



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
Washington, D.C. 20224

SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR SBSE EMPLOYMENT TAX TERRITORY MANAGERS, GROUP  
MANAGERS AND SPECIALISTS

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SUBJECT: Interim Guidance – Procedures for Examinations Involving Third-Party Payers  
(TPP)

This memorandum supersedes IGM SBSE 04-0414-0033 issued April 28, 2014. The purpose is to clarify procedures for employment tax examinations when the employer utilizes the services of a Third Party Payor (TPP), such as a Payroll Service Provider, Reporting Agent, a Section 31.3504-1 Agent with an approved Form 2678, or Professional Employer Organization (also known as an employee leasing organization), etc.

Many employers outsource their payroll and related tax duties to a TPP who may report, collect, deposit, or pay employment taxes with federal, state, and local authorities on behalf of the employer clients. Even though this outsourcing occurs, the common law employer remains ultimately responsible for the deposit, payment, and reporting of federal employment tax liabilities. Thus, even though the employer may forward the tax amounts to the TPP to make the tax deposits, if the TPP fails to make the federal employment tax payments, the employer remains liable for the taxes and the IRS may assess penalties and interest on the employer's account.

During the audit of an employer that uses the services of a TPP, the examiner must inform the employer that it is not relieved of the responsibility to ensure that its tax returns are filed timely, and that taxes are deposited or paid correctly and timely. Additionally, the examiner must instruct the employer to take actions to determine that its filing and payment responsibilities are met. The responsibilities are dependent on the type of TPP the employer uses.

Payroll Service Providers and Reporting Agents

Payroll Service Providers (PSP) and Reporting Agents (RA) prepare and file employment tax returns under each employer's EIN. For employers who use either a PSP or RA, the examiner should instruct the employer to take the following actions to ensure timely filing of its tax returns and deposits or payments:

- Verify its employer address is the address on record with the IRS, not the address of the PSP or RA. This will ensure the employer remains informed of tax matters involving its business because the IRS will send correspondence to the employer's address of record if there are any issues with an account. Examiners must check IDRS and inform the employer which address we have on file. Further, the examiner should instruct the employer that it could verify the address of record by calling the IRS Business and Specialty Tax Line at (800) 829-4933.
- Verify the PSP or RA uses the Electronic Federal Tax Payment System (EFTPS) when making employment tax deposits and payments.

- Enroll in EFTPS so the employer can view EFTPS deposits and payments made on its behalf under its EIN. Information about enrolling on EFTPS is located at [www.eftps.gov](http://www.eftps.gov). Effective January 2014, EFTPS will be issuing Inquiry PINs to all employers who are registered on EFTPS by their TPPs. Inquiry PINs allow employers to view their deposit history without a separate EFTPS enrollment.

An examiner conducting an audit of an employer using a PSP or RA must document in the case file that the examiner provided the above information to the taxpayer. The examiner must also provide the employer with a copy of [Fact Sheet 2013-9, Tips for Employers that Outsource Payroll Duties](#).

Rev. Proc. 2012-32 requires RAs to provide clients with a quarterly, written statement. The written statement must advise the client that it remains responsible for the timely filing of tax returns and timely payment of employment taxes, even if the client authorizes a RA to file returns and make payments on its behalf. This statement also includes a recommendation for the client to enroll in EFTPS to monitor its account.

### Section 31.3504-1 Agent with an approved Form 2678

An employer may request authorization from the IRS on Form 2678 to appoint an agent to act on behalf of the employer with regard to its employment tax obligations. Once the IRS has approved Form 2678, the agent assumes liability along with the employer for the employer's Social Security tax, Medicare tax, and federal income tax withholding, reporting, and payment responsibilities with regard to wages the agent pays. An agent with an approved Form 2678 must file aggregate Forms 941 (e-file or paper) using the agent's EIN. The agent generally cannot file aggregate Form 940 returns using the agent's EIN.<sup>1</sup> An agent with an approved Form 2678 must attach a Schedule R (Form 941): Allocation Schedule for Aggregate Form 941 Filers, to the aggregate Form 941 to provide an allocation of the aggregate amounts reported on the employment tax return filed by the agent.

Examiners should advise the employer that it remains liable along with the agent. In addition, the Examiner should advise the employer to use due diligence in requesting authorization from the IRS to appoint an agent on Form 2678, and continuing to use the agent after the authorization is approved.

### Professional Employer Organization (PEO)

A PEO might file an aggregate Form 941 using the PEO's EIN. Examiners should advise an employer that uses a PEO that, generally, the employer is not relieved of its employment tax obligation with regard to wages paid to its employees by using a PEO. In addition, the Examiner should advise the employer to use due diligence in selecting and continuing to use the services of any PEO. Examiners auditing an employer who is using a PEO must also contact Judith 'Judy' Davis of Specialty Programs, Employment Tax, via e-mail. Employment Tax Policy is currently developing procedures for addressing PEO issues relating to certain third parties (including PEOs) that are subject to Regulations Section 31.3504-2, Designation of Payor to Perform Acts of an Employer. Examiners must provide Judy with the following information:

- Name and EIN of client
- Tax Periods under examination
- Name and EIN of PEO

This guidance is effective immediately. If you have any questions or issues with TPPs, please discuss with your manager. Your manager or Territory Manager may contact Judith Davis, Specialty Programs, Employment Tax.

cc: [www.irs.gov](http://www.irs.gov)

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<sup>1</sup> An exception applies for an employer that is a home care service recipient disabled individual or other welfare recipient receiving in home-care through a state or local program. See Rev. Proc. 2013-39