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Looming Danger for Business Owners and Officers- IRS Increases Efforts to Impose Personal Liability

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During recent congressional hearings regarding IRS tax collection efforts, a top IRS official promised Congress that the agency "will do better" in collecting billions in "trust fund" taxes that businesses collected but never remitted to the government. Several members of Congress also stated that the IRS should develop an expedited process for assessing Trust Fund Recovery Penalties ("TFRP") against businesses *and the key officers and employees thereof*. Based on the statements of these key IRS officials, and on the current Congressional stance, more taxpayers will face the prospect of dealing with potential TFRP tax assessments and the significant impact it may have on the individual(s) separate and apart from the business.

Aviation related businesses in particular (such as airlines and charter operators) need to understand the magnitude of this concern as they increasingly find themselves in a cash flow crunch due to unstable economic conditions. These businesses are faced with skyrocketing operating costs including higher fuel costs and increases in the costs of airport fees and food, in addition to typical carrying costs associated with the ownership or leasing of aircraft needed to operate the business. Furthermore, the downturn in the U.S. real estate market and the ever-declining U.S. stock market are making it harder for businesses to secure funds to meet the deficit in cash flow.

As a result, many businesses find that they need cash to pay debts that are due immediately. Faced with what seems to be an insurmountable problem, some of the individuals that manage these businesses may decide to pay creditors and vendors by using portions of collected Federal Employment (or what is commonly called "trust fund") taxes for that purpose, thinking they will make up for the shortfall at some later date. However, many if not most of these individuals do not consider the dire consequences that could follow if those taxes are not ultimately paid. They may be unaware of the significant personal cost and liability to themselves that could arise when "borrowing" money from the IRS in this manner.

The following is a brief description of the TFRP, an extremely onerous enforcement tool that the IRS possesses, and its possible application in the context of aviation related businesses and the individuals that manage them.

The Trust Fund Recovery Penalty

To encourage prompt payment of withheld Federal Employment taxes and collected Federal Excise taxes, Congress passed a law that provides for the TFRP. These taxes are called "trust fund" taxes because the business that collects those taxes actually holds them in trust for the federal government until the business deposits such taxes with the IRS. *The IRS may levy the TFRP against an individual who is responsible for collecting unpaid trust fund taxes if the IRS cannot immediately collect such taxes from the business even when a business is still operating*.

In particular, the TFRP may be assessed against an individual (s) who:

- Is responsible for collecting or paying withheld Federal Employment taxes, or for paying collected Federal Excise taxes, and
- Willfully fails to collect or pay them.

A "responsible person" is a person or group of people who has the duty to perform and the power to direct the collecting, accounting, and paying of "trust fund" taxes. This person may be:

- An officer or an employee of a corporation;
- A member or employee of a partnership;
- A corporate director or shareholder;
- member of a board of trustees of a nonprofit organization; and
- Another person with authority and control over funds to direct their disbursement.

For "willfulness" to exist, the responsible person:

- Must have been, or should have been aware of the outstanding taxes; and
- Either intentionally have disregarded the law or have been plainly indifferent to its requirements (no evil

intent or bad motive is required).

Using available funds to pay other creditors when the business is unable to pay the employment taxes is an indication of willfulness.

The amount of the TFRP is equal to the unpaid balance of the "trust fund" tax. The IRS calculates the TFRP amount based on:

- The unpaid amount of employment taxes withheld, including the employee's portion of withheld social security, or

- The unpaid amount of collected excise taxes.

What to Do?

If an individual is in a situation in which the TFRP may be assessed against that individual, it is of paramount importance for that individual to respond promptly to any IRS correspondence relating to such an assessment and to aggressively defend oneself. In most cases, the individual will have 60 days from the date of the IRS's letter proposing to assess the TFRP (75 days if this letter is addressed to an individual outside the United States) to appeal the proposed assessment. The failure to respond to such a letter will result in the assessment of the TFRP against such individual and the issuance of a Notice and Demand for Payment.

Once the IRS assesses the TFRP, it can take collection action against the individual's personal assets. For instance, the IRS can file a federal tax lien or take levy or other seizure action. Therefore, prompt action is essential in such cases.

There are methods available to mitigate the effects of the TFRP. Designated payments of unpaid trust fund taxes by a business can be helpful in reducing individual personal liability for the TFRP. Another possibility is the abatement of other penalties (late payment, failure to file, etc.) at the entity level, which may free up cash to be used to pay trust fund taxes and reduce the TFRP

The assistance of a knowledgeable aviation tax attorney with particular experience in dealing with the IRS Collection Division can prove invaluable especially for an aviation related business where personal exposure extends to both Federal Employment and Excise taxes. Such a professional can often limit the personal liability of an individual taxpayer that has been the TFRP.

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Ober|Kaler's Aviation Tax and Transactions group provides full-service tax and regulatory planning and counseling services to corporate aircraft owners, operators and managers. The group's services include Code Section 1031 tax-free exchanges, federal tax and regulatory planning, state sales and use tax planning, and preparation and negotiation of transactional documents commonly used in the business aviation industry, including aircraft purchase agreements, leases, joint-ownership and joint-use agreements, management and charter agreements, and fractional program documents.

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