Designated Payments and the Trust Fund Recovery Penalty: A Look at Potential Remedies.

To ensure that employers properly handle payroll taxes, Section 6672 imposes a penalty on individuals associated with the employer, making them potentially liable for any short fall in the payment of taxes that are withheld from employees' paychecks. When payroll taxes are transmitted, the payments have two components: one portion represents the employer's share of FICA and FUTA, and the other represents the employees' withholding. The IRS accepts written direction on the application of voluntary payments, so that savvy employers will provide a designation with each tax payment, indicating that the funds transmitted are to be applied first to the satisfaction of trust fund taxes and then to the employer's liability. Using this type of designation limits the likelihood that a shortfall results in individual liability for senior management of the employer.

A recent Seventh Circuit case looked at an interesting problem: what remedies are available if the IRS does not apply the payments in the manner designated by the taxpayer. In *Gessert v. United States,* 2013 U.S. App. LEXIS 59 (7th Cir. Jan. 3, 2013), an employer and its principal both sued to enforce alleged instructions that tax payments were not applied as directed. The weapon that they chose was Section 7433 of the Code, which provides that: "[i]f, in connection with any collection of Federal tax with respect to a taxpayer, any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence, disregards any provision of this title, or any regulation promulgated under this title, such taxpayer may bring a civil action for damages . . . ."

The claims of both the employer and its principal under this section had been dismissed by the district court, and the Seventh Circuit affirmed. The Seventh Circuit concluded that the employer's principal, Robert Gessert, could not sue under Section 7433 because he had not been the subject of any improper collection activity; the IRS had assessed the trust fund recovery penalty against him but had not undertaken any collection activity. 2013 U.S. App. LEXIS 59 at *8-*10. The court read Section 7433 as only providing a remedy to a taxpayer who has been the subject of improper collection activity, which is an appropriate reading of the plain language of the statute. Turning to the employer's claim, the Seventh Circuit held that it had not suffered any economic harm as a result of the misapplication of payments and therefore had no viable claim. 2013 U.S. App. LEXIS 59 at *11.

Mr. Gessert had also brought a traditional refund claim to back stop his claim under Section 7433; while this claim was theoretically viable, it was rejected on the merits because the only directions on how the payments should be applied was oral, and IRS policy requires written direction. *Id.* at *20-*23.

The upshot is that Section 7433 won't provide a remedy to someone who believes that an assessed trust fund recovery penalty is improperly inflated due to a failure to apply funds as directed in the absence of actual collection activity. The appropriate step is to follow the normal process of pursuing a refund claim.

Jim Malone is a tax lawyer in Philadelphia. © 2013, MALONE LLC.