittedly responsible individual would need to fall to avoid liability under section 6672. For individuals who denied responsibility at the time of the failure to pay over the collected taxes, the discussion would quickly shift to the third parties such individual alleges to have taken over the responsibility and the facts in support of such a takeover of responsi-

71. Willfulness under section 6672 is not defined in the Internal Revenue Code. The standard in section 6672 differs from willfulness in a criminal case. The criminal standard is “a voluntary, intentional violation of a known legal duty.” Cheek v. United States, 498 U.S. 192, 192, 111 S. Ct. 604, 605 (1991). The standard for willful conduct in section 6672 requires only a “voluntary, conscious, and intentional — as opposed to accidental— decision not to remit funds properly withheld to the government.” Kalb v. United States, 505 F.2d 506, 511 (2d Cir. 1974). Other courts have defined willfulness under section 6672 as the decision to prefer other creditors over the government. Muck v. United States, 3 F.3d 1378, 1381 (10th Cir. 1993). Courts will generally find willfulness present if either the responsible individual knows that other creditors are being paid when the government is not or the responsible person should have known that was happening given all of the circumstances. Usually, defenses to willfulness involve attempts to pin knowledge of the facts on others coupled with a reliance that the others were doing what they were supposed to do. The success of this type defense usually turns on the nature of the job held by the responsible person and the reasonableness of any reliance given the nature of the job and past actions by others on whom they relied.

Not all states have a willfulness component to their determination of liability. Some states also hold officers strictly liable. For these reasons use of state law data on both responsibility and willfulness is not a perfect match for federal law.
bility. This could all take place before a field collection officer had to track down individuals associated with the corporation and would allow the collection officer to focus efforts on collecting information before beginning the field work.

The IRS would want to establish a presumption concerning responsibility for those individuals listed by the entity as responsible. The presumptions would not necessarily control the outcome but would put an emphasis on individuals paying attention to the information provided to the IRS concerning responsibility. The presumption should provide that any individual listed with the IRS as responsible for the payment of the collected taxes meets the test of responsibility absent clear and convincing evidence that such individual did not hold a responsible position during the quarter(s) at issue.

The second aspect of this proposal concerns the acknowledgment of the individuals designated as responsible and the information pro-

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72. IRS Revenue Officers begin considering the potential applicability of the trust fund recovery penalty ("TFRP") during the first field visit to the entity taxpayer. IRS Internal Revenue Manual (August 1, 2009), § 5.1.10.3.2, available at http://www.irs.gov/irm/part5/irm_05-001-010.html#d0e227. After the first meeting with the entity taxpayer, revenue officers decide whether to pursue the TFRP, but the presumption is to pursue the TFRP. Id. at § 5.7.4.1. In investigating the TFRP, revenue officers follow four general procedures, establishing responsibility, establishing willfulness, conducting collectability determinations, and conducting Form 4180 interviews. Id. at § 5.7.3.1.2. The revenue officer identifies potential responsible persons by reviewing the corporate by-laws to determine duties of officers and determining who has the authority to hire and fire employees, determine which creditors to pay, control payroll and disbursements, sign employment tax returns, and make federal tax deposits. Id. at § 5.7.3.3.1. During the first field visit to the entity taxpayer, revenue officers must conduct interviews with the greatest number of potentially responsible persons possible. Id. at § 5.7.4.2. The revenue officer's personal interview achieves a dual purpose, to give information and gather information. Id. The revenue officer discusses the TFRP and potential personal liability, while also gathering bank statements and cancelled checks to support asserting the TFRP. Id. The revenue officer attempts to fill out Form 4180 to record as much information about the person's duties and authority in the entity to determine if the statutory tests for a responsible person have been met to support asserting the TFRP. Id. The revenue officer also must review corporate records such as articles of incorporation, minute books, payroll records, and employment tax returns to determine the duties of the officers and the responsibilities of the individuals to file and pay collected taxes. Id. Revenue officers also review bank records such as canceled checks, signature cards and loan applications to determine who had authority to sign checks, deposit funds, and obligate the entity by borrowing money. Id. The revenue officer reviews all information and documentation collected during the investigation and prepares a report on Form 4183. Id. at § 4.2.1. The revenue officer makes a determination as to whether each person meets the statutory tests for responsible persons and conducts a collectability inquiry for each person. Id. The report details the revenue officer's recommendations for assertion or non assertion of the TFRP as to each potentially responsible person investigated by the revenue officer. Id.

73. The IRS can seek to create an administrative presumption that listing your name as responsible with the IRS is treated as meeting the test for responsibility. If section 6672 were amended to specifically provide for this presumption, it would be safer for the IRS to engage in this reliance for a part of its proof of section 6672 liability.
vided to those individuals. The proposal contemplates that anyone listed as responsible for payment of an entity's collected taxes would personally sign a form, under penalty of perjury, acknowledging his or her status as a responsible person.\footnote{Presently, Kansas imposes this requirement in Part 11 of the Kansas Business Tax Application. Part 11 requires that the entity "List all owners, partners, corporate officers and directors. Provide the personal information and signatures of all persons who have control or authority over how business funds or assets are spent." Kansas Business Tax Application (2009), available at http://www.ksrevenue.org/pdf/forms/crl16.pdf. By requiring each responsible officer to personally sign the form, Kansas makes each of these individuals acknowledge that they are indeed responsible rather than relying on one person to list others who may, or may not, agree that they are responsible once problems occur. Requiring these signatures is an integral part of the process of proving these individuals have responsibility. The form Kansas uses could be adopted by the IRS.} Having individuals sign such an acknowledgement serves several purposes that promote effective tax administration.\footnote{Having individuals sign not only provides proof of responsibility when an issue arises but it provides the opportunity to give those self-identified individuals information about the duties of a responsible officer. Providing information to the responsible officers could impact their decision-making when the time comes for making payments to the IRS versus other creditors. Several states provide information in their registration booklets about the personal liability that may apply when collected taxes are not paid. For example, Virginia cites to its state statute holding individuals personally liable on the second page of its Business Registration Application where it requires a listing of all responsible persons, and again on the seventh page where it describes the consequences of failure to pay the collected taxes. See Virginia Business Registration Application (2009), available at www.tax.virginia.gov/web_pdf/busforms/fr199.pdf (setting forth requirements to register a business in Virginia). The literature examining effective compliance mechanisms suggest the providing of information as one of the components of effective administration. Report and Recommendations, supra note, 59 at 368-383.} First, it forces the individuals signing such a form to acknowledge their position as a trustee of the IRS. Second, it provides them with knowledge that the liability of the entity for collected taxes has a different character than other liabilities that the entity owes, because this liability extends to individuals responsible for non-payment who have the protection of the corporate shield from almost all other debts of the entity.\footnote{See Corrie Lynn Lyle, The Wrath of I.R.C. 6672: The Renewed Call for Change – Is Anyone Listening? If You are a Corporate Official, You Had Better Be, 74 S. Cal. L. Rev. 1133, 1135 (2001) ("Most corporate officers . . . do not realize that this [the failure to pay over the collected taxes] is a Pandora's Box that can result in personal liability for thousands or even millions of dollars in unpaid payroll taxes."). The author of the article does not cite to any authority for the statement that most corporate officers do not realize the difference between failure to pay these collected taxes and failure to pay other corporate liabilities, but the sentiment expressed in the article is widely held by those who have encountered individuals trying to explain why the section 6672 liability should not attach to them. Almost universally, they profess a lack of knowledge of the consequence of their action in preferring other creditors over the payment of the collected taxes to the United States.} Third, it informs the individual of the seriousness of this obligation which, in turn, should cause that indi-
individual to prioritize which creditors to pay when cash flow problems occur.\textsuperscript{77}

This proposal has two components. One is acknowledgment by the individual that he or she has responsibility for the payment of the collected tax. The second component has equal value and it concerns the information provided to these self-identifying individuals. The acknowledgment will take place at or near the time of incorporation when the entity has not yet had cash flow problems. This should be a teachable moment for the individuals running the entity. This teachable moment should not pass without an effort to teach the individuals the duties of a trustee and the consequences of the failure to carry out those duties.\textsuperscript{78}

To accomplish the teaching of these principles, the IRS

\textsuperscript{77.} See U.S. Gov't Accounting Office, GAO-99-256, Payroll Taxes: Billions in Delinquent Taxes and Penalties Due but Unlikely to Be Collected, 15 (1999) ("The GAO report contains a discussion of IRS efforts at taxpayer education in this area. Some collection officials observed that the persons most in need of this training did not attend. At least, the IRS offered the training; however, if the education effort is to succeed it must reach everyone who is potentially responsible."). In testimony before the Senate Committee on Homeland Security and Government Affairs on July 29, 2008, Linda Stiff recited a litany of actions taken by the IRS to inform small businesses of their employment tax responsibilities:

"One of the means to accomplish this is through the use of the Federal Tax Deposit Alert process which helps to identify, at an early stage, taxpayers classified as bi-weekly depositors who have not made federal tax deposits during the current quarter, or have made deposits in substantially lower amounts from prior quarters. Virtually all of the IRS functional and operating divisions participate in employment tax outreach and education. . . . Applicants for a new Employer Identification Numbers receive considerable information based on what they indicate on their Form SS-4. Those who state they have or will have employees automatically get a copy of Circular E, Employer's Tax Guide; information for making Federal Tax Deposits; and enrollment information for the Electronic Federal Tax Payment System . . . . The IRS also works with community partners to present Small Business Tax Workshops throughout the United States. These workshops instruct new and prospective business owners in federal tax responsibilities, including employment taxes. . . . Quarterly, the IRS sends out approximately seven million SSA IRS Reporter newsletters with Form 941, Employer’s Quarterly Federal Tax Return. The newsletter contains information on subjects such as Social Security law, the Electronic Federal Tax Payment System, or changes in Social Security or IRS electronic filing systems. In addition, in 2007, the IRS developed a new brochure, Publication 4591 – Small Business Federal Tax Responsibilities, which includes information about employment taxes."

Written Testimony of IRS Deputy Commissioner Linda Stiff Before the Senate Committee on Homeland Security and Government Affairs Permanent Subcommittee on Investigations on the Collection of Federal Employment Taxes, 3-10 (July 29, 2008). Publication 4591 itself provides little information. Circular E addresses the trust fund penalty on page 24 of a 69 page publication and even then does not talk about the fact the collected taxes are held in trust or that the trust fund penalty is non-dischargeable in bankruptcy. Much information exists on the web and undoubtedly good information is transmitted in training sessions for those who attend; however, as noted in the GAO report, the persons who most need to know are the least likely to attend such sessions. This is why requiring each responsible officer to sign and acknowledge the duty at the outset is critical.

\textsuperscript{78.} Oklahoma has a powerful statement above the signature line:
should create a detailed handout and provide it to the individuals as a part of a package they receive with the acknowledgement form.\textsuperscript{79}

The handout should explain the reasons why the IRS uses business entities to collect taxes for it, the way the collected tax system works, and the proper method for paying over collected employment and excise taxes. The booklet should further explain the civil and criminal penalties applicable to individuals who breach those duties. Finally, it should explain the bankruptcy consequences of the liability for collected taxes and the fact that this liability, unlike all other tax

\textsuperscript{79} Many states do this in their business registration package. See, e.g., Alabama Department of Revenue Combined Registration/Application (2009), available at www.excel-pay.com/ . /ALCom101%20-%20CombinedRegistrationApplication.pdf (Alabama) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); Kansas Business Tax Application (2009), available at http://www.ksrevenue.org/pdf/forms/cr16.pdf (Kansas) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); Minnesota Application for Business Registration Instruction Booklet (2009), available at http://www.taxes.state.mn.us/instructions/sbr_in.pdf (Minnesota) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); Business Registration Application & Instructions (2009), available at www.state.nj.us/treasury/taxation/pdf/other_forms/git-er/njwt.pdf (New Jersey) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); North Carolina Business Registration Application for Income Tax Withholding (2009), available at www.dornc.com/downloads/fillin/NCBR_webfill.pdf (North Carolina) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); Application to Register for Income Tax Withholding and Sales and Use Tax Permit (2009), available at http://www.nd.gov/tax/salesanduse/forms/withholdsalesapplication-enabled.pdf (North Dakota) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); Pennsylvania Enterprise Registration Form and Instructions (2009), available at www.revenue.state.pa.us/revenue/lib/revenue/pa-100.pdf (Pennsylvania) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); Utah State Business and Tax Registration, TC-69 (2009), available at tax.utah.gov/forms/current/tc-69.pdf (Utah) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes); Virginia Business Registration Application (2009), available at www.tax.virginia.gov/web_pdf/bus/forms/fr199.pdf (Virginia) (requiring acknowledgement by an individual that he or she has responsibility for the payment of trust fund taxes).
liabilities, can never result in a discharge of this debt through bankruptcy filed by the entity or a responsible officer. This type of information will allow individuals embarking on this trust relationship to enter it with their eyes open rather than discovering years later that their decisions to pay trade creditors rather than the IRS created disastrous financial results. By being better informed, the individuals responsible for the collection of the monies held in trust should take compliance with the payment of the trust taxes more seriously.

No matter how often the individuals associated with an entity receive reminders concerning the need to accurately identify responsible officers of the entity, it is certain that either the wrong individuals will be identified initially or no one will update the information as the entity business changes over time. For this reason a third component to this proposal exists. This component concerns the consequences for failing to update the information to the IRS as new individuals become responsible for the payment of the collected taxes.

The directive requiring entities to identify responsible officers at the time of the EIN application needs to contain a further directive requiring identification of individuals as changes occur. While the IRS can administratively order that the list of responsible officers initially contain all of the responsible individuals and that any additional individuals inform the IRS as they become responsible, these administrative directions will have few teeth without some consequence for failure to provide this information. To ensure that the initial group contains all of the responsible persons and that necessary changes to the group are provided to the IRS as the business changes, legislation may become necessary to enact a penalty structure for failure to register changes with the IRS. This penalty structure should be a penalty separate from the section 6672 penalty. The penalty would need to be significant enough to deter individuals from trying to hide from the section 6672 liability by refusing or neglecting to identify themselves to the IRS at incorporation or as newly responsible individuals joined the entity.

Many small companies contract out their employment tax compliance work to payroll provider companies. These companies offer a

80. 11 U.S.C. §§ 507(a)(8)(C), 523(a)(1)(A) (2009). The liability for collected taxes receives priority status without regard to its age. Because it has priority status, the exceptions to discharge always apply to individual debtors. Because it has priority status, an entity in a chapter 11 reorganization must provide for full payment in order to obtain plan confirmation. 11 U.S.C. § 1129(a)(9)(C) (2009).

81. For a link between information and compliance see 8 n.35, supra (linking information and compliance).

82. One state, Michigan, not on the list for requiring information on responsible officers, has identified the situation with payroll providers as another problem area for collected taxes, which is causing non compliance. Michigan specifically informs entities
range of services concerning payroll and payroll tax compliance. A typical contract between a payroll tax provider and a small business entity might have the payroll tax provider preparing payroll, paying payroll, preparing the quarterly Form 941 form, and paying the Form 941 taxes. The payroll provider typically has an agreement allowing it to withdraw the necessary funds from the entity's bank account. Problems have arisen with payroll provider companies. Entities contracting with payroll provider companies and the responsible officers of these entities may think that the hiring of these type companies resolves all employment tax issues, but it does not. The hiring of such a company does not absolve the entity and its officers of their duties regarding the trust fund taxes. Michigan specifically addresses this issue with a form it requires. The IRS should adopt something

that the hiring of a payroll provider does not remove responsible individuals from their obligation to pay over the collected taxes. See Michigan Tax Form 3683 (2009), available at www.michigan.gov/documents/3683f_2906_7.pdf (informing businesses that the hiring of a payroll provider does not remove responsible officers from their obligation to pay trust fund taxes). “Payroll Service Provider” is a name given to members of an industry that manages the administrative aspects of a company's payroll. Usually, the company provides the payroll service provider (PSP) with employee names and compensation and the PSP does payroll processing, check generation and distribution, payroll tax filing, and W-2 generation. In more sophisticated arrangements, the PSP might also handle 401(k) management, employee handbook development, and direct deposit registration. Almost all PSPs handle the payroll tax filing. The IRS even has a list of approved PSPs. See IRS Payroll Service Providers, http://www.irs.gov/efile/lists/0,,id=101120,00.html (last visited October 12, 2009) (listing payroll service providers). The companies on that list all have web sites that detail their services. Most companies working with PSPs have little trouble meeting their collected tax obligations to the IRS as long as they have cash to make the required payments. A few PSPs have acted irresponsibly with the money from their clients. When this happens, the company suffers the loss rather than the IRS because the PSP is the agent of the company.

Several payroll provider companies found their clients' money too tempting and took the money intended to pay the taxes of their clients without paying it over to the IRS. Usually, these schemes ran something like a Ponzi scheme in order for the payroll provider to keep out of trouble as long as possible. See, e.g., Atlas Hotels v. United States, 140 F.3d 1245 (9th Cir. Cal. 1998) (affirming summary judgment to defendant United States in plaintiffs, payroll tax service providers, action seeking a refund of late payment penalties and interest paid by the company to whom plaintiffs provided payroll tax service); Morin v. Fronties Business Technologies, 288 B.R. 663 (W.D.N.Y. 2003) (affirming orders of bankruptcy court); Pediatric Affiliates v. United States, 230 Fed. Appx. 167 (3d Cir. N.J. 2007) (affirming the district court's order dismissing the taxpayer's complaint); Wolff v. United States, 372 B.R. 244 (D. Md. 2007) (affirming order of the bankruptcy court with respect to its dismissal of all counts, except avoidance of preferential transfers made within ninety days preceding the petition date and turnover of avoided preferential payments which was remanded to the bankruptcy court).

On line 22 of Michigan's Form 518 "Registration for Michigan Taxes" Michigan requests those filling out the form to check a box "if you use a payroll service that produces your payroll checks and sends income tax withholding payments to the State." Michigan also requests that taxpayers using a payroll provider fill out and attach to their registration Michigan Form 3683 "Payroll Service Provider Combined Power of Attorney Authorization and Corporate Officer Liability (COL) Certificate for Businesses." See Michigan Tax Form 3683 (2009), available at www.michigan.gov/documents/3683f_2906_7.pdf (detailing Michigan requirements for businesses using a
similar to the Michigan form because so many small companies use payroll providers and may not realize that the use of these entities does not absolve them from liability.

Individuals seeking to hide from the IRS by refusing or neglecting to self-identify as a responsible officer should bear a cost for that behavior. At present, no penalty exists beyond that for failure to pay for individuals who cause the collected taxes to go unpaid. The section 6672 liability, while labeled a penalty, simply serves as a collection device for retrieving the unpaid collected taxes. Arguably, all individuals responsible for the failure to pay over the collected taxes should have true penalties assessed against them in addition to the liability for the unpaid collected tax. This proposal does not go that far and seeks only to impose a “true” penalty on those individuals who fail to identify themselves as responsible for the payment of the collected taxes, and thereby cause the IRS to do additional work and take additional time in determining who should have the section 6672 liability assessed against them. The clearly willful failure to self-identify should serve as a factor in determining whether to prosecute someone for failure to pay the trust fund taxes since, coupled with the failure to pay the liability, the failure to self-identify could demonstrate an intent to evade the payment of the liability both at the corporate and individual level.

In addition to a penalty for failing to self-identify as a responsible officer, the statute of limitations for assessment should be tolled with respect to anyone who has not self-identified as a responsible officer because the IRS will be mislead by the names on file and need time to recover the correct information. A statutory change should treat the statute of limitations on assessment of the section 6672 liability as not beginning until a person identified himself or herself to the IRS as a responsible person of an entity. If the person never provides the necessary self-identification, then the statute of limitations would never run, similar to the situation with unfiled returns.

85. The penalty for failure to list oneself as a responsible officer could either be imposed irrespective of substantive compliance similar to the FBAR penalties or it could require substantive compliance as a triggering mechanism. Because the penalty should be substantial enough to inflict pain for non-compliance, requiring a substantive compliance triggering mechanism makes it easier to support a higher penalty. Alternatively, the penalty could exist for simple failure to notify with a higher penalty amount if it is coupled with non-compliance. Compliance should be made easy by having a line on the Form 941, or similar collected tax document, asking if there have been any changes in the ranks of responsible officers since the last filing (or the initial EIN request) and providing an attachment to the form for the new responsible officers to sign.
This proposal does impose an additional burden on small businesses because it causes more information to be provided at the time of the application for the EIN, and because of the ongoing obligation to update the names of the responsible officers. It imposes additional burdens on the IRS to keep track of the responsible officer information provided through this process. The information sought, however, is consistent with the type of information generally available about trustees and should allow the IRS to move much more quickly to assess section 6672 liabilities, which should in turn, promote compliance. Also, the targeted information provided to responsible officers at the time of incorporation should also enhance compliance.

Most of the changes needed to implement this proposal fall within the administrative powers of the IRS. It controls the EIN process and can change it with its own authority. The aspects of the proposal imposing a penalty on persons who do not update the responsible person information and tolling the statute of limitations on assessment for those persons require a legislative change.

B. INCENTIVES FOR SMALL BUSINESSES TO TIMELY PAY COLLECTED TAXES

Businesses do not have a choice whether to become trustees for the Internal Revenue Service ("IRS").86 If a business has employees or if it engages in an industry in which excise taxes exist, a business must become a trustee for the IRS to the extent that it engages in conduct that has these aspects.87 Becoming a trustee imposes burdens on businesses, particularly small businesses, which are not currently compensated by the IRS.88 Many small businesses with payroll obligations hire companies called payroll providers to assist them


87. See Treas. Reg. § 31.3102-1(a) ("The employer shall collect from each of his employees, the employee tax with respect to wages for employment performed for the employer by the employee... The employer is required to collect the tax, notwithstanding the wages are paid in something other than money, and to pay over the tax in money."); Treas. Reg. 31.3402(a)-1(b) ("The employer is required to collect the tax by deducting and withholding the amount thereof from the employee's wages..."); Treas. Reg. 49.4251-2(c) (regarding telephone excise taxes "[t]he taxes imposed by section 4251 are payable by the person paying for the services rendered, and must be paid to the person rendering the services who is required to collect the tax and return and pay over the tax").

88. See MARK CRAIN, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS 28, 50 (SBA Office of Advocacy 2005) (discussing the disproportionality of the burden imposed by federal regulations on small business); J. SCOTT MOODY, THE COST OF COMPLYING WITH THE FEDERAL INCOME TAX, SPECIAL REPORT No. 114 10 (Tax Foundation 2002) (estimating how much it costs individuals and businesses to read the rules, fill out forms, and do all the necessary things to comply with the nation's tax laws); Francis Chittenden, et al., TAX REGULATION AND SMALL-BUSINESS IN THE USA, UK, AUSTRALIA AND
through the thicket of rules and regulations necessary to comply with the employment tax rules – particularly the withholding rules.\textsuperscript{89}

About half of the states have addressed the cost of administering the sales tax receipts by carving out from the payment of sales taxes a small fraction of the cost which the business entity may keep as an acknowledgement of the cost of administering the tax system for their state government.\textsuperscript{90} A similar system could be adopted for the IRS to compensate small businesses for the cost of handling the withholding or the excises taxes they must collect.\textsuperscript{91} The system would be built

\textit{New Zealand,} 21 \textsc{Int'l Small Bus. J.} 93, 98-99 (2002) (determining that small businesses face much higher costs per employee compared with large firms).


\textsuperscript{90} See \textsc{John F. Due & John L. Mikesell, Sales Taxation: State and Local Structure and Administration} 327 (John Hopkins University Press 2d ed. 1983); Phillip Mattera with Leigh McIlvaine, \textit{Skimming the Sales Tax: How Wal-Mart and other Big Retailers (Legally) Keep a Cut of the Taxes We Pay on Everyday Purchases,} 50 \textsc{State Tax Notes} 713 (2008). As discussed in \textit{Skimming the Sales Tax} the manner in which states affect this carve-out varies wildly among the states. Usually, the carve-out takes the form of a percentage of sales taxes collected. The percentage varies wildly from state to state. Some states cap the amount of recovery a retailer can obtain under this statute while others have no cap. As discussed further below, this proposal suggests a modest percentage of the collected taxes be used, as the base from which to compute the incentive payment while a reasonable cap is placed on the total amount of incentive payment available to avoid creating a significant windfall to any one recipient.

The concept of paying taxpayers for collecting taxes is somewhat controversial. Certainly, real economic costs exist with the program of collecting these taxes. Some cooperation from the taxpayer may be built if the program is properly administered. Such an incentive could also assist with respect to the filing of tax returns.

\textsuperscript{91} This proposal only applies to small businesses because the incentive to pay appears much more needed for small businesses run by entrepreneurs than large business run by executives and managers. The benefit could be cut off at the point used to divide taxpayers categorized as Small Business Self Employed under the IRS scale or some other categorization pegged more closely to the compliance issues presented by non payment of collected taxes. If you allow all businesses to participate in this type of incentive, the types of problems that exist in those states with unlimited sales tax discounts will result. See Mattera, \textit{supra} note 84. In states with unlimited refunds the large retailers, who would comply in any event and for whom the cost of compliance is insignificant relative to their overall operation, soak up the lion's share of the of discounts paid out under the program. \textit{See Pennsylvania Budget and Policy Center, A Tax Windfall Whose Time Has Passed, Understanding Pennsylvania's Sales Tax vendor Discount Program} (2008) ("The sales tax discount program cost Pennsylvania nearly $74 million in 2007-2008. Nearly $12 million of that went to 10 corporations with sales exceeding $1 billion in the state. On average, each of those vendors kept $1.16 million in sales tax they collected. Small businesses, by contrast, received only a few dollars from the pro-
using incentives that reward compliance, creating a carrot for entities that timely complied with their handling of collected taxes.\textsuperscript{92} As the early years of a small business are challenging both financially and educationally, it is recommended that the incentive be limited in time to the first three years of the new entity’s existence. These are the years the incentive would do the most good to aid the business over a difficult financial time and to train the business leaders in good management of the money held in trust.

At present, penalties serve as the only motivator to timely pay collected taxes over to the IRS. While penalties may have a deterrent effect, they do not provide a motivating influence on small businesses struggling to meet the cash demands placed upon them.\textsuperscript{93} The duty to collect and pay excise and employment taxes is an expense that falls most heavily on small businesses. Providing some relief from this expense while simultaneously providing a financial incentive to timely file and pay should improve compliance.\textsuperscript{94}

Using \textit{ABC, Inc.} ("ABC") as the model again, an illustration of the way the incentive would work may be seen. Assume that \textit{ABC} was a small business and it timely filed its employment tax returns for all quarters of 2008. \textit{ABC} would qualify for a small discount on its employment tax liability for each of those quarters. If, in a future program. A little more than half of the 301,000 licensed vendors in the state, with sales less than $100,000, got average discounts of $9, while another 21% got nothing").

\textsuperscript{92} Because the goal is to get the taxpayers off on the right foot, one way to hold down the cost of this incentive other than limiting it to small businesses is to limit it in time to the first two or three years of a taxpayer’s business. These early years are critical times for small businesses because over half fail within the first four years. \textit{See} Effrat, \textit{supra} note 10, at 204-06 (discussing the danger of failure for the self-employed and small businesses). Having learned good behavior in the early years, the surviving taxpayers would then be well trained on these tax obligations and poised to continue with good compliance.

\textsuperscript{93} \textit{See} Dennis J. Ventry, Jr., \textit{Cooperative Tax Regulations}, 41 CONN. L. REV. 431 (2009) (making a case for discounted rates for timely and accurate compliance); \textit{see also} Joshua D. Rosenberg, \textit{The Psychology of Taxes: Why They Drive Us Crazy, and How We Can Make Them Sane}, 16 VA. TAX REV. 155, 168 (1996) ("People are significantly more likely to actually adopt desired behaviors in response to a system that: (1) uses rewards for correct behaviors in addition to, and where possible, in place of, punishments for wrong behaviors; and (2) ensures that both positive reinforcers and punishments are administered swiftly and consistently").

ter, it failed to timely file or timely pay its employment tax for a quarter, it would lose the ability to receive a discount for that quarter.

Providing a small incentive to pay collected taxes not only follows policy considerations for effective tax administration but also relieves the cost burden imposed on small business by the current structure.\textsuperscript{95} Compliance with the employment and excise tax rules concerning collecting taxes for the IRS simply imposes a duty on small companies to aid in governmental function without compensation.\textsuperscript{96} This proposal would recognize that cost to the entities while withholding such payments if the business entity did not meet its collected tax obligations.\textsuperscript{97}

This proposal limits itself to the costs incurred by small businesses and does not provide any monetary incentive for large and mid-size businesses. The reason for that limitation has two bases. First, the vast majority of unpaid collected taxes occur in small businesses and not large or mid-size businesses. Larger businesses have legal counsel who advise the owners on the potential individual liability which exists in failing to pay over the collected taxes. Individuals running these businesses may have a large equity stake in the businesses but usually they do not. In these businesses the entity does not serve as an extension of the individual; rather the individuals responsible

\textsuperscript{95} As with bonds, discussed \textit{infra}, providing some compensation for the service of acting as a trustee fits into the traditional model of serving as a trustee. The Government definitely benefits from the work done by the business entity serving as a trustee and collecting the taxes. Just as certain trustees should be bonded to insure compliance with the trustee duties so should certain trustees be compensated for their efforts on behalf of the Government. Because this proposal excludes large entities and non-compliant entities from the incentive program, it is not a perfect match with outside trustee, but the proposal does reflect a more traditional model for interaction between the trustee and the beneficiary. Interim Report, Small Seller and Vendor Compensation Task Force of the Streamlined Sales Tax Governing Board (December 15, 2008); see also Sales Tax Fairness and Simplification Act, H.R. 3396, 110th Cong. § 6(a)(14) (2007) (detailing vendor compensation); Sales Tax Fairness and Simplification Act, S. 34, 110th Cong. § 7(a)(14) (2007).

\textsuperscript{96} While merely a tangential thought, the recent debate concerning private debt collection of federal taxes raises an interesting contrast with the use of businesses to collect the bulk of federal taxes. Many commentators assailed the use of private debt collectors for what was an “inherently governmental function.” Yet, they failed to address the fact that most federal taxes are privately collected at the front end. The objections to private debt collection caused it to end. See IRS Private Debt Collection, http://www.irs.gov/businesses/small/article/0,,id=155136,00.html (last visited August 1, 2009) (discussing private debt collection); National Taxpayer Advocate’s Report to Congress, 27 (2009), available at http://www.irs.gov/pub/irs-utl/fy09objectivesreport.pdf (discussing private debt collection).

\textsuperscript{97} Only trustees that timely file the returns for the collected taxes and timely pay the taxes reflected on those returns would be eligible for the incentive discount. This limitation on the discount reflects the practices of most, but not all, of the states with the incentive discount program. See Good Jobs First, Skimming the Sales Tax: How Wal-Mart and Other Big Retailers (Legally) Keep a Cut of the Taxes We Pay on Everyday Purchases 20-22 (November 2008) (finding [tiwenty-six states have this feature).
for running the entity have a separate identity from the entity. These individuals know the severe risk to their personal finances that exists if the collected taxes are not timely paid over to the IRS. Rewarding these individuals with a small monetary incentive to pay the taxes does nothing to provide them with a true incentive to pay. Those incentives already exist. Second, the cost to the small business of compliance with the regime of holding taxes in trust is much higher on a percentage basis than the cost to a large business.98

On the contrary, with small businesses, where the entity often serves merely as an extension of the individual, incentives of this type could provide a meaningful alternative to the individual and the entity. These small businesses typically have thin capitalization and a constant need for ready cash. Providing these businesses with a tangible monetary benefit for timely paying their taxes serves not only to provide an incentive to them to timely pay the taxes, but also to remind them of the responsibility to do so.

This proposal distinguishes between businesses based on size and age to target the entities most likely have compliance problems with payment of collected taxes and most likely to experience financial burdens in complying. Through the carrot of this financial assistance these fragile entities may learn good habits at the outset with the hope that the good habits will remain once the incentive is removed. The proposal would increase the administrative burden on the IRS by causing it to create and run the incentive program, but the expectation is that the overall administrative burden may be decreased by higher compliance.

Implementation of this proposal would require a legislative change to permit incentive payments as well as administrative rules to implement the system.

98. A recent national survey commissioned by the Joint Cost of Collection Study, a public/private sector group, and conducted by PricewaterhouseCoopers LLP, has shown that in fiscal year 2003 the total cost to sellers to collect state and local sales taxes was $6.8 billion. This amount was calculated after subtractions for state vendor discounts and retailer float on the sales tax revenues. The study showed that for fiscal year 2003, for retailers selling between $150,000 and $1 million the average cost was 13.47 percent of the sales taxes collected or approximately $2,386; for mid-size retailer, between $1 million and $10 million in sales, the average cost was 5.2 percent or approximately $5,279; and for the larger retailers, over $10 million in sales, the average cost of collection was 2.17 percent or approximately $18,233. See National Economic Consulting, Retail Sales Tax Compliance Costs: A National Estimate 12 (PriceWaterhouseCoopers 2006). It is important to remember that these amounts, including the total cost for all retailers of $6.8 billion, are not reimbursed to the retailer by the state or local government, these costs come out of the retailer's own pocket. See Sales Tax Fairness and Simplification Act: Hearing on H.R. 3396 Before the Subcomm. on Admin and Commercial Law Comm. on the Judiciary, 110th Cong. (97) (2007) (statement of Steven Rauschenberger, Past President, National Conference of State Legislatures).
C. REQUIRE BONDS OF INDIVIDUALS OR ENTITIES WITH HISTORY OF FAILURE TO PAY COLLECTED TAXES

The trustor in creating a trust can make whatever provision with respect to the duties, powers, and requirements of the trustee as he or she may deem wise. This concept crossed over into the area of trustees for collected taxes, but only at the state level and essentially only for sales taxes. This proposal suggests that the concept of bonding trustees should migrate to the collected federal tax regime to provide protection for the Internal Revenue Service ("IRS") and an incentive for prompt payment for the entities and their responsible officers acting as trustees. As state laws on this subject essentially only impose the bonding requirement on sales taxes and because the primary federal tax situation in which bonding would arise is employment taxes, a brief discussion of the differences in those situations is necessary.

This proposal permits the IRS to require a bond from an entity if the entity failed to pay collected taxes on a timely basis or if one of the principals of the entity was previously assessed a responsible officer penalty. Together with the power to require a bond, the IRS needs an enforcement mechanism when an entity continues to operate without posting the required bond. That enforcement mechanism should include quick access to the federal district court or Tax Court to enjoin the entity from continued operation without the posting of the bond. Without the ability to enjoin the entity, the bond requirement will have little effect.

100. Appendix B, set forth below, contains a list of the laws of the states concerning bonding of retailers who incur state sales tax obligations. Four out of five states have some form of bonding requirement. Some states have a list of criteria. For example, Arizona, Florida, Georgia, and Iowa have bonding requirements. Other states simply leave the decision to require a bond to the tax administrator. For example, Maryland requires a bond "to protect tax revenue", New Jersey requires a bond whenever the "director deems necessary", and New Mexico requires a bond whenever it is necessary to ensure payment of any tax. States that provide some guidance to their tax administrators concerning when a bond is necessary, create a better atmosphere for administration since both the tax administrators and the public know when to expect a bond. Some states describe in their statute when a bond should be released due to prolonged compliance. For example, California requires that security held by the Board shall be released after a three-year period in which the person has timely filed all returns and paid all taxes to California.

101. It would have little effect because the entity could simply refuse to post the bond, continue operations and continue to add on additional unpaid employment tax liabilities. The ability to enjoin entities from continued operation arguably exists as an option for the IRS already. See U.S. GOV'T ACCOUNTING OFFICE, GAO-99-256, PAYROLL TAXES: BILLIONS IN DELINQUENT TAXES AND PENALTIES DUE BUT UNLIKELY TO BE COLLECTED, 16 (1999) ("A few field personnel noted that IRS could seek injunctions through the U.S. Attorney's Office to prevent taxpayers from accumulating multiple payroll tax delinquencies and that District Counsel prefer not to seek such injunctions due to the
Using ABC, Inc. ("ABC") again, an example of how the bonding provisions would work can be shown. When ABC begins its business, the IRS would not require a bond unless one of the persons responsible for payment of ABC's collected taxes was someone who was previously assessed a responsible officer penalty. As long as ABC continued to timely file and pay its collected tax obligations, the IRS would not request a bond from ABC. However, if at some point ABC fell behind in filing or paying its collected tax returns, then the IRS could require that ABC post a bond to ensure payment of collected taxes in the future. The amount of the bond would relate to the quarterly liability incurred by ABC.

The state laws cited above almost uniformly impose the bonding requirement only in sales tax situations.\textsuperscript{102} State sales taxes operate in a manner essentially identical to excise taxes on the federal level. In these situations a customer comes to the entity seeking to purchase goods or services. A sales or excise tax exists on the goods or services purchased. The entity selling the goods or services collects the sales or excise tax at the time of the purchase of the goods or services, and then holds the tax so collected for the governmental unit to which it relates.

In these situations the entity actually received money from a third party that it holds in trust. Cold hard cash, or its electronic equivalent, exists in the bank account of the entity collecting such payments. In contrast, employment taxes do not involve the receipt of a payment from any outside source. In the employment tax context, the entity makes payroll and pays its employees wages in the contracted amount at the contracted time. At the time of the payment of the wages, the entity takes on an obligation to pay over to the appropriate governmental unit an amount equal to the withheld income and social security taxes credited to each employee at the time of the pay-

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\textsuperscript{102} See Appendix B (listing state bonding requirements).
roll payment. The entity holds the withheld income and social security taxes in trust for the governmental unit; however, there may or may not actually be any "cold hard cash" associated with the trust the entity holds for the governmental unit. In some situations, entities will set up separate trust bank accounts and deposit into those accounts the amount of money necessary to fund the employment tax trust. In many situations, the entity simply has an entry on its books that it owes the governmental unit a sum certain for the withheld income and social security taxes, but no actual dollars are set aside and the entity may have no cash reserves with which to pay the collected taxes.

The sales tax situation involves the entity actually holding a third party's money paid to the entity to hold in trust, whereas the payroll tax situation involves a sometimes fictional trust in which the entity never actually deposited dollars and certainly does not hold money belonging to third parties for the payment of the trust liability. Therefore, a question exists as to whether a distinction can be drawn between the two types of collected tax situations for purposes of imposing a bond or requiring other actions. States seem to have drawn a distinction between collected taxes that a business entity receives in hand, e.g., a sales tax, and a collected tax a business entity should establish, e.g., employment taxes. The distinctions states have drawn contain no discussion of why states do not require a bond for unpaid employment taxes. States have simply created laws only applicable to sales taxes even in states in which both sales and employment taxes exist. This proposal does not recognize the distinction between sales and employment taxes for purposes of setting up a bond requirement. Both situations involve taxes collected for a governmental unit.


104. See Appendix A; Fogg, supra note 5, at 46 (identifying states that impose interest on responsible officers from the due date of return). Most states do have employment taxes; however, no states appear to require a bond for the payment of employment taxes. Compare Appendix A; Fogg, supra note 5, at 46 (identifying states that impose interest on responsible officers from the due date of return) with Appendix B (identifying states with bonding requirements). While most states do not distinguish how they charge interest to responsible persons based on whether the underlying tax is a sales tax or an employment tax, four states (Idaho, New York, West Virginia, and South Carolina) make that distinction. See IRS Service Center Advisory, IRS SCA 200026024, 2000 WL 33116108 (June 30, 2000). It is unclear whether states have made these distinctions knowingly based on specific policies or have simply come to these results through different legislative paths when the employment taxes and sales taxes did not move in tandem.
The fact that in one situation the entity holds money coming from third parties for the governmental unit and in the other it holds money the entity itself must set aside does not seem an adequate basis for distinguishing between the two situations for purposes of determining whether a bond requirement advances the collection of the unpaid collected tax.

Internal Revenue Code ("IRC") section 6672\textsuperscript{105} has a rarely used provision that an individual tagged with the liability under that section can use a bond to forestall collection on the liability while a lawsuit for refund takes place.\textsuperscript{106} The bond described in section 6672(c) occurs totally at the discretion of the individual allegedly responsible and occurs after non-payment of the collected tax has resulted in a section 6672 assessment. Almost no one used this provision before 1998 because the IRS had a policy of generally not collecting on the section 6672 liability while the refund action played out. However, with the passage of IRC section 6331(i)\textsuperscript{107} as a part of the Revenue Reform Act of 1998, collection action during a refund proceeding for a divisible tax essentially became impossible absent jeopardy or consent by the taxpayer.\textsuperscript{108} Nothing in section 6672 or the employment or excise tax provisions allows the IRS to require a bond of certain individuals or entities, even if those individuals or entities have demonstrated in the past that they do not timely file the appropriate returns and pay the collected taxes.\textsuperscript{109}

The bonding requirement provides incentives for entities to remain current on their payments to the IRS for collected taxes since no bond is needed for entities that remain current. A new entity would not need to post a bond to ensure payment of its collected taxes unless the IRS had concerns about the entity's ability to timely pay the collected taxes. Such a concern, in a new entity, would arise if one or

\begin{footnotes}
\item[106] See I.R.C. § 6672(c)(1)(C), (c)(3) (2009) (setting forth procedure if a taxpayer fails to collect and pay over tax to the IRS or attempts to evade or defeat a tax).
\item[108] I.R.C. § 6331(i) (2009) ("(1) In General – No levy may be made under subsection (a) on the property or rights to property of any person with respect to any unpaid divisible tax during the pendency of any proceeding brought by such person to a proper Federal trial court for the recovery of any portion of such divisible tax which was paid by such person . . . . ").
\item[109] The effect of requiring a bond may terminate the business because the cash strapped entity will not have the resources to post the bond. This result could have long-term beneficial effects for tax administration by removing at an early stage those businesses that simply are not viable, but obviously, it also has the effect of placing more pressure on already vulnerable small businesses. Because many small businesses with outstanding collected taxes due to the IRS will have difficulty finding a surety willing to post a bond or because the cost of the bond will be prohibitively high, this provision is likely to result in few bonds. Taxpayers will be forced to pay the tax, go out of business, or be enjoined.
\end{footnotes}
more of the individuals identified as responsible for that entity had a previous section 6672 assessment. Assuming none of the responsible officers had a previous section 6672 assessment and the entity had no history of non-compliance with payment of collected taxes, the IRS would generally not seek to impose a bond unless some demonstrated concern about payment of the collected taxes existed.\textsuperscript{110}

If an entity fell behind in filing the returns for collected taxes or paying the collected taxes, then the IRS could impose a bond on the entity to ensure payment of the taxes. The decision to require the posting of a bond would belong solely to the IRS. The amount of the bond should relate to the amount of the collected tax exposure the IRS faces. Current section 6672(c)(3) sets a good limit on the bond. It requires a person assessed a section 6672 liability to post a bond equal to one and one-half times the amount of the assessed section 6672 liability. A similar limit of one and one-half of the unpaid collected taxes due from the entity for past quarters and projected due from the entity in the quarter in which the bond imposition occurs would serve as an adequate safety net for the IRS. The trigger for the imposition of the bond could be a letter from the IRS to the entity notifying the entity of the unpaid collected taxes, calculating the necessary amount of the bond, and giving the taxpayer fifteen days to obtain the bond and provide proof to the IRS of its existence. The failure to obtain and present the bond within fifteen days after notification could trigger the right of the IRS to obtain an injunction requiring cessation of all business activities to avoid further increases in the amount of the unpaid collected taxes.\textsuperscript{111}

\textsuperscript{110} If a responsible person or officer of the entity had an outstanding liability at the time of incorporation, then a bond would be required unless the prior tax issues were resolved. See Utah State Business and Tax Registration, TC-69 (2009), available at http://tax.utah.gov/forms/current/tc-69.pdf (setting forth requirements to register a business in Utah). Even if the prior issues were resolved, the existence of prior liabilities by one or more of the responsible persons or officers of a newly formed entity, may provide a basis for requiring a bond since their past behavior may suggest the potential for problems with payment of the collected taxes. This is an area where the suggestion for identification of responsible persons provides the government with a basis to research the background of the individuals running the entity that seeks to become a trustee of the government and allows the government to inform itself whether a bond or some other action is needed in order to protect itself.

\textsuperscript{111} An entity that continually increases the amount of unpaid collected taxes as it keeps its doors open is engaged in the "pyramiding" of taxes. The pyramiding of collected taxes has long been a major problem for the IRS. Allowing the IRS a quick entrance into court to stop the pyramiding of further taxes would solve a problem for the IRS in dealing with pyramiding situations. See Written Testimony of IRS Deputy Commissioner Linda Stiff Before the Senate Committee on Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations on the Collection of Federal Employment Taxes, 2 (July 29, 2008) ("Taxpayers often attempt to 'pyramid' their liabilities as a means of deferring payment or delaying enforcement action. One form of pyramiding occurs when the same business fails to remit payroll taxes for multiple
Another aspect of the bonding requirement concerns termination of the bond upon timely performance of the tax paying obligations over a period of time. At least one state that requires the posting of a bond in certain circumstances allows the bonding requirement to lapse after the entity has met its collected tax obligations for a specified period. The federal statute should adopt a similar lapsing provision to provide an incentive to entities to meet their obligations and thereby reduce their operating costs.

The bonding statute should have a triggering mechanism tailored to the overriding concern in the collected tax arena—pyramiding of liabilities. Frequently, the IRS has no basis for closing a business that engages in pyramiding and it can do nothing to collect from the entity as the entity continues operations but does not pay over its collected tax obligation. This means that the government subsidizes the continuation of the entity with little or no expectation of ever receiving payment on the collected taxes.

Entities that do not pay their employment taxes for more than one quarter or that have an outstanding collected tax liability in excess of $10,000 (or some other number sufficiently high to raise concerns about pyramiding) should be subjected to the bonding requirement. If the bonding requirement applies the IRS can contact the entity in person or by certified mail and request the posting of a bond. The taxpayer would have fifteen days (or some other relatively short period of time) to obtain the bond and notify the IRS of its procurement.

The bond would remain in place until the taxpayer cured the outstanding liability and kept current on its collected tax liability for two consecutive quarters. If the liability was satisfied and the taxpayer kept current, then the IRS would release the taxpayer from the bond obligation. If the taxpayer incurred further collected tax liabilities while the bond was in place, then the IRS could call the bond and liquidate it to satisfy all outstanding federal tax liabilities of the entity. To continue operations the taxpayer would need to post a new bond, within fifteen days after liquidation of the first bond, equal to twice the first bond.

In situations in which the taxpayer was notified by the IRS of the need to post a bond or in which a bond was liquidated, the failure of

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112. See Cal. Rev. & Tax. Code § 6701 (Deering 2009) (allowing bonding requirement to lapse after entity has met its collected tax obligations for a three year period).
the taxpayer to purchase a bond as required would trigger for the IRS the right to seek an injunction. The injunction would prohibit the business from incurring further collected tax liability without first paying the outstanding balance on the current collected tax liability and posting a bond to insure proper payment in the future.\textsuperscript{113}

For the injunction process to be effective, it should involve a summary proceeding similar to a summons enforcement action.\textsuperscript{114} The proof required to obtain the injunction should require merely a transcript of account demonstrating a collected tax liability in more than one quarter or an outstanding collected tax liability in excess of $10,000 together with proof of the mailing or hand delivery of the request for a bond and the refusal or failure to procure the bond. Once the IRS proved the existence of the liability, the request for the bond and the failure on the taxpayer’s part to procure the bond, the federal district court should enjoin the taxpayer from further operation until the payment of the liability or the posting of an appropriate bond. In this manner the IRS would have the tools necessary to stop further pyramiding of the collected tax liability.

The bonding requirement conforms not only with current trust law but also with the literature on incentives. As mentioned above, many trustees, particularly trustees having control over large amounts of money, must post a bond even if they operate within a bank that has handled trust matters for hundreds of years. Requiring a bond for tax collection trustees who have demonstrated a problem

\textsuperscript{113} The IRS has the ability to enjoin certain noncompliance with tax laws currently using one of three provisions in the Internal Revenue Code: 1) I.R.C. section 7402 provides a broad injunction to enforce the tax laws. It is little used because it is broad and relies on traditional equitable considerations rather than specific statutory conditions. Occasionally, the IRS has considered using this provision to seek to stop the pyramiding of collected taxes but essentially has not done so because the statute is too unwieldy for that purpose; 2) I.R.C. section 7407 provides for an injunction against return preparers—this injunction has been routinely used during the past decade; 3) I.R.C. section 7408 provides for an injunction against specified activities related to tax shelters and certain reportable transactions—this injunction provision has also been routinely used during the past decade. See Rifkin, supra note 64, at 402 (providing an overview of the injunctive remedies). These provisions do not sufficiently address the pyramiding of taxes to fit the purpose of this proposal. Only section 7402 could arguably apply and is too slow and unwieldy. A narrowly tailored provision like section 7407 or section 7408 is needed as well as an expedited path to obtaining an injunction.

\textsuperscript{114} Summons enforcement occurs pursuant to I.R.C. sections 7604 and 7402(b). The proceeding to enforce the summons is described as a summary proceeding because of the relatively small amount of information the government must put into evidence before the burden shifts to the taxpayer and because of the expedited nature of the procedure. These are traits needed for an effective injunction procedure with respect to taxpayers who fail to timely post a bond because speed is necessary to prevent pyramiding of taxes. See Internal Revenue Manual, available at http://www.irs.gov/irm/part34/irm_34-006-003.html#d0e10 (describing summons procedures); Department of Justice Summons Enforcement Manuel, available at http://www.usdoj.gov/tax/readingroom/summonsman/SumEnfMan_May2006.pdf (describing summons enforcement).
with timely meeting their obligations seems only logical as a method for controlling a group of trustees that the IRS has no choice in selecting. The existence of bonding requirements for entities also provides an incentive for entities collecting taxes to meet their obligations to avoid the bonding requirement, or to rid themselves of the bonding requirement if already imposed. Coupling the bonding requirement with the ability of the IRS to obtain an injunction provides teeth to the bonding requirement. The goal of this provision is to stop pyramiding at the earliest possible point and to avoid having to seek collection from an entity that probably has nothing from which to collect.

This requirement will impose burdens on both the taxpayer and the IRS. Entities hit with the bonding requirement will face a significant burden because of the cost of posting a bond. This burden may lead to some business closures at an earlier point than would otherwise occur. The implementation of the bonding requirement will also impose additional administrative duties on the IRS although the increased compliance brought about by the bonds may, on the whole, decrease the administrative burden the IRS faces with respect to collected taxes.

The bonding proposal requires legislative action both to create the bond and to create an enforcement mechanism through the injunction. Significant administrative rules as well as structure will also be necessary to implement this proposal.

D. **ELIMINATE THE WITHHOLDING AND SOCIAL SECURITY CREDIT FOR RESPONSIBLE INDIVIDUALS WHO FAIL TO PAY THE ENTITY'S COLLECTED EMPLOYMENT TAXES**

The current system rewards individuals who make decisions causing the entities they control to fail to pay over collected employment taxes. While the reward received by these individuals may not itself create an incentive to fail to pay the employment taxes, the manner in which the failure manifests itself on the individual's return certainly does not deter future failures. A change is needed in the system for crediting individuals for withheld income and social security taxes to eliminate the benefits available to those who cause these taxes to go unpaid.

This proposal seeks to eliminate the credit for income and social security tax payments received by employees of an entity if those employees were responsible for the failure of the entity to pay over the collected taxes. Currently, Internal Revenue Code ("IRC") section 31\(^{115}\) grants a credit to all employees for the amount of income and

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social security taxes withheld from their paychecks. The credit should not extend to individuals who caused the collected taxes not to be paid. This proposal would eliminate the credit for responsible officers if the return on which the collected taxes are reported is not timely filed and all taxes shown thereon are not timely paid.

Perhaps the best way to illustrate the current system is through an example. The circumstances at ABC, Inc. ("ABC"), introduced above, can also work for this illustration. Assume that George serves as the President and Chief Executive Officer of ABC during all quarters of 2008, and that George holds one-hundred percent of the stock of ABC. No one other than George has responsibility for the decision of whether to pay the taxes collected for the Internal Revenue Service ("IRS") over to it. When the IRC section 6672\(^1\) assessment occurs for ABC's unpaid collected taxes, the assessment will only be made against George. In addition to his ownership of the company, George also serves as one of the twenty-five employees of ABC making $500 per week for his work.

During each week in 2008, ABC holds out $50 of income tax and $25 of social security tax from George. The total amount of income tax withheld during 2008 is $2,600, and the total amount of social security tax withheld is $1,300. ABC issues George a Form W-2 at the conclusion of 2008 showing his wage income of $26,000 together with his withheld income and social security taxes. George files his return for 2008 showing the income reported on the W-2 and claiming credit for the withheld income tax. A report goes to the Social Security Administration ("SSA") showing the total amount of compensation George received in 2008 together with the social security contribution made by him through his employer. George receives credit from SSA for the four quarters he worked in 2008\(^2\) and he also receives credit on his 2008 income tax return for the withheld income tax. A report goes to the Social Security Administration ("SSA") showing the total amount of compensation George received in 2008 together with the social security contribution made by him through his employer. George receives credit from SSA for the four quarters he worked in 2008\(^2\) and he also receives credit on his 2008 income tax return for the withheld income tax.\(^1\)George individually receives credit from SSA and from the IRS even if ABC never ends up paying the collected taxes to the IRS and the IRS never collects these taxes from George pursuant to section 6672.

In this situation, George receives a significant benefit from the government, the government receives nothing, and George created the situation in which the government receives nothing. Imagine further

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\(2\) Morales v. United States, 805 F. Supp. 1062, 1067 n.5 (D. Puerto Rico 1992) ("Where the employer withholds social security taxes but fails to pay over the funds, the employee is not liable to the government for the amount of the withheld taxes and is entitled to credit notwithstanding the employer's default . . . ").

\(3\) I.R.C. § 31(a) (2009); Treas. Reg. § 1.31-1. See also IRS Publication 505 (Rev. March 2009), available at www.irs.gov/pub/irs-pdf/p505.pdf (generally explaining the posting of this credit).
that most individuals who hold the position of President and Chief Executive Officer of an entity do not receive the same compensation as the other workers. Usually, the individual who caused the failure to pay the collected taxes receives the highest compensation of all of the employees. While it makes sense to credit all of the non-responsible employees whose taxes the company withheld, it does not make sense to provide this benefit to the very individual (or individuals in the case of more than one responsible officer) who caused the problem in the first place. For the "innocent" employees, they had no choice concerning the withholding of the tax from their paychecks and no choice concerning the failure of the company to properly remit the collected amount to the IRS. The company served as the agent of the IRS and not of the individual "innocent" employees.

In contrast, the individual responsible for failing to pay over the collected taxes had total control. That individual, acting through the entity, served in a position of trustee. That individual breached the trust. That individual made the decisions causing the failure to remit the collected taxes to the IRS. That individual should not receive a reward for these failures by having the unpaid collected taxes credited to his or her account. Instead, that individual should bear the burden of the loss as a consequence of the actions. How can that individual properly bear the burden created by their actions? Eliminate IRC section 31(a)\textsuperscript{119} with respect to the responsible person for withholding taxes and eliminate the parallel provision\textsuperscript{120} with respect to the withheld social security taxes. Make the individual personally responsible for payment of these taxes prior to deliver of any benefits under social security for those quarters or any benefits for withheld income taxes.

These benefits should be eliminated for each quarter in which the entity does not timely file the appropriate return and remit the full amount of the collected taxes. Any shortfall in remission of the collected taxes should be treated as the failure to pay the taxes withheld from the responsible officer(s). As a consequence, the late filing of the employment tax return by the entity (absent reasonable cause) or the late payment of the taxes reflected on the return (absent reasonable cause) will result in the loss of the credit for withheld income taxes on the return of the individual responsible officer(s), and will result in the loss of any social security benefits for the individual responsible officer(s) for the quarter for which the return was late or unpaid.\textsuperscript{121}

\textsuperscript{119} 26 U.S.C. § 31(a) (2010).
\textsuperscript{120} See Morales, 805 F. Supp at 1067 n.5.
\textsuperscript{121} A similar loss of social security benefits exists already for self-employed individuals. A self employed individual who fails to correctly report self employment income before three years, three months and 15 days after the close of the tax years loses all social security benefits on the self employment income even if it is later determined
Receiving credit for the withheld taxes not remitted to the IRS provides a significant benefit to those individuals whose actions cause the problem. Eliminating this benefit places consequences on the actions of the individual responsible officer that have immediate and tangible effects. The responsible officer will immediately need to find the funds to pay the personal income tax liability or the IRS will have the right to begin collection of that liability as soon as the assessment occurs on the income tax return. While the first proposal, above, seeks to collapse the long waiting period before collection begins on responsible officers, this proposal will have that effect with respect to a portion of the liability, assuming that the individual timely files an income tax return.

This provision also creates a real penalty for those individuals who fail in their responsibilities to see that collected employment taxes are remitted to the IRS. The current situation provides no penalty for the failure to ensure the payment of the collected taxes and actually provides a perverse incentive since the individual committing the bad act receives the full tax benefit, and the IRS must bear the full brunt of the loss where the tax goes uncollected. Reversing that equation eliminates the inequity of having responsible officers benefit from their actions. With this approach, the responsible officer may never pay the income tax liability and the section 6672 liability may never get paid, but, at least the responsible officer remains liable for both. Further, the elimination of the social security benefits may impact the responsible officer in a tangible way. It reduces the amount of eligible quarters the individual can accumulate. It potentially reduces from the equation “phantom” high earning quarters in which the individual gets credit for high earnings yet the taxes themselves never make it to the social security fund.

These tangible and immediate impacts on an individual may have a benefit in driving the individual’s behavior with respect to the collected tax of the entity. The current system, which insulates individuals from their own bad acts at the entity, further fosters a culture of treating the collected taxes as just another liability instead of a liability held in trust. This proposal may cause potentially responsible persons to ensure the payment of the collected taxes because of the direct impact payment has on their personal income tax liability.

that such income exists and even if the individual must pay the self employment tax on said income. See 42 U.S.C. § 405 (2009); 20 C.F.R. 404.802 (2009); Maone v. United States, 212 Ct. Cl. 591, 1977 WL 25823 (Ct. Cl. 1977)).

To create rough parallel treatment between responsible officers, employees, and self employed individuals, responsible officers should lose the social security taxes that are not remitted with the return when due.
If the collected taxes never get paid, this proposal creates logical
symmetry between the unpaid collected taxes on the employment tax
return and the individual's income and social security taxes. The cur-
current system can hardly be justified by anything other than adminis-
trative convenience. Allowing the persons who breached their duties
as trustees to receive the tangible benefit of a credit for the very taxes
they caused to go unpaid is almost impossible to justify.

Even in situations in which the collected taxes eventually get
paid, this proposal simply serves as a penalty that seeks to modify
behavior and impose a true penalty on inappropriate conduct. The po-
tential loss of the credit on their personal return should create a very
tangible incentive to insure timely payment of collected taxes. The
administrative burden on the IRS of administering this penalty
should not be great.

This proposal will require a legislative change to section 31 to pre-
vent the crediting of the withheld tax to the responsible officer's indi-
vidual income tax liability. It will also require a change to the social
security laws.

E. CREATE AN INCENTIVE FOR THE RESPONSIBLE OFFICERS TO PAY
THE INTERNAL REVENUE CODE SECTION 6672 LIABILITY
WHERE MORE THAN ONE RESPONSIBLE OFFICER
EXISTS

A truly perverse system exists today when multiple individuals
owe the liability under Internal Revenue Code ("IRC") section 6672. The
system provides exactly the opposite incentive that one would
want for a tax collection system. The system can best be described
through an illustration. Again, ABC, Inc. ("ABC") will supply the
background for the illustration.

Assume that three individuals bear responsibility for the pay-
ment of the collected taxes at ABC. During the first quarter of 2008,
ABC fails to pay its employment taxes. During the entire quarter,
George, Mary, and Bob each had the requisite responsibility and will-
fulness to make them liable for the section 6672 assessment. A sec-
tion 6672 liability of $24,375 is made against each of them on April 1,
2009, and notice and demand made to each of them pursuant to IRC
section 6303. Then collection begins.

Because of policy statement P-5-14, the Internal Revenue Ser-
vice ("IRS") treats the section 6672 liability as an alternative means of

124. Formerly, P-5-60.
collecting the unpaid collected taxes and not as a penalty.\textsuperscript{125} Therefore, it seeks to collect the liability only once.\textsuperscript{126} In seeking to collect the liability once, however, it will seek to collect it from each of the three individuals until it obtains full satisfaction of the liability.\textsuperscript{127}

Assume that George sends the IRS $24,375 which it receives on April 6, 2009; that Mary sends the IRS $24,375 which it receives on April 7, 2009; and that Bob sends the IRS $24,375 which it receives on April 8, 2009. Setting aside for purposes of this example the issue of interest and penalties and assuming that $24,375 provides full remittance, the IRS now has three times the amount it seeks to collect. Since it seeks to collect the tax only once, it will return the excess to the responsible officers, and it has a protocol for returning the excess proceeds.\textsuperscript{128} The IRS protocol calls for it to send Mary and Bob back the full amount that they paid to the IRS because it keeps the first money that it collects. George has the right, pursuant to section 6672(d) to sue Mary and Bob for the right of contribution but no right to refund from the IRS (assuming that he was correctly assessed.)

The application of Internal Revenue Manual ("IRM") 5.17.7.1.9 creates precisely the wrong type of incentive for people in this situation. This provision essentially states to multiple responsible officers that you are a chump if you choose to pay the liability and you should do everything in your power to avoid paying the liability before your fellow responsible officers do so. Presumably, IRM 5.17.7.1.9 seeks to foster the rule of only collecting once as set forth in Policy Statement P-5-14; however, it promotes in responsible officers a strong desire to do everything in their power to avoid paying the section 6672 liability in hopes that the IRS will collect first from one or more of the other responsible officers. If the reason for adopting IRM 5.17.7.1.9 was to foster the rule of only collecting once, that rule can be honored while still promoting the prompt payment of the collected taxes.

\textsuperscript{125} P-5-14 states: "The withheld employment and income taxes or collected excise taxes will be collected only once, whether from the business, or from one or more of its responsible persons."

\textsuperscript{126} See IRS Internal Revenue Manual § 1.2.14.1.3 (August 1, 2009), available at http://www.irs.gov/irm/part1/irm_01-002-014.html ("The full unpaid trust fund amount will be paid only once in a particular case . . . "); id. § 5.7.3.1(8), available at http://www.irs.gov/irm/part5/irm_05-007-003.html#d0e10 ( "If, after the assertion of the TFRP, the corporation pays the delinquent tax, the FFRP assessment will be abated."); id. at § 5.17.7.1.9(2), available at http://www.irs.gov/irm/part5/irm_05-017-007.html; see generally POSTN-124416-08, 2008 TNT 184-8.

\textsuperscript{127} See IRS Internal Revenue Manual § 5.17.7.1.9 (August 1, 2009), available at http://www.irs.gov/irm/part5/irm_05-017-007.html#d0e10, 5.7.3; IRS Service Center Advisory 200026024, 2000 WL 331116108 (April 20, 2000).

Instead of driving people away from payment, the IRS should adopt a policy that promotes prompt payment of the collected taxes. To do this it could adopt a policy somewhat parallel to the whistleblower provisions that promote individuals to come forward to the IRS with information by providing rewards. Here the goal would be to promote the responsible officers to come forward with early payment in return for a potential reward. The potential reward in the multiple responsible officer contexts is the refund of the money paid by the earliest responsible officer to step forward and pay the liability. The IRS should seek to reverse the scenario described in the example above in which George, the first to pay, lost all rights to the money while Mary and Bob, who paid later, had their money returned to them in full.

This proposal suggests that the IRS treat the first person to pay as someone who is eligible for a reward of having all or a portion of the money returned to them should the IRS succeed in collecting from one or more of the other responsible officers. This proposal contemplates that the IRS would continue to collect the responsible officer liability from everyone against whom it was assessed. Collection efforts in this regard could be fairly passive such as filing the notice of federal tax lien and making offsets. Even these relatively passive ef-

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129. Because the goal is to promote the responsible officers to come forward to pay the liability, this proposal does not seek to reward those responsible officers from whom the IRS collects the tax through some form of collection action, including offset. The policy here would parallel the current law concerning designation of payments. See Ida v. Commissioner, 108 F. Supp.2d 1181, 1183 (D. Kan. 2000) ("A taxpayer who "voluntarily" makes payments to the IRS has a right to designate the tax liability to which the payment will apply); O'Dell v. United States, 326 F.2d 451, 456 (10th Cir. 1964). When a taxpayer makes a voluntary payment without directing the application of the funds, the IRS may decide how to apply it. Liddon v. United States, 448 F.2d 509, 513 (5th Cir. 1971). However, where the taxpayer makes a payment "involuntarily," the IRS will decide how to apply the payment. Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983).

In Amos v. Commissioner, 47 T.C. 65, 69 (1966), the Tax Court defined "involuntary payment." If a taxpayer voluntarily pays the liability, the taxpayer can designate how that payment is applied to any outstanding liabilities. If the taxpayer does not voluntarily pay, the IRS can apply the payment in a manner that preserves its best interest. Similarly, involuntary payments of the collected tax by responsible officers would not trigger the rewards this proposal seeks to provide to responsible officers who step forward and satisfy the liability.

130. In addition to the issue of voluntary vs. involuntary payment of the liability as a triggering mechanism for reaping the benefits of this statute, an issue exists concerning the treatment of a volunteer who steps forward and pays a portion but not all of the liability. The proposal suggests that responsible officers who pay a portion of the liability do not garner the full benefit of the repayment reward. These payments should post on a quarter-by-quarter basis. To the extent that a responsible officer makes a payment that fully pays one or more quarters but not the entire liability, then that individual should receive the reward for the quarters that are fully paid. To the extent that quarters are partially paid, the individual would receive no reward.
forts have the result of bringing a fair amount of money into the IRS coffers. The goal of continued collection allows the money recovered from the responsible officers who did not pay first to be refunded to the responsible officer who paid first. Through this mechanism the responsible officer paying first has the potential to fully recover and the IRS stands indemnified from the time of the payment by the first responsible officer. A further incentive could be created if the late payment penalties recovered from the later paying responsible officers were given to the first paying responsible officer as a bonus for paying first.

All of this could be accomplished without significant collection effort by the IRS other than filing the notice of federal tax lien and making available offsets. The IRS has no responsibility to take enforced collection action against the later paying responsible officers, although the IRS could take such action if it so chose. The IRS could also file claims in bankruptcy if one or more of the responsible officers filed bankruptcy petitions. The responsible person paying first has no guarantee that the other responsible officers will pay and that through such payments some or all of the money paid over will be returned as a refund, but at least the first paying responsible officer has a chance for that to happen and an incentive to pay quickly to reap that potential benefit. This proposal maintains the ability of the first responsible office to seek contributions from the other responsible officers as an alternative to seeking a refund from the IRS as it collects their payments. This proposal does not change the policy of only collecting the unpaid collected tax once. It simply modifies the manner in which the one payment is achieved by providing an incentive for one of the responsible officers to pay quickly and serve a role that is essentially that of guarantor.

The early payment proposal should effectively guarantee the IRS payment of the collected taxes in those situations in which someone steps forward. By providing an incentive to pay and removing a significant impediment to payment, this system should greatly increase collection effectiveness. This proposal should not present a significant burden to either the responsible officers or the IRS. This proposal merely requires a change in the administrative rule concerning the posting of payments.

VI. CONCLUSION

Having created a largely successful structural system of using business entities to collect federal taxes directly from the parties subject to the tax, Congress and the Internal Revenue Service (“IRS”) have failed to devise a structure that will insure the business entities
that collect these taxes actually pay them over to the IRS. The proposals herein seek to begin a discussion designed to create an appropriate structural system that ensures the IRS ultimately receives payment. The variety of the proposals addresses the variety of reasons for non-payment. Giving thought to creating the proper structure to ensure payment should help in reducing this corner of the tax gap.
VII. APPENDIX A

STATES REQUIRING IDENTIFICATION OF RESPONSIBLE PARTIES

Alabama


Alabama requires identification of current owners, partners, corporate officers, and employers. The Alabama Starting A New Business brochure discusses trust fund taxes; it clearly states that if owners, partners, or corporate officers occupy positions within a business in which they have authority and control over the payment of creditors, and they choose to pay other creditors over the government, the owner, partner, or corporate officer can be held personally liable for the tax. The brochure further states that bankruptcy cannot waive this debt.

Alaska


Alaska has no income or sales tax, but employment security tax, administered by the Department of Labor, requires withholding and remittance by employers. The Department of Labor requires disclosure of corporate officers and there is a duty to notify the Department of changes; however, there is no duty to specifically identify responsible officers.

Arizona


Arizona requires identification of owners, partners, and corporate officers, but does not require designation of a responsible party for taxation purposes. Arizona statute simply states that the employer is liable.
Arkansas


Arkansas requires the signature of the owner or responsible party when registering to withhold wages.

California


California requires identification of corporate officers for withheld income taxes. For sales taxes, California requires identification of corporate officers, cautioning that failure to update will cause the listed corporate officers to be personally liable for unpaid taxes.

Colorado


Colorado requires disclosure of owners, partners, and corporate officers, but does not require designation of a responsible party.

Connecticut


Connecticut requires disclosure of owners, partners, and corporate officers, but does not require disclosure of a responsible party.

Delaware

30-11-VII DEL. CODE REGS. § 1151-1156 (Weil 2009); Delaware Combined Registration Application (2009), available at revenue.delaware.gov/services/current bt/cra.pdf; Email from Margaret Boyle, Delaware Division of Revenue, to Fleming Ware, Research Assistant,
Delaware requires disclosure of owners, partners, and corporate officers, but does not require identification of a responsible party.

**District of Columbia**


The District of Columbia requires disclosure of owners, partners, and principal officers. Statutes state that an officer or director of a corporation, general partner of a partnership, or similar principal of business shall be liable for a penalty equal to the tax not paid over to the state.

**Florida**


Florida does not collect personal income tax.

**Georgia**


Georgia requires either disclosure of an important person in the business, including that person’s SSN or ITIN, or disclosure of all owners, partners, or corporate officers.

**Hawaii**


Hawaii requires identification of the corporate officers but not responsible officers.

**Idaho**


Idaho requires identification of corporate officers but not responsible officers.
Illinois


Indiana


Iowa

IOWA CODE §§ 701-38.1(8), 46.3(422), 46.3(1) (2009); The Iowa Business Tax Registration Form requires identification of responsible parties.

Kansas


Kansas requires identification of all owners, partners, corporate officers, and directors. The Kansas Withholding Tax Guide states that officers and directors of corporations, sole proprietors, and partners are personally liable for any unpaid withheld tax, along with any other person determined to be a responsible party.

Kentucky


Kentucky requires identification of owners and responsible parties. A Kentucky statute states that parties such as the president, vice president, secretary, treasurer, or any other person holding an equivalent corporate office shall be held personally liable, joint and severally, for any tax required to be withheld.

Louisiana

LA. ADMIN. CODE tit. 61, § 1511 (2009); Louisiana Application for Revenue Account Number and Instructions (2009), available at revenue.louisiana.gov/sections/business/intro.aspx; Louisiana Withholding Brochure.
Louisiana requires identification of corporate officers, partners, or owners. Administrative law states that a withholding agent is personally liable for amounts required to be withheld.

**Maine**

Revenue Services and Department of Labor Application for Tax Registration (2009), available at www.maineboats.com/files/MEApplicationTaxRegistration.pdf; Email from Maine Revenue Service, Compliance Division, to Fleming Ware, Research Assistant, Villanova University School of Law (June 18, 2009, 10:51 EST) (on file with author).

Maine requires disclosure of the person responsible for the finances of the corporation and all directors, partners, and officers. Any or all listed individuals may be held individually liable for any taxes withheld.

**Maryland**


Maryland requires identification of the person(s) responsible for remitting taxes.

**Massachusetts**


Massachusetts requires new businesses to designate someone as the Master Business Administrator. This individual receives authority over all electronic business. Massachusetts Department of Revenue requires all withholding forms be completed online.
Michigan


Michigan requires identification of corporate officers. Listed corporate officers can be personally liable for unpaid taxes. If the corporation hires a payroll provider, the corporation must file Form 3683, which has to be signed by the corporate officer responsible for paying taxes acknowledging the personal liability for unpaid taxes. There is a duty to update this form if the responsible person changes.

Minnesota


Minnesota further states that the supplied information will be used for assessment of unpaid taxes.

Mississippi

Miss. Code Ann. § 27-7-307 (2008). Mississippi requires a list of the officers, directors, managing partners, or members who have any responsibility for fiscal management.

Missouri


Missouri requires identification of all officers, partners, and sole proprietors, but not of responsible parties.

Montana


The Registration Application requires listing of the President or Partner, Secretary or Partner, and Treasurer or Partner but not specifically the person whom is responsible for remitting withholding taxes. The Montana Annual Wage Withholding Tax Reconciliation requires a name and address when filing the form.
Nebraska


Nebraska requires identification of all corporate officers but does not require disclosure of the responsible party.

Nevada

**NEV. REV. STAT. §§ 360.780, 360.784 (2009); Nevada Business Registration Form and Instructions (2005), available at [http://tax.state.nv.us/documents/APP-01.00%20Nevada%20Business%20Registration%20-%202002-17-05.doc](http://tax.state.nv.us/documents/APP-01.00%20Nevada%20Business%20Registration%20-%202002-17-05.doc).**

Nevada requires identification of corporate officers but not responsible officers.

New Hampshire


New Hampshire does not collect personal income tax.

New Jersey


New Jersey requires taxpayers to disclose the name and SSN of all owners, partners, or responsible corporate officers. The New Jersey Department of the Treasury states that a responsible party may be any officer or employee of a corporation who is under the duty to collect and remit trust fund taxes to the State on behalf of the corporation. The Tax Court of New Jersey looks to factors laid out in *Cooperstein* to determine who is a responsible party.

New Mexico

**N.M. CODE R. § 3.3.2.8-10 (Weil 2009); Application for Business Tax Identification Number (2009, available at [www.tax.state.nm.us/](http://www.tax.state.nm.us/).**

New Mexico requires disclosure of owners, partners, corporate officers, and shareholders, but does not require disclosure of a responsible party.

**New York**


The Department of Taxation and Finance requires identification of corporate officers. Businesses are required to update corporate officer information. The update form references responsible persons.

**North Carolina**


The North Carolina Department of Revenue requires taxpayers register for withholding. Taxpayers must disclose responsible persons on the withholding registration form.

**North Dakota**


The State Tax Department requires identification of corporate officers for registration. Guidelines warn of potential personal liability of corporate officers if the entity fails to remit taxes; however, corporate officers can completely elect out of personal responsibility if the entity posts a bond.

**Ohio**

OHIO REV. CODE ANN. § 5747.13 (2009); OHIO ADMIN. CODE 5703:7-15 (2009); Ohio Employer Withholding Tax General Guidelines
Ohio Withholding Tax Registration requires disclosure of the name and title of individuals responsible for remitting Ohio withholding tax.

Oklahoma


All managers and members of any LLC shall be liable for the failed remittance of any withholding tax, unless, during the period for which the assessment was made, a manager(s) or member(s) was specified as a responsible party for withholding tax purposes.

Oregon


The Oregon Employment Department requires all employers to disclose all corporate officers and for what each officer is responsible (filing tax returns, paying taxes, hiring/firing, determining which creditors to pay first).

Pennsylvania


Pennsylvania requires identification of responsible parties on the Enterprise Registration Form and identification of the type of tax each person is responsible for remitting. The Enterprise Registration Form also states that responsible parties can be personally assessed if the entity does not pay.

Rhode Island

State of Rhode Island Business Registration, https://www.ri.gov/taxation/BAR/ (last visited August 1, 2009).

Rhode Island requires identification of corporate officers but not identification of responsible officers.
South Carolina

South Carolina Tax Form 111 and Instructions, available at http://www.sctax.org/Forms+and+Instructions/Current+Years+Forms+and+Instructions/default.htm. South Carolina requires identification of corporate officers on its registration form but not responsible officers.

South Dakota


Tennessee


Texas


Utah

UTAH CODE ANN. § 59-10-405.5 (2009); Utah State Business and Tax Registration, TC-69 (2009), available at tax.utah.gov/forms/current/tc-69.pdf; Utah Business Guide, www.utah.gov/services/business.html (last visited August 1, 2009). Utah requires identification of corporate officers on its registration form, but not responsible parties. The form states that all officers will be reviewed by the Department of Revenue for past unpaid tax debts and may be required to post a bond. The form also requires acknowledgment of potential personal liability of officers and the requirement to update corporate officer status.
Vermont


The Department of Taxes requires businesses open a Vermont Business Account. Businesses must identify all business principals with fiscal responsibility on this account.

Virginia


The Department of Taxation requires business to register with the State. The registration form includes a separate section for listing responsible persons.

Washington


Washington requires identification of all owners and spouses, but does not require designation of responsible officers.

West Virginia


The Tax Commissioner requires identification of corporate officers to obtain the required business registration certificate. Responsible parties do not have to be identified.

Wisconsin

WIS. STAT. §§ 71.67(6), 73.03(50)(a) (2009); Application for Business Tax Registration (2009), available at http://www.dor.state.wi.us/forms/sales/index.html. Wisconsin requires identification of corporate officers but not responsible officers.
Wyoming


VIII. APPENDIX B

STATE BONDING REQUIREMENTS

Alabama

Alabama does not have a bonding requirement.

Alaska

Alaska does not have a bonding requirement.

Arizona

ARIz. REV. STAT. ANN. §§ 42-1102, 42-5006-07 (2009); ARIZ. ADMIN. CODE §§ R15-5-2207, R15-5-601 (2009). Arizona may require a bond to secure the payment of any tax if the taxpayer has not previously paid taxes. A bond may be required if a licensee, filing monthly, has been delinquent four times within two years, if an applicant had its prior license revoked, if an applicant had delinquencies under a previous license, or if the Department concludes that an applicant would be unable to remit taxes. A contractor licensed by the Registrar of Contractors and a dealer of manufactured housing that has not had a principal place of business in Arizona for over one year is generally required to furnish a bond. Any person who has not had a principal place of business in Arizona for over one year who enters a prime construction contract in excess of $50,000 must furnish a bond equal to transaction privilege tax on the contract price and obtain a certificate from the Director.

Arkansas

Arkansas does not have a bonding requirement.

California

CAL. REV. & TAX. CODE § 6701 (Deering 2009). California allows the Board, whenever it deems it necessary to ensure compliance, to
require any person to place with it any security that the Board deter-
mines. Security held by the Board shall be released after a three-year
period in which the person has timely filed all returns and paid all
taxes to California.

*Colorado*

Colorado does not have a bonding requirement.

*Connecticut*

nue can require any person subject to sales or use tax to deposit secur-
ity for payment. Security can be in any form and amount the
Commissioner determines, up to six times the taxpayers estimated tax
liability for the applicable reporting period.

*Delaware*

Delaware does not have a bonding requirement.

*District of Columbia*

D.C. Code § 47-2208 (2009). The Office of Tax and Revenue may
require a security bond from vendors engaged in business in the Dis-
trict to ensure payment of tax. A bond can also be required from ven-
dors not engaged in business in the District, but authorized to pay the
tax and collect reimbursement from it.

*Florida*

Fla. Stat. § 221.16(2) (2009). The Department of Revenue can
require a bond to ensure payment of the tax prior to issuing a certifi-
cate of registration. In determining if a bond is needed, and the
amount thereof, the Department must consider: (1) applicant's prior
compliance history; (2) type of business; (3) type of inventory; (4) busi-
ness location; (5) applicant's financial status; and (6) anticipated vol-
ume of business. The Department may also require the posting of a
bond to guarantee the payment of the taxes before issuing an im-
porter's permit to a person importing taxable personal property in its
own trucks in connection with that person's business.

*Georgia*

Ga. Code Ann. §§ 48-8-57(a), 48-2-51, 48-2-59(c), 48-8-63(e)
(2009); Ga. Comp. R. & Regs. 560-12-1-.16, 560-12-2-.26(8) (2009);
Georgia provides for the posting of a bond in the following situations:
(1) chronically delinquent dealers; (2) direct payment permit holders;
(3) jeopardy assessments; (4) appeals to superior court; and (5) subcontractors.

**Hawaii**

_Haw. Rev. Stat._ § 231-24(d) (2009). Collection of a tax pursuant to a jeopardy bond can be stayed by filing with the Department a bond in whatever amount and with whatever surety the Department deems appropriate, together with any further security the department deems necessary to ensure the collection of taxes.

**Idaho**

_Idaho Code Ann._ § 63-3625 (2009). Idaho may require security if the State Tax Commissioner believes a retailer is not complying with applicable tax statutes. The Commissioner may require security from habitual delinquents.

**Illinois**

_35 Ill. Comp. Stat._ 120/12 (2009). Any person filing an action under the Administrative Review Law to review a final assessment or revised final assessment issued by the Department must post security within twenty days after filing the complaint.

**Indiana**

_IND. Code §§ 6-2.5-6-12(a), 6-2.5-7-8 (2009). The Department of Revenue may require a retail merchant to post security if it determines the bond is necessary to insure payment of sales and use tax. The department may also require a motor fuel distributor to file a bond.

**Iowa**

_Iowa Code _§ 421.27, 423.35 (2009); _Iowa Admin. Code _r. 701-11-10 (2009). The Director may require any person subject to tax to file a bond in order to secure the collection of the tax due. A bond is required under the following situations: (1) when the Director determines that certain segments of the business community are experiencing above average financial failures which might jeopardize the collection of the tax; (2) when an applicant for a new sales tax permit, after a complete investigation of the applicant’s financial status, would be unable to timely remit the tax; (3) when a new applicant’s record under a permit for a prior business shows delinquencies; (4) when the department experienced collection problems while a new applicant was engaged in a prior business; (5) when a new applicant is
substantially similar to a person who would have been required to post a bond under the certain set guidelines. Existing permit holders may be required to file a bond if they have: (1) one or more delinquencies in remitting sales tax or filing timely returns in the last 24 months; (2) two or more delinquencies remitting sales tax or filing timely returns during the last 24 months if filing quarterly; (3) four or more delinquencies in remitting sales tax or filing timely deposits or returns during the last 24 months if filing returns on a monthly basis; and (5) eight or more delinquencies during the last 24 months if filing on a semimonthly basis.

Kansas

KAN. STAT. ANN. § 79-3616 (2009). Any person subject to tax may be required to post a bond if the Director of Taxation determines that the collection of taxes needs to be secure. Corporations applying for a registration certification must post a bond.

Kentucky

KY. REV. STAT. ANN. § 139.660(1) (2009). Security may be required of any taxpayer subject to state sales and use taxes.

Louisiana

LA. REV. STAT. ANN. §§ 47.9, 47.306(D)(1) (2009); LA. ADMIN. CODE tit. 611, § 4373(C)(1). Contractors and subcontractors who are nonresidents must file a surety bond for all contracts.

Maine

ME. REV. STAT. ANN. tit. 36, §§ 5231(2), 145A (2009). A bond may be required when an extension of time to pay the tax is granted. A bond is required to stay collection following a jeopardy assessment.

Maryland

CODE ANN. TAX-GEN. § 13-825(g) (West 2009). To protect tax revenue, the comptroller can set an amount to secure payment of tax that is due or may become due and required acceptable security to be posted.

Massachusetts

MASS. GEN. LAWS ch. 64H, § 30A (2009); MASS. GEN. LAWS ch. 64I, § 31A (2009); 830 MASS. CODE REGS. 62C.66.1, 64H.3.1(5) (2009); Massachusetts DOR Directive 06-6, 11/20/2006. Nonresident contractors must deposit with the Department of Revenue an amount equal to five
percent of the total amount of the contract or furnish a guarantee bond to ensure payment of the tax unless the project is less than $20,000 or the owner of the real estate being constructed is a tax-exempt organization or a government agency exempt from tax. Transient vendors are required to post and maintain a bond to ensure payment of the tax if: (1) the transient vendor solicits taxable sales without first registering as a vendor; or (2) a notice of assessment is issued to the transient vendor and the vendor fails to pay the assessed amount. The Commissioner may require a purchaser with direct payment authority to post a bond in an amount acceptable to the Commissioner as a condition of receiving a Form ST-14, Direct Payment Certificate. Taxpayers must post security if the Commissioner assesses the tax for failing to file a return, for filing a false return, or if the Commissioner determines that: (1) the collection of the tax will be jeopardized by delay; (2) the return filing or payment history of the taxpayer raises doubt as to the collection of the tax if delayed; or (3) an abatement application or petition is frivolous and has been filed primarily to avoid prompt payment of the tax.

**Michigan**

*MICH. COMP. LAWS § 205.53 (2009).* If a person engages in a business for which a privilege tax is imposed, the person shall apply for and obtain a license from the Department for the current tax year. If the Department considers it necessary in order to secure collection of the tax, if a taxpayer has at any time failed, refused, or neglected to pay any tax or interest or penalty upon a tax or has attempted to evade the payment of any tax, or if the applicant is a corporation and the Department has reason to believe that the management or control of the corporation is under persons who have failed to pay any tax or interest or penalty upon a tax under this act, the Department shall require a surety bond payable to the state.

**Minnesota**

*Minn. Stat. § 297A.92 (2009).* The commissioner may require a retailer to deposit security with the commissioner. In lieu of the security, the commissioner may require a retailer to file a bond.

**Mississippi**

*Miss. Code Ann. §§ 27-65-21, 23, 33, 61 (2009); IV-1-03 Miss. Code R. § 35 (2009).* The commissioner may require taxpayers to file a bond in an amount double the aggregate tax liability of the taxpayer for any previous three months period within the last calendar year or estimated three-month tax liability. The bond is to be conditioned for
the prompt payment of taxes that are due for each return. The Commissioner may require a taxpayer to post a bond for other circumstances where the Commissioner feels it is necessary. Any taxpayer operating a business from their home or from a temporary location must post a cash or surety bond sufficient to cover the estimated tax liability for a six-month period. Persons in the business of selling mobile homes must post a cash or surety bond in an amount not less than two times estimated liability for three months or prepay the tax before a sales tax permit may be issued. Any person who fails to comply with all the provisions of the sales tax law forfeits his right to do business in the state until the person complies with all the provisions, posts an adequate bond, and pays all taxes due. A surety bond is required of persons who: (1) fail to obtain a sales tax permit before going into business; (2) continues to operate a business after revocation of the sales tax permit; (3) fails to keep adequate records and invoices as required by the state sales tax laws; (4) fails or refuses to permit inspection of records; or (5) fails to pay any taxes due under the state sales tax laws. Resident contractors and nonresident contractors subject to the contractor's tax must either prepay the estimated contractor's tax or file a bond with sufficient sureties approved by the Commissioner conditioned on the payment of all sales, use, income, withholding, and motor fuels tax.

Missouri

Mo. Rev. Stat. §§ 144.087(1), 144.625 (2009); Mo. Code Regs. Ann. tit. 12, § 10-104.020(1) (2009). Taxpayers must pay tax owed plus interest and penalties before a license may be issued. A taxpayer who has defaulted on the filling of payment of sales or use tax may obtain or reinstate their retail sales license by filing a bond with the Department of Revenue. The Department may also require vendors to file bonds where necessary to secure payment of use tax.

Montana

Mont. Code Ann. § 15-68-512 (2009). The Department of Revenue may require a retailer to deposit security in a form and amount that the Department determines is appropriate. In lieu of security, the Department may require a seller to file a bond to guarantee solvency and responsibility.

Nebraska

Neb. Rev. Stat. § 77-2710 (2009). Transient and itinerant vendors are required to post a bond. Nonresident contractors may be required to post a bond.
Nevada

NEV. REV. STAT. §§ 372.510, 372.825 (2009). The Department, whenever it deems it necessary to insure compliance with this chapter, may require any person subject to tax to place with it such security as the Department deems necessary. A person who obtains a permit to collect sales tax after July 1, 1985, shall deposit with the Department security in an amount equal to twice the estimated yearly tax due quarterly, or three times the estimated average tax due monthly if filing monthly returns, but not less than $100. Any person holding a permit in good standing on July 1, 1985, who becomes delinquent, files a late return, or whose check tendered as payment is dishonored shall deposit additional security with the Department. The Department shall require an organization which is habitually delinquent to deposit with the Department security in an amount equal to three times the average actual tax due quarterly if the organization files its returns quarterly or five times the average actual tax due monthly if the organization files its returns for monthly periods.

New Hampshire

New Hampshire does not have a bonding requirement.

New Jersey

N.J. REV. STAT. §§ 54:32B-18, 54:49-2 (2009). If the Director deems it necessary to protect the revenues to be obtained under the state sales and use tax law, he or she may require any person required to collect the tax to file a bond to secure the payment of any tax due or which may become due.

New Mexico

N.M. STAT. § 7-1-54 (2009). Whenever it is necessary to ensure payment of any tax, the Department is authorized to require or allow any person to furnish an acceptable surety bond in an appropriate amount. If any person neglects to comply with a notice to furnish security, the Department may demand compliance. If a risk exists that the tax due will not be paid, the Secretary may require any person liable to furnish security. The Secretary may require taxpayers who protest an assessment or the payment of tax to furnish security for amounts greater than $200,000.

New York

N.Y. TAX LAW §§ 1137-38, 1252 (Gould 2009); N.Y. COMP. CODES R. & REGS. tit. 20, § IV(A)(539.5) (2009). The Department of Taxation
and Finance can require persons who are required to collect tax to file a bond to secure payment of any tax, interest, or penalties. The collection of any jeopardy assessment may be stayed by filing a bond with the Department. Where the Department of Taxation and Finance deems it necessary to protect the revenues to be collected, it has the power to require a bond under the procedures set forth in the state sales and compensating use tax law. Whenever the Department deems it necessary to protect the revenues due, it may require any holder of a certificate of authority who is required to collect tax to file a bond in such amount as may be determined by the department to secure payment of the tax, penalties, or interest due or which may become due.

**North Carolina**

N.C. GEN. STAT. § 105-164.40 (2009). The Secretary can require a taxpayer to file an indemnity bond sufficient to protect the interest of the state when a jeopardy assessment is made.

**North Dakota**

N.D. CENT. CODE § 57-39.2-12(3); N.D. ADMIN. CODE 81-04.1-04-05 (2009). The Commissioner can require a taxpayer to file a bond when it is necessary to secure the collection of tax. Security must be posted by operators of carnivals, circuses, show troupes, and similar organizations.

**Ohio**

OHIO REV. CODE ANN. §§ 5739.05, 5739.15, 5739.30, 5741.06 (LexisNexis 2009); OHIO ADMIN. CODE 5703:9-08 (2009). The Tax Commissioner may require a bond under the following circumstances: (1) if a vendor or seller is authorized to prepay the tax; (2) failure to file two consecutive monthly returns, or three or more returns in a twelve month period; or (3) if a person issued a jeopardy assessment wishes to stay execution by filling a petition for reassessment.

**Oklahoma**

OKLA. STAT. tit. 68, § 1368 (2009); OKLA. ADMIN. CODE § 710: 65-9-2(a)(1) (2009). The Tax Commissioner may require every person who holds a sales tax permit and who is a delinquent taxpayer to furnish to the Commission a cash bond or other security as the Commission deems necessary to secure payment of taxes. Group three vendors must make a sufficient cash deposit or sufficient bond with the Tax Commission as to secure payment of semiannual tax liability before doing business in Oklahoma.
Oregon

Oregon does not have a bonding requirement.

Pennsylvania

PA. CONS. STAT. § 7277 (2009). The Department of Revenue can require a bond to be filed by a nonresident individual or foreign business entity that is subject to the Pennsylvania sales-use tax and is not authorized to do business in Pennsylvania or does not have an established place of business in the state. If such out-of-state individual is a building contractor or a supplier delivering materials for work in Pennsylvania, a bond is required. The Department can require a bond to be filed by a person who petitions it for reassessment if the assessment exceeds $500. A transient vendor must post a bond in the amount of $500.

Rhode Island

R.I. GEN. LAWS § 44-19-23 (2009). The Tax Administrator may require any person subject to the taxes imposed by Rhode Island to file with the Administrator a bond to secure the payment of taxes due or which may become due.

South Carolina

S.C. CODE ANN. § 12-54-200(A). The Department of Revenue may, at its discretion, require taxpayers to post a cash or surety bond upon the taxpayers' failure to file a timely return or pay any tax for as many as two tax filing periods during a twelve-month period.

South Dakota

South Dakota does not have a bonding requirement.

Tennessee

TENN. CODE ANN. § 67-6-522 (2009). Dealers who become delinquent for more than ninety days in the payment of any sales or use tax due to Tennessee must post with the Commissioner cash or an indemnity bond with good and solvent surety to secure proper payment of sales and use taxes for which the dealers may become liable.

Texas

TEX. TAX CODE ANN. § 151.251 (Vernon 2009); 34 TEX. ADMN. CODE § 3.327(a) (2009). Applicants for sales tax permits and those required to register as retainers must furnish a bond or security.
Utah

Utah does not have a bonding requirement.

Vermont

VT. STAT. ANN. tit. 32, § 8916 (2009). When deemed necessary to protect motor vehicle purchase and use tax revenues, the Commissioner of Motor Vehicles may require a rental company to file a bond issued by a surety company in an amount fixed by the Commissioner that does not exceed the total potential tax liability of the company to secure payment of any tax, penalties, or interest due.

Virginia

VA. CODE ANN. § 58.1-630 (2009). The Commissioner may require any person subject to the tax to file a bond.

Washington

Washington does not have a bonding requirement.

West Virginia

W. VA. CODE R. §§ 11-15-8b, 11-12-20-21, 11-15A-12 (2009); West Virginia Taxpayer Services Division Publications TSD-330, 11/01/1999, TSD-317, 4/00/1993. Nonresident contractors are required to post a cash bond, a corporate surety bond, or an umbrella surety bond prior to performing any contracting activity in West Virginia. Transient vendors are required to post a $500 bond with the Tax Commissioner. The Tax Commissioner is authorized to require any taxpayer or retailer required to collect tax to file a bond as security for payment of the tax.

Wisconsin

WIS. STAT. § 77.61 (2009). The Department may require any person who is or will be liable to it for tax to place with it a security that the Department determines. In determining the amount of the security, the taxpayer’s payment of other taxes administered and any other relevant facts may be considered. A certified service provider who has contracted with a seller and filed an application to collect and remit sales and use taxes on behalf of the seller must submit a surety bond to the Department to guarantee payment of the taxes.
Wyoming