Office of Chief Counsel
Internal Revenue Service
memorandum

CC:PA:01:GSemasek
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date: March 9, 2015

to: Thomas Garvey
Revenue Officer Policy Analyst
SE:S:ECS:CP:ET

from: Blaise G. Dusenberry
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(Procedure & Administration)

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subject: Correcting the Account of a Professional Employer Organization Not Liable for Employment Taxes

This responds to your inquiry of December 2014 regarding the above topic. This advice may not be used or cited as precedent.

ISSUES

1. Whether Code sections 6020 and 6404 provide authority to the Service to prepare and file a Form 941-X in order to remove or abate employment tax liabilities[1] of a professional employer organization.

2. If the answer to issue #1 is yes, what documents must the Service prepare and execute to prepare a valid substitute for return under section 6020(b)?

3. If the answer to issue #1 is no, is there an alternative basis in the Code for abating the tax liability of a professional employer organization?

CONCLUSIONS

1. Code section 6404 is the legal authority upon which the Service may abate employment tax liabilities assessed against a professional employer organization in the circumstances noted below. Section 6020, which authorizes substitutes for return against non-filers, is an insufficient legal basis for removing or abating a previously made assessment of tax.

[1] "Employment taxes" refers to the liability stemming from the requirements employers must deduct and withhold federal income tax and Federal Insurance Contributions (FICA) taxes from wages paid to their employees under sections 3402(a) and 3102, and are separately liable for the employer's share of FICA taxes under section 3111.

2. Because a substitute for return prepared and filed by the Service pursuant to section 6020 is not a means for extinguishing or abating assessed tax liability, we do not discuss the documents constituting a SFR aimed at amending a Form 941 (*Employer's Quarterly Federal Tax Return*), previously filed by a PEO to show $0 as the employment tax liability.

3. Because the Code includes authority to remove/abate an assessment against a PEO in the circumstances noted in your request, this issue is moot.

FACTS

You requested assistance from our office because the Service is uncertain of the correct procedure to follow in attempting to assess an employer for employment tax liabilities for the same reporting period for which the Service previously assessed a third party, such as a professional employer organization ("PEO").[2] The Service generally seeks to obtain an assessment against the employer after efforts to collect the past due employment taxes from the PEO are unsuccessful. Your request pertains to the employment tax periods pre-dating March 31, 2014, which was the effective date of section 31.3504-2.

Your memorandum states in part, "Under current employment tax law, *only* the common law employer remains liable for employment tax reporting, depositing and paying, even when utilizing the services of a PEO unless the PEO is determined to be an IRC 3401(d)(1) employer." (emphasis added). You confirmed that the PEO in your example is not an agent which has been authorized by the Service pursuant to Code section 3504 and the implementing regulation, Treas. Reg. § 31.3504-1, to perform the acts required of the employer. The employer did not file a Form 2678 (Employer/Payer of Agent) with the Service to appoint the PEO as an agent. As a result, only the common law employer, and not the PEO, is liable for the employment taxes.

Per our discussions, you also noted that the Service's computer system is capable of recording only one assessment of employment taxes for a reporting period. Thus, you would like to know the procedure for extinguishing or abating an assessment of employment taxes against the PEO so that the Service will be able to make an assessment of the same employment tax liability for the same reporting period against the common law employer.[3]

DISCUSSION

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[2] A professional employer organization (PEO) is an example of a third party which contracts to perform the employment tax obligations of the employer-client. The PEO files employment tax returns and makes payments under its own EIN.

[3] The same issue seems likely to arise if a third-party of a different variety performs the employment tax obligations of a common law employer.

Sections 31.3102-1(d) and 31.3403-1 of the Treasury regulations establish that an employer is liable for the withholding and payment of employment taxes, whether or not amounts have been withheld. Employers are obligated to file employment tax returns reporting employment taxes for each employment tax period. Generally, an employer files Form 941- *Employer's Quarterly Federal Tax* Return, to report wages the employer paid—during a quarter of a calendar year—that are subject to federal income tax withholding and FICA taxes. I.R.C. § 6001; Treas. Reg. 31.6011(a)-1(a)(1) and 31.6011(a)-4(a)(1).

Some employers, for a variety of business reasons, enter into agreements with third parties to satisfy the employers' responsibilities regarding employment taxes. The third party ensures that the employer's withholding, reporting and payment obligations are satisfied. Code section 3504 authorizes the Service to designate a third party agent, fiduciary or other person to perform the acts required of employers regarding employment taxes. When so designated, the third party performing such acts is subject to all provisions of law, including penalties, and regulations applicable to the employer. The employer, though, remains subject to all provisions of law, penalties and regulations pertaining to the requirement to file employment tax returns and to make timely deposits and payments. I.R.C. § 3504; Treas. Reg. §31.3504-1(a).[4]

Substitutes for Return under section 6020

Code section 6020 authorizes the Service to prepare and file a tax return for a person who, although required by the internal revenue laws or a regulation to file his own tax return, fails to do so. I.R.C. § 6020(a) and (b). A return prepared under authority of section 6020 is commonly known as a substitute for returns (SFR). *Cibirac v. Commissioner*, 120 T.C. 163, 166 (2003). The courts have opined that the purpose of section 6020(b) is to provide the Service with a mechanism to assess the civil tax liability against a non- filer. *United States v. Lacy*, 658 F.2d 396 (5th Cir. 1981)(*citing United States v. Harrision,* 30 A.F.T.R.2d P 72-5104 (E.D. N.Y. 1971)). A SFR, for example, is essential to enable the Service to meet its burden of production to support the assessment of the addition to tax under section 6651(a)(2) for failure to pay tax against a non-filer. A taxpayer is liable for this addition to tax only when tax is shown on a filed return. *Wheeler v. Commissioner*, 127 T.C. 200, 208-09 (2006). Under section 6651(g), a SFR made by the Service under authority of section 6020(b) is treated as the return filed by the taxpayer for purposes of determining the amount of the addition for failure to pay under section 6651(a)(2). *Wheeler* ; *El Waamiq-Ali v. Commissioner*, T.C. Memo. 2010-86.

Neither case law nor the legislative history associated with section 6020 (or its predecessor provisions) indicates Congress intended SFRs as a means of extinguishing or abating a valid assessment of tax. *Lacy*; An Act to provide Internal Revenue to support the Government, to pay Interest on the Public Debt, and for other Purposes, ch.

[4] Because your request pertains to employment tax periods occurring prior to March 31, 2014, the effective date of Treas. Reg. § 31.3504-2, we refrain from discussing the features of that regulation.

173, §§ 13-14 (June 30, 1864); Internal Revenue Code of 1954, Ch. 736, 68A Stat. 740(1954); H.R. Rep. No. 83-1337, at 399 (1954); S. Rep. No. 83-1622, at 565 (1954). Code section 6020 and a SFR, purporting to amend a Form 941 previously filed by a PEO, are unlikely to provide the legal grounds for removing or abating the employment tax assessment made against a PEO. A party challenging the Service's reliance on a SFR as authority to remove an assessment of tax in these circumstances could argue that section 6020(b) cannot be reasonably interpreted as authorizing reversals or abatements as this would render the abatement authority in section 6404 surplusage. *Square D Co. & Subsid. v. Commissioner,* 438 F.3d 739, 745 (7th Cir. 2006); *Rand v. Commissioner*, 141 T.C. No. 12 (2013).

Abatements

Section 6404 authorizes the Service to abate the unpaid portion of the assessment of any tax liability, or any portion thereof, which is: (1) excessive in amount; (2) is assessed after the expiration of the period of limitations properly applicable thereto; or (3) is erroneously or illegally assessed. *Poretto v. Director of Internal Revenue,* 295 F.2d 499, 501 (5th Cir. 1961) (abatement authority under section 6404 not a mandatory duty imposed on district director); *Michael v. Commissioner,* 133 T.C. 237 (2009).

In the circumstances you described, the PEO was never authorized under the employment tax laws, specifically § 3504 and Treas. Reg. § 31.3504-1, as the agent to perform the acts required of the common law employer with regard to the latter's employment tax responsibilities. The PEO is not the employer or a third-party payor, which has been designated to perform the acts required of the employer. Because the Service's assessment of employment taxes against the PEO in this situation was either excessive in amount or erroneously assessed, the Service may abate the assessment under section 6404(a) and the implementing regulation, Treas. Reg. § 301.6404-1.

I trust that this has been helpful. Please contact Gerald Semasek at (202) 317-5414 if you have any questions.

cc: Paul J. Carlino
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