**Office of Chief Counsel**
**Internal Revenue Service**
# Memorandum

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subject: Professional Employment Organizations and the TFRP

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

## ISSUE

Whether the Service can assert the trust fund recovery penalty against an officer of a professional employment organization that failed to remit its clients' trust fund taxes to the IRS.

## CONCLUSION

The IRS can assert the trust fund recovery penalty against an officer of a professional employment organization that failed to remit its clients' trust fund taxes to the Internal Revenue Service when the professional employment organization filed the client companies' employment tax returns under the professional employment organization's name.

## FACTS

Small businesses often contract with professional employment organizations (PEOs), also known as employee leasing companies, to ensure compliance with workplace laws and regulations. In the typical contract between a PEO and a client, the PEO becomes the 'co-employer' of the clients' employees. Each week, the client companies email, fax, or mail the PEO the number of hours worked by each employee. The PEO computes the FICA, Medicare, withholding tax, workers' compensation, and 401(k) contributions of each employee and bills the client for the amount. The PEO then receives the amount from the client companies and the contract requires the PEO to pay the employees and make the clients' federal tax deposits. However, some PEOs do not make the federal tax deposits and instead divert the funds entrusted to them for other purposes.

Some PEOs file the client companies' employment tax returns under the PEO's name and list the PEO as the employer of the client companies' employees. When the PEO does this, it self-assesses the clients' employment tax liabilities as the PEO's employment tax liability and the IRS assesses additional amounts of the client companies' unpaid employment tax liabilities against the PEO as well.

LAW AND ANALYSIS

I.R.C. § 6672(a) imposes a 100% penalty on any person required to collect, truthfully account for, and pay over trust fund taxes but who willfully fails to collect, truthfully account for, or pay over such tax, or who willfully attempts to evade the payment of such tax. For purposes of the trust fund recovery penalty, willful means voluntarily, knowingly, consciously, intentionally, or recklessly. United States v. Landau, 956 F. Supp. 1160, 1162 (S.D. N.Y. 1997). No evil intent or bad motive is required for there to be a willful failure to pay a trust fund tax. Crowd Mgmt. Servs., Inc. v. United States, 889 F.Supp. 1313, 1318 (D. Or. 1995). Potentially responsible persons for purposes of the TFRP include employees, stockholders, surety lenders, and other persons or entities outside the delinquent employer corporation. Hanes v. Longley, 1984 WL 705 (N.D. Okla. 1984). When determining who is a responsible party, the IRS looks at who signs and files the employment tax returns and who makes the federal tax deposits. Taylor v. IRS, 69 F.3d 411, 416-17 (10th Cir. 1995); Waychoff v. United States, 1979 WL 1455 (S.D. Tex. 1979).

A PEO is directly liable for the client companies' unpaid trust fund taxes when the PEO files the client companies' employment tax returns under the PEO's name, and lists itself as the employer of the clients' employees.[1] By doing so, the PEO self-assessed its clients' employment tax liabilities against itself. Assuming the IRS establishes that an officer of a PEO was responsible for the remittance of the client companies' trust

[1] Although the contract between the PEO and the client company makes the PEO a 'co-employer' of the clients' companies employees, the IRS cannot use the contract as a basis for arguing that the PEO is the employer or co-employer of the client companies' employees. In order to be a co-employer, both employer entities must separately satisfy the common law employer test. Rev. Rul. 66-162, 1966-1 C.B. 234 (citing Restatement (Second) of Agency § 226). A PEO does not have the right to direct or control the employees and therefore, cannot satisfy the common law employer test.

fund taxes to the IRS, then the IRS can assert the TFRP against that officer in order to collect the unpaid trust fund taxes of the client companies.

Further, the Court of Appeals for the Eleventh Circuit has held the officer of a PEO liable under I.R.C. § 6672(a) for the failure to remit its clients' trust fund taxes to the IRS. Thosteson v. United States, 331 F.3d 1294, 1299 (11th Cir. 2003). In Thosteson, the court found the PEO to be the employer of the clients' employees for purposes of payroll processing and payroll taxes. Id. at 1298. If courts will hold PEOs to be the employer of leased employees for payroll purposes and the officers of PEOs liable for the TFRP in such cases, then courts will likely uphold the TFRP against the officer of a PEO that self-assessed the its clients' employment tax liabilities against itself. This is because by self-assessing the clients' employment tax liabilities against itself, the PEO is holding itself out as the employer of the client's employees.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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