



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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR LINDA L. WONG, ASSOCIATE AREA COUNSEL (SBSE) –
DALLAS CC:SB:6:DAL:2

FROM: Robert A. Miller,
Senior Technician Reviewer, Branch 3
(Collection, Bankruptcy Summonses)

SUBJECT: Taxpayer
Your Proposed Employment Tax Injunction Suit Letter of
August 8, 2001, for a Trust Fund Compliance Initiative Case

This Chief Counsel Advice (CCA) responds generally to your office's request of August 8, 2001, that we review and forward to the Tax Division, pursuant to CCDM 34.6.1.3.(2)n, a proposed suit letter requesting that the United States seek an employment tax injunction and other relief against the above-named taxpayer and its principal in a Trust Fund Compliance Initiative (TFCI) case. As described further below, we did not approve the proposed suit letter as submitted by your office and we were unable to modify the proposed suit letter appropriately on our own without communicating with you substantively in writing regarding certain matters described herein that we believe merit further consideration by your office, in consultation with your local client function. In accordance with I.R.C. § 6110(k)(3), this CCA should not be cited as precedent.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

LEGEND

Taxpayer
Taxpayer's Principal
Taxpayer's Predecessor
Year 1
Year 2
Year 3
Year 4
Year 5
Year 6

- Year 7
- Year 8
- Year 9
- Year 10
- Quarter 1
- Quarter 2
- Quarter 3
- Quarter 4
- Quarter 5
- Quarter 6
- Quarter 7
- Quarter 8
- Quarter 9
- Quarter 10
- Quarter 11
- Quarter 12
- Quarter 13 (Q13)
- Quarter 14 (Q14)
- Quarter 15 (Q15)
- Quarter 16 (Q16)
- Quarter 17 (Q17)
- Quarter 18 (Q18)
- Quarter 19 (Q19)
- Quarter 20 (Q20)
- Quarter 21 (Q21)
- Quarter 22 (Q22)
- Quarter 23 (Q23)
- Quarter 24 (Q24)
- Quarter 25 (Q25)
- Quarter 26
- Month 1
- Month 2
- Month 3
- Month 4
- Month 5
- Month 6
- Month 7 (M7)
- Month 8 (M8)
- Month 9 (M9)
- Month 10 (M10)
- Month 11 (M11)
- Month 12 (M12)
- Month 13 (M13)
- Month 14 (M14)
- Month 15 (M15)
- Month 16 (M16)

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Amount 59

In evaluating your office's proposed suit letter for this case, we attempted to go beyond the facts identified in the proposed suit letter itself by also reviewing the three sets of transcripts (for the taxpayer, the predecessor of the taxpayer, and the principal of the taxpayer) and the recent ICS history notes for the taxpayer that were included in the administrative file your office forwarded to us along with the proposed suit letter. Many of our questions and concerns are factual in nature and we have raised them, in part, because our office is not entirely confident of its own ability to interpret and analyze all the information fairly disclosed or suggested by the data entries on these particular documents. Accordingly, the factual discussion below concerns "apparent facts," rather than matters we can confidently say are "facts." Initially, as you know, we had hoped to send your office an annotated chronology of these apparent facts and events, with a request that your office discuss these matters with your local client function and obtain further information as to whether we understand the apparent facts correctly. However, we have been advised that our initial proposed annotated chronology in this case, and the accompanying proposed charts, was close to the line of representing CCA to your office, so we have elected to reformat our prior proposed questions in the manner shown herein. Some of the apparent facts in this case are discussed immediately below in unredacted form, while other apparent facts are discussed in the Hazards & Further Development Suggestions section of this memorandum near the end, which we have redacted for disclosure purposes to the taxpayer and the public on various privilege grounds.

APPARENT FACTS

The taxpayer is a Subchapter S corporation that is apparently owned 100% by the taxpayer's principal. Prior to quarter 11, the taxpayer's business operations were conducted by a predecessor company which was a sole proprietorship that was also owned 100% by the taxpayer's principal. The taxpayer's principal, the taxpayer's predecessor, and the taxpayer each have a long history of failing to comply with the federal tax laws and this interlocking history of non-compliance will likely become a part of the record of the proposed injunction suit, especially if the requested relief is contested by the taxpayer and/or the taxpayer's principal. Accordingly, we have attempted below to recount what we can discern of the interlocking chronology of the Service's various interactions with these three related taxpayers. Please attempt to verify our interpretations and statements of events below with your local client function, and include an appropriately corrected version of these events in the revised proposed suit recommendation letter, if any, that you may eventually forward to us again for pre-review purposes.

Older Background Events

For the first three quarters of year 1, the taxpayer's predecessor company apparently failed to file timely Form 941 returns. These delinquent returns apparently were not filed until date 1, and Notices of Federal Tax Lien (NFTLs) and levies were required to obtain payment of the amounts due by the taxpayer's predecessor for these quarters.

For all four quarters of year 2, the taxpayer's predecessor company also apparently failed to file timely Form 941 returns. Delinquent returns for the first three quarters of year 2 were apparently filed at the same time as the delinquent returns for year 1 (date 1), while the fourth quarter return was filed in date 2. The Service also filed NFTLs for the tax amounts due for these four quarters, and the balances still due on the last three quarters of year 2 were eventually included many years later among the tax periods covered by an offer-in-compromise (OIC) that was submitted by the taxpayer's principal and accepted by the Service, but the OIC was ultimately defaulted. The taxpayer's principal was personally liable for all of these unpaid Form 941 amounts incurred by the taxpayer's predecessor company because the company was then organized as a sole proprietorship which the principal wholly owned and operated.

For the first three quarters of year 3, the taxpayer's predecessor company also failed to file timely Form 941 returns and failed to pay the tax balances due with these returns. During the third quarter of year 3, the taxpayer states that it incorporated. This incorporation of the business was apparently closely preceded by Service collection contacts with the predecessor company, because soon after quarter 10 ended, in date 3, the Service filed its NFTLs against the taxpayer's predecessor for its quarter 1 through 7 Form 941 liabilities, plus a year 2 Form 940 liability.

In year 4, the taxpayer's principal failed to file her year 3 Form 1040 return and the principal ultimately never filed her individual return for this year. The Service eventually audited the taxpayer's principal for this unfiled year 3 return year and assessed an audit deficiency, for which a balance due still apparently remains.

In year 5, the taxpayer's principal again failed to file her year 4 Form 1040 return on time. The Service commenced its audit of the principal's unfiled year 3 return in date 4. In date 5, the Service also filed another set of NFTLs against the apparently then inactive predecessor to the taxpayer for its quarter 8 through 11 Form 941 liabilities and its year 3 Form 940 liability – all debts for which the taxpayer's principal was personally liable. Following the commencement of this audit for an earlier unfiled tax year and the second known round of NFTL filings against the predecessor sole proprietorship company, the taxpayer's principal filed her delinquent year 4 Form 1040 return in date 6, showing an unpaid balance due of about amount 1, plus penalties and interest.

A few months later, in date 7, the Service assessed an audit deficiency against the taxpayer's principal for her unfiled year 3 Form 1040 return year, in amount 2, plus penalties and interest. In date 8, the Service filed NFTLs against the taxpayer's principal for the audit deficiency assessed against her a few months earlier for her year 3 Form 1040 tax and for her delinquently self-assessed, but unpaid balance due for her year 4 Form 1040 taxes. Levies by the Service thereafter followed to attempt to collect these large Form 1040 balances owed by the taxpayer's principal, but the Service's levy proceeds for these Form 1040 liabilities in date 9 totaled less than \$500. About the time of the Service's small levy recoveries for the principal's earlier tax years 3 and 4, the principal filed her year 5 Form 1040 return, on extension, again showing another large balance due of about amount 3, plus penalties and interest. In date 10, the Service filed another NFTL against the taxpayer's principal for her year 5 Form 1040 balance due.

In date 11, the taxpayer's principal filed her year 6 Form 1040 return timely, on extension, and reported withholding credits that were amount 4 in excess of her self-reported individual income tax liability for this year. The apparent year 6 Form 1040 overpayment was retained by the Service at that time through offset procedures for the principal's earlier tax debts. Later, in date 23, the Service eventually determined that the taxpayer's principal had underreported her income and income tax liability for this tax year, and a tax deficiency (amount 5) approximately twice as large as the initial excess withholding credit was assessed by the Service against the principal for this period, plus penalties and interest.

On or about date 12, the taxpayer's principal apparently presented the Service with a proposed OIC which encompassed the principal's Form 1040 liabilities for years 3 through 5 (but not year 6, the year the principal reported an overpayment) and the predecessor to the taxpayer's Form 941 liabilities (for which the principal was personally liable) for quarters 5, 6, 7, 8, and 11. The non-standard terms of the principal's OIC at this time is not something we were able to interpret from the transcripts we reviewed, but we understand that the standard preprinted Form 656

for OICs at this time included a requirement for the principal who submitted the OIC for her past liabilities to stay in compliance with her tax return and payment obligations for the five years following the Service's acceptance of the OIC. While this OIC was pending with the Service, the Service determined that the principal had underreported her income and income tax for her year 5 Form 1040 year (included in the OIC periods) and it assessed a tax deficiency of amount 6 against her for this period in date 13, plus penalties and interest. Nevertheless, on or about date 16, approximately six months after the taxpayer's principal submitted her personal OIC, the Service apparently accepted the OIC. However, within seven months of this acceptance the OIC was considered in default.

More Recent, Pre-TFCI Background Events

About the time the taxpayer's principal submitted her personal OIC to the Service, the taxpayer missed one or more Federal Tax Deposits (FTDs) required for the taxpayer's Form 941 for quarter 13. Since six FTDs were made by the taxpayer for this quarter, the tax balance due of amount 7 for the quarter represented about 19.5% of the total Form 941 tax assessed for the period, but penalties and interest also were assessed by the Service in date 14.

In date 15, the first active revenue officer identified by name to us was apparently assigned to collect the taxpayer's Form 941 liabilities for quarter 13, plus a small amount (amount 8) due for quarter 12. On a field call to the taxpayer's business in date 15, the revenue officer secured a check from the taxpayer's principal for enough to full pay these two quarter balances, but by date 17 the revenue officer was aware that this check had bounced. Even before date 17, this revenue officer received an FTD alert notifying her that the taxpayer was apparently about amount 9 short in its FTDs for the then recently ended Form 941 quarter for quarter 14. The taxpayer made up some of this shortfall with a late FTD after it filed its quarter 14 Form 941, but there remained a tax balance due of amount 10 for this quarter (not including penalties and interest), which represented a shortfall of about 18.5% of the total tax assessed for this quarter.

As previously stated, the OIC of the taxpayer's principal for her personal (individual and sole proprietorship) tax liabilities was apparently accepted by the Service on or about date 16. By date 17, the first active revenue officer described above had been assigned to collect the above-described, remaining shortfalls of the taxpayer for quarters 13 and 14. In date 18, the revenue officer sent the taxpayer a Letter 1058 (Final Notice of Intent to Levy) for these two quarters. As recapped in the pre-TFCI Payments chart shown near the bottom of this section of our memorandum, the Service was eventually able to collect the entire amounts due for these two full quarters through a series of four successive levies on the taxpayer's bank account over a four month period, beginning in date 19 and ending in date 25.

However, while the Service was engaging in a series of pre-levy notices and levies on the taxpayer's bank account in order to satisfy the taxpayer's employment tax liabilities for these earlier Form 941 quarters, the taxpayer was making no FTDs or

other voluntary payments for its Form 941 taxes for quarters 16 and 17. The taxpayer's failure to pay any Form 941 taxes for these two quarters while the levy activity described above was occurring did not appear in Cff inventory while the first identified revenue officer was handling the case, in part because the taxpayer was delinquent in filing these returns.

Meanwhile, in the same time period, the taxpayer's principal filed her year 7 Form 1040 return on extension and her withholding credits and a small additional payment for that period reflected full payment of her self-assessed tax for this period. About two years later, the Service apparently again determined that the taxpayer's principal underreported her income and income tax for this period and a tax deficiency of amount 11 was assessed. Also, in the same time period when the above-described series of levies were made against the taxpayer's bank account, the Service finally determined that the taxpayer's principal had underreported her income and income tax for her year 6 Form 1040 period (a period not covered by the accepted OIC) and a tax deficiency of amount 5, plus penalties and interest, was assessed against the taxpayer's principal for this year in date 23. As you know, in analogous circumstances in another case, our office has previously opined that the Service could exercise its right to declare a taxpayer's OIC in default in the above-described type of fact pattern,¹ though we can not tell from the transcript alone whether the failure of the taxpayer's principal to pay this post-OIC acceptance deficiency was the leading cause for the Service determining that the taxpayer's principal was in default of her OIC as of date 25.

On January 19, 1999, the collection due process (CDP) rights contained in the RRA of 1998, sections 6320 and 6330, became effective for new NFTLs and new IRS proposed levies. However, insofar as we could tell from the records provided, this taxpayer and the taxpayer's principal have not yet attempted to exercise any of their CDP rights; accordingly, the existence and potential exercise of these CDP rights to delay collection by the Service in the future should not be relied upon as an additional ground for the requested injunctive relief in this particular case, unless these circumstances change.

In dates 26 and 27, the taxpayer filed its delinquent Form 941 returns for quarters 16 and 17, respectively, reflecting unpaid tax, penalties, and interest that totaled about amount 12, after the notice series was complete. As previously indicated, the taxpayer made no FTDs or other voluntary payments for these two year 8 quarters, during which time the Service had been levying on the taxpayer's bank account to collect prior quarter taxes owed. In the first three quarters of year 9, the taxpayer also made only one FTD that did not bounce, though a late (apparent) voluntary payment for quarter 18 eventually did leave the taxpayer with only a small balance that required IRS levy action to complete collection for this quarter. In date 28, the taxpayer's principal failed to file her personal Form 1040 for year 8 within the extended time allowed by the Service.

¹ See 2000 IRS CCA LEXIS 147.

On date 29, the taxpayer's assessed employment tax liabilities that had gone beyond the fourth notice stage were assigned to the second active revenue officer identified by name to us. The tax periods assigned to the revenue officer at this time for collection were the large Form 941 balances outstanding for the taxpayer's quarters 16 and 17, the small Form 941 balance for the taxpayer's quarter 18, and a Form 940 balance for year 8. At this time, the taxpayer was also delinquent in filing its Forms 941 for quarters 19 and 20 and the taxpayer never made any FTDs or voluntary payments for these quarters, but these two most recent quarters were not yet assigned to the field for collection. Since the taxpayer was known to be a trust fund repeater, the revenue officer issued the taxpayer a Letter 1058 on date 30, for the four periods with then assessed balances due.

In dates 31 and 32, this second active revenue officer solicited and obtained from the taxpayer its delinquent Forms 941 for the last three quarters of year 9, which showed an aggregate tax balance due of about amount 13, plus penalties and interest. Also, beginning in date 32 and continuing through date 35, the Service made a series of three successive levies on the taxpayer's bank account which resulted in full payment of three of the earlier tax periods for which the revenue officer had already issued the Letter 1058 and resulted in partial payment for the remaining Form 941 liability for quarter 17. The results of these bank levies are again recapped below as part of the pre-TFCI payment chart shown near the bottom of this section of our present memorandum. However, as the previous active revenue officer discovered, while the Service was engaging in this further series of pre-levy notices and levies on the taxpayer's bank account in order to satisfy the taxpayer's employment tax liabilities for these earlier Form 941 quarters, the taxpayer was making relatively small FTD payments for its Form 941 taxes for the current quarters 22 and 23; the taxpayer's FTDs and voluntary payments for these two quarters represented only about 22.5% of the total assessed liabilities for these quarters, not including penalties and interest.

About the time this second identified active revenue officer received the proceeds of these successive bank levies and was finding the taxpayer falling still further behind in compliance for current periods – in the date 36 period – the Service's Dallas District identified the taxpayer as an appropriate candidate for the TFCI pilot project being initiated in the district. As we understand the records we reviewed, the taxpayer's payment history (through FTDs, voluntary payments, levy proceeds, and setoffs) for its recent pre-TFCI Form 941 periods may be roughly illustrated by the chart on the following pages.

Pre-TFCI Payments of Taxpayer's Form 941 Taxes

| <u>Period</u> | <u>Tax Assessed²</u> | <u>FTDs</u> | <u>Other Voluntary Payments</u> | <u>Levy Proceeds & Other Details</u> <i>[1st identified RO's levies below]</i> |
|---------------|---------------------------------|-------------|---------------------------------|--|
| Q13 | A14 | A15 | A16 [check bounces] | -A17 - 1 st bank levy full pays on date 20. |
| Q14 | A18 | A19 | None | -A20 - 1 st bank levy part pays on date 20. -A21 - 2 nd bank levy part pays on date 21. -A22 - 3 rd bank levy part pays on date 22. -A23 - 4 th bank levy full pays on date 24. |
| Q15 | A24 | A25 | A26 | -A27 - proceeds of 1 st bank levy for Q13 & 14 full pays penalty balance on date 20. |
| ----- | | | | |
| Q16 | A28 | None | None | <i>[2nd identified RO's levies below]</i> -A29 - 1 st bank levy part pays on date 33. -A30 - 2 nd bank levy full pays on date 34. |
| Q17 | A31 | None | None | -Zero - 1 st bank levy on date 33 part pays earlier period only. -A32 - 2 nd bank levy part pays on date 34. -A33 - 3 rd bank levy parts pays on date 35. -A34 - setoff from Q24 overpayment. -A35 - setoff from Q25 overpayment. |
| Q18 | A36 | A37 | A36 | -A38 - 1 st bank levy full pays this penalty balance on date 33. |

| <u>Period</u> | <u>Tax Assessed</u> | <u>FTDs</u> | <u>Other Voluntary Payments</u> | <u>Levy Proceeds & Other Details</u> |
|---------------|---------------------|-------------|---------------------------------|--|
|---------------|---------------------|-------------|---------------------------------|--|

² These assessed tax figures do not include penalties, interest, or fees.

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|-----|-----|------|------|--|
| Q19 | A39 | None | None | -Accepted into TFCI before referred to Cff for collection. |
| Q20 | A40 | None | None | -Same as above. |
| Q21 | A41 | A42 | None | -Same as above. |
| Q22 | A43 | A44 | None | -Same as above. |
| Q23 | A45 | A46 | None | -Same as above |

Based upon our above-described, more complete understanding of the older and the more recent pre-TFCI selection background information for the taxpayer and the taxpayer's principal, we now agree with the Dallas District's decision that the taxpayer was an appropriate candidate for inclusion in the district's TFCI project. The taxpayer's outstanding pre-TFCI total and recent unpaid quarterly trust fund tax liabilities were significant (easily within the Service's resource conservation tolerances) and the taxpayer and its principal have a long history of non-compliance with the employment tax laws. The taxpayer's principal already has a large outstanding personal tax liability which continues to increase, and prior levy efforts against her assets were unproductive; accordingly, asserting the trust fund recovery penalty (TFRP) under section 6672 against the taxpayer's principal is not at all likely to be productive. Finally, although a particular revenue officer may be capable of obtaining full payment of particular assigned Form 941 quarters with assessed tax liabilities from this taxpayer by issuing a Letter 1058 and then a succession of levies on the taxpayer's bank account over a several month period, the pre-TFCI pattern indicates that this taxpayer would likely end up being deeper in debt to the Service for misapplied trust fund taxes at the end of this succession of bank levies. That is because this taxpayer has established a pattern of not making current FTDs, not filing current Form 941 returns timely, and not making current non-FTD voluntary payments to any significant extent while bank levies are occurring or for any period thereafter until the new balance due periods have been assessed, have gone through the four notice process, and have then been assigned to another revenue officer for collection. Accordingly, we now agree that the Service in this case had no adequate, pre-TFCI legal remedies that would have allowed it to obtain anything close to compliance from this taxpayer.

Post-TFCI Selection Events

After the Dallas District selected this taxpayer for the TFCI project, the taxpayer's case was assigned to a third active revenue officer identified by name to us, and this third revenue officer in turn worked closely with the district's TFCI coordinator, also a revenue officer. On date 37, and again three days later, the district's TFCI coordinator attempted to deliver personally to the taxpayer's principal a Letter 903 warning notice for the taxpayer. After a third attempt by the TFCI coordinator to deliver the Letter 903 personally to the taxpayer's principal, on date 38, the district's TFCI coordinator left the Letter 903 for the taxpayer in a sealed envelope with the taxpayer's receptionist and asked for the receptionist to give it to the taxpayer principal and to instruct the taxpayer's principal to call the third revenue officer (whose name and telephone number appeared on the letter) upon her receipt of the letter. The TFCI coordinator was advised at this time that the taxpayer ordinarily paid employees on the days 1 and 2 of each month, that the taxpayer had ten employees, and that the taxpayer's revenues were about 99.5% from Medicare claims and the remaining 0.5% was from Medicaid claims.

As of date 39, the taxpayer's principal had failed to call the revenue officer as requested to discuss the Letter 903, and the revenue officer and the TFCI coordinator had decided that it was time to move the taxpayer to the next stage of the TFCI administrative progression. Accordingly, on this date, the revenue officer and the TFCI coordinator made another visit to the taxpayer's place of business to hand-deliver the Form 2481 to the taxpayer's principal and to explain its requirements – to open and make deposits to the special tax deposit (STD) bank account described in section 7512, to pay over the deposited amounts to the revenue officer monthly, and to file monthly Forms 941-M with the revenue officer. The revenue officer and coordinator accomplished these tasks. The taxpayer's receptionist confirmed that she had delivered the prior sealed envelope with the Letter 903 to the taxpayer's principal, but the principal indicated she had not yet read the letter. The revenue officer asked the principal to open the STD account by date 40, to fax a copy of the bank signature card to the revenue officer, and thereafter to send the revenue officer copies of the bank deposit slips and STD monthly bank statement along with the taxpayer's Forms 941-M. The revenue officer also discussed missing returns and FTDs for recent periods with the taxpayer's principal. Finally, the revenue officer advised the principal that a NFTL would be filed for the taxpayer's unpaid taxes that had already been assessed and noticed.

After two telephone calls from the revenue officer and a further personal visit from the TFCI coordinator, the taxpayer eventually managed to open the STD bank account correctly on date 41, six days later than requested but apparently by the time of the taxpayer's first regular payroll after delivery of the Form 2481. On date 42, the Service apparently filed a NFTL against the taxpayer for its Form 941 liabilities for four pre-TFCI quarters (quarters 17, 19, 20, and 21). As you know, our office has previously opined, in another case, that the Service's action of filing a

NFTL against a taxpayer that is under STD requirements is not inconsistent with civil TFCI guidelines and goals.³

On date 43, the revenue officer called the taxpayer's principal and asked why the taxpayer had not yet filed its Form 941-M for month 1 with the revenue officer. This was appropriate, for even though the Form 2481 was not delivered until date 39, it is actually retroactive in requiring monthly filing for "all prior months ... within the calendar quarter that have not yet been reported on a quarterly return." In date 44, the revenue officer did receive from the taxpayer its Form 941-Ms for months 1 and 2, but checks paying the tax for these two months were reportedly not provided then because the bank where the STD account was located would not permit the taxpayer to use temporary checks for the account and the permanent checks were not available yet. In date 44, the taxpayer also filed its Form 1120S for year 9, showing a loss of about amount 47 for that year.

In date 45, the revenue officer apparently received the taxpayer's month 3 Form 941-M and checks for the taxpayer's Form 941-M liabilities for months 1 through 3 (e.g., the first quarter under TFCI). Together with the taxpayer's FTDs for month 1, before STD requirements were imposed, the taxpayer's checks in date 45 resulted in the taxpayer actually overpaying its Form 941 liabilities for quarter 24 by amount 34. The Service appropriately retained this overpayment for offset against the taxpayer's outstanding Form 941 tax liability for quarter 17.

In date 46, the revenue officer continued experiencing difficulties and delays in obtaining the taxpayer's payroll records, the taxpayer's STD bank statements, and current financial statements from the taxpayer and the taxpayer's principal. During this month, a representative of the taxpayer apparently indicated that the company's bookkeeper "was busted by CI" and the taxpayer's principal was attempting to do the company books herself, with some difficulty. Later, in date 48, the taxpayer's principal told the revenue officer that the company's bookkeeper was back "after being exonerated by CI." Later still, in date 51, the taxpayer's principal indicated that she was now going to prepare the taxpayer's Forms 941-M herself.

In date 47, the revenue officer apparently received the taxpayer's months 4 and 5 Forms 941-M, along with checks to cover the taxes due for these months. In date 48, the revenue officer apparently received the taxpayer's month 6 Form 941-M, along with a check to cover taxes for this month. As with the prior quarter under TFCI, the taxpayer actually apparently overpaid its Form 941 liability for quarter 25 (the second quarter under TFCI) by amount 35, and the Service appropriately retained the overpayment for offset purposes against an outstanding prior tax debt.

³ See 2001 IRS CCA LEXIS 78, *23.

On or about date 49, the Service apparently⁴ received a payment of amount 48 from the taxpayer for its quarter 26 Form 941 taxes. This amount matches the taxes shown as due and paid on the taxpayer's month 7 Form 941-M in the file. On or about date 50, the revenue officer apparently conducted an interview with the taxpayer's principal to determine her liability for the TFRP (a Form "4180 interview"). On or about date 52, the Service apparently⁵ received another payment of amount 49 from the taxpayer for its quarter 26 Form 941 taxes. This amount again matches the taxes shown as due and paid on the taxpayer's month 8 Form 941-M in the file. As of the date of referral to your office, the taxpayer apparently had not yet filed a month 9 Form 941-M with the revenue officer, nor paid any amount of tax for that month.

On or about date 53, the Service apparently filed another NFTL against the taxpayer, this time for the taxpayer's Form 941 liabilities for two additional pre-TFCI quarters (quarters 22 and 23) and for the taxpayer's year 9 Form 940 liability. At this time, the taxpayer's principal reportedly advised the revenue officer that she had recently married and that her spouse was unemployed.

On date 54, the Service received the taxpayer's Form 1120S for year 10, reflecting ordinary income of amount 50 in excess of deductions for the year. On date 55, the transcripts in the file forwarded to our office were apparently printed by the Service. On date 56, the Service stamped as received the taxpayer's Forms 941-M for months 10 and 11. These returns appeared to indicate on their face that deposits were made by the taxpayer to cover full payment of the tax liabilities shown due for these two months, however, we are not able to confirm whether the payments were, in fact, made for these months after the transcripts were printed.

As we understand the records we reviewed, the taxpayer's voluntary payment record for TFCI Form 941 periods may be roughly illustrated by the chart below, which has several question marks appearing for some of the figures after the eighth month the taxpayer was under TFCI. This is in case later printed IRS transcripts would show that Forms 941-M were actually later filed and tax payments were made for these periods.

Post-TFCI Selection Payments of Taxpayer's Form 941 Taxes

| <u>Period</u> | <u>Tax Per Return</u> | <u>Taxes Paid</u> | <u>Comments</u> |
|---------------|-----------------------|-------------------|--|
| Q24 | A51 | A52 | Overpayment of A34 is retained by IRS and setoff against pre-TFCI debts. IRS |

⁴ This is based upon our interpretation of the transcripts your office enclosed. Please verify.

⁵ This is again based upon our interpretation of the transcripts your office enclosed. Please verify.

consolidated 3 months of Forms 941-M into one quarterly Form 941, as IRM directs.

| | | | |
|-----|-----|-----|--|
| Q25 | A53 | A54 | Overpayment of A35 is again retained by IRS and setoff against pre-TFCI debts, and the tax per quarterly return is based on consolidated Forms 941-M for 3 months. |
| M7 | A48 | A48 | Tax per Form 941-M not assessed as of date 57, because M9 941-M not filed yet. |
| M8 | A49 | A49 | Tax per Form 941-M not assessed as of date 57, because M9 941-M not filed yet. |
| M9 | ? | ? | M9 Form 941-M unfiled as of date 57. |
| M10 | A55 | ? | Transcript printed date 55 does not show tax possibly paid with Form 941-M received date 56. Return shows total deposits for period of A56, a small overpayment. |
| M11 | A57 | ? | Transcript printed date 55 does not show tax possibly paid with Form 941-M received date 56. Return shows deposits for period of A58. |
| M12 | ? | ? | No information re this period. |
| M13 | ? | ? | No information re this period. |

| <u>Period</u> | <u>Tax Per Return</u> | <u>Taxes Paid</u> | <u>Comments</u> |
|---------------|-----------------------|-------------------|--|
| M14 | ? | ? | No information re this period; ended after referral. |
| M15 | ? | ? | No information re this period; ended after referral. |
| M16 | ? | ? | No information re this period; ended after referral. |

Upon our return of the file to you for further development with this memorandum, one of the principal tasks that we request that your office perform before referring this matter back to us again is to fill in the above-noted question mark gaps in the post-TFCI selection record. If the taxpayer or a successor/nominee (owned and/or operated by the taxpayer's longtime principal) has, in fact, remained in business and has, in fact, not paid any or not paid a substantial portion⁶ of the taxes due by it for these eight recent months, then a renewed request by your office for the United States to seek an employment tax injunction against this TFCI taxpayer or the above described type of successor/nominee taxpayer would likely receive a more speedy and favorable reception by our office, subject to your careful consideration of the other matters also discussed later herein.

SOME GENERAL TFCI GUIDELINES APPLICABLE TO THIS CASE

Chief Counsel's office and the Justice Department have repeatedly indicated a willingness to commit the resources necessary to refer and pursue appropriate employment tax injunction cases that may arise from the TFCI program. In addition to the factors already discussed above that made this taxpayer an appropriate candidate for initial inclusion in the Dallas District's TFCI project, an appropriate injunction case for a typical taxpayer first going through the TFCI administrative progression will generally be a case where an in-business taxpayer, after being placed under the STD regime, fails to comply substantially with its Form 941 tax payment obligations. If the bottom line is that a taxpayer under STD has paid or even overpaid its Form 941 obligations for particular tax periods, then that taxpayer should be considered as having substantially complied for those periods for purposes of whether an employment tax injunction is now necessary.

There are a variety of ways in which a taxpayer may technically have failed to comply with all section 7512 requirements, including the following which were apparently all present at times in this case: initially opening the STD account with an improper caption and opening the STD account later than instructed; making deposits to the STD account late or sometimes not at all; filing Forms 941-M with the revenue officer late; paying the revenue officer late; writing a fully honored payment check that was apparently covered for a time by float; or failing to provide the revenue officer with copies of certain requested STD deposit slips, STD bank

⁶ At this point, we are not seeking to limit or define a specific percentage of total tax figure that represents non-payment of a "substantial portion" of the taxpayer's taxes. Non-payment of 95% of these taxes for several periods due would seemingly be "substantial," while non-payment of 5% of the taxes due for these periods would seemingly not be "substantial" enough for this particular taxpayer (with fewer than 15 employees, at last report) to justify the resources necessary for the United States to seek an injunction. We ask that your office exercise appropriate judgment, in conjunction with the local client function, in evaluating when this taxpayer's failure to pay Form 941 taxes is substantial enough for it to be cost effective for the United States to seek an injunction.

statements, or payroll records.⁷ However, if the Service is satisfied that the taxpayer has finally paid in full for the tax periods at issue by the time the taxpayer's case is ripe for referral to the Tax Division for seeking an injunction, then the taxpayer's prior technical violations of section 7512 and other Code provisions for these fully paid tax periods is not likely to carry the day in seeking an injunction. Accordingly, while some description of these early technical violations of section 7512 requirements may be appropriate as background in a suit letter (along with a discussion of a taxpayer's pre-TFCI history), the general focus of a suit letter for post-TFCI selection periods should be on those periods where the taxpayer has continued to demonstrate a substantial failure to pay the current taxes still owed for several periods after being placed under STD, which suggests a substantial likelihood that non-payment of taxes will continue by a taxpayer in future periods if an appropriate injunction order is not entered by the court.

A suit seeking an employment tax injunction against a taxpayer pursuant to section 7402(a) is a proceeding in equity. A fundamental principle of equitable jurisprudence is that "whoever comes into equity must come with clean hands." This means that the agents of a party seeking to set the judicial machinery in motion and obtain some equitable remedy must have been fair, equitable, and honest in their conduct with respect to the particular controversy in issue. See 27A Am. Jur. 2d Equity § 126 (1996). Similar to our previously described approach to the circumstances where the Government will seek equity – where the taxpayer's failure to comply is substantial, rather than technical – we believe the Government may ultimately be found to have "unclean hands" only when the Government's agents took inappropriate actions which substantially infringed upon the taxpayer's rights and ability to comply with the tax compliance violations that the Government is asking the court to remedy through equity. "Unclean hands" do not arise from circumstances where a Government employee has, in good faith, simply failed to follow or misinterpreted a current IRM provision or other instructions for handling a particular type of a case and this technical non-compliance has had no material effect on the taxpayer's substantial failure to comply for the periods at issue.⁸

In addition to your request that the Government seek forward-looking injunctive relief along the lines of that recently granted in the case of United States v. Lopez,

⁷ We fully understand that dealing appropriately with these "technical" violations of section 7512 by a taxpayer is time-consuming and aggravating for a revenue officer, but a successful injunction proceeding is going to mean more involvement, not less, by the revenue officer with the taxpayer, and it is also going to involve the additional time of Chief Counsel's office, the Tax Division, and the judicial system.

⁸ However, in fairness to the Tax Division, to avoid potential surprise to Government counsel on cross-examination of the Government's likely witnesses, an effort should be made in a suit recommendation letter to identify known circumstances where a Government agent was in technical non-compliance with any internal handling instructions for a case.

2001 U.S. Dist. LEXIS 9904 (S.D. Cal. 2001), your proposed suit letter also suggests that the Government request injunctive relief to compel the taxpayer and the taxpayer's principal "to pay the I.R.S. the presently unpaid trust fund taxes and non-trust fund employment taxes," an amount we understand would be in excess of amount 59 (with penalties and interest), and presumably then to hold the taxpayer and the taxpayer's principal in contempt of such an order for payment of back taxes if the taxpayer failed to pay such prior period taxes within the time frame contained in such an order. It is common for the United States to seek a court order to reduce large tax claims to judgment, especially when the ordinary collection limitation period is close to expiring but the Service reasonably believes the judgment may be collectible in the extended time frame allowed by such a judgment. However, we are not aware of and you have not cited us to any authority for a court to order a taxpayer to pay a civil tax judgment or face contempt, and possible imprisonment, for failing to pay taxes in accordance with such an order when a taxpayer has not been expatriating or otherwise concealing its assets.⁹ In this case, we think there may be an untested alternative way, albeit slower than the method your office was proposing, for the United States to obtain a court order that may allow the Service to secure eventual, full payment of the taxpayer's back taxes while the injunction for future periods is also in effect. This would be to seek a court order which mimics the effect of a "continual levy" of the sort described in section 6331(h),¹⁰ by directing the payor/holder of nearly all of the taxpayer's accounts receivable (the United States) to pay/setoff for the Service an established percentage of the taxpayer's present and future accounts receivables until the taxpayer's past period tax liabilities are satisfied in full. We suggest that you discuss the mechanics of this type of potential alternative remedy for collection of the taxpayer's back taxes with your local client function.

Assuming that your office and the local client function decide to forward another revised suit recommendation letter for this taxpayer to our office for pre-approval, after considering the matters discussed herein, we suggest that your revised proposed letter include a request that the Tax Division make sure to publicize its efforts/successes in this case appropriately and that your office also agree to provide appropriate assistance to the Tax Division in this regard. As you know, the Service generally hopes to be able to use its Letter 903 and STD administrative tools as a more cost effective means than an injunction to obtain compliance by TFCI taxpayers with their ongoing employment tax obligations. The deterrent effect of these administrative tools depends, in part, upon taxpayers and the practitioner

⁹ You have not suggested, for instance, that your office is seeking or that appropriate circumstances are present to seek a writ of *ne exeat republica*.

¹⁰ As discussed in a recent GAO Report, continual levies by the Service on a taxpayer's Medicare account receivables are apparently not expected to be available on a systemic basis, through the Financial Management Service, before late 2006. See "Tax Administration: Millions of Dollars Could be Collected If IRS Levied More Federal Payments," GAO-01-711 (July 2001).

community realizing that the Service is serious about pursuing civil injunctions against non-compliant TFCI taxpayers. This awareness should be enhanced by effective publicity of the civil injunction cases the United States chooses to bring to court. Under Tax Division guidelines, we understand that the publicity given to civil cases of this type will generally be limited (insofar as particular taxpayer information is concerned) to information disclosed in the public record (e.g., the complaint, other pleadings, public hearings, and the court's orders) for the approximate time period that such publicity would represent "news." As the Tax Division will learn of the content of these court pleadings and court orders before your office does, we think your office could be most helpful in agreeing to provide the Tax Division (in advance of the complaint being filed) with an appropriate general, summary description of the procedures and goals of the TFCI program in your district for publicity purposes.

As with the order entered in the previously cited Lopez injunction case, we recommend that the Government's complaint in an employment tax case identify the name and address of a specific IRS field employee to whom the periodic affidavits called for by the injunction should be delivered. Accordingly, assuming your office prepares a revised, proposed suit letter for this case, we recommend that the letter contain the name and address of the IRS field employee whom the Service wishes to perform this future monitoring/testifying duty for the court. The proposed designated employee could be, but need not necessarily be, the revenue officer who monitored the taxpayer during the TFCI administrative steps.

HAZARDS & FURTHER DEVELOPMENT SUGGESTIONS

[Redacted]

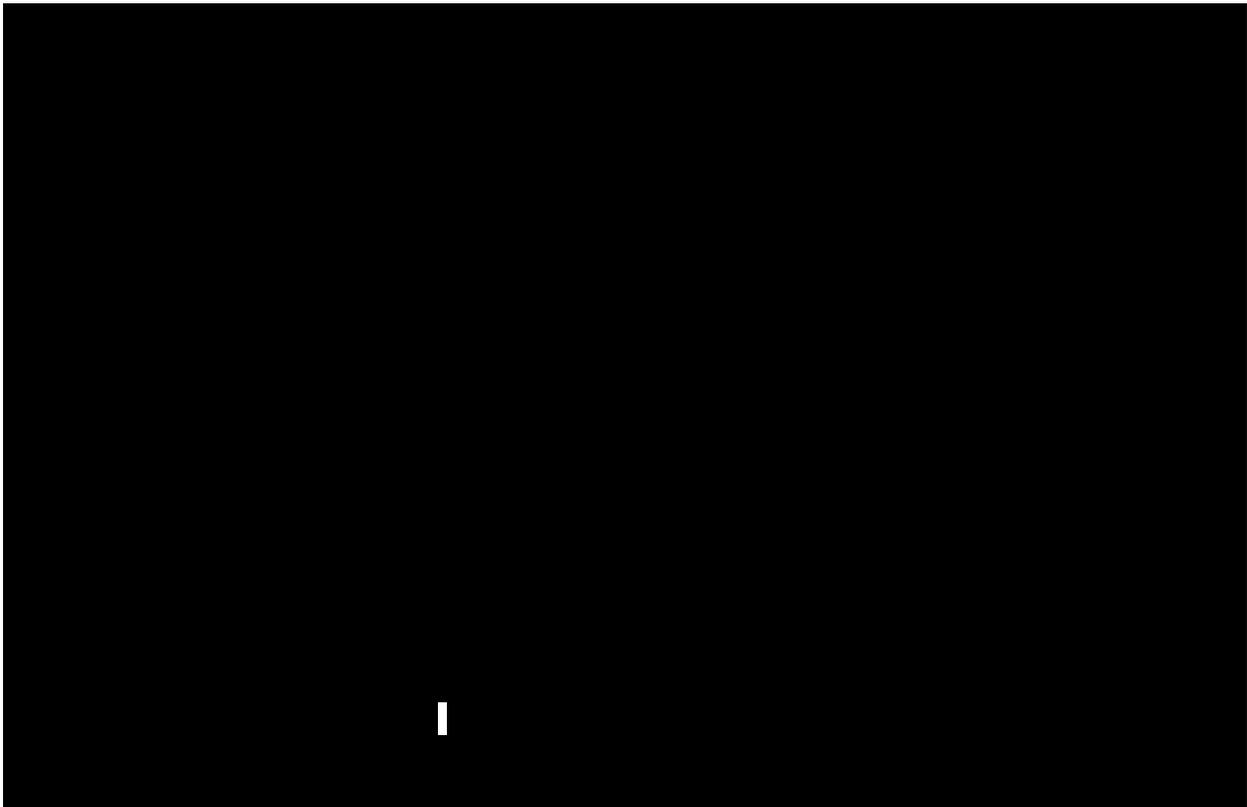
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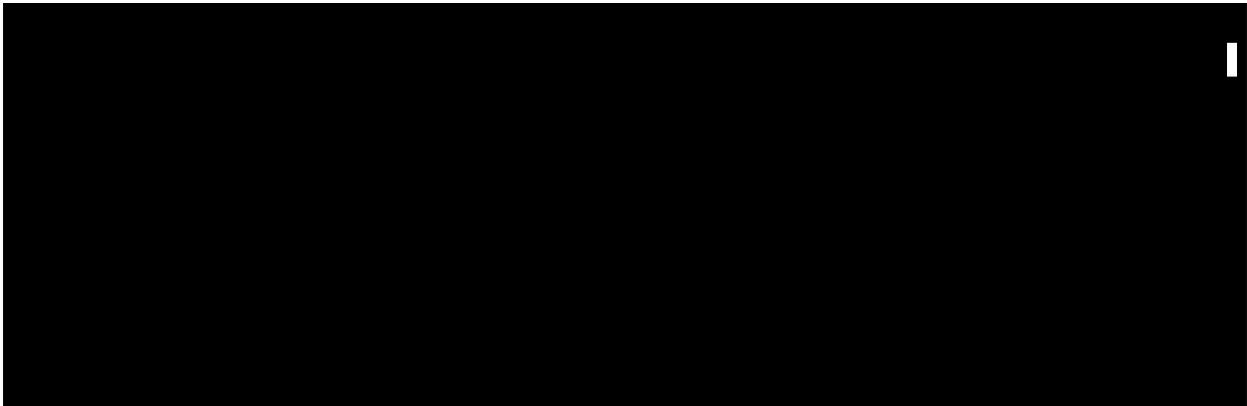
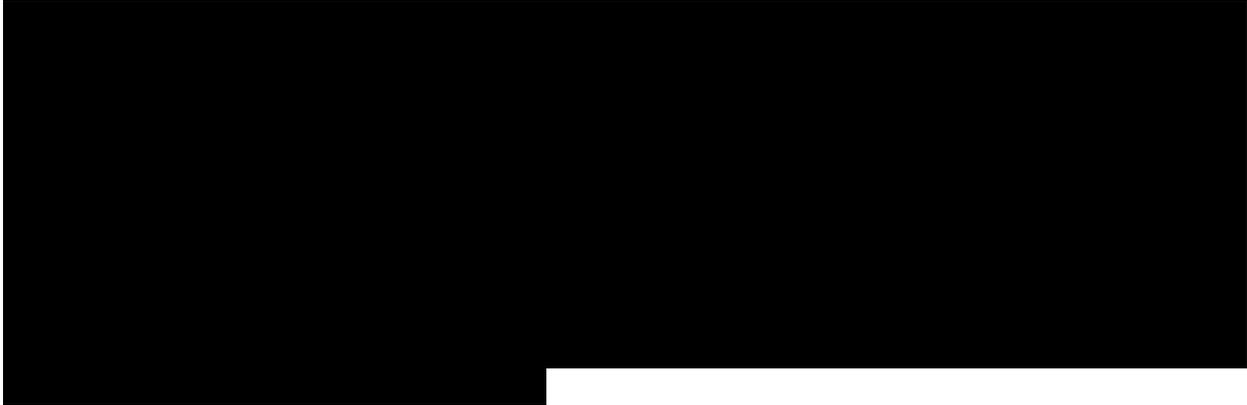
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CONCLUSION

For the reasons described above, we are returning your office's proposed suit letter and the administrative file herewith. If you have any questions regarding this advice, please call the attorney in my branch assigned to this case at 202-622-3630.