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MEMORANDUM FOR TAXPAYER ADVOCATE SERVICE EMPLOYEES

FROM: /s/ Nina E. Olson
National Taxpayer Advocate

SUBJECT: Interim Guidance on Advocating for Employers
Affected by Third Party Payer Misconduct

The purpose of this memorandum is to provide Taxpayer Advocate Service (TAS) employees guidance on advocating for employers affected by payroll service provider (PSP) and other third party payer misconduct.

Background

Some employers enter into agreements with third parties to perform some or all of their federal employment tax obligations. These obligations include withholding and depositing taxes, and filing employment and information returns. Multiple issues arise when the third party fails to file timely returns, make timely deposits, or pay tax on behalf of the employer.

[IRM 5.1.24.4](#), *Types of Third-Party Payer Arrangements*, and its subsections describe the most common types of third party payer arrangements. Exhibit [5.1.24-1](#), *Third-Party Arrangement Chart*, summarizes the differences between three of these arrangements. For convenience, this memorandum will refer to all these arrangements as third party payers. Between fiscal years 2007 and 2012, based on IRS

recommendations, the Department of Justice criminally prosecuted at least 24 different third party payer owners who collected about \$300 million in employment taxes from thousands of client employers and did not pay the funds over to the IRS.¹

Employers may request TAS assistance related to some or all of the following IRS issues caused by third party payer misconduct, fraud, or other bad acts:

- Penalty abatement (failure to file, failure to pay, failure to deposit, information return, and trust fund recovery);
- Compromise of a portion of the tax the employer paid to the third party payer that the third party payer failed to pay over to the IRS (including penalty and interest accrued on such tax);
- Relief from IRS enforcement action (levy, lien, etc.); and
- Secondary issues relating to the financial difficulties caused by paying the IRS the employment tax liabilities after having paid the same amount to the third party payer which the employer intended as payment for the original IRS liability.

When assisting the employer, TAS employees should remember (and remind IRS employees) that from the employer's perspective, he or she has already paid the tax once, albeit to the third party. Thus, to the employer, it feels like he or she is being asked to pay the same tax twice. In advocating on behalf of the employer, TAS employees should be sensitive to the emotional and economic reality of the taxpayer's situation.²

Case Building for Employers Affected by Third Party Payer Misconduct

Focus initial TAS case building on determining the extent of the problem and stopping similar problems from occurring in additional tax periods.

- Determine the tax periods affected and which tax forms, tax deposits, and tax payments were late, insufficient, or missing. Use IDRS research to verify IRS records match the employer's records in adjacent tax periods, and the employer address of record is

¹ TIGTA, Ref. # 2015-40-023, *Processes Are Needed to Link Third-Party Payers and Employers to Reduce Risks Related to Employment Tax Fraud*, 12 available at <http://www.treasury.gov/tigta/auditreports/2015reports/201540023fr.pdf> (Mar. 2, 2015).

² See National Taxpayer Advocate Public Forum on Taxpayer Needs and Preferences, Baltimore, MD, May13, 2016, Statement of Angela Armstrong at https://taxpayeradvocate.irs.gov/Media/Default/Documents/PublicForums/Transcripts/BaltimoreMD_Transcript_051316.pdf.

accurate. Research Form W-2 and W-3 filings to determine if the third party payer misconduct extended to those returns.

- Identify proposed or assessed penalties and IRS enforcement actions taken using IDRS, ICS, AMS, and ALS.
- Secure supporting documentation from the employer about the third party payer arrangement.
 - Identity of third party payer;³
 - Copy of contract or agreement;
 - Details of the third party payer embezzlement or other bad acts, including;
 - Steps the third party payer took to conceal its actions from the employer (e.g., emails or voicemail messages between the employer and third party payer, interception of correspondence from the IRS, etc.);
 - Any criminal or civil charges against the third party payer (court records, media reports, bankruptcy filings, etc.); and
 - The success or likelihood of success the employer had in recovering monies taken by the third party payer (civil actions filed, criminal reparations, reimbursement from a bonding authority or insurance company, etc.).
 - Evidence the employer acted in a responsible manner;
 - Employer took reasonable steps and exercised due diligence when selecting the third party payer to provide payroll services (e.g., asked for and received references, checked with the Better Business Bureau, verified the third party payer was bonded or licensed if required by state laws and regulations, etc.);
 - Employer timely paid the third party payer all the employment taxes due or set aside funds available to pay the taxes in a timely manner (e.g., employer bank records);
 - Employer took reasonable steps to verify the third party payer fulfilled the obligations of the arrangement (e.g., reviewed bank statements, checked the Electronic Federal Tax Payment System (EFTPS)); and
 - Once the employer learned of the third party payer misconduct, it took immediate steps to remedy the problem (e.g., promptly filed any missing returns and

³ If the third party payer is a Certified Professional Employer Organizations (CPEOs), a CPEO customer may not be liable for federal employment taxes imposed on remuneration remitted by the CPEO to employees covered by the customer's contract with the CPEO. More information on the CPEO program is at www.irs.gov/CPEO.

began timely filing and depositing its current employment tax obligations). If the employer did not take immediate steps to remedy the problem, are there mitigating factors that hampered the employer's ability to act (serious illness, natural disaster, etc.)?

Advocating for Employers Affected by Third Party Payer Misconduct

Initial TAS advocacy will stabilize the situation to give the employer and TAS time to propose a collection alternative to resolve the problem. These initial actions may include requesting suspension of collection action (see [IRM 13.1.10.15](#), *Suspending Collection Action*) and recommending withdrawal of a Notice of Federal Tax Lien (see [IRM 5.12.9](#), *Withdrawal of Notice of Federal Tax Lien*).

When the facts show third party payer bad acts caused failure to timely file or pay employment taxes, and the employer acted in a responsible and prudent manner, TAS will advocate for relief. The nature of TAS advocacy will vary **for each tax period** depending on certain facts.

1. Situation 1: The third party payer failed to take certain actions required under its arrangement with the employer, but didn't intercept any funds intended to pay federal employment taxes.
2. Situation 2: The third party payer actions include intercepting funds intended to pay federal employment taxes, but the employer has fully paid the tax due to the IRS by the time the employer sought TAS assistance.
3. Situation 3: The third party payer actions include intercepting funds intended to pay federal employment taxes, and the employer hasn't fully paid the tax due to the IRS by the time the employer sought TAS assistance.

Situation 1: The Third Party Payer Did Not Intercept Any Federal Employment Taxes

For some tax periods, the third party payer may have failed to file returns and make timely deposits or payments, but didn't intercept federal employment taxes. Verify the employer took immediate steps to remedy any problems (e.g., filed required returns and paid the tax) as soon as it learned of the third party payer misconduct.

There is no relief available for interest charged on employment taxes paid late (IRC §6404(e)(1) does not apply to employment taxes). However,

TAS can advocate for the employer's request for penalty relief based on reasonable cause. Most third party payer arrangements don't relieve the employer of its employment tax obligations. Therefore, advocating for relief based on erroneous advice or reliance on a tax advisor is unlikely to be effective. Instead, advocate based on general ordinary business care and prudence.

If the third party payer took steps to conceal its actions from the employer, consider advocating based on inability to obtain records. The records available to the employer may show the employer reasonably believed it met all its obligations. The records that would have revealed it had unmet obligations were not obtainable because the third party payer concealed them from the employer.

If a revenue officer conducts a Trust Fund Recovery Penalty (TFRP) investigation, advocate for non-assertion of the TFRP on the responsible persons in the employer's organization. Depending on the type of third party payer arrangement used, the revenue officer may be able to assess the TFRP against responsible persons within the third party payer.

References

[IRM 20.1.1.3.2](#), *Reasonable Cause*;
[IRM 20.1.1.3.2.2](#), *Ordinary Business Care and Prudence*;
[IRM 20.1.1.3.2.2.3](#), *Unable to Obtain Records*;
[IRM 20.1.1.3.2.2.4](#), *Mistake Was Made*;
[IRM 20.1.1.3.2.2.5](#), *Erroneous Advice or Reliance*;
[IRM 20.1.1.3.3.4.3](#), *Advice from a Tax Advisor*;
[IRM 20.2.7.4](#), *Unreasonable Error or Delay in Performing a Ministerial or Managerial Act - IRC §6404(e)(1)*; and
[IRM 5.1.24.5.8](#), *TFRP Investigations*.

Situation 2: The Employer Has Full Paid the Tax to the IRS

By the time some employers seek TAS assistance, they may have fully paid the tax on the account, even though they paid the full amount to the third party payer as well. From the employer's perspective, they have paid the tax twice. However, the employer is not entitled to a refund because they are still liable for the tax. There is no mechanism under the law to file an offer in compromise (OIC) on taxes already paid.

In most of these cases, advocating for penalty abatement, using the same references and advocacy approach as discussed in Situation 1 above, will achieve the best result for that tax period. Work with the employer to analyze the situation and advocate for what makes sense.

Example 1: A third party payer intercepted \$10,000 in tax deposits intended for the employer's Form 941, *Employer's Quarterly Federal Tax Return*, failed to file the return as required by the third party payer contract, and hid both actions from the employer. The employer discovered the bad acts, filed a correct Form 941 and paid the \$10,000 tax due (again) to the IRS. However, the employer still owes \$2,500 in penalties and \$400 interest. The interest will decrease to \$300 if the IRS abates the penalties. The employer determines the cost of preparing the OIC and paying the user fee is not cost effective when the IRS can only compromise \$300 in interest. TAS advocates for penalty abatement.

If the interest charges are significant enough that it would be cost effective to file an offer compromising on the interest, refer to Situation 3 below.

In addition, discuss with the employer whether paying the IRS the same amount of funds that were improperly intercepted by the third party payer caused problems for the employer in other tax periods. For example, the employer may be unable to pay a current tax liability because it used those funds to pay the IRS for a tax period where the third party payer improperly intercepted the original funds intended for that employment tax liability. Advocate for resolution of the balance owed for the current tax period (installment agreement, currently not collectible, or doubt as to collectibility offer in compromise) based on the relevant facts and the option chosen by the employer.

Situation 3: The Employer Has Not Fully Paid the Tax to the IRS

To assist victims of third party payer fraud, Congress enacted Section 106 of the Omnibus Appropriations Bill in 2014, stating the "Internal Revenue Service shall give special consideration to an offer-in-compromise from a taxpayer who has been the victim of fraud by a third party payroll tax preparer." The IRS recently revised IRM 5.8.11 to reflect this provision. The IRM chapter discusses the special consideration given to victims of third party payer fraud and explains how offer specialists investigate and expeditiously process offers submitted by taxpayers affected by third party payer fraud.

If the employer has unpaid tax for the tax period, consider an offer in compromise (OIC). An OIC can cover the tax, interest, and penalties imposed on the employer. If the employer has unpaid tax for the tax period, consider an offer based on doubt as to collectibility with special circumstances. If the taxpayer does not qualify for a doubt as to collectibility with special circumstances, then consider making an effective tax administration (ETA) offer based on economic hardship. If the

taxpayer does not qualify for such an offer, then consider making an ETA offer based on public policy or equity considerations. Factors establishing special circumstances are the same as those considered under ETA:

- Economic hardship (applies to sole proprietorships only);
- Public policy; or
- Equity.

The employer may offer less than the tax owed, seeking to compromise all penalties and interest, along with some of the tax, based on equity factors. When advocating that the IRS accept the offer, note that acceptance will not result in any financial gain or unfair advantage to the employer over its competitors. Based on communications with the taxpayer, identify the amount of funds intercepted by the third party payer that was intended as payment for the original IRS liability. From the employer's perspective paying even a small fraction of these funds twice (once to the third party payer, and again to the IRS) is an additional burden on the employer.

Discuss with the employer to see if paying the federal employment taxes to the IRS will create hardships for individuals or the community. Will the employer have to lay off some employees? Will the employer have to curtail activities that benefit the community or the local economy? Identify these issues in the TAS recommendation. The IRS considers these factors as compelling public policy factors that favor acceptance. However, these hardship or community elements do not have to be present for TAS to advocate for acceptance of an offer of an amount less than the tax owed if compelling equity factors exist.

Highlight any efforts the employer made to mitigate the loss through collection or civil action against the third party payer. If the IRS is concerned that the employer may receive reimbursement in the future, advocate that the IRS accept the agreement but also secure a collateral agreement for payment from any future recovery.

Alternatively, if the employer submits an offer for the full amount of the remaining tax, exclusive of penalty and interest, financial statements, Forms 433-A (OIC), *Collection Information Statement for Individuals*, and 433-B (OIC), *Collection Information Statement for Business*, are not required (see [IRM 5.8.11.5\(3\)](#), *Documentation and Verification*).

If a revenue officer conducts a Trust Fund Recovery Penalty (TFRP) investigation, advocate for non-assertion of the TFRP on the responsible persons in the employer's organization. Depending on the type of third party payer arrangement used, the revenue officer may be able to assess the TFRP against responsible persons within the third party payer. An investigation of the third party payer or individuals within it for TFRP

purposes will not delay the consideration or acceptance of an OIC from the employer.⁴

Due to the complex collection issues involved with third party payer misconduct and ETA OICs, consider making a referral to a Revenue Officer Technical Advisor (ROTA) for guidance.

Example 2: An employer contracted a third party payer to handle all payroll tax matters. The employer chose a third party payer that had been in business for several years and contacted other businesses using the third party payer who stated the third party payer operated appropriately. When the IRS contacted the employer about the delinquency, the employer immediately started making federal tax deposits. No factors weigh against offer acceptance (compliance history, the state has no third party payer bonding requirements, etc.). Since the employer acted in a reasonable manner, TAS advocates for IRS acceptance of the ETA OIC.

References

[IRM 5.1.24](#).5.7, *Offers in Compromise*;
[IRM 5.8.11](#).2.2.1, *Public Policy or Equity Compelling Factors*;
[IRM 5.8.11](#).4.2, *Financial Statement Analysis*;
[IRM 5.8.11](#).4.3, *Determining an Acceptable Offer Amount*;
[IRM 5.8.11](#).4.3.1, *Determining an Acceptable Offer Amount (Fraudulent Acts of a PSP)*;
[IRM 5.8.11](#).5, *Documentation and Verification*; and
[IRM 5.1.24](#).5.8, *TFRP Investigations*.

Coordination with Systemic Advocacy

If you identify a third party payer misconduct case where the actions of the third party payer affected multiple clients, notify your manager and add a submission to the Systemic Advocacy Management System (SAMS). The SAMS submission should include:

- The phrase “Refer to Task Force 33726” in the SAMS description;
- Case number(s) of the third party payer misconduct cases linked to this particular third party payer;
- Whether a list of the third party payer’s victims exists (from a CI investigation, criminal indictment, media reports, etc.), and whether you have a copy of that list; and

⁴ [IRM 5.8.11](#).5 (3), *Documentation and Verification*.

- Do not put any personally identifiable information (PII) on SAMS.

Reporting third party payer misconduct via SAMS is important so the IRS (especially Field Collection) learns of all potential victims of third party payer misconduct, and can coordinate fair and equitable treatment of the third party payer clients (especially those not in TAS). See [IRM 5.1.24.5.1, Assignment of Third-Party Payer Client Cases](#). If third party payer misconduct victims are localized to a particular location, Systemic Advocacy may contact the local LTA to coordinate help for non-TAS taxpayers.

Educate Employers to Limit Future Third Party Payer Problems

- If the employer receives a CP 148A or CP 148B notice of an unauthorized address change, advise the employer to contact the IRS immediately. The IRS sends a notice to both the old and new address to protect taxpayers from unauthorized address changes made by third parties. An incorrect address means the employer will not receive future notices about balances due, penalty assessments, or unfiled returns.
- Recommend the employer monitor third party payer withdrawals from their bank accounts and use their [Electronic Federal Tax Payment System \(EFTPS\) Inquiry PIN](#) to verify payments made by a third party on the employer's behalf.
- A summary of the steps the employer can take to protect themselves appears in the [Tax Toolkit](#) at [Third Party Arrangements for Employment Taxes](#).
- Further information can be found by searching for "outsourcing payroll duties" on www.irs.gov.

Case Coding

Use the National Office Use (N.O. Use) code "PSP" to identify cases involving taxpayers affected by third party payer misconduct.

Effect on other documents

TAS will incorporate this guidance into the next revision of [IRM 13.1.24, Advocating for Case Resolution](#).

Contact

Please contact Michael Kenyon, Deputy Executive Director of Case Advocacy, Technical Support and Guidance, at (701) 237-8299, if you have questions.