

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Area Counsel 1 (Manhattan)
(Small Business/Self-Employed)

from: Robert A. Miller, Senior Technician Reviewer, Branch 3
Collection, Bankruptcy & Summonses
(Procedure & Administration)

subject: TFRP Calculation -- Sequence of Payment Application for Partial Payments of
Employer Tax Liability in light of Revenue Procedure 2002-26

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

ISSUE

How does the Internal Revenue Service apply partial payments made by a business entity before January 1, 2003 on its Form 941 employer tax liability where the Trust Fund Recovery Penalty ("TFRP") liability has been assessed and the Letter 1153 (DO) has been sent to the responsible person before June 19, 2000?

CONCLUSION

A voluntary partial payment made by a business entity before January 1, 2003 on its Form 941 employer tax liability, where the TFRP liability has been assessed and the Letter 1153 (DO) has been sent to the responsible person before June 19, 2000, will be applied pursuant to the taxpayer's written instructions. A partial involuntary and/or undesignated payment made under the same circumstances will be applied first to the non-trust fund portion of tax, then to assessed lien fees and collection costs, then assessed penalties, then assessed interest, then accrued penalties and accrued interest, and then finally to the trust fund portion of the tax.

LAW AND ANALYSIS

Revenue Procedure 2002-26, 2002-1 C.B. 746, 2002-15 I.R.B. 746, applies to all taxes under the Internal Revenue Code, except alcohol, tobacco, and firearms taxes and harbor maintenance taxes. Rev. Proc. 2002-26 § 2. This guidance states the Service's position regarding the application, by the Service, of partial payments of tax, penalty, and interest to one or more taxable periods. See Rev. Proc. 2002-26 § 1.

Revenue Procedure 2002-26, section 3.02, provides that a voluntary partial payment accompanied by written directions as to its application will be applied pursuant to the taxpayer's written instructions. Revenue Procedure 2002-26, section 3.02, provides that partial payments remitted to the Service without written direction as to the designation will be applied by the Service "in the order of priority that the Service determines will serve its best interest." (emphasis added). Generally, the order of priority that the Service determines will serve its best interest means that undesignated payments are applied first to the liability with the shortest or most imminent statute of limitations for collections, then to the liability with the next shortest statute and so on and so forth.¹

In the context of assessments where the TFRP notice, Letter 1153, was issued prior to June 19, 2000, and the undesignated and/or involuntary partial payment of tax was received through December 31, 2002, the Service determined that it was in its best interest to apply undesignated payments in a manner other than "for successive periods in descending order of priority until the payment is absorbed." Effective for these assessments, the Service applied any undesignated and/or involuntary partial payment of tax received through December 31, 2002 first to the non-trust fund portion of tax, then to assessed lien fees and collection costs, then assessed penalties, then assessed interest, then accrued penalties and accrued interest, and then finally to the trust fund portion of the tax.

Insofar as this policy reflected the Service's interest in maximizing collection of trust fund taxes, it is consistent with Revenue Procedure 2002-26. As noted above, the Service will generally apply undesignated payments "for successive periods in descending order of priority until the payment is absorbed" but the Service is not required to do so if such application does not serve its best interest. Rev. Proc. 2002-26 § 3.02. If a different allocation is determined to be in the Service's best interest, the Service is not required to apply the payment "in descending order of priority."

Once a payment is applied or allocated, however, it should not be moved or reallocated unless the Service determines that the initial application was erroneous, e.g., the payment was designated and it was applied to the wrong period or the payment was obtained pursuant to a levy and it was applied to a period not listed on a levy. A

¹ The tax period or liability with the shortest collection statute is not always the earliest or oldest tax period or liability.

payment should never be moved or reallocated solely to maximize collection potential or to maximize trust fund recovery penalty assessment.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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