



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

5.1.24

MARCH 2, 2018

EFFECTIVE DATE

(03-02-2018)

PURPOSE

- (1) This transmits revised IRM 5.1.24, *Field Collecting Procedures, Third-Party Payer Arrangements for Employment Taxes*.

MATERIAL CHANGES

- (1) Minor editorial changes made throughout the text.
- (2) Updated legal references, IRM references and linkages where necessary.
- (3) IRM 5.1.24.1 expanded from Overview to Program Scope and Objectives.
- (4) IRM 5.1.24.4 Updated to include Certified Professional Employer Organizations.
- (5) IRM 5.1.24.4.4.1(2) Deleted reference to paper return Schedule R filing requirement for agents filing for 1,000 or more clients.
- (6) IRM 5.1.24.5(1) Added language concerning consolidation of related cases for assignment.
- (7) IRM 5.1.24.5(2) Added language on consideration of penalty abatement for victims of payroll service provider failure or fraud.
- (8) IRM 5.1.24.5(3) Added language on personal liability under IRC 6672 for victims of payroll service provider failure or fraud.
- (9) IRM 5.1.24.5(4) Added language to require revenue officers address compliance of adversely impacted TPP clients.
- (10) IRM 5.1.24.5.1(2) Added language concerning promotion of consistent treatment for similarly situated taxpayers.
- (11) IRM 5.1.24.5.2(4) Added guidance for Letter 4838 on ICS Sub Code 505 PSP client cases.
- (12) IRM 5.1.24.5.2(2) Added language concerning Taxpayer Bill of Rights and the availability of Taxpayer Advocate Service assistance.
- (13) IRM 5.1.24.5.2(3) Added note and IRM citation for Offer in Compromise, Public Policy or Equity Grounds, direction to consider FPLP blocking or releasing for victims of PSP fraud.
- (14) IRM 5.1.24.5.3(1) Content updated to reflect automatic issuance of EFTPS Inquiry PINs.
- (15) IRM 5.1.24.5.5(4) Added content about addressing penalty issues prior to submission of returns.
- (16) IRM 5.1.24.5.6(1) Added language concerning alleged PSP fraud and ETA Offers in Compromise.
- (17) IRM 5.1.24.5.6(4) Added language concerning consideration of additional factors when determining responsibility under IRC 6672 for victims of PSP failure and fraud.
- (18) IRM 5.1.24.5.7 updated with new Offer in Compromise IRM citations

- (19) IRM 5.1.24.5.9(4) Added requirement to notify Area Coordinator when client of TPP alleges liability is the result of TPP fraud or failure.
- (20) IRM 5.1.24.5.9(5) Added example of potential CI impact on TPP client case.
- (21) IRM 5.1.24.5.9(6) Added language concerning review of FPLP FEDCON levy appropriateness in cases of client-victims of fraudulent PSPs.
- (22) IRM 5.1.24.6(5) Changed Counsel point of contact from SBSE to TEGE
- (23) IRM 5.1.24.6.1 Content updated to include additional information about Certified Professional Employer Organizations (CPEO), including the public listings website.
- (24) IRM 5.1.24.6.2 Updated to reference service agreement or contract.
- (25) IRM 5.1.24.6.3 Added guidance for when a PEO claims to be certified
- (26) IRM 5.1.24.6.5(1) Added language relating to request for PEO client list and itemized wage, tax, and payment information at initial contact.
- (27) IRM 5.1.24.6.6 Updated to include Certified Professional Employer Organizations (CPEOs)
- (28) Exhibit 5.1.24-1 Updated to include CPEO information.
- (29) Exhibit 5.1.24-2 New exhibit to list acronyms and definitions.

EFFECT ON OTHER DOCUMENTS

This material supersedes IRM 5.1.24, dated November 06, 2015.

AUDIENCE

SB/SE Collection Employees

Kristen E. Bailey
Director, Collection Policy
Small Business/Self-Employed Division

5.1.24
Third-Party Payer Arrangements for Employment Taxes

Table of Contents

- 5.1.24.1 Program Scope and Objectives
 - 5.1.24.1.1 Background
 - 5.1.24.1.2 Authority
 - 5.1.24.1.3 Responsibilities
 - 5.1.24.1.4 Program Management and Review
 - 5.1.24.1.5 Program Controls
 - 5.1.24.1.6 Terms
 - 5.1.24.1.7 Acronyms
- 5.1.24.2 Employment Taxes
- 5.1.24.3 Employer
 - 5.1.24.3.1 Common Law Employer
 - 5.1.24.3.1.1 Common Law Employer Obligations and Filing Requirements
 - 5.1.24.3.2 IRC 3401(d)(1) Employer
 - 5.1.24.3.2.1 Control of the Payment of Wages
 - 5.1.24.3.2.2 IRC 3401(d)(1) Employer Filing Requirements
- 5.1.24.4 Types of Third-Party Payer Arrangements
 - 5.1.24.4.1 Temporary Staffing Service
 - 5.1.24.4.1.1 Temporary Staffing Service Filing Requirements
 - 5.1.24.4.2 Payroll Service Provider
 - 5.1.24.4.3 Reporting Agent
 - 5.1.24.4.3.1 Reporting Agents File (RAF)
 - 5.1.24.4.4 IRC 3504 Agent
 - 5.1.24.4.4.1 IRC 3504 Agent Filing Requirements
 - 5.1.24.4.5 IRC 3505 Lender, Surety or Other Person
 - 5.1.24.4.5.1 IRC 3505(a)
 - 5.1.24.4.5.2 IRC 3505(b)
 - 5.1.24.4.5.3 Collection Under IRC 3505
- 5.1.24.5 Collection Actions in Cases Involving Third-Party Payers
 - 5.1.24.5.1 Assignment of Third-Party Payer Client Cases
 - 5.1.24.5.2 Initial Contact with a Client of a Third-Party Payer
 - 5.1.24.5.3 Use of Electronic Federal Tax Payment System (EFTPS) for Payment Verification
 - 5.1.24.5.4 Unauthorized Changes of Address by Third-Party Payer
 - 5.1.24.5.5 Penalty Abatement for Clients of Third-Party Payers
 - 5.1.24.5.5.1 Reasonable Cause Assistant
 - 5.1.24.5.6 Case Resolution

- 5.1.24.5.7 Offers in Compromise
- 5.1.24.5.8 Trust Fund Recovery Penalty (TFRP) Investigations
- 5.1.24.5.9 Employment Tax Fraud
- 5.1.24.6 Professional Employer Organization (Employee Leasing Company)
 - 5.1.24.6.1 Certified Professional Employer Organization
 - 5.1.24.6.2 Non-Certified Professional Employer Organization
 - 5.1.24.6.3 Impact of a PEO Arrangement on Client
 - 5.1.24.6.4 Pursuing Collection from PEOs
 - 5.1.24.6.4.1 Pursuing Collection from Successor PEO Entities
 - 5.1.24.6.4.2 Injunctive Relief
 - 5.1.24.6.5 Pursuing Collection from PEO Clients

#

Exhibits

- 5.1.24-1 Third-Party Arrangement Chart
- 5.1.24-2 Acronyms

5.1.24.1
(03-02-2018)
Program Scope and Objectives

- (1) **Purpose:** This Internal Revenue Manual (IRM) provides instruction for identifying and resolving taxpayer cases involving a third-party payer (TPP).
- (2) **Audience:** The primary users for this IRM are Collection employees in the Small Business/Self Employed (SBSE) operating division.
- (3) **Policy Owner:** Director, Collection Policy
- (4) **Program Owner:** Collection Policy - Employment Tax Group
- (5) **Primary Stakeholders:**
 - Field Collection
 - Campus Collection
- (6) **Program Goals:** By following the processes and procedures provided in this IRM Collection employees working third-party payer cases will be able to:
 - Determine liability in cases involving third-party payers
 - Take appropriate action to address delinquencies involving third-party payers
 - Assist employers adversely impacted by the fraudulent activity of a third-party payer

5.1.24.1.1
(03-02-2018)
Background

- (1) This IRM section provides a summary of the different types of third-party payer arrangements and procedural guidance for Collection employees investigating employment tax delinquencies involving employers and third-party payers.
- (2) An employer may choose to enter into an agreement with a third party in which the third party performs some or all of the employer's federal employment tax withholding, reporting and payment obligations. Collection issues arise when the third party fails to file returns, make deposits, or pay on behalf of the employer.
- (3) The liability of the employer for employment taxes may shift depending on the type of third-party arrangement.
- (4) Liability is always determined by the provisions of the Internal Revenue Code (IRC or Code) and cannot be altered by a private agreement or contract between an employer (see IRM 5.1.24.3) and a third party.

5.1.24.1.2
(03-02-2018)
Authority

- (1) Authorities related to this section include:
 - IRC 3401, *Definitions*
 - IRC 3504, *Acts to be performed by agents*
 - IRC 3505, *Liability of third parties paying or providing for wages*
 - IRC 3511, *Certified professional employer organizations*
 - IRC 7705, *Certified professional employer organizations*
 - Notice 2017-49
 - Rev. Proc. 2012-32
 - Rev. Proc. 2013-39
 - Rev. Proc. 2017-14
 - Rev. Proc. 2016-33

5.1.24.1.3
(03-02-2018)

Responsibilities

- (1) The Director, Collection Policy is responsible for the policies and procedures within the Collection Third-Party Payer program.
- (2) The Collection Policy - Employment Tax Group is responsible for development and delivery of policies and procedures within the program.
- (3) Collection employees are responsible for implementing these policies and procedures in appropriate situations involving third-party payers.

5.1.24.1.4
(03-02-2018)

Program Management and Review

- (1) Program reviews are conducted on a periodic basis with the use of data from the Integrated Collection System (ICS). ICS and ENTITY systems provide access to reports that can be used to obtain information on employment tax cases in general, including information on case age, case balance, case status, and timeliness of employee actions.
- (2) Program effectiveness is measured through periodic operational and program reviews, including managerial case reviews and National Quality Review System reviews.

5.1.24.1.5
(03-02-2018)

Program Controls

- (1) Program controls to oversee the processing of balance due and delinquent return cases involving third-party payers and their clients are found in IRM 1.4.50, *Resource Guide for Managers, Collection Group Manager, Territory Manager and Area Director Operational Aid*.
- (2) ICS and ENTITY systems provide resources and tools to help employees and management ensure that cases are worked timely and appropriately.
- (3) Collection Area PSP-PEO Coordinators have been designated to facilitate the sharing of information and coordination of issues involving third-party payer cases.
- (4) The Electronic Federal Tax Payment System (EFTPS) serves as a program control, allowing employers to verify payments being made on their behalf by authorized TPPs.

5.1.24.1.6
(03-02-2018)

Terms

- (1) This IRM section contains the following terms:

Defined Terms

Word	Definition
Timely	In accordance with established due dates.

5.1.24.1.7
(03-02-2018)

Acronyms

- (1) See Exhibit 5.1.24-2, *Acronyms*, for list of commonly used acronyms and their definitions.

5.1.24.2
(08-15-2012)

Employment Taxes

- (1) Federal employment taxes are imposed on wages paid to employees and are comprised of the Federal Insurance Contributions Act (FICA) tax, Federal Unemployment Tax Act (FUTA) tax, and income tax withholding (ITW). The Railroad Retirement Tax Act (RRTA) imposes a tax on compensation paid to railroad employees and employee representatives.

- (2) FICA tax is composed of a tax for Old-Age, Survivors, and Disability Insurance (OASDI) and a tax for Hospital Insurance (HI). The OASDI portion of FICA tax is only imposed on wages up to the wage base for OASDI for that year. There is no dollar limit on the amount of wages subject to the HI portion of FICA tax.
- (3) Under IRC 3306(b)(1), FUTA tax is only imposed on the first \$7,000 of wages paid by an employer to an employee in a calendar year.
- (4) There is no dollar limit on the amount of wages subject to ITW.
- (5) The RRTA serves as the functional equivalent of FICA for railroad employers, employees, and employee representatives (a group unique to the railroad industry). Tax under the RRTA is divided into tiers and each tier finances different benefits. Tier 1 RRTA tax provides equivalent social security and Medicare benefits. IRC 3201(a) imposes Tier 1 RRTA on employees and IRC 3211(a) imposes Tier 1 RRTA tax on employee representatives.

5.1.24.3
(08-15-2012)
Employer

- (1) Under IRC 3401(d) an employer is defined as the person for whom an individual performs or performed any services of whatever nature as an employee, except that under IRC 3401(d)(1) if the person for whom the individual performs or performed the services does not have control of the payment of wages for such services, then the term “employer” means the person having control of such wages.

5.1.24.3.1
(08-15-2012)
Common Law Employer

- (1) A common law employer is any person who has the status of employer under the usual common law rules applicable in determining the employer-employee relationship.
- (2) The existence of an employer-employee relationship generally is determined using the common law control test and is based on the facts and circumstances of each case.
- (3) Generally, an employer-employee relationship exists under the common law when the person for whom the services are performed has the right to direct and control the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. In other words, an employee is subject to the will and control of the employer not only as to what shall be done, but how it shall be done. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so.
- (4) To determine whether the common law control test is satisfied in a particular case, the IRS and Social Security Administration (SSA) compiled a list of 20 factors used in court decisions to determine worker status. These 20 factors were published in Rev. Rul. 87-41, 1987-1 C.B. 296, and are sometimes called the twenty-factor test. The twenty-factor test is an analytical tool and not a legal test for determining worker status. The legal test is whether there is a right to direct and control the means and details of the work. Because of the difficulty in applying the twenty-factor test and because business trends have changed over the years, the Service now uses a modified approach with respect to worker classification. Rather than listing items of evidence under the 20 factors, the approach now is to group the items of evidence into the following three main categories:

- **Behavioral control** relates to facts that show whether the business has a right to direct or control how the worker performs the specific tasks for which he or she is engaged, including instructions and training.
- **Financial control** relates to facts that show whether the business has a right to direct and control the financial and business aspects of the worker's activities, including the extent to which the worker has a significant investment, unreimbursed business expenses, or may realize a profit or loss, and the extent to which the worker makes his or her services available to the relevant market.
- **Relationship of the parties** relates to facts that show how the parties perceive their relationship. These facts may include the intent of the parties in establishing the relationship, written contracts, the permanency of the relationship, and the extent to which services performed by the worker are a key aspect of the regular business of the company.

- (5) See IRM 4.23.5, *Technical Guidelines for Employment Tax Issues*, and its exhibits for further information.
- (6) When the common law test outlined in 5.1.24.3.1(4) above is met, the person for whom services are performed is considered the common law employer and the individual who performs the services is considered an employee of the common law employer.

5.1.24.3.1.1
(08-15-2012)

**Common Law Employer
Obligations and Filing
Requirements**

- (1) A common law employer generally is required to deduct and withhold ITW and FICA taxes from wages it pays to its employees under IRC 3402(a) and IRC 3102(a), respectively, and is separately liable for the employer's share of FICA taxes as well as for FUTA taxes under IRC 3111 and IRC 3301, respectively.
- (2) A common law employer who pays compensation subject to the RRTA is required to deduct and withhold taxes from its employees' compensation under IRC 3202, and is separately liable for the employer's share of RRTA tax under IRC 3221.
- (3) A common law employer who pays wages subject to FICA and ITW must file Form 941, *Employer's QUARTERLY Federal Tax Return* (or other Form 94X series return as applicable). See IRM 21.7.2, *Employment and Railroad Tax Returns*, for additional information on Form 94X series returns.
- (4) A common law employer who pays wages subject to FUTA must file Form 940, *Employer's Annual Federal Unemployment Tax Return*. See IRM 21.7.3, *Unemployment Taxes*, for additional information on Form 940.
- (5) A common law employer who pays compensation subject to RRTA must file Form CT-1, *Employer's Annual Railroad Retirement Tax Return*. See IRM 21.7.2.6, *CT-1, CT-2 Railroad Tax Returns*, for additional information on Form CT-1.
- (6) A common law employer must file Forms W-2, *Wage and Tax Statement*, and Form W-3, *Transmittal of Wage and Tax Statements*, with the SSA and furnish a Form W-2 to each employee, reporting the amount of wages and taxes withheld.
- (7) A common law employer must obtain an employer identification number (EIN) using Form SS-4, *Application for Employer Identification Number*, for use in filing employment tax returns, depositing taxes, and filing information returns with the SSA and employees. An EIN is a nine-digit number used by the IRS to

identify tax accounts of employers. See IRM 21.7.13, *Assigning Employer Identification Numbers (EINs)*, for further information.

- (8) Generally, the IRS is not bound by any agreement or contract between a common law employer and a third party that purports to transfer the employment tax obligations of the common law employer to the third party. See also IRM 5.1.24.3.2 and IRM 5.1.24.6.1.
- (9) Employment tax obligations to withhold, report, and pay employment taxes are derived with reference to the common law employer.
- (10) IRC 3401(d)(1) describes one very limited circumstance where a third party who is not the common law employer is treated as the employer for purposes of satisfying the employment tax obligations. See IRM 5.1.24.3.2.

5.1.24.3.2
(08-15-2012)
IRC 3401(d)(1) Employer

- (1) IRC 3401(d)(1) provides that if the person for whom the individual performs or performed the services does not have control of the payment of wages for such person, the term “employer” means the person having control of the payment of such wages.
- (2) In those limited circumstances when the common law employer does not have control of the payment of wages, the person having control of the payment of wages will be considered the employer who has the obligation to withhold, report, and pay employment taxes.
- (3) While IRC 3401(d)(1) is a federal income tax withholding provision, courts have applied the IRC 3401(d)(1) definition of employer to determine the liability for the withholding and payment of FICA and FUTA taxes. See, e.g., *Otte v. United States*, 419 U.S. 43 (1974); *In re Armadillo Corp. v. Ennis.*, 561 F.2d 1382 (10th Cir. 1977). Due to the similarity in the purpose and scope of RRTA to the purpose and scope of the FICA, the same definition also applies to RRTA taxes. Thus, an IRC 3401(d)(1) employer is responsible for withholding, reporting, and paying ITW, FICA, FUTA and RRTA taxes.
- (4) A person in control of the payment of wages is commonly referred to as the “section 3401(d)(1) employer” or the “statutory employer”.

5.1.24.3.2.1
(08-15-2012)
Control of the Payment of Wages

- (1) A third party is the section 3401(d)(1) employer only if it has exclusive control over the payment of wages. Treasury Regulation 31.3401(d)-1(f) provides that the term “employer” means the person having legal control of the payment of the wages. If it shares control with the common law employer, then the third party is not a section 3401(d)(1) employer.
- (2) Whether or not a third party is in control of the payment of wages depends upon the facts and circumstances. Generally, the IRS considers a third party to be in control of the payment of wages if the payment is not contingent upon, or proximately related to, the third party having first received funds from the employer. Conversely, if the payment of wages is contingent on, or proximately related to, the common law employer’s transfer of funds to the third party, the Service considers the common law employer to be in control of the payment of wages. Thus, the common law employer remains obligated to withhold, report, and pay employment taxes.

- (3) The determination of whether a third party is a section 3401(d)(1) employer is based on the facts and circumstances. The third-party payer could be a section 3401(d)(1) employer for some payments and not for others.
- 5.1.24.3.2.2
(08-15-2012)
IRC 3401(d)(1) Employer Filing Requirements
- (1) A section 3401(d)(1) employer is obligated to withhold, report, and pay employment taxes, as if it was the common law employer using its own EIN. See IRM 5.1.24.3.1.
- (2) If a third-party payer controls the payment of wages within the meaning of section 3401(d)(1) for more than one common law employer, it must file employment tax returns that include all wages it paid on behalf of all of the common law employers' employees for the year.
- (3) The section 3401(d)(1) employer is not required to identify any common law employers on its returns.
- (4) Although a section 3401(d)(1) employer is liable for the payment of employment taxes, the determination of whether an employee has wages as defined by the FICA, FUTA, or ITW provisions of the Internal Revenue Code is made by reference to the common law employer. Thus, if an employee has multiple common law employers during a calendar year, the section 3401(d)(1) employer must apply a separate FICA and FUTA wage base for each common law employer. See *Cencast Services v. United States*, 62 Fed.Cl. 159 (2004), **aff'd.**, 729 F.3d 1352, 1360 (Fed. Cir. 2013), **cert. denied**, 134 S. Ct. 2841 (2014).
- (5) Similarly, the determination of whether an employee is engaged in employment as defined by the FICA or FUTA is made by reference to the common law employer. See *Blue Lake Rancheria v. United States*, 653 F.3d 1112 (9th Cir. 2011).
- (6) A section 3401(d)(1) employer must file Forms W-2 and W-3 with the SSA and furnish a Form W-2 to each employee, reporting the amount of wages and taxes withheld using its own EIN.
- 5.1.24.4
(03-02-2018)
Types of Third-Party Payer Arrangements
- (1) A common law employer or a section 3401(d)(1) employer may use a third party to perform some or all of the employer's federal employment tax withholding, reporting, and payment obligations. Additionally, the common law employer's use of a section 3401(d)(1) employer is itself a type of third-party payer arrangement.
- (2) There are a variety of third-party payer arrangements. The most common are:
- IRC 3401(d)(1) Employer (IRM 5.1.24.3.2)
 - Temporary Staffing Service
 - Payroll Service Provider
 - Reporting Agent
 - IRC 3504 Agent
 - IRC 3505 Lender, Surety, or Other Person
 - Professional Employer Organization (PEO)
 - Certified Professional Employee Organization (CPEO)
- (3) See Exhibit 5.1.24-1 for a chart illustrating the differences between a payroll service provider, reporting agent, IRC 3504 agent and CPEO.

5.1.24.4.1
(08-15-2012)
**Temporary Staffing
Service**

- (1) A temporary staffing service (TSS) provides workers to supplement a firm's workforce for a short or indefinite period to address conditions such as employee absences, temporary skill shortages, or seasonal workloads. Typically, a TSS recruits and, in some cases, trains workers and assigns them to a firm/client on a non-permanent basis. The TSS also controls the payment of the workers' wages and provides the workers with other benefits.
- (2) Workers provided by a TSS traditionally make up only a small portion of the TSS client's workforce and usually perform services for the client for a brief period.
- (3) After a worker completes work for one client, the TSS typically reassigns workers to a different client.

5.1.24.4.1.1
(08-15-2012)
**Temporary Staffing
Service Filing
Requirements**

- (1) A TSS who recruits, trains, and controls the job assignments of the workers and sets the workers' wages is likely to be the common law employer of the workers it provides to a client. When a TSS is the common law employer of workers it provides to a client, the TSS must withhold, report, and pay employment taxes consistent with its status as a common law employer. See IRM 5.1.24.3.1.
- (2) When the TSS is a common law employer of workers provided by the TSS to the client, the client has no employment tax liability related to the workers provided by the TSS.
- (3) Even though the workers may provide services for multiple clients of the TSS during the year, the TSS as the common law employer uses a single FICA and FUTA wage base when computing taxes.
- (4) The TSS, who is a common law employer of workers it provides to a client, must file Forms W-2 and W-3 with the SSA and furnish a Form W-2 to each employee, reporting the amount of wages and taxes withheld using its own EIN.

5.1.24.4.2
(08-15-2012)
Payroll Service Provider

- (1) A payroll service provider (PSP) is a third party that can help an employer administer payroll and employment taxes on behalf of an employer.
- (2) An employer may enter into an agreement with a PSP under which the employer authorizes the PSP to perform one or more of the following acts on the employer's behalf:
 - Prepare the paychecks for the employees of the employer.
 - Prepare Forms 940 and 941 for the employer using the employer's EIN.
 - File Forms 940 and 941 for the employer, which are signed by the employer.
 - Make federal tax deposits (FTDs) and federal tax payments and submit this information for the taxes reported on the Forms 940 and 941.
 - Prepare Form W-3 and Forms W-2 for the employees of the employer using the employer's EIN.
- (3) A PSP is not liable for an employer's employment taxes as either an employer or an agent.
- (4) An employer's use of a PSP does not relieve the employer of its employment tax obligations or liability for employment taxes.

5.1.24.4.3
(11-06-2015)
Reporting Agent

- (1) A reporting agent is a type of PSP. See IRM 5.1.24.4.2.
- (2) An employer may enter into an agreement with a reporting agent under which the employer authorizes the reporting agent to perform one or more of the following acts on the employer's behalf:
 - Sign and file, often electronically, certain tax returns, such as Forms 940 and 941, using the EIN of the employer.
 - Make FTDs and federal tax payments, including using the Electronic Federal Tax Payment System, using the EIN of the employer.
 - Submit FTD and federal tax payment information, including to EFTPS, using the EIN of the employer.
 - Receive duplicate copies of official notices, correspondence, deposit requirements, and transcripts of certain other information.
- (3) The IRS has prescribed Form 8655, *Reporting Agent Authorization*, as the appropriate authorization form for employers to designate a PSP as a reporting agent. See Rev. Proc. 2012-32 and Pub 1474, *Technical Specifications Guide for Reporting Agent Authorization and Federal Tax Depositors*, for further information.
- (4) A reporting agent may act for more than one employer, but must submit a separate Form 8655 for each employer.
- (5) To authorize a reporting agent to sign and file paper Forms 940 and 941 on the employer's behalf, an employer must provide the Service with a completed Form 2848, *Power of Attorney and Declaration of Representative*.

Note: A reporting agent has the authority to file amended forms on paper for any form it filed electronically for the employer.

- (6) A reporting agent does not have to complete the paid preparer section of a Form 941 unless it offers legal advice to its client.
- (7) An employer's use of a reporting agent does not relieve the employer of its employment tax obligations or liability for employment tax.
- (8) Also see IRM 5.1.23.3.4, *Authority Granted by Form 8655*, for additional information.

5.1.24.4.3.1
(11-06-2015)
Reporting Agents File (RAF)

- (1) Forms 8655 are processed to the Reporting Agents File (RAF) maintained by the Ogden Accounts Management Campus.
- (2) Form 8655 information can be researched using the Integrated Data Retrieval System (IDRS) command code RFINK.
- (3) For more information on Form 8655 and RFINK, see IRM 21.3.9, *Taxpayer Contacts, Processing Reporting Agents File Authorizations*.

5.1.24.4.4
(03-02-2018)
IRC 3504 Agent

- (1) IRC 3504 provides that if a fiduciary, agent, or other person has control, receipt, custody, or disposal of, or pays wages to employees, the Service is authorized to designate the fiduciary, agent, or other person as an agent of the employer.

- (2) This agent of the employer is commonly referred to as a “section 3504 agent”, a “Form 2678 agent”, or an “aggregate filer” (although “aggregate filer” may also refer to CPEOs).
- (3) The IRS has prescribed Form 2678, *Employer/Payer Appointment of Agent*, as the appropriate authorization form for employers to authorize a person as a section 3504 agent. See Rev. Proc. 2013-39 for further information.
- (4) A section 3504 agent may act as agent for more than one employer, but each employer must submit a separate Form 2678 seeking IRS approval.
- (5) Once approved, a section 3504 agent may file the following returns on the employer’s behalf:
 - Form 941, *Employer’s QUARTERLY Federal Tax Return*
 - Form 943, *Employer’s Annual Federal Tax Return for Agricultural Employees*
 - Form 944, *Employer’s ANNUAL Federal Tax Return*
 - Form 945, *Annual Return of Withheld Federal Income Tax*
 - Form CT-1, *Employer’s Annual Railroad Retirement Tax Return*
 - Form CT-2, *Employee Representative’s Quarterly Railroad Tax Return*
- (6) Generally, an employer can not appoint a section 3504 agent to report, deposit, and pay taxes reported on Form 940, unless the employer is a home care service recipient (HCSR). See Rev. Proc. 2013-39, for further information.
- (7) See IRM 21.7.2.4.11.3(2) and (3) for more information on home care service recipients and section 3504 agents that act on behalf of HCSR employers.
- (8) Since January 2007, a TC 971 Action Code 382, 383, 384, or 385 is input to the employer’s account to indicate the appointment of a section 3504 agent. This 971 transaction code is displayed on IDRS Command Codes ENMOD and BMFOL“E”. It contains a cross reference to the section 3504 agent’s EIN.
- (9) Both the section 3504 agent and the employer are liable for the employer’s employment taxes while the agent authorization is in effect.

5.1.24.4.4.1
(11-06-2015)
IRC 3504 Agent Filing Requirements

- (1) A section 3504 agent must file an aggregate return for each tax-return period on behalf of the employers it represents, using the section 3504 agent’s own EIN and address.
- (2) Beginning with tax year 2010, a section 3504 agent filing an aggregate Form 941 on behalf of one or more employers must attach a *Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers*, to the Form 941. The Schedule R (Form 941) provides the IRS with client-specific information to support the totals reported by an agent on an aggregate Form 941. The Schedule R (Form 941) includes a list of employers as well as a breakdown of the payroll liability of each employer to support the aggregate totals reported by the agent on the Form 941. A section 3504 agent may file Form 941 electronically or by paper submission. Schedule R (Form 941) information is currently stored in the Servicewide Employment Tax Research System (SWETRS). See IRM 21.7.2.4.4.3, *Loose Schedule R (Form 941): Allocation Schedule for Aggregate Form 941 Filers*, for further information.
- (3) A section 3504 agent approved to file an aggregate Form 940 on behalf of one or more HCSR employers must attach a *Schedule R (Form 940), Allocation*

Schedule for Aggregate Form 940 Filers, to the Form 940. The Schedule R (Form 940) includes a list of HCSR employers as well as a breakdown of the payroll liability of each HCSR employer to support the aggregate totals reported by the agent on the Form 940. See IRM 21.7.3.4.6.1, *Schedule R (Form 940): Allocation Schedule for Aggregate Form 940 Filers*, for further information.

Note: The Schedule R (Form 941) and Schedule R (Form 940) are not interchangeable.

- (4) Generally, a section 3504 agent must file Forms W-2 and W-3 with the SSA and furnish a Form W-2 to each employee, reporting the amount of wages and taxes withheld using its own EIN. (Special rules apply if the section 3504 agent is acting as an agent for two or more employers and pays social security wages to an employee in excess of the social security wage base).

5.1.24.4.5
(08-15-2012)
**IRC 3505 Lender, Surety
or Other Person**

- (1) Under IRC 3505, lenders, sureties, or other persons who are not employers may be personally liable for withheld taxes due. This can be an alternative means of collecting the withheld taxes.

5.1.24.4.5.1
(08-15-2012)
IRC 3505(a)

- (1) Under IRC 3505(a), a third party that pays wages directly to employees of an employer may be personally liable for an amount equal to the full amount of withholding taxes due under the FICA, RRTA, and/or ITW provisions of the Code.
- (2) See also IRM 5.17.7.2.1, *Liability for Direct Payment of Wages - IRC 3505(a)*.

5.1.24.4.5.2
(08-15-2012)
IRC 3505(b)

- (1) Under IRC 3505(b), a third party that supplies funds to an employer for the specific purpose of paying wages to the employer's employees may be personally liable for the withholding taxes under the FICA, RRTA and/or ITW provisions of the Code. However, the liability will not exceed 25% of the amount supplied for the payment of wages.
- (2) The following two conditions must exist:
- The third party must know the funds advanced are to be used specifically for the payment of wages, and
 - The third party must have actual notice or knowledge at the time the funds are advanced that the employer does not intend to or will not be able to pay the withheld taxes.
- (3) See also IRM 5.17.7.2.2, *Liability When Funds are Supplied - IRC 3505(b)*.

5.1.24.4.5.3
(08-15-2012)
**Collection Under IRC
3505**

- (1) The assertion of liability on a lender, surety, or other person under IRC 3505 does not relieve the employer from liability. However, amounts paid to the United States under IRC 3505 will be credited against the liability of the employer. The employer, and not the third party, remains liable to file related employment tax returns and information reporting returns.
- (2) To collect from a lender, surety, or other third party under IRC 3505, the United States must bring suit against the third party within 10 years after the assess-

ment of the tax against the employer. The 10-year collection period is suspended when the collection period against the taxpayer employer is suspended under IRC 6503.

- (3) See IRM 5.1.14.3, *Liability for Third Party Paying Wages or Supplying Funds for Payment of Taxes*, and IRM 5.17.7.2.3, *Collection of Liabilities under IRC 3505(a) and (b)*, for more information.

5.1.24.5
(03-02-2018)
Collection Actions in Cases Involving Third-Party Payers

- (1) The common law employer or section 3401(d)(1) employer is ultimately responsible to withhold, report and pay federal employment taxes. Even though the employer may forward the tax amounts to a third party to make the tax deposits or payments, the employer remains liable unless the third party is the section 3401(d)(1) employer or a CPEO. Generally, the CPEO is solely liable for paying the customer's employment taxes, filing returns, and making deposits and payments for the taxes reported with regard to remuneration it pays to work site employees (as defined in IRC 7705(e)). However, a CPEO and its customer may both be liable with regard to remuneration the CPEO pays to non-worksites employees. For a detailed definition of work site employee, see section 1 of Revenue Procedure 2017-14. See also IRM 5.1.24.6.1. Subject to geographical and resource constraints, whenever possible, cases involving related TPPs suspected of failing to make tax deposits or payments on behalf of clients should be consolidated for assignment (e.g., revenue officer, Field Collection group) to facilitate coordinated collection activity and investigation of potential fraud. (See also, IRM 5.1.24.6.4.1, *Pursuing Collection from Successor PEO Entities*, and IRM 5.1.24.5.9, *Employment Tax Fraud*.)
- (2) If the third party fails to make the federal tax deposits or payments, the IRS may assess penalties and interest on the employer's account subject to the exceptions described in IRM 5.1.24.5(1). The employer is liable for all taxes, penalties and interest due. When it has been established the employer is the victim of payroll service provider failure or fraud, all penalties on periods associated with the failure or fraud will be considered for abatement. See IRM 5.1.24.5.5 for more information.
- (3) Responsible persons of the employer may also be held personally liable under IRC 6672 for certain unpaid federal taxes. See IRM 5.1.24.5.8 for more information. When it has been established that the employer is a victim of payroll service provider failure or fraud, additional factors should be considered when investigating willfulness and responsibility of potentially responsible persons. See IRM 5.1.24.5.8 for more information.
- (4) Revenue officers will document the ICS case history with actions taken to address the compliance of adversely impacted clients for all TPP case assignments (see IRM 5.1.24.5.1, *Assignment of Third-Party Payer Client Cases*).
- (5) For assistance on determining liability in third-party payer situations, contact CC:TEGEDC. If necessary, CC:TEGEDC will coordinate with CC:SBSE area counsel.

5.1.24.5.1
(03-02-2018)
Assignment of Third-Party Payer Client Cases

- (1) Each Collection area has designated an individual to act as a liaison between revenue officers and Collection Policy for the sharing of information and the coordination of PSP and other third-party payer issues. A list of Area Coordinators and their contact information can be found at <http://mysbse.web.irs.gov/Collection/toolsprocesses/EmployTax/tff/contacts/17431.aspx>

- (2) Employment tax non-compliance by a third-party payer may result in a large number of delinquent client accounts. Assignment of these cases, when identified, should be coordinated through the area's PSP/PEO coordinator. Subject to available resources in Field Collection, client cases related to the fraud or failure of a TPP should be consolidated for assignment (e.g., revenue officer, group, territory) to facilitate the issuance of background information and promote consistent treatment. In certain circumstances, the Area PSP/PEO Coordinator may also be able to assist with the identification of a PSP's client list through internal sources and coordinate with Campus Collection to promote consistent treatment of similarly situated taxpayers.
- (3) At the discretion of local management, Letter 4838, *Payroll Service Provider Client*, may be used to make initial contact with clients of a non-compliant payroll service provider. Letter 4838 contains information concerning special consideration available to victims of PSP fraud through the Offer in Compromise program. See IRM 5.1.10.3(4) for procedures regarding the use of appointment letters.
- (4) For cases designated as sub code 505 on ICS (Payroll Service Provider Client), if Letter 4838 is not used to make initial contact it should be generated from the ICS template menu and delivered to the client during initial field contact.

Note: ICS sub code 505 is input to designate and track PSP **client** cases. Do not use sub code 505 for a non-compliant payroll service provider, only for the clients of the non-compliant payroll service provider.

5.1.24.5.2 (03-02-2018)

Initial Contact with a Client of a Third-Party Payer

- (1) In some of these cases, the initial contact by a revenue officer may be the first time the employer is learning of the noncompliance and tax delinquency. Therefore, during initial contact with an employer who may be unaware of non-payment actions of a third-party payer, the revenue officer should be sensitive to the taxpayer's possible situation.
- (2) Taxpayer rights are summarized in the Taxpayer Bill of Rights (*TBOR*), which includes the right to receive assistance from the Taxpayer Advocate Service if the taxpayer is experiencing financial difficulty or if the IRS has not resolved the taxpayer's tax issues properly and timely through its normal channels. See Pub 1, *Your Rights as a Taxpayer*, for more information. Refer to IRM 13.1.7, *Taxpayer Advocate Service (TAS) Case Criteria*, for additional information.
- (3) In addition to following the procedures outlined in IRM 5.1.10.3.2, *Effective Initial Contact*, the revenue officer should encourage the employer's future compliance by:
 - a. Advising the employer it remains responsible for the deposit and payment of employment taxes even though it may have entered into a third-party payer arrangement,
 - b. Discussing the use of EFTPS to verify payments made by a third party on the employer's behalf (see IRM 5.1.24.5.3),
 - c. Reviewing unauthorized changes of address by third-party payers (see IRM 5.1.24.5.4),
 - d. Being alert to information received in discussions with the employer that indicates possible reasons for penalty abatement (see IRM 5.1.24.5.5),
 - e. Discussing an offer in compromise as part of the collection determination (see IRM 5.1.24.5.7),

Note: If the taxpayer demonstrates that the criminal or fraudulent act of a third party is directly responsible for the tax liability, compromise may promote effective tax administration and allow for relief. See IRM 5.8.11.2.2, *Public Policy or Equity Grounds*, for additional information

, and

- f. If the employer is identified as a federal contractor, determining whether the facts and circumstances of the case warrant the blocking or releasing of Federal Payment Levy Program (FPLP) levies (see IRM 5.1.24.5.9).
- (4) When a PSP or reporting agent files returns on behalf of a taxpayer using the taxpayer's EIN, the revenue officer should review the taxpayer's copies of its employment returns, W-2s, and W-3 to determine if these records match the information that has been provided to the IRS and SSA. A tactic used by third-party payers, intent on defrauding clients, is to provide clients with accurate employment tax returns, W-2s, and W-3 while filing employment tax and informational returns with the IRS that understate the amount of wages on which taxes are owed. Checking IDRS Command Code BMFOLU will provide information on filed employment tax returns.
 - (5) When a taxpayer enters into an arrangement where the TPP is not a § 3504 agent (IRM 5.1.24.4.4) or a CPEO (IRM 5.1.24.6.1) and the TPP uses its own EIN to file and pay employment taxes on behalf of the taxpayer, the taxpayer will most likely not have copies of employment tax returns, W-2s, or a W-3 that provide taxpayer-specific information to reconcile with IRS records.
 - (6) If the TPP is a § 3504 agent (IRM 5.1.24.4.4) or a CPEO (IRM 5.1.24.6.1), the TPP is required to file a Schedule R with its aggregate Form 941 that provides taxpayer-specific information. In addition, a CPEO and a § 3504 agent that services a HCSR (IRM 5.1.24.4.4) must file a Schedule R with its aggregate Form 940.

Note: Information contained on filed Schedule R is available from the Service Wide Employment Tax Research System (SWETRS).

5.1.24.5.3
(03-02-2018)
**Use of Electronic
Federal Tax Payment
System (EFTPS) for
Payment Verification**

- (1) An employer should ensure its PSP is using EFTPS so the employer can confirm payments are being made on its behalf. An employer can register on the EFTPS system to get its own PIN and use this PIN to periodically verify payments. On January 24, 2014, EFTPS began issuing Inquiry PINs to new clients of payroll service batch providers if the batch provider client was not already enrolled in EFTPS. An Inquiry PIN allows an employer without an EFTPS account to monitor EFTPS payment submissions made on their behalf by a payroll service provider. A "red flag" should arise the first time a payroll service provider misses or makes a late payment.
- (2) When an employer registers on EFTPS, it will have on-line access to its payment history for 16 months. In addition, registering on EFTPS allows an employer to make tax payments its third-party payer is not authorized to make on its behalf, such as estimated tax payments and FTDs for returns or periods not included in the PSP-employer arrangement.

5.1.24.5.4
(08-15-2012)
**Unauthorized Changes
of Address by
Third-Party Payer**

- (1) When there are issues with a taxpayer's account, the IRS sends correspondence to the employer at the address of record. Generally, the address of record is the master file address that posted from the most recently filed and properly processed return.
- (2) Rev. Proc. 2010–16 describes the various ways taxpayers can give a new address to the Service.
- (3) A third-party payer may sometimes improperly change its client's address of record to that of the third-party payer to limit the client's ability to be informed of tax matters involving its business.
- (4) An employer may grant permission for the third-party payer to receive copies of IRS correspondence by using Form 8821, *Tax Information Authorization*, Form 2848, *Power of Attorney and Declaration of Representative*, or Form 8655, *Reporting Agent Authorization*, as appropriate. See IRM 5.1.23, *Taxpayer Representation*, for additional information. This is not a "change of address", and the employer should continue to receive correspondence.
- (5) An unauthorized change of address made by an employer's third-party payer is a potential indicator of fraud. See IRM 5.1.24.5.9 below for further information on employment tax fraud.
- (6) See IRM 5.1.18, *Locating Taxpayers and their Assets*, for the various locator tools and sources available to revenue officers for locating taxpayers and the procedures for verifying their addresses.

5.1.24.5.5
(03-02-2018)
**Penalty Abatement for
Clients of Third-Party
Payers**

- (1) Depending on the facts and circumstances, the IRS may abate certain penalties such as failure to pay, failure to file and failure to deposit. When working with an employer, practitioner, or PSP to resolve the employer's account, determine whether the facts and circumstances of each individual case meet reasonable cause criteria as discussed in IRM 20.1.1, *Penalty Handbook, Introduction and Penalty Relief*.
- (2) Penalty relief may not be appropriate in all cases. Under no circumstances may interest be removed for reasonable cause. Some factors to consider in evaluating penalty abatement requests in these types of cases are:
 - The employer had sufficient funds available to pay the taxes at the time due, and the third-party payer timely received or debited the funds.
 - The period of time during which the employer was unable to comply with the law due to circumstances beyond the employer's control.
 - The timeliness of the employer's corrective actions, once the employer had actual knowledge of the tax problem(s).
 - The source of the financial problem(s) has been removed (such as the third-party payer has been replaced), and recent compliance clearly demonstrates the tax problem(s) was(were) solely the result of the third-party payer's actions.
 - Documentation supports the facts and circumstances presented by the employer.
- (3) In certain circumstances where the employer has been harmed by its third-party payer, additional factors to consider for meeting reasonable cause include:

- Whether the employer had knowledge of a pattern of noncompliance by the third-party payer at the time the delinquencies were accruing.
- Whether the third-party payer used fraud or deception to conceal the noncompliance from detection by the client.

- (4) To reduce taxpayer burden, whenever possible address penalty issues prior to submission of tax returns for processing.
- (5) For further information on failure to deposit penalties in cases involving third-party payers, see IRM 20.1.4.24.4.1, *Third Party Mishandling*.

5.1.24.5.5.1
(08-15-2012)
Reasonable Cause Assistant

- (1) Use the *Reporting Agent* category in the Reasonable Cause Assistant (RCA) program for consideration of a penalty relief request from an affected employer whose third-party payer failed to pay employment taxes over to the IRS. See also, IRM 20.1.1.3.6, *Reasonable Cause Assistant (RC)*.

5.1.24.5.6
(03-02-2018)
Case Resolution

- (1) An interview should be conducted with the employer to determine the appropriate case resolution. If the employer alleges PSP fraud and does not dispute their ability to pay the liability in full, explain the option to file an offer in compromise based on public policy or equity grounds (ETA) as an alternative to full payment. If there is no PSP fraud, encourage the employer to pay the liability in full to avoid the accrual of penalties and interest and the possibility of filing a Notice of Federal Tax Lien (NFTL). Inform the employer there are also fees associated with entering into an installment agreement or submitting an offer in compromise. The fees for an installment agreement may vary. If an ETA offer based on equity/public policy is accepted, the filing fee is either applied to the offer amount or refunded to the taxpayer. Also, taxpayers who operate as sole proprietors with household income at or below 250 % of the Department of Health and Human Services (DHHS) poverty guidelines are exempt from the offer in compromise fee.
- (2) If the employer is unable to full pay the liability, or alleges PSP fraud and does not dispute their ability to pay the liability in full but opts not to submit an offer in compromise based on public policy or equity grounds, analyze the taxpayer's financial condition to make one or more of the following decisions:
 - a. Make a lien filing determination (IRM 5.12.2.3).
 - b. Enter into an Installment Agreement (IRM 5.14.1).
 - c. Explain other Offer in Compromise provisions (IRM 5.8.1 and IRM 5.1.24.5.7).
 - d. Report the account Currently Not Collectible (IRM 5.16.1).
 - e. Initiate enforcement action if assets are available to pay the liability and the taxpayer is unwilling to resolve its account (IRM 5.10.1).
- (3) When appropriate, deviations from the allowable living expense standards used for financial analysis must be thoroughly documented in the case history (IRM 5.15.1.7).
- (4) If the taxpayer's liability includes trust fund employment taxes, a Trust Fund Recovery Penalty (TFRP) determination must be made. When it has been established that the employer is the victim of PSP fraud, additional factors should be considered when investigating the willfulness and responsibility of potentially responsible persons. See IRM 5.7.4.2, *TFRP Determinations, Interviews, and Investigations*, and IRM 5.1.24.5.8 for further information.

5.1.24.5.7
(03-02-2018)

Offers in Compromise

- (1) An offer in compromise is a legitimate alternative to declaring a case currently not collectible or to a protracted installment agreement. Information regarding types of offers may be found in IRM 5.8.4.2, *Effective Tax Administration (ETA) and Doubt as to Collectibility with Special Circumstances (DATCSC)*, and IRM 5.8.4.3, *Doubt as to Collectibility*.
- (2) For an employer whose liability was affected by the actions of a third-party payer, an offer in compromise with Exceptional Circumstances (ETA) may be a viable collection alternative based on the facts and circumstances of the employer's individual case. The specific considerations for an offer in compromise based on public policy or equity grounds) are outlined in IRM 5.8.11.2.2(4). The Service considers several factors when evaluating offers from impacted businesses; see IRM 5.8.11.4.3.1, *Determining an Acceptable Offer Amount (Fraudulent Acts of a PSP)*.
- (3) A revenue officer who secures an offer in compromise from an employer whose liability was affected by the actions of a third-party payer will write across the top of the original Form 656, *Offer in Compromise*, in red "Payroll Service Provider Offer". The employee will also complete Form 657, *Offer in Compromise/Revenue Officer Report*. The original Form 656, the application fee and the appropriate Tax Increase Prevention and Reconciliation Act (TIPRA) payment, collection information statements with attached substantiation, and the Form 657 must be forwarded within 24 hours to the appropriate Centralized Offer in Compromise campus. See IRM 5.8.1.12.1, *Initial Receipts of Offers Received Elsewhere in the Service*, for additional information regarding the documents which should be submitted with the offer package.

Note: Per the exception in IRM 5.8.11.4.2, *Financial Statement Analysis*, if the fraudulent activity of a PSP caused the delinquency, **and** the offer amount is equal to the full amount of tax, exclusive of penalty and interest, financial statements (Form 433-B(OIC) and/or Form 433-A(OIC)) are not required.

5.1.24.5.8
(08-15-2012)

**Trust Fund Recovery
Penalty (TFRP)
Investigations**

- (1) Under IRC 6672, the TFRP may be recommended against any person required to collect, account for, and pay over taxes held in trust (a responsible person) who willfully fails to perform any of these activities. In cases involving third-party payer arrangements, potentially responsible persons may include:
 - Payroll Service Provider
 - Responsible parties within a PSP
 - Professional Employer Organization
 - Responsible parties within a PEO
 - Responsible parties within the common law employer (client of PSP/ PEO)
- (2) Each recommendation for assertion of the TFRP against a third-party payer that is a related responsible person (RRP) must stand on its own merits based on the facts discovered during the TFRP investigation regarding "responsibility" and "willfulness".
- (3) Factors to be considered when determining the potential "responsibility" and "willfulness" of a third-party payer are:
 - **Responsibility**
Identification of the person(s) within the third-party payer who had significant control over the payment of the client's employment taxes.

- **Willfulness**

Willful means intentional, deliberate, voluntary, reckless, knowing, as opposed to accidental. No evil intent or bad motive is required.

- (4) Factors to be considered for establishing “responsibility” and “willfulness” of a responsible person within a common law employer/client where there is a third-party payer arrangement are:

- **Responsibility**

The use of a third-party payer such as a PSP or a PEO does not relieve the common law employer and employees of the common law employer who are responsible for collecting, accounting for, and paying over the common law employer’s employment taxes from the responsibility of ensuring that all of the common law employer’s federal tax obligations are met.

- **Willfulness**

Willfulness means intentional, deliberate, voluntary, reckless, knowing, as opposed to accidental. No evil intent or bad motive is required.

- (5) Additional factors to be considered when determining “willfulness”:

- Whether the responsible person had knowledge of a pattern of noncompliance by the third-party payer at the time the delinquencies were accruing.
- Whether the third-party payer used fraud or deception to conceal the noncompliance from detection by the client.
- Whether the client had received prior IRS notices indicating that employment tax returns had not been filed, or are inaccurate, or that employment taxes had not been paid.
- The actions the client has taken to ensure its federal employment tax obligations have been met after becoming aware of the tax delinquencies, e.g. reporting the problem(s) to the IRS and the proper authorities, ensuring current tax debts have been timely reported and paid, and working with the IRS on a reasonable plan to resolve past debts.

- (6) The same guidance for contacting third parties and for issuing L3164A, as outlined in IRM 5.7.4.2.5, *Third Party Interviews and Third Party Contact Considerations*, applies when working TFRP investigations involving third-party payers.

- (7) Consult with local area counsel in any case involving whether a third-party payer is a responsible person(s) under IRC 6672 for the TFRP.

- (8) See IRM 5.7.3, *Establishing Responsibility and Willfulness for the Trust Fund Recovery Penalty (TFRP)*, IRM 5.7.4, *Investigation and Recommendation of TFRP*, and IRM 5.17.7, *Liability of Third Parties for Unpaid Employment Taxes*, for further information.

5.1.24.5.9
(03-02-2018)
Employment Tax Fraud

- (1) When investigating cases involving unpaid payroll taxes and third-party payer arrangements, revenue officers should be alert for potential indicators of fraud. See IRM 25.1.2, *Recognizing and Developing Fraud*, and IRM 25.1.8.2, *Trust Fund Violations*, for further information.

- (2) When initial indicators of fraud are identified, the revenue officer will discuss the case with the group manager. If the group manager concurs with the fraud potential, the revenue officer should contact the local fraud technical advisor (FTA).
- (3) When there is an indication of multiple clients being harmed by a third-party payer, contact the Area PSP/PEO Coordinator for assistance in identifying the client list through internal sources. A list of Area Coordinators and their contact information can be found at <http://mysbse.web.irs.gov/Collection/toolsprocesses/EmployTax/tff/contacts/17431.aspx>.
- (4) When a client of a third-party payer alleges that their tax liability is the result of TPP fraud or failure, revenue officers will notify their Area PSP-PEO Coordinator. The notification will include the name and EIN of the employer/client, the name and EIN of the TPP, and any pertinent information that will assist the Area Coordinator's research. Depending on the facts and circumstances of each case, the Area Coordinator may recommend assignment of the TPP case for investigation. The Area Coordinator will help coordinate assignment of related cases (see IRM 5.1.24.5.1 above).
- (5) In some instances, revenue officers will be assigned cases involving the clients of a fraudulent third-party payer who is under criminal investigation. There may or may not be a TC 914, Active Criminal Investigation, placed on the client accounts. The presence of a TC 914 on a third-party payer case may impact activities in related client cases.

Example: Criminal Investigation (CI) may request TPP officers not be contacted, impacting the revenue officer's ability to conduct trust fund recovery penalty interviews.

Therefore, it is important to check with Criminal Investigation and see if they have an open case on the third-party payer. When CI has an open investigation, follow procedures for parallel investigations outlined in IRM 5.1.5, *Balancing Civil and Criminal Cases*. Also advise the Area PSP/PEO Coordinator of the parallel investigations.

- (6) When a case involving the client of a fraudulent TPP is identified as a federal contractor or vendor, review IRM 5.11.7.2.6, *Blocking or Releasing FPLP Levy*, to determine whether the facts and circumstances of the case warrant blocking or releasing Federal Contractor (FEDCON) levies. See IRM 5.7.9.3, *Working Federal Contractor Cases*, for additional information.

5.1.24.6
(03-02-2018)

Professional Employer Organization (Employee Leasing Company)

- (1) A professional employer organization (PEO), sometimes referred to as an employee leasing company, enters into an agreement with a client to perform some or all of the federal employment tax withholding, reporting, and payment functions related to workers performing services for the client. A PEO also may manage human resources, employee benefits, workers compensation claims and unemployment insurance claims for the client.
- (2) A PEO may represent to a client that the PEO is the employer of the workers providing services to the client. In these cases, a PEO may not request authorization from the Service on Form 8655 to be a reporting agent, or on Form 2678 to be a section 3504 agent.
- (3) A majority of states have enacted laws that require licensing of PEOs. Some states may also require each PEO to report its clients to the state. The location

for PEO licensing and reporting of information varies by state. State PEO laws have no bearing on the determination of an entity's liability for federal employment tax purposes.

- (4) The determination of an entity's liability for federal employment tax purposes must be determined under the Code and applicable regulations.
- (5) For assistance on determining liability in PEO situations, contact CC:TEGEDC.

Note: CC:TEGEDC will coordinate with CC:SEBE area counsel if necessary.

5.1.24.6.1
(03-02-2018)
**Certified Professional
Employer Organization**

- (1) The Tax Increase Prevention Act of 2014 (TIPA), enacted December 19, 2014, provides that a certified professional employer organization (CPEO) be treated as the employer of any worksite employee performing services for any customer of such organization, but only with respect to remuneration paid by the CPEO.
- (2) Two new IRC sections were enacted, sections 3511 and 7705, which provide requirements and definitions for CPEOs. The first CPEOs were certified by the IRS with a certification effective date of 01/01/2017. Thus, this IRM provision only applies to returns filed after 01/01/2017.
- (3) Under § 3511(a)(1), a CPEO is treated as the only employer and assumes all employment tax liability and responsibilities for the remuneration it pays to work site employees of its customers. Under § 3511(c)(1), a CPEO is treated as the employer for all remuneration it pays to its customer's non-work site employees, but the customer is also concurrently liable.
- (4) Section 7705 and Treas. Reg. § 301.7705-1T define a certified professional employer organization (CPEO). A CPEO must be certified under the rules prescribed by Treas. Reg. § 301.7705-2T. CPEOs are required to meet tax status, background, financial reporting, and other requirements.
- (5) A CPEO files employment tax returns, W-2s, and a W-3 under its own EIN and must file aggregate Forms 940 and 941, each with an accompanying Schedule R reporting each client's information.
- (6) A CPEO must report the commencement or termination of any service contract using Form 8973. CPEOs also use Form 8973 to identify the forms that the CPEO will file reporting wages or compensation paid to employees performing services for the customer. Form 8973 includes a CPEO Consent to Disclosure of Tax Information, on which the CPEO consents to the IRS disclosing CPEO employment tax return information to the customer to the extent necessary to carry out the purposes of the CPEO program. See Rev. Proc. 2017-14 and IRM 11.3.2, *Disclosure of Official Information, Disclosure to Persons with a Material Interest*, for additional information.
- (7) A listing of organizations certified as CPEOs may be viewed at: <https://www.irs.gov/tax-professionals/cpeo-public-listings>. The link also displays suspended and revoked organizations.
- (8) If a CPEO's certification is suspended or revoked, the CPEO must provide written notice to each of its customers within 10 days of the notice of suspension or revocation.

Note: This is a high level overview of CPEOs. Revenue Officers should look at the following guidance for additional information: Treas. Reg. § § 31.3511-1, 301.7705-1T, 301.7705-2T, Rev. Proc. 2016-33, Notice 2016-49, and Rev. Proc. 2017-14. Revenue Officers may also contact CC:TEGEDC for additional assistance.

5.1.24.6.2
(03-02-2018)

**Non-Certified
Professional Employer
Organization**

- (1) A PEO is not required to become certified under the Code. Those that do not will be subject to current law and enforcement.
- (2) Under final regulations, published at Treas. Reg. § 31.3504-2, and effective for wages paid in quarters beginning after March 31, 2014, if a payor, such as a non-certified PEO, pays wages or compensation to individuals performing services for a client pursuant to a service agreement between the payor and the client, the payor may be designated to perform acts of an employer, including liability for the employer's employment taxes, with respect to the wages or compensation paid by the payor to those individuals.
- (3) Request a copy of the service agreement or contract between the payor and client at initial contact. Include a copy of the contract when seeking CC:TEGEDC opinion or Examination Employment Tax determination on whether a payor may be designated to perform the acts of an employer. CC:TEGEDC will coordinate with CC:SBSE area counsel if necessary. If a payor is designated under Treas. Reg. § 31.3504-2, the payor and employer are concurrently liable for the employer's employment taxes.
- (4) A service agreement is defined in the regulations as an agreement pursuant to which the payor:
 - Asserts it is the employer (or "co-employer") of the individual(s) performing services for the client;
 - Pays wages or compensation to the individual(s) for services the individual(s) perform for the client; and
 - Assumes responsibility to collect, report, and pay, or assumes liability for, any taxes applicable under subtitle C of the Code with respect to the wages or compensation paid by the payor to the individual(s) performing services for the client.

5.1.24.6.3
(03-02-2018)

**Impact of a PEO
Arrangement on Client**

- (1) If the contractual documents provide that the PEO assumes some or all of the employer rights and obligations, in particular with regard to payroll and applicable taxes, a client may believe it is not liable for federal employment tax obligations. However, the rules established in the IRC determine which party is liable for employment taxes, and the Service is not generally bound by any agreement between an employer and a third party.
- (2) Use of a PEO does not relieve a client from its employment tax obligations if the client is the employer of the workers who perform services for the client and the PEO is not the section 3401(d)(1) employer or a PEO. See IRM 5.1.24.3 and IRM 5.1.24.3.2. An employer cannot contract away its responsibility to withhold, report and pay applicable employment taxes. In an employment tax case, a determination of who is the employer determines employment tax liability.
- (3) Whether the client is the common law employer depends on the facts and circumstances, such as whether the client directs and controls the day-to-day

performance of the workers' duties, retains the authority to hire and fire the workers, and sets the hourly wage or salary. A PEO may not exhibit the degree of direction and control over workers providing services to a client to satisfy the common law standard and thus, may not become liable under the Code as the common law employer.

- (4) If a PEO claims to be certified, review IRM 5.1.24.6.1 and <https://www.irs.gov/tax-professionals/cpeo-public-listings> to see if the PEO is listed as a CPEO.
- (5) Depending on the facts and circumstances, a PEO may not be in control of the payment of wages within the meaning of section 3401(d)(1). The Service's position is that an entity is in control of the payment of wages within the meaning of section 3401(d)(1) if the entity pays wages to the employees regardless of whether the common law employer advances funds to pay the wages. Conversely, if the payment of the employees is contingent on, or proximately related to, the transfer of funds from the common law employer to the third party, the third party is not in control of the payment of wages.
- (6) When a PEO files employment tax returns and Forms W-2 using its own name and EIN without identifying its clients or allocating wages to its clients on employment tax returns, the client will not get credit for having paid employment

#

5.1.24.6.4
(08-15-2012)
**Pursuing Collection
from PEOs**

- (1) It is important to secure a copy of the contract or agreement for service from the PEO or its client(s) as part of a collection investigation to determine the relationship between the PEO and its client(s). However, a contract is only representative of the parties understanding of the relationship and is not generally binding on the Service. Even though the contract may attempt to transfer the employment tax obligations to the PEO, the determination of who is the employer is a facts and circumstances analysis. See also, IRM 5.1.24.3.2 and IRM 5.1.24.6.1, and Chief Counsel Advice number 20173502.
- (2) If the facts and circumstances indicate that a PEO is liable for employment taxes, the revenue officer must pursue collection from the PEO. For a discuss-

#

#

- (5) Some PEOs are structured to have one parent company with multiple subsidiaries, each having its own EIN and employment tax filing requirements. Each subsidiary is set up to manage a different group of clients. Clients may be grouped by industry or location. It is important to determine a PEO’s structure, and when appropriate, to conduct cross compliance on all related BMF entities.

5.1.24.6.4.1
(11-06-2015)
**Pursuing Collection
from Successor PEO
Entities**

- (1) One problem encountered with PEOs is the closing of one PEO entity immediately followed by the opening of another PEO entity under a new EIN. The new entity often performs the same type of work and has the same clients, assets, location, and employees operating the new business.
- (2) Once the assets and income of a liable PEO entity have been transferred, the “successor entity” theory may be used to collect from the new PEO entity. For further information on the use of the successor entity theory to collect against transferred assets or from the income and assets of the new entity, see IRM 5.1.30.9, *Successor Entities*.

5.1.24.6.4.2
(11-06-2015)
Injunctive Relief

- (1) When administrative collection actions fail to bring a PEO into compliance, it may be necessary to initiate injunctive relief measures to stop a PEO from pyramiding. See IRM 5.7.2.3, *Referrals for Civil Enforcement*, and IRM 5.17.4.17, *Civil Injunctions Under IRC 7402(a) to Restrain Pyramiding*, for complete procedures.

5.1.24.6.5
(03-02-2018)
**Pursuing Collection
from PEO Clients**

- (1) When a PEO fails to pay employment taxes on wages attributable to any client employees, if the facts and circumstances indicate that the client(s) remained the common law employer(s) and the PEO was not the 3401(d) (1) employer or a CPEO, the Service should attempt to identify the client(s) with unpaid liabilities. At initial contact, revenue officers should request from the PEO a client list with itemized wage, tax and payment information for each delinquent period. Depending on facts and circumstances, it may be possible to assess each client for the full amount of its employment tax liability. See IRM

#

- (4) Once the employment tax is assessed against the client for wages attributable to the client employees prior to April 01, 2014, any corresponding tax liability previously assessed against the PEO under its name and EIN is considered excessive in amount or erroneously assessed (i.e., the excess paid by the PEO) and must be abated. Code section 6404 authorizes the IRS to abate the unpaid portion of the assessment of tax or any liability in respect 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.
- (5) In the absence of a Form 941-X or amended Form 940 submitted by a PEO to remove the excessive or erroneously assessed tax of its client(s) for a tax period ending prior to April 01, 2014, the revenue officer must prepare a separate Form 3870, *Request for Adjustment*, for each client to abate the excessive or erroneously assessed tax. In the Reason for Adjustment box, include the following information:
- PEO Employment Tax Adjustment per IRC 6404**
 - Requested action: Abate tax (TC 150) dated (MM-DD-YYYY) in the amount of (provide amount equal to tax assessed against the PEO client) and abate FTD Penalty **attributable to the tax being abated** (TC 186) dated (MM-DD-YYYY) in amount of (provide amount of FTD penalty).
 - Justification: There can be only one party liable for employment tax prior to April 01, 2014. The PEO is not the employer liable for this tax and the tax was subsequently assessed under this PEO's common law employer client's EIN. Thus, abatement of the tax previously assessed against the PEO is required. Client TXMOD attached. (If available, a client allocation schedule from PEO may also be attached.)

Example: XYZ PEO entered into an agreement with Employer A, effective January 1, 2013. Under the agreement, XYZ PEO hired Employer A's employees as its own employees and provided them back to Employer A to perform services for Employer A. XYZ PEO also assumed responsibility to make payment of the individuals' wages and for the collection, reporting, and payment of applicable taxes. For all pay periods in the first quarter of 2013, Employer A provided XYZ PEO with an amount equal to the gross payroll (that is, wage and tax amounts) of the individuals, and XYZ PEO paid wages (less the applicable withholding) to the individuals performing services for Employer A. XYZ PEO also reported the wage and tax amounts on Form 941 filed for the first quarter of 2013 under XYZ PEO's EIN. Employer A's wage and tax amounts were \$500,000.00 and \$176,500.00 respectively. XYZ PEO did not make any federal tax deposits or payments for the first quarter of 2013, which resulted in unpaid tax of \$176,500.00 for Employer A.

An IRS investigation of XYZ PEO's 941 balance due of \$1 million for the first quarter of 2013 determined the PEO was not the common law employer or section 3401(d)(1) employer of the individuals and Employer A had yet to file a Form 941 for this tax period. The revenue officer assigned the PEO 941 balance due contacted Employer A, advised the employer it remained responsible for the reporting and payment of the taxes for its employees and secured a Form 941 for the first quarter of 2013 under Employer A's EIN. Employer A's Form 941 for the first

Exhibit 5.1.24-1 (03-02-2018)

Third-Party Arrangement Chart

Third-Party Arrangement Authority	Payroll Service Provider (PSP)	Reporting Agent Form 8655 (RA)	IRC 3504 Agent Form 2678 Agent Aggregate Filer	Certified Professional Employer Organization (CPEO)
Can file certain employment tax returns?	Yes. The PSP prepares a separate return for each client using the client's EIN. After employer/client signs the return, either the client or the PSP may file the return on paper.	Yes. The RA signs and is generally required to file electronically a separate return for each client, using the employer's/client's EIN. The RA must e-file returns listed in Rev. Proc. 2012-32 and shown on the Form 8655 authorization request, if the forms are available for electronic filing. Only forms that are not able to be electronically filed can be filed using paper forms.	Yes. The agent files an aggregate return for all employers/clients, using the agent's EIN. The agent can file those returns listed on Form 2678 appointment request.	Yes. The CPEO files an aggregate return for all customers, using the CPEO's EIN. CPEO files those returns listed on Form 8973.
Can make deposits and payments for employment taxes reported on returns?	Yes. The PSP deposits and pays tax liabilities on behalf of each client, using the client's separate EIN, according to each client's deposit requirements.	Yes. The RA deposits and pays tax liabilities on behalf of each client, using the client's separate EIN, according to each client's deposit requirements.	Yes. The agent deposits and pays for tax liabilities the agent has aggregated and reported using the agent's EIN, according to the agent's deposit requirements. Agent can make deposits and payments for those employment taxes reported on returns listed on Form 2678 appointment request.	Yes. The CPEO deposits and pays for tax liabilities the CPEO has aggregated and reported using the CPEO's EIN, according to the CPEO's deposit requirements. The CPEO makes deposits and payments for those employment taxes reported on returns listed on Form 8973.

Exhibit 5.1.24-1 (Cont. 1) (03-02-2018)
Third-Party Arrangement Chart

Third-Party Arrangement Authority	Payroll Service Provider (PSP)	Reporting Agent Form 8655 (RA)	IRC 3504 Agent Form 2678 Agent Aggregate Filer	Certified Professional Employer Organization (CPEO)
Can file Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return?	Yes. After the employer/client signs the return, the client or PSP files separate returns using client's EIN.	Yes. The RA signs and generally files electronically separate returns using client's EIN.	No. Clients must file FUTA tax returns using their own EINs. However, there is an exception for Home Health Care Recipients through a state or local program.	Yes. The CPEO files an aggregate FUTA return for all customers/clients, using the CPEO's EIN.
Has employment tax liability?	No. Employer/Client, not the PSP, remains liable for ensuring all tax returns are filed timely and all deposits and payments are made timely.	No. Employer/Client, not the RA, remains liable for ensuring all tax returns are filed timely and all deposits and payments are made timely.	Yes. Employer/Client and agent are both liable for paying the client's employment taxes, filing returns and making deposits and payments for the taxes reported.	Yes. Generally, the CPEO is solely liable for paying the customer's employment taxes, filing returns and making deposits and payments for the taxes reported with regard to remuneration it pays to worksite employees (as defined in IRC 7705(e)). CPEO and customer may both be liable with regard to remuneration the CPEO pays to non-worksite employees.
Specific guidance in addition to IRC, regulations and Publication 15, Circular E.		Rev. Proc. 2012-32	Rev. Proc. 2013-39, Treas. Reg 31.3504-1	Rev. Proc. 2017-14

Exhibit 5.1.24-2 (03-02-2018)

Acronyms

(1) The table lists commonly used acronyms and their definitions:

Acronym	Definition
CI	Criminal Investigation
CPEO	Certified Professional Employer Organization
DATCSC	Doubt as to Collectibility with Special Circumstances
DHHS	Department of Health and Human Services
EFTPS	Electronic Federal Tax Payment System
EIN	Employer Identification Number
ETA	Effective Tax Administration
FEDCON	Federal Contractor
FICA	Federal Insurance Contributions Act
FPLP	Federal Payment Levy Program
FTA	Fraud Technical Advisor
FTD	Federal Tax Deposit
FUTA	Federal Unemployment Tax Act
HCSR	Home Care Service Recipient
HI	Hospital Insurance
ICS	Integrated Collection System
IDRS	Integrated Data Retrieval System
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
ITW	Income Tax Withholding
NFTL	Notice of Federal Tax Lien
OASDI	Old-Age, Survivor and Disability Insurance
PEO	Professional Employer Organization
PSP	Payroll Service Provider
RAF	Reporting Agents File
RCA	Reasonable Cause Assistant
RRP	Related Responsible Person
RRTA	Railroad Retirement Tax Act
SBSE	Small Business/Self-Employed

Exhibit 5.1.24-2 (Cont. 1) (03-02-2018)**Acronyms**

Acronym	Definition
SSA	Social Security Administration
SWETRS	Service Wide Employment Tax Research System
TAS	Taxpayer Advocate Service
TBOR	Taxpayer Bill of Rights
TEGE	Tax Exempt Government Entities
TFRP	Trust Fund Recovery Penalty
TIPRA	Tax Increase Prevention and Reconciliation Act
TPP	Third-Party Payer
TSS	Temporary Staffing Service