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# The Pernicious Reach of 26 U.S.C. Section 6672

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# VIRGINIA TAX REVIEW

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## THE PERNICIOUS REACH OF 26 U.S.C. SECTION 6672

*Mary A. Bedikian\**

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*Only he who actually calls the tune should be held accountable to the piper.*<sup>1</sup>

#### I. INTRODUCTION

When a corporation fails to pay withholding taxes, section 6672 of the Internal Revenue Code (the "Code") imposes personal liability on those corporate employers and officers deemed "responsible" and "willful" for the deficiency.<sup>2</sup> This provision is triggered

<sup>1</sup> *Werner v. United States*, 374 F. Supp. 558, 563 (D. Conn. 1974).

<sup>2</sup> I.R.C. § 6672(a). Section 6672(a) states, in pertinent part:

Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or willfully attempts in any manner to evade or truthfully account for and pay over such tax, or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

Id.

when the employer who is directly liable fails to pay.<sup>3</sup> The Internal Revenue Service (the "Service") places taxes collected pursuant to section 6672 in "a special fund in trust for the United States."<sup>4</sup> Since the funds are held in trust, they may not be used by the corporation as working capital.<sup>5</sup> In essence, section 6672 provides an alternate source to which the government can turn if the employer fails to collect or misdirects the funds,<sup>6</sup> and it is an impor-

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<sup>3</sup> Several provisions of the Internal Revenue Code require third persons to collect taxes from the taxpayer. See I.R.C. §§ 3102(a) and 3402(a) which respectively require deduction from wages paid to employees of the employer's share of FICA taxes and the withholding tax on wages applicable to individual income taxes.

<sup>4</sup> I.R.C. § 7501(a). Section 7501(a) states, in pertinent part:

(a) General rule. Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of the tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

Id. Trust fund taxes accrue from the date the taxes are withheld from the employees' paychecks until the date the employer is required to pay the taxes to the government. Under current Code requirements, payment is made quarterly. Once net wages are paid to the employee, the taxes withheld are credited to the employee regardless of whether they are paid by the employer. *Slodov v. United States*, 436 U.S. 238 (1978).

<sup>5</sup> *Slodov v. United States*, 436 U.S. 238 (1978); *Donelan Phelps & Co. v. United States*, 876 F.2d 1373, 1375 (8th Cir. 1989); *Gustin v. United States*, 876 F.2d 485, 491 (5th Cir. 1989); *Collins v. United States*, 848 F.2d 740, 741 (6th Cir. 1988); *Gephart v. United States*, 818 F.2d 469, 472 (6th Cir. 1987); *McGlothin v. United States*, 720 F.2d 6, 8 (6th Cir. 1983).

<sup>6</sup> I.R.C. § 7501 does not require a corporation to segregate the withheld taxes from its general fund. *Newsome v. United States*, 431 F.2d 742 (5th Cir. 1970). Funds must be segregated in a separate bank account only when specifically requested by the government. See I.R.C. § 7512. Section 7512 states in pertinent part:

(a) General Rule. - Whenever any person who is required to collect, account for, and pay over any tax imposed by subtitle C, or chapter 33—

(1) at the time and in the manner prescribed by law or regulations

(A) fails to collect, truthfully account for, or pay over such tax, or

(B) fails to make deposits, payments, or returns of such tax, and

(2) is notified, by notice delivered in hand to such person, of any such failure, then all the requirements of subsection (b) shall be complied with. In the case of a corporation, partnership, or trust, notice delivered in hand to an officer, partner, or trustee, shall, for purposes of this section, be deemed to be notice delivered in hand to such corporation, partnership, or trust and to all officers, partners, trustees, and employees thereof.

(b) Requirements. Any person who is required to collect, account for, and pay over any tax imposed by subtitle C or Chapter 33, if notice has been delivered to such person in accordance with subsection (a), shall collect the taxes imposed by subtitle C or chapter 33 which becomes collectible after delivery of such notice, shall (not later than the end of the second banking day after any amount of such taxes is collected) deposit such amount in a separate account in a bank (as defined in section 581), and

tant protection of the tax collection process.

The Service is responsible for enforcing section 6672. If a corporation fails to pay the taxes due by an employee, the Service incurs an immediate pecuniary loss because the employee is given full credit for taxes that were to be withheld by the employer. To protect against such loss, the Service institutes the tax collection process against the corporation. If the corporation is insolvent, as is often the case, the Service will assert the "third party" device and actively pursue the officers and directors<sup>7</sup> for the deficiency. As in the case of deficiency assessments,<sup>8</sup> the Service can seize assets and encumber property before a determination has been made as to who the "responsible person" is.

Once a person is assessed, attempts to stay collection have proven largely unsuccessful.<sup>9</sup> Securing a stay requires a bond.<sup>10</sup> However, this protection is illusory in two respects. First, the allegedly responsible taxpayer has almost always exhausted his liquid assets to defend the action. Second, the value of the bond must cover the assessment, an amount frequently disproportionate to

shall keep the amount of such taxes in such account until payment over to the United States. Any such account shall be designated as a special fund in trust for the United States, payable to the United States by such person as trustee.

Id. The absence of a segregation requirement creates a unique problem for § 6672 cases. When a trust exists, funds are usually segregated and the trustee has a fiduciary obligation to ensure that they are preserved for the beneficiary. In § 6672 cases, employers typically commingle all funds, making it difficult to identify the *res* of the trust. Since the funds accumulate in a single account, they are a tempting source of cash to a floundering corporation. See *Slodov*, 436 U.S. at 238.

<sup>7</sup> This administrative practice has translated into a presumption as a matter of law. Consequently, the taxpayer carries the burden of proof. See *United States v. Lease*, 346 F.2d 696 (2nd Cir. 1965). See also *infra* § II(D)(2) for a more complete explanation of this presumption.

<sup>8</sup> Section 6861 permits the Service to depart from its standard system of assessment and collection in exigent circumstances, i.e. when collection will be jeopardized by delay. Pre-assessment judicial review is not required.

<sup>9</sup> Charles E. Falk, *Trust Fund Tax Liability: A Kinder and Gentler I.R.S.?*, 34 *Tax Mgmt.* 117 (1993).

<sup>10</sup> 26 U.S.C. § 6672 provides in part:

(b) Extension of period of collection where bond is filed.

(1) In general, if, within 30 days after the day on which notice and demand of any penalty under subsection (a) is made against any person, such person -

(A) pays an amount which is less than the minimum amount required to commence a proceeding in court with respect to his liability for such penalty,

(B) files a claim for refund of the amount so paid, and

(C) furnishes a bond which meets the requirements of paragraph (3).

the accumulated assets of many taxpayers.

Unlike tax deficiency claims, persons assessed under section 6672 must apply for a refund either in federal district court or in the Court of Federal Claims.<sup>11</sup> To defeat the assessment, taxpayers have asserted constitutional violations,<sup>12</sup> non-willful depletion of funds by predecessors,<sup>13</sup> reliance on third parties,<sup>14</sup> reliance on Service agents,<sup>15</sup> delegation of authority,<sup>16</sup> lack of fiscal control,<sup>17</sup> and

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<sup>11</sup> The federal district courts have concurrent jurisdiction with the Court of Federal Claims (formerly the Claims Court) to hear § 6672 cases. 28 U.S.C. §§ 1346(a)(1), 1491. Appeals from either court are taken to the federal court of appeals or the federal circuit court of appeals respectively. Taxpayers in § 6672 cases cannot challenge the validity of the penalty in United States Tax Court because a deficiency notice, a condition precedent to jurisdiction, is not present. *Boynton v. United States*, 566 F.2d 50, 53 (9th Cir. 1977).

Assessed taxpayers must pay the divisible amount of a penalty assessment attributable to a single individual's withholding before instituting a refund action. I.R.C. §§ 6672, 1346. As a matter of strategy, taxpayers may be attracted to the Court of Federal Claims because it has produced more favorable precedent than the federal district courts. See *Stewart v. United States*, 19 Cl. Ct. 1 (1989); *Heimark v. United States*, 14 Cl. Ct. 643 (1989); *Fiest v. United States*, 607 F.2d 954 (Cl. Ct. 1979). See also *Schultz v. United States*, 19 Cl. Ct. 280 (1990) where the Claims Court was willing to examine the personal fault component of willfulness.

If the case is brought in federal district court, it is usually tried to a jury. However, at least two circuits have held there is no right to a jury trial in a § 6672 case if fraudulent conveyances are also involved. *United States v. McMahan*, 556 F.2d 362 (5th Cir. 1977); *Gefen v. United States*, 400 F.2d 476 (5th Cir. 1968)(following *Damsky v. Zavatt*, 289 F.2d 46 (2nd Cir. 1961)).

<sup>12</sup> *Cooper v. United States*, 593 F. Supp. 117 (E.D.Va. 1982) (finding that plaintiff did not present evidence that the Service had departed from its administrative practice and singled plaintiff out for harsher treatment than that accorded other taxpayers); *Cohn v. United States*, 399 F. Supp. 168, 171 (E.D.N.Y. 1975) (noting that "[A] legislative classification must be sustained unless it is patently arbitrary and bears no rational relationship to a legitimate governmental interest") (quoting *Frontiero v. Richardson*, 411 U.S. 677, 683 (1973)). Since the government has a compelling interest in the prompt collection of its lawful revenue, the classification [taxpayers who are assessed deficiencies in income, estate and gift taxes are permitted to contest liability *prior* to payment] is justified. *Id.*

<sup>13</sup> This defense is valid if the fund balance falls below the amount of taxes withheld. *Slodov v. United States*, 436 U.S. 238 (1978).

<sup>14</sup> *Newsome v. United States*, 431 F.2d 742 (5th Cir. 1970) (by relying on third party information, "mere reasonable expectation of sufficient funds at a later date is not a defense to a charge of willful failure to comply with the commands of section 6672").

<sup>15</sup> *North v. United States*, 951 F.2d 1259 (10th Cir. 1991), cert. denied, 112 S. Ct. 1675 (1992) (finding that allegations of affirmative misconduct by officials were insufficient to prevent application of penalties, specifically where the Service entered into an agreement to permit continuation of a delinquent company and failed to exercise its rights in valid, judicially perfected security interests).

<sup>16</sup> *Mazo v. United States*, 591 F.2d 1151 (5th Cir. 1979), cert. denied, 444 U.S. 842 (1979) (providing that the mere delegation of responsibility to another will not shield the otherwise responsible person from liability; delegation is effective if it is comprehensive as to power

failure of the Service to collect taxes from the employer.<sup>18</sup> Despite these arguments, courts have uniformly upheld the application of section 6672,<sup>19</sup> prompting several commentators to conclude that

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and authority over corporate affairs and the ultimate control over corporate management is placed completely in another officer.). See also *Daugherty v. United States*, 19 Cl. Ct. 335, 346 (1989). As currently applied, the delegation theory is contrary to the earlier lines of cases. See *Campbell v. Nixon*, 207 F. Supp. 826, 829 (E.D. Mich. 1962); *Wiggins v. United States*, 188 F. Supp. 374 (E.D. Tenn. 1960).

<sup>17</sup> *Bauer v. United States*, 543 F.2d 142, 148-49 (Ct. Cl. 1976) (finding that taxpayer was "at best" only a nominal figure of authority in the fiscal area).

<sup>18</sup> *Spivak v. United States*, 370 F.2d 612 (2nd Cir. 1967) (finding that the government's election to pursue responsible persons rather than the assets of an insolvent corporation was an appropriate exercise of administrative discretion). See also *United States v. Amon*, 669 F.2d 1351 (10th Cir. 1981) (providing that selective prosecution is permitted in both criminal and civil contexts without raising the specter of "government misconduct"); *Van Westerhuyzen v. U. S. Treasury Department*, 407 F. Supp. 334 (D. Minn. 1975); *Kelly v. Lethert*, 362 F.2d 629 (8th Cir. 1966).

<sup>19</sup> In examining the application of the statute, courts have focused on whether the targeted persons are responsible for collecting and paying over trust fund taxes and have willfully failed to remit such taxes to the Service. Of the approximately 270 federal and claims court cases decided since the Code's 1954 codification, taxpayers have prevailed in only twenty-three, mostly on technical grounds.

SUPREME COURT: *Slodov v. United States*, 436 U.S. 238 (1978) (willfulness prong of § 6672 is not intended to impose liability without personal fault).

FEDERAL COURTS OF APPEAL: *Elmore v. United States*, 842 F.2d 1128 (8th Cir. 1988) (trial court erred in omitting a *Slodov* instruction, specifically, the timing of assumption of control); *Nolan v. United States*, 829 F.2d 1126 (6th Cir. 1987) (taxpayer's judgment was reversed and remanded because the jury instructions omitted reference to "deliberate" choice, a critical component of willfulness); *Barrett v. United States*, 580 F.2d 449 (9th Cir. 1978) (taxpayer, who was dominated by her husband, did not have ultimate authority over expenditure of funds); *Haffa v. United States*, 516 F.2d 931 (7th Cir. 1975) (taxpayer lacked control over disposition of funds); *Adams v. United States*, 504 F.2d 73 (7th Cir. 1974) (case remanded to determine if taxpayer exercised substantial control over company's finances); *Dudley v. United States*, 428 F.2d 1196 (9th Cir. 1970) (taxpayer ceased being a responsible person before he had knowledge that the check to the Service was dishonored); *United States v. Graham*, 309 F.2d 210 (9th Cir. 1962) (case remanded to determine if board controlled payment of taxes or whether power was delegated to corporate officer).

FEDERAL DISTRICT COURTS: *Graunke v. United States*, 711 F. Supp. 388 (N.D. Ill. 1989) (taxpayer's authority was limited to accounting and bill paying at sole shareholder's order); *Mattingly v. United States*, 711 F. Supp. 1535 (D. Nev. 1989) (taxpayer's duties were confined to signing prepared checks at request of company president); *Abramson v. United States*, 55 A.F.T.R.2d (P-H) 1479 (E.D.N.Y. 1985) (taxpayer's limited check writing authority cannot be deemed to be discretion over which creditors to pay first); *Geiger v. United States*, 583 F. Supp. 1166 (D. Ariz. 1984) (although taxpayer had check writing authority, he lacked final word over monetary matters); *Fort v. United States*, 48 A.F.T.R.2d (P-H) 1427 (N.D. Ill. 1981) (taxpayer was not a responsible person; his check writing authority was a clerical duty); *Howard v. United States*, 38 A.F.T.R.2d (P-H) 6228 (N.D. Ohio 1976) (taxpayer was found not to be a responsible person); *United States v. Stanton*, 37 A.F.T.R.2d (P-H) 5744 (S.D. Fla. 1976) (taxpayer lacked responsibility for collection and payment of

the statute's reach is excessive and that its current application undermines, if not eviscerates, statutory intent. One such commentator noted: "Application of section 6672, as currently interpreted, often impose[s] a harsh penalty on morally innocent and unsuspecting business managers."<sup>20</sup> Another argued: "It is certainly not fair to saddle an individual corporate employee who is not responsible for the problem with a staggering corporate debt just to provide an alternate means of collection."<sup>21</sup> In reality, section 6672 is intended to be a powerful deterrent against the promiscuous or deliberate use of money which rightfully belongs to the government. It is only when courts construe the statute mechanically, without regard to the actual control possessed by the "responsible person," that section 6672 begins to reveal its most pernicious side.<sup>22</sup>

Part I of this article provides a framework for understanding the evolution of section 6672 by examining its historical underpinnings. Part II discusses the "responsible" component of section 6672, the judicially-created formulae for imposing penalties, and the justification for a bright-line test. Part III addresses the "will-

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taxes because he had no control over business finances); *Fried v. United States*, 68-1 U.S. Tax Cas. (CCH) ¶ 9372 (S.D. Fla. 1968) (taxpayer was not willful as he was prevented from making payment by co-signer's refusal to sign check); *Petrie v. United States*, 62-2 U.S. Tax Cas. (CCH) ¶ 9600 (N.D. Ga. 1962) (jury found taxpayer not responsible after "bad purpose" was stricken from "willful" definition); *Campbell v. Nixon*, 207 F. Supp. 826 (E.D. Mich. 1962) (taxpayer lacked authority to direct payment of tax obligations); *Bellah v. Patterson*, 197 F. Supp. 522 (N.D. Ala. 1961) (since taxpayer was not involved in financial aspects of company, she was not willful).

CLAIMS COURT•COURT OF CLAIMS: *Heimark v. United States*, 18 Cl. Ct. 15 (1989) (taxpayer lacked the status, duty and authority to make him a responsible person); *Stewart v. United States*, 19 Cl. Ct. 1 (1989) (taxpayer lacked final word over which creditors would be paid although he was an officer and an owner of the corporation); *Feist v. United States*, 607 F.2d 954 (Cl. Ct. 1979) (taxpayer was not willful because he acted in good faith by relying on successor entity's representation to satisfy the delinquency); *McCarty v. United States*, 437 F.2d 961 (Cl. Ct. 1971) (United States Navy, not taxpayer, was obligated to carry out taxpayer company's agreement with Service after it took over the company).

<sup>20</sup> Stephen J. Vasek, *The Hidden Tax Trap of I.R.C. Section 6672*, 67 Ky. L.J. 27, 73 (1978).

<sup>21</sup> James E. Hungerford, *Howard v. United States: Who Should Be Responsible for the 100 Percent Penalty?*, 12 U. Puget Sound L. Rev. 451, 470 (1989).

<sup>22</sup> The harsh effect of the statute was best captured by the Seventh Circuit: "[T]he statute is harsh, but the danger against which it is directed - that of failing to pay over money withheld from employees until it is too late, because the company has gone broke - is an acute one against which, perhaps, only harsh measures are availing." *Wright v. United States*, 809 F.2d 425, 428 (7th Cir. 1987). That this "remedial" statute is so endowed, combined with the magnitude of the corporate debt, makes the court's standard of review absolutely crucial to a just result.



fulness" requirement of section 6672 and its dilution in recent court interpretations. Finally, part IV assesses the impact of section 6672 legislation and the implications of retaining a collection system which penalizes unsuspecting corporate employees and essentially rubber-stamps the assessments of the Service. In the absence of major legislative reform, the author invites a return to a higher standard of willfulness akin to the pre-1959 applications which required an intent and capacity to defraud the government. This standard would balance government and individual interests while leaving intact the section's primary objective: to impose personal liability only on those persons responsible for deliberately diverting or dissipating "trust fund" taxes.

## II. STATUTORY HISTORY

### A. *Early Revenue Acts*

In the early 1800s, internal revenue represented only a fraction of total government revenue. Until the Civil War this revenue was matched by customs duties. Congress expanded the tax system in 1861, and, in order to collect money to accommodate the wartime effort, a special income tax was levied.<sup>23</sup> Penalty provisions included incarceration of taxpayers and property levies.<sup>24</sup> Intentional acts, distinguished from acts of neglect, were punishable by more severe penalties.<sup>25</sup>

In 1894, Congress passed a second income tax which was soon declared unconstitutional by the Supreme Court.<sup>26</sup> Nineteen years later, Congress enacted the Sixteenth Amendment which authorized Congress to lay and collect taxes from various sources and which became the fountainhead for section 6672 and all precursor provisions.

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<sup>23</sup> Bernard Grossfeld and James D. Bryle, *A Brief Comparative History of the Origins of the Income Tax in Great Britain, Germany and the United States*, 2 J. of T. P. 211, 237-40 (1983).

<sup>24</sup> Gerald P. Moran, *Willfulness: The Inner Sanctum or Unnecessary Element of Section 6672*, 11 Tol. L. Rev. 709, 726 (1980).

<sup>25</sup> *Id.* at 727.

<sup>26</sup> *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895).

*B. Revenue Act of 1918*

The antecedent provision of section 6672 was the Revenue Act of 1918.<sup>27</sup> Section 1308 of this act established a three-tiered scale of penalties for failure to comply with the federal excise tax provisions.<sup>28</sup> The third provision imposed an added criminal sanction equal to 100% of the evaded tax "if the offender willfully refused to comply with the general excise tax provisions."<sup>29</sup> Professor Moran has suggested that by employing the term willful, "Congress intended to impose a criminal sanction only where there existed an intentional and high degree of fault closely resembling, if not identical to, an interest to defraud the government of its taxes."<sup>30</sup>

Six years later, Congress enacted the Revenue Act of 1924.<sup>31</sup> The Act's substantive changes confirmed the relationship between the use of "willful" in criminal tax provisions and the antecedent provisions of the Revenue Acts of 1918 and 1921.<sup>32</sup> In addition to imposing a 100% penalty, the act provided:

Any person required under this Act to collect, account for and pay over any tax imposed by this Act, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this Act or the payment thereof, shall, in addition to other penalties provided by law, *be guilty of a felony . . . .*<sup>33</sup>

This penalty, which remained applicable to excise tax violations only, was proposed for inclusion in the general criminal tax sec-

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<sup>27</sup> Moran, *supra* note 24, at 732.

<sup>28</sup> Revenue Act of 1918, Ch. 18, section 1308(e), 40 Stat. 1057, 1143. This section reads: Any person who willfully refuses to pay, collect, or truly account for and pay over any such tax shall in addition to other penalties provided by law be liable to a penalty of the amount of the tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected: *Provided, However,* That no penalty shall be assessed under this subdivision for any offense for which a penalty may be assessed under authority of section 3176 of the Revised Statutes, as amended, or of section 605 or 620 of this Act, or for any offense for which a penalty has been recovered under section 3256 of the Revised Statutes.

*Id.*

<sup>29</sup> Moran, *supra* note 24, at 733.

<sup>30</sup> *Id.* at 737.

<sup>31</sup> Revenue Act of 1924, Pub. L. No. 176, 43 Stat. 253 (1924).

<sup>32</sup> Moran, *supra* note 24, at 740.

<sup>33</sup> Revenue Act of 1924, Pub. L. No. 176, 43 Stat. 253 § 1017(b) (emphasis added).

tion.<sup>34</sup> Subsequent tax revenue acts made all excise tax penalties applicable to social security taxes.<sup>35</sup> In 1939, the Code was once again consolidated and penalties relating to income and excise taxes were separately stated.<sup>36</sup> The graduated concept of misdemeanor to felony was not altered.<sup>37</sup> The 100% penalty, still confined to excise taxes, remained applicable only to the criminal tax provisions.<sup>38</sup>

### C. Tax Payment Act of 1943

In 1943, Congress enacted the Tax Payment Act (the "Act") which added excise tax penalties to the requirement to withhold income taxes.<sup>41</sup> The Act made clear that the responsibility for withholding *and paying* the tax rested with the employer. What was left unclear was the relationship of the Act to the withholding provisions of the 1935 Social Security Act. The Conference Report explained that the purposes of the legislation were "to promote efficiency and flexibility in the administration of the tax by the Government and the operations of the employer."<sup>42</sup> Ultimately, the Act was read into the Social Security Act of 1935 and excise tax penalties were imposed for failure to withhold income taxes.<sup>43</sup> Congress infused social security taxes with withholding taxes in one fell swoop, devoid of explication. By dismantling, rearranging, and amending a few provisions, the 100% penalty could now be characterized as an alternative means of at-source taxation.<sup>44</sup>

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<sup>34</sup> Moran, *supra* note 24, at 740.

<sup>35</sup> *Id.* at 745-47; Act of Aug. 14, 1935, ch. 531, § 807(a), 49 Stat. 620, 638.

<sup>36</sup> Int. Rev. Code of 1939; see also Moran, *supra* note 24, at 745-46.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.* at 747.

<sup>41</sup> Current Tax Payment Act of 1943, Pub. L. No. 68, 57 Stat. 126 (1943) (codified in U.S.C.A. §123).

<sup>42</sup> H.R. Rep. No. 510, 78th Cong., 1st Sess. (1943), reprinted in 1943 U.S.C.C.A.N. 2-41, 2-55. The Conference Report explained the modification: "Section 1627 under the Senate bill provides that all provisions of law, including penalties, applicable with respect to the social security tax on employees . . . shall, insofar as applicable and not inconsistent with the provisions of new subchapter D of chapter 9, be applicable with respect to the tax imposed under that subchapter." *Id.* at 2-56. See also Moran, *supra* note 24, at 748.

<sup>43</sup> H.R. Rep. No. 510, 78th Cong., 1st Sess. (1943), reprinted in 1943 U.S.C.C.A.N. 2-41, 2-56.

<sup>44</sup> Moran, *supra* note 24, at 748. "Collected at the source" refers to where the transaction took place.

#### D. 1954 Code Codification and Genesis of Section 6672

The final major overhaul of the Code occurred in 1954. The 100% penalty, now section 6672, was severed from the criminal provisions of earlier revenue acts and consolidated with the non-criminal penalties.<sup>45</sup> This initiative was undertaken to achieve procedural order and to combine all administrative provisions together in Subtitle F.<sup>46</sup> Section 6672, no longer a separate criminal penalty, was incorporated into the "Assessable Penalties" of subpart B.<sup>47</sup> As with earlier acts, Congress expressed no intent to alter its meaning by the procedural switch.<sup>48</sup>

While the legislative history of section 6672 may not illuminate the congressional intent concerning that provision, it is indisputable that the penalty was originally part of the criminal tax penalties. Recognizing this historical antecedent is critical to a correct interpretation of the statute. Although a judge's responsibility is to interpret the text of the statute and not necessarily to "reconstruct the intentions of legislators,"<sup>49</sup> such restraint can and should occur only if the language is unambiguous. However, if the text in question is ambiguous, it is necessary for the judge to "rationalize the law - make those adjustments that coexisting texts require in order that the *corpus juris* on a whole makes sense."<sup>50</sup> In the construction of section 6672, this element of judicial scrutiny has been noticeably absent.

### III. "RESPONSIBLE PERSON" — A REALITY TEST

#### A. *The Mazo Formula*

Prior to 1979, courts had no benchmark for determining who was a "responsible person." In 1979, the Fifth Circuit decided *Mazo v.*

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<sup>45</sup> Int. Rev. Code of 1954 §6672.

<sup>46</sup> H.R. Rep. No. 1337, 83rd Cong., 2d Sess. (1954), reprinted in 1954 U.S.C.C.A.N. 4137, 4543.

<sup>47</sup> Moran, *supra* note 24, at 749.

<sup>48</sup> H.R. Rep. No. 1337, 83rd Cong., 2d Sess. (1954), reprinted in 1954 U.S.C.C.A.N. 4137, 4568.

<sup>49</sup> Note, Why Learned Hand Would Never Consult Legislative History Today, 105 Harv. L. Rev. 1005 (1992).

<sup>50</sup> See, e.g., Wisconsin Pub. Intervenor v. Mortier, 111 S. Ct. 2476, 2487-88, 2490-91 (1991) (Scalia, J., Concurring); Antonin Scalia, Speech on Use of Legislative History (delivered between Fall, 1985 and Spring, 1986 at various law schools) (transcripts on file at Harvard Law School Library).

*United States*.<sup>51</sup> The court rejected the taxpayer's argument that liability is predicated on actual knowledge of the tax liability, choosing instead to fashion a three-part test to satisfy the inquiry concerning responsibility: "responsibility is a matter of status, duty and authority, not knowledge."<sup>52</sup> Courts must consider all three factors in assessing a corporate officer's potential liability for non-payment of taxes.<sup>53</sup> The status analysis focuses on the person's position within the corporate hierarchy, e.g. director, shareholder, or officer.<sup>54</sup> The determination concerning duty shifts the focus to responsibility and is occasionally, but not often, set forth explicitly or implicitly in corporate minutes,<sup>55</sup> articles of incorporation<sup>56</sup> or corporate by-laws.<sup>57</sup> Finally, the authority analysis considers who had power to control the decision-making process by which funds were allocated to creditors other than the government.

Since *Mazo*, courts have applied this three-part test to determine whether an individual is a "responsible person." The test makes eminent sense if applied correctly. But in numerous cases decided after *Mazo*, courts have altered the analysis, using status to reach the issue of whether the person's duty entailed the obligation to pay creditors. This revision of the test is both confusing and unwise. For high corporate officials, as opposed to bookkeepers who typically perform ministerial rather than discretionary acts, duty might be easily derived from status. On the other hand, non-officeholders and employees, including those who work for charitable organizations, also have been held liable for the penalty.<sup>58</sup> Even this extension of liability would be acceptable if the

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<sup>51</sup> *Mazo v. United States*, 591 F.2d 1151 (5th Cir. 1979), cert. denied, 444 U.S. 842 (1979).

<sup>52</sup> *Id.* at 1156.

<sup>53</sup> In *Mazo*, the officers protested the district court's decision granting the government's motion for summary judgment by claiming that each had title and position without authority. The Fifth Circuit concluded that they were responsible persons both before and after the tax liability accrued under the statute since, "to paraphrase an aphorism of the last President Harry Truman, the corporate buck stopped with them." *Id.* at 1152. They were therefore under a duty to use the after-acquired funds to satisfy the tax obligation. *Id.* at 1157.

<sup>54</sup> *Bloom v. United States*, 272 F.2d 215 (9th Cir. 1959); *Shepherd v. United States*, 38 A.F.T.R. 2d (P-H) ¶ 76-6103 (E.D. Mich. 1976); *White v. United States*, 372 F.2d 513 (Cl. Ct. 1967).

<sup>55</sup> *Nolan v. United States*, 829 F.2d 1126 (6th Cir. 1987).

<sup>56</sup> *Schweitzer v. United States*, 193 F. Supp. 309, 312 (D. Neb. 1961).

<sup>57</sup> *United States v. Strebler*, 313 F.2d 402, 404 (8th Cir. 1963).

<sup>58</sup> See *In re Stanley*, 92-2 U.S. Tax Cas. (CCH) ¶ 50,480, 85,655 (E.D.N.C. 1992) (holding

factors were weighted properly, with a clear focus on authority. However, as one commentator has correctly noted: "Status as a separate factor tends to skew the focus of the inquiry."<sup>59</sup> While status may be relevant to the inquiry because it could be indicative of duty, the proper test should focus on duty and authority because these are key indicators of responsibility.

Without a proper, balanced focus, courts cannot function as a laboratory for reflection, increasing the propensity for an arbitrary or unjust result. This propensity became a reality in a series of appellate cases decided in the Fifth and Eleventh Circuits. In *Howard v. United States*,<sup>60</sup> the taxpayer Howard, a director, minority shareholder, Treasurer and Executive Vice-President, was in charge of the corporation's day-to-day business affairs.<sup>61</sup> Howard issued a check to the Service but Jennings, the President and majority shareholder, ordered Howard not to pay the Service any more money.<sup>62</sup> He also relieved Howard of his duties for several weeks.<sup>63</sup> After reinstating Howard, Jennings instructed him not to pay any bills without his approval.<sup>64</sup>

Even though Howard did not have ultimate authority over corporate affairs, the court imposed liability, finding that Howard had sufficient authority to be deemed a "responsible person." Defining "authority" as the "effective power to pay," the court concluded Howard was so vested because he signed checks to creditors other than the government, and these checks had been issued by Howard's signature alone without the approval of the chief executive officer.<sup>65</sup> The court noted: "The fact that Jennings might well have fired Howard had he disobeyed Jennings' instructions and paid the taxes does not make Howard any less responsible for their pay-

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controlling persons of anti-poverty organizations are liable for the 100% penalty). See also *Mulcahy v. United States*, 237 F. Supp. 656 (S.D. Tex. 1964) (asserting that a person who is merely counsel for a corporation may be held liable to the 100% penalty, thereby denying the parties request for injunction).

<sup>59</sup> See *Hungerford*, supra note 21, at 463.

<sup>60</sup> 711 F.2d 729 (5th Cir. 1983).

<sup>61</sup> *Id.* at 731. The chances of a person being found responsible are heightened if s/he occupies more than a single position, particularly if one of those positions places the person close to corporate finances. See infra note 81 and accompanying text.

<sup>62</sup> *Howard*, 711 F.2d at 731.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 734.

ment.”<sup>66</sup> Howard’s obligation under section 6672 was ostensibly paramount to following the directives of his superior.

According to the court, Howard had the status and the requisite authority to pay creditors even though the authority was not plenary. But Howard’s authority did not extend to the payment of taxes. The court’s failure to acknowledge this indispensable provision of the statute indicates that *Howard* was wrongly decided. Despite the weighty public interest in ensuring payment of government trust funds, the judicial expansion in *Howard* is unjustified and places persons like Howard in a virtual catch-22: not following his superior’s directive would have subjected him to termination while following the directive would have subjected him to enormous penalties.

*Howard* represents an errant departure from the pronouncements of earlier courts and a renunciation of the final word test first articulated in *Adams v. United States*.<sup>67</sup> Under this test, a person is responsible if he had the final word over what bills, including taxes, should be paid.<sup>68</sup> In *Howard*, the court clearly acknowledged the taxpayer’s limited ability to make these decisions but focused instead on his position within the corporate structure and his authority to sign small checks without the approval of Jennings. One wonders how the court would have decided this case if Howard had in fact paid the Service in small dollar increments coterminous with his authority. Based on the Fifth Circuit’s analysis, Howard not only would have been assessed for the balance of the tax, he also would have been terminated.

Despite the analytical flaws of *Howard*, the Eleventh Circuit

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<sup>66</sup> *Id.* The court was unaffected by Howard’s concern regarding job tenure:

Howard had the status, duty and authority to pay the taxes owed, and would only have lost that authority after he had paid them . . . . Had Jennings fired Howard for paying the taxes, Howard would have at least fulfilled his legal obligations (footnote omitted). Faced with the possibility of leaving the frying pan with only minor burns, Howard chose instead to stay on in the vain hope of avoiding the fire. While we appreciate the difficulty of his position, we cannot condone his abdication of the responsibility imposed upon him by law.

*Id.*

<sup>67</sup> 504 F.2d 73 (7th Cir. 1974).

<sup>68</sup> With the eventual solidification of the *Mazo* test, the final word standard, defined as “ultimate control,” was replaced with “significant [not ultimate, nor exclusive] control.” The effect of this alteration was to increase the likelihood of a superficial judicial analysis to justify the government’s imperative of securing the trust fund taxes.

adopted its holding without scrutiny in *Roth v. United States*.<sup>69</sup> Roth, who was neither a director nor a stockholder of the corporation, was held liable for his employer's failure to pay withholding taxes despite the fact that he was specifically instructed by Dobbins, the company's CEO, not to pay.<sup>70</sup> The court essentially concluded that no instruction by Dobbins could effectively bar an otherwise responsible person from paying these funds in accordance with the law. Even after he was instructed by Dobbins not to pay the taxes, Roth continued to make wage deductions knowing that he could not transmit funds to the government.<sup>71</sup> The statute creates a distinct obligation on every responsible officer to remit the withheld taxes to the Service.<sup>72</sup> Therefore, Roth was a responsible person as a matter of law.<sup>73</sup> As in *Howard*, the court decided that Roth was under no obligation to obey directives from Dobbins not to pay the taxes.<sup>74</sup>

In dissent, Judge Godbold correctly explained that section 6672 was not intended to impose liability when a person fails to exercise authority which he did not have, or — even if he had authority — when his failure to exercise such authority was not willful.<sup>75</sup> Although Roth could sign checks, the employer had withdrawn his authority to choose which creditors to pay.<sup>76</sup> Godbold asserted: “[R]esponsibility to pay must derive from status and authority, not status and authority from responsibility to pay.”<sup>77</sup>

The district court in *Roth* had explicitly rejected *Howard*, stating that the decision was a “totally surprising and unnecessary departure” from existing law and that it “unjustifiably and harshly penalizes an individual who acted as would any reasonable man under those circumstances.”<sup>78</sup> Nonetheless, simply because Roth

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<sup>69</sup> 779 F.2d 1567 (11th Cir. 1986).

<sup>70</sup> *Id.* at 1571-72.

<sup>71</sup> *Id.* at 1571.

<sup>72</sup> *Id.* at 1572.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.* at 1574. (Godbold, C. J., concurring in part, dissenting in part.)

<sup>76</sup> *Id.* at 1573.

<sup>77</sup> *Id.* at 1575.

<sup>78</sup> 84-1 U.S. Tax Cas. (CCH) ¶ 9319, 83,730 (N.D. Ala. 1984). Concerned with the severe ramifications of *Howard*, the court asserted:

This court is therefore quite surprised that the *Howard* court announced a rule that now requires employees to make the hard and very difficult decision of facing unemployment or gambling that the company will pay the taxes at some future date. An



had some uncontestable check-writing authority, the Eleventh Circuit reversed,<sup>79</sup> despite the fact that such authority did not extend to writing checks to the Service.

Both *Howard* and *Roth* are examples of judicial fact-finding gone awry. Neither employee had authority to direct the required payment to the Service. As a result, the holdings in both cases are unduly severe and incompatible with the language in section 6672 which requires the employee to be under a duty to pay the tax.

### B. *The Elaboration of Mazo's "Control" [Authority] Factor*

Although *Mazo* established the three-part test concerning responsible persons, without more, the test is difficult if not impossible to apply. Section 6672 cases are fact-intensive and often the line between sufficient and insufficient control is unclear. For example, it has been held that exercising authority to co-sign checks is not in and of itself enough to impose responsibility.<sup>80</sup>

Courts have used a number of factors to determine whether the requisite degree of control exists. These factors are:

(1) The identity of corporate officers, directors and shareholders;<sup>81</sup>

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employee lacking a determinative voice as to which creditors will be paid should not be faced with such a choice.

Id.

<sup>79</sup> *Roth*, 779 F.2d at 1572.

<sup>80</sup> *Haffa v. United States*, 516 F.2d 931 (7th Cir. 1975).

<sup>81</sup> The assumption is that high-ranking officials can exercise decision-making authority. This includes the authority to divert funds to preferred creditors. In nearly all reported cases, the responsible person has been either a shareholder, director or officer of the corporate entity. Often, the responsible person has several titles.

PRE-SECTION 6672: *Bloom v. United States*, 272 F.2d 215 (9th Cir. 1959) (majority shareholder, president and chief executive officer); *In re Haynes*, 88 F. Supp. 379 (D.Kan. 1949) (shareholder, director, president).

SECTION 6672-FEDERAL COURTS OF APPEAL: *McDonald v. United States*, 939 F.2d 916 (11th Cir. 1991) (shareholder and president); *Kizzier v. United States*, 598 F.2d 1128 (8th Cir. 1979) (shareholder, president and treasurer); *Turner v. United States*, 423 F.2d 448 (9th Cir. 1970) (director and vice-president); *George v. United States*, 819 F.2d 1008 (11th Cir. 1987) (shareholder, director, vice-president); *Frazier v. United States*, 304 F.2d 528 (5th Cir. 1962) (shareholder and president).

SECTION 6672-FEDERAL DISTRICT COURTS: *Sherman v. United States*, 490 F. Supp. 747 (E.D. Mi. 1980) (director and president); *Goebert v. United States*, 412 F. Supp. 356 (E.D. Pa. 1976) (shareholder and president); *Braden v. United States*, 318 F. Supp. 1189 (S.D. Ohio 1970) (shareholder, director and treasurer).

SECTION 6672-CLAIMS COURT-COURT OF CLAIMS: *Schultz v. United States*, 19

(2) The duties of the officer as outlined in the corporate by-laws;<sup>82</sup>

(3) The identity of individuals who prepared taxes forms;<sup>83</sup>

(4) The identity of individuals who hired and fired personnel;<sup>84</sup>  
and

(5) The identity of individuals who controlled the financial affairs of the corporation. This usually refers to individuals who possess the ability to write checks on behalf of the corporation.<sup>85</sup>

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Cl.Ct. 280 (1990) (shareholder and president); *Burack v. United States*, 461 F.2d 1282 (Ct. Cl. 1972) (shareholder and vice president).

<sup>82</sup> *McDermitt v. United States*, 91-1 U.S. Tax Cas. (CCH) ¶ 50,094 (S.D. Ohio 1991); *United States v. Strebler*, 313 F.2d 402 (8th Cir. 1963).

<sup>83</sup> For variations on the tax preparation theme, see *Godfrey v. United States*, 748 F.2d 1568, 1575 (Fed. Cir. 1984) (concluding that mechanical duties of signing checks and preparing tax returns are not determinative of liability); *McGlothlin v. United States*, 720 F.2d 6, 8 (6th Cir. 1983) (providing that to be "responsible," it is not necessary that a person be the one who prepared tax returns); *Labowitz v. United States*, 352 F.Supp. 202, 205 (S.D.N.Y. 1972) (providing that signing of tax returns combined with part payment agreement was tantamount to an admission of liability); *Peck v. United States*, 91-1 U.S. Tax Cas. (CCH) ¶ 50,208 (D. Md. 1991) (concluding that signing of the forms goes to the issue of *knowledge* of tax delinquency, not necessarily control over the payment function).

<sup>84</sup> *Thibodeau v. United States*, 828 F.2d 1499, 1503 (11th Cir. 1987) (indicia of responsibility includes the duty to hire and fire employees); *Moore v. United States*, 465 F.2d 514, 517 (5th Cir. 1972) (taxpayer had the authority to hire and fire employees); *IRS. v. Blais*, 612 F. Supp. 700, 707 (D. Mass. 1985) (taxpayer, exercising power of attorney, hired and fired employees); *Gold v. United States*, 506 F. Supp. 473, 478 (E.D.N.Y. 1981) (taxpayer tacitly approved the corporation's hiring decisions); *Labowitz v. United States*, 352 F. Supp. 202, 208 (S.D.N.Y. 1972) ("In considering who the responsible person is under section 6672 the court may also consider the identity of the individual who hired and controlled the employees"); *Schultz v. United States*, 19 Cl. Ct. 280, 284 (1990) (taxpayer exercised final authority over personnel decisions); *White v. United States*, 372 F.2d 513, 517 (Ct. Cl. 1967) (taxpayer hired and laid off employees).

<sup>85</sup> Check signing authority assumes a particular saliency in determining whether significant control over corporate funds exists. Significantly, it demonstrates the ability to move money. In almost all cases where liability was upheld, the taxpayer had either full signatory or co-signatory status on corporate checking accounts.

PRE-SECTION 6672: *Wiggins v. United States*, 188 F. Supp. 374 (E.D. Tenn. 1960).

SECTION 6672-FEDERAL COURTS OF APPEAL: 1ST CIRCUIT - *Thomsen v. United States*, 887 F.2d 12 (1st Cir. 1989); *Caterino v. United States*, 794 F.2d 1 (1st Cir. 1986); *Harrington v. United States*, 504 F.2d 1306 (1st Cir. 1974). 2ND CIRCUIT - *Hochstein v. United States*, 900 F.2d 543 (2nd Cir. 1990), cert. denied, 112 S. Ct. 2967 (1992). 5TH CIRCUIT - *Morgan v. United States*, 937 F.2d 281 (5th Cir. 1991); *Wood v. United States*, 808 F.2d 411 (5th Cir. 1987); *Howard v. United States*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. United States*, 591 F.2d 1151 (5th Cir.), cert. denied, 444 U.S. 842 (1979); *Genins v. United States*, 489 F.2d 95 (5th Cir. 1974); *Brown v. United States*, 464 F.2d 590 (5th Cir. 1972), cert. denied, 410 U.S. 908 (1973); *Moore v. United States*, 465 F.2d 514 (5th Cir. 1972);

These factors are non-exclusive and generally guide a court in

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Mueller v. Nixon, 470 F.2d 1348 (6th Cir. 1972), cert. denied, 412 U.S. 949 (1972); Newsome v. United States, 431 F.2d 742 (5th Cir. 1970); Hewitt v. United States, 377 F.2d 921 (5th Cir. 1967); Cash v. Campbell, 346 F.2d 670 (5th Cir. 1965); Frazier v. United States, 304 F.2d 528 (5th Cir. 1962). 6TH CIRCUIT - Collins v. United States, 848 F.2d 740 (6th Cir. 1988); Gephart v. United States, 818 F.2d 469 (6th Cir. 1987); Calderone v. United States, 799 F.2d 254 (6th Cir. 1986); 7TH CIRCUIT - Purdy Co. of Ill. v. United States, 814 F.2d 1183 (7th Cir. 1987); Wright v. United States, 809 F.2d 425 (7th Cir. 1987); Flan v. United States, 326 F. 2d 356, 358 (7th Cir. 1964). 8TH CIRCUIT - Kizzier v. United States, 598 F.2d 1128 (8th Cir. 1979); Emshwiller v. United States, 565 F.2d 1042, 1045 (8th Cir. 1977); United States v. Strebler, 313 F.2d 402 (8th Cir. 1963). 9TH CIRCUIT - Teel v. United States, 529 F.2d 903 (9th Cir. 1976); Turner v. United States, 423 F.2d 448 (9th Cir. 1970). 11TH CIRCUIT - Williams v. United States, 931 F.2d 805 (11th Cir. 1991); Smith v. United States, 894 F.2d 1549 (11th Cir. 1990); George v. United States, 819 F.2d 1008 (11th Cir. 1987); Thibodeau v. United States, 828 F.2d 1499 (11th Cir. 1987); Roth v. United States, 779 F.2d 1567 (11th Cir. 1986).

SECTION 6672•FEDERAL DISTRICT COURTS: Carlson v. United States, 91-1 U.S. Tax Cas. (CCH) ¶ 50,262 (D. Utah 1991); Peek v. United States, 91-1 U.S. Tax Cas. (CCH) ¶ 50,208 (D. Md. 1991); Mattingly v. United States, 711 F. Supp. 1535 (D. Nev. 1989); Causey v. United States, 683 F. Supp. 1381 (M.D. Ga. 1988); Simpson v. United States, 664 F. Supp. 43 (E.D.N.Y. 1987); IRS v. Blais, 612 F. Supp. 700 (D. Mass 1985); Huggins v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9192 (N.D. Tex. 1984); Hildebrand v. United States, 563 F. Supp. 1259 (D.N.J. 1983); Verdung v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9324 (N.D. Ill. 1983); Silberberg v. United States, 524 F. Supp. 744 (E.D.N.Y. 1981); Gold v. United States, 506 F. Supp. 473 (E.D.N.Y. 1981); Sherman v. United States, 490 F. Supp. 747 (E.D. Mich. 1980); United States v. Newell, 79-1 U.S. Tax Cas. (CCH) ¶ 9178 (S.D. Fla. 1978); Goebert v. United States, 412 F. Supp. 356 (E.D. Pa. 1976); Hoeniger v. United States, 76-1 U.S. Tax Cas. (CCH) ¶ 9296 (S.D.N.Y. 1976); Shepherd v. United States, 38 A.F.T.R. 2d (P-H) ¶ 76-5332 (E.D. Mich. 1976); Jacoby v. United States, 75-2 U.S. Tax Cas. (CCH) ¶ 9853 (S.D.N.Y. 1975); Adams v. United States, 35 A.F.T.R. 2d (P-H) ¶ 75-583 (W.D. Wisc. 1974); Garnett v. United States, 385 F. Supp. 665 (E.D. Ky. 1974); Miller v. United States, 33 A.F.T.R. 2d (P-H) ¶ 74-1007 (M.D. Fla. 1974); Stake v. United States, 347 F. Supp. 823 (D. Minn. 1972); Braden v. United States, 318 F. Supp. 1189 (S.D. Ohio 1970); Guthrie v. United States, 316 F. Supp. 1225 (E.D. Wisc. 1970); National Bank of Commerce v. Phinney, 65-2 U.S. Tax Cas. (CCH) ¶ 9512 (S.D. Tex. 1965); United States v. Sefansky, 16 A.F.T.R. 2d (P-H) ¶ 65-5176 (E.D. Mich. 1965); Schweitzer v. United States, 193 F. Supp. 309 (D. Neb. 1961).

SECTION 6672•CLAIMS COURT•COURT OF CLAIMS: Schultz v. United States, 19 Cl. Ct. 280 (1990); Heimark v. United States, 18 Cl. Ct. 15 (1989); Stewart v. United States, 19 Cl. Ct. 1 (1989); McCarty v. United States, 437 F.2d 961 (Ct. Cl. 1971); Barrett v. United States, 580 F.2d 449 (Ct. Cl. 1978); Bolding v. United States, 565 F.2d 663 (Ct. Cl. 1977); Bauer v. United States, 543 F.2d 142 (Ct. Cl. 1976) (noting that "[i]n each case in this court in which a person was found to possess the requisite 'duty' under section 6672 of the code, it has been established by the evidence that he actually signed or co-signed corporate checks"); Burack v. United States, 461 F.2d 1282 (Ct. Cl. 1972); White v. United States, 372 F.2d 513 (Ct. Cl. 1967).

SECTION 6672•BANKRUPTCY COURT: Matter of Osborn, 4 B.R. 431 (Bankr. W.D. Mo. 1979).

Check signing authority may not be dispositive if other signatures are required. Compare Fried v. United States, 68-1 U.S. Tax Cas. (CCH) ¶ 9372 (S.D. Fla. 1968), holding that

determining whether an individual is a responsible party. No one factor is determinative.<sup>86</sup>

*C. The Scope of the "Responsible Person" Net: Who's In/  
Who's Out*

Section 6672 triggers a 100% penalty against "[a]ny person required to collect, truthfully account for, and pay over any tax."<sup>87</sup> The Code defines person in section 6671(b) as: "an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is *under a duty to perform the act in respect of which the violation occurs.*"<sup>88</sup> The Ninth Circuit addressed the issue of who qualifies as a person for the purposes of this section in *United States v. Graham*.<sup>89</sup> Graham contended that he was not a "person" within the meaning of 6671(b) since he functioned as an outside board member and was not an executive officer or employee. Rejecting this narrow construction as inherently contrary to the purpose and spirit of section 6672, the court concluded that while the term "person" includes officer and employee, it does not exclude other classifications: "The section must be construed to include all those so connected with a corporation as to be responsible for the performance of the act in respect of which the violation occurred."<sup>90</sup>

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plaintiff was not a responsible person and had no duty to pay the tax, with *Kraus v. United States*, 85-1 U.S. Tax Cas. (CCH) ¶ 9310 (E.D.N.Y. 1985), holding that veto power over the disbursement of corporate funds constituted sufficient authority. Kraus was without authority to sign checks in excess of \$150 without the approval of his supervisor. The court determined that Kraus had the authority to block the dissipation of funds simply by refusing to place his signature on the checks used to pay other creditors. "As a co-signer on all checks who knowingly divert[ed] trust funds to other sources, he [was] personally liable." *Kraus*, 85-1 U.S. Tax Cas. (CCH) at 87,752.

<sup>86</sup> See *McDermitt v. United States*, 954 F.2d 1245 (6th Cir. 1992).

<sup>87</sup> I.R.C. § 6672(a).

<sup>88</sup> I.R.C. § 6671(b) (emphasis added).

<sup>89</sup> 309 F.2d 210 (9th Cir. 1962).

<sup>90</sup> *Id.* at 212. This broad definition of "person" was solidified by the Sixth Circuit in *Mueller v. Nixon*, 470 F.2d 1348, 1350 (6th Cir. 1972), cert. denied, 412 U.S. 949 (1973). *Mueller*, who was neither an employee nor an officer of the corporation, was nonetheless found to be within the scope of § 6671(b) because he had complete control over corporate operations. "The definition of 'person' employed by Congress is not phrased in terms of exclusion. . . . [B]y use of the word 'include[s]' the definition suggests a calculated indefiniteness with respect to the outer limits of the term' defined." *Id.* at 1350 (quoting *First Nat'l Bank In Plant City, Plant City, Florida v. Dickinson*, 396 U.S. 122 (1969)). The view that authority need not arise out of any "officer or employee" status within the corporate

Since *Graham*, courts have expanded the reach of section 6672 to include lenders and sureties,<sup>91</sup> an attorney who functions outside the corporate hierarchy,<sup>92</sup> and an accounting firm.<sup>93</sup> The

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hierarchy is generally accepted. See *United States v. Lawrence*, 327 F. Supp. 650 (N.D. Tex. 1971) (finding that the sole beneficiary of deceased responsible person was a person liable for the 100% penalty under the Texas Probate Court); *Regan & Co. v. United States*, 290 F. Supp. 470 (E.D.N.Y. 1968) (holding that a joint venture and its president were both persons required to collect, truthfully account for and pay over withholding taxes); *Melillo v. United States*, 244 F. Supp. 323 (E.D.N.Y. 1965) (finding that plaintiff, by virtue of control over the finances of a bakery he was purchasing, was a responsible person); *Flan v. United States*, 326 F.2d 356 (7th Cir. 1964) (finding that president and principal stockholder was a "person"); *Tiffany v. United States*, 228 F. Supp. 700 (D.N.J. 1963) (noting that controlling stockholder who exercised authority over operations was a responsible person); *Botta v. Scanlon*, 314 F.2d 392, 394 (2nd Cir. 1963) (reference to officers and employees in § 6671(b) may be exemplary and not inclusive).

<sup>91</sup> *Pacific National Insur. Co. v. United States*, 422 F.2d 26 (9th Cir), cert. denied, 398 U.S. 937 (1970). The court rejected the argument that Pacific was not the employer of Central's employees nor an officer or employee of Central:

[I]t is our conclusion that the language of these provisions is broad enough to reach an entity which assumes the function of determining whether or not an employer will pay over taxes withheld from its employees; that this reading of the language serves the evident purpose of the statute; and that the district court's findings that Pacific performed this function with respect to Central is fully justified by the record.

It would frustrate [the statute's] purpose needlessly to imply a condition limiting the application of the section to those nominally charged with controlling disbursements of a corporate employer, thus immunizing those who, through agreement with or default of those nominally responsible, have exercised this corporate function in fact.

*Id.* at 30-31. See also *Anderson v. United States*, 561 F.2d 162 (8th Cir. 1977). The court's emphasis on substance over form was even more evident in *United States v. Security Pacific Business Credit*, 956 F.2d 703 (7th Cir. 1992). In a case of first impression, the Seventh Circuit interpreted the intersection of § 6672, § 3505(b) and cumulative liability. Rejecting the lender's argument that one adjudged a responsible person will *ipso facto* face a § 3505(b) violation and that "Congress must have had a reason for not making the penalty in § 6672 equal to the sum of the tax due and interest on the tax," the court concluded:

[L]egislative omniscience is not a realistic assumption . . . . [I]t belongs to a style of statutory interpretation that places greater emphasis on the text of statutes than on intentions behind them . . . . Liability for two wrongs that inflict two distinct harms is not generally less just because the two wrongs are committed by one person rather than by two.

*Id.* at 707. The cumulation of penalties was upheld. *Id.*

<sup>92</sup> In *Brown v. United States*, 464 F.2d 590 (5th Cir. 1972), the Fifth Circuit Court of Appeals imposed § 6672 liability on an attorney who became nominal president of his client's corporation. The court was not persuaded by Brown's argument that he possessed only token managerial responsibility and his co-signature on company checks was "literally a rubber stamp." *Id.* at 591. While Brown may have lacked the direct personal duty to collect, account for, and pay over the taxes, he co-signed all corporate checks, actively participated in efforts to secure additional financing for relief, and made the decision to terminate Gulf's operations. In a clear caveat, the court said, "Were we to hold to the contrary — that lack of

point is that courts have not allowed persons or entities who have the actual power to pay available corporate funds to the Service to escape liability based on a literal reading of the term "responsible person."

#### *D. The Justification for a Bright-Line Test*

##### *1. The Need to Protect the Innocent*

The built-in safeguards of section 6672 offer protection to those who do not have control over the financial affairs of the corporation, specifically, disbursements of funds and priorities of payments to creditors.<sup>94</sup> Even assuming requisite control can be estab-

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individual authority to sign corporate checks insulated Brown from liability — we would surely open the door to protective co-signing arrangements. The effect of such a holding would tend to emasculate section 6672." *Id.* at 591.

<sup>93</sup> *In re Quattrone Accountants*, 895 F.2d 921 (3rd Cir. 1990) (an accounting firm which has significant control over the debtor's finances, i.e. authority to pay monthly bills without prior approval, the unrestricted use of a signature stamp of the president and treasurer of the company, and the authority to determine priority of payment is "responsible"). *Id.* at 927. But, courts have correctly responded to situations where the Service becomes too zealous in pursuing persons with significant authority, regardless of whether they are directors, officers, or shareholders. See *In re Gary Ray Brown v. United States*, 130 B.R. 456 (Bankr. W.D. Pa. 1991) (holding that a debtor who is hired as temporary manager for six weeks but who has no authority to sign checks, hire key employees, prepare tax returns, or decide priority of payment, cannot be held "responsible"); *In re Tripplett*, 115 B.R. 955 (Bankr. N.D. Ill. 1990) (holding that a temporary manager of a church academy, who had authority to sign checks once others determined who should be paid, was not a "responsible" person); see also *Simpson v. United States*, 664 F. Supp. 43 (E.D.N.Y. 1987) (finding that a hospital's board of trustees, which did not function in or administer the day-to-day operations of the hospital, sign checks or participate in the crucial financial functions - collecting, accounting, or paying of withholding taxes - was not responsible: "[N]o rational individual would volunteer to serve on the board of a not-for-profit corporation, unless, at least, he were covered by a substantial insurance policy."). *Id.* at 49. See generally Doreen McCall, Comment, Who is a "Responsible Person" - The Overreaching Power of the Internal Revenue Service to Collect Employer Withholding Taxes, 18 Ohio N.U.L. Rev. 905 (1992).

<sup>94</sup> A person who lacks total control over fiscal affairs cannot be a responsible person. *Bauer v. United States*, 543 F.2d 142, 148 (Ct. Cl. 1976). In *Bauer*, the Court distinguished between control over fiscal areas versus the more technical areas of production, quality control and scheduling. Taxpayer was appointed rather than elected to the board of directors and the business operation did not subscribe to the customary corporate formalities of annual meetings and minutes. See also *Clouse v. United States*, No. 88-1010, Slip op. (6th Cir. 1989). In discussing Clouse's role in corporate affairs, the Sixth Circuit focused on his supervision of the manufacturing operation, a function tangential to the financial affairs of OCTRA. "The ability of Clouse, as a substantial creditor to negotiate for repayment of his debt, or as an unpaid landlord to lock out a tenant, is quite distinct from any corporate authority to direct payment of creditor." *Id.* at 9 (emphasis added).

lished, unencumbered funds must be available.<sup>95</sup> The law does not require satisfaction of tax liabilities where other creditors have perfected their interests.<sup>96</sup>

On the other hand, the severity of the statute cannot be underestimated. It is harsh and far-reaching, intended to protect the government when responsible persons dip into the "trust fund" and deliberately allocate money for uses other than payment of the tax liability. Regardless of the amount of money involved, which can be virtually inconsequential, the act itself constitutes a preference over the government, thus triggering the assessment. Once the assessment is generated, the taxpayer faces an extraordinary maze of presumptions and burdens, causing one commentator to note: "Section 6672 has no parallel in the tax legislation of the United States."<sup>97</sup>

## 2. *Taxpayer Carries the Burden of Proof*

The taxpayer carries the burden of proving that he was not a responsible party in both refund claims and the counterclaim;<sup>98</sup> this is a difficult burden to meet because assessments are made in summary fashion and are presumptively correct. In an attempt to avoid having to meet this burden, plaintiffs have asserted due process claims against assessment procedures.

In *Oliver v. United States*, taxpayer claimed a due process violation when, after acquiring the entire administrative file, she could not glean the basis for the assessment.<sup>99</sup> Taxpayer contended that she was denied an opportunity to challenge a presumptively correct assessment which she assumed the burden of rebutting.<sup>100</sup> The court conceded that "[f]airness may indeed require that the tax-

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<sup>95</sup> *Slodov v. United States*, 436 U.S. 238 (1978). See also *infra* § II(D)(5).

<sup>96</sup> *In re Premo*, 116 B.R. 515 (Bankr. E.D. Mich. 1990).

<sup>97</sup> See *Moran*, *supra* note 24.

<sup>98</sup> *Collins v. United States*, 848 F.2d 740, 742 (6th Cir. 1988); *Ruth v. United States*, 823 F.2d 1091, 1093 (7th Cir. 1987); *Calderone v. United States*, 799 F.2d 254, 258 (6th Cir. 1986); *Sinder v. United States*, 655 F.2d 729, 731 (6th Cir. 1981); see also *McDermitt v. United States*, 954 F.2d 1245, 1251 (6th Cir. 1992) (asserting that "[w]hen a party pays part of the penalty existing for failure to pay withheld taxes and the government counterclaims for the remainder of the refund, the taxpayer has the burden of proving that the assessment was wrong . . . [and the] assessment is presumed to be correct.").

<sup>99</sup> 921 F.2d 916, 921 (9th Cir. 1990).

<sup>100</sup> *Id.* at 921.

payer know the basis for an assessment.”<sup>101</sup> However, the district court did not limit its inquiry to a differential review of the administrative record, but instead afforded the taxpayers a *de novo* trial with respect to the merits of their claim for a refund.<sup>102</sup> Since taxpayer was given the usual discovery powers of a full adversarial proceeding, a due process violation could not be sustained.<sup>103</sup>

Additionally, a taxpayer cannot assert a due process claim to require a judicial hearing prior to the Service’s attachment of assets on partial payment satisfaction. In *Cohn v. United States*,<sup>104</sup> the plaintiffs did not contest section 6672 liabilities but instead raised only constitutional claims. Plaintiffs’ challenge was predicated on the ground that there was no judicial hearing to contest the imposition of the section 6672 penalty. Even though plaintiffs met the jurisdictional requirement of partial payment, they remained responsible for the full assessment during the course of proceedings.<sup>105</sup> Plaintiffs claimed that they suffered a deprivation of property without due process of law when they were forced to post a security bond for the full amount of the assessment.<sup>106</sup> Relying on *Phillips v. Commissioner*,<sup>107</sup> the court rejected plaintiffs’ argument and reiterated the supremacy of the government’s interest in protecting the collection of taxes:

[I]t has already been shown that the right of the United States to exact immediate payment and to relegate the taxpayer to a suit for recovery is paramount. The privilege of delaying payment pending immediate judicial review, by filing a bond, was granted by the sovereign as a matter of grace solely for the convenience of the taxpayer.<sup>108</sup>

Once again, the decisions confirm the unique character of section 6672 cases. Due process violations do not operate in the withholding tax context inasmuch as taxpayers receive the benefit of a trial

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<sup>101</sup> *Id.* (quoting *United States v. Stonehill*, 702 F.2d 1288, 1297 (9th Cir. 1983)).

<sup>102</sup> *Id.* at 921.

<sup>103</sup> *Id.* at 922.

<sup>104</sup> 399 F. Supp. 168 (E.D.N.Y. 1975).

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> 283 U.S. 589 (1931).

<sup>108</sup> *Id.* at 170. See also *Fuentes v. Shevin*, 407 U.S. 67 (1983); *Kalb v. United States*, 505 F.2d 506 (2nd Cir. 1974); *Bernardi v. United States*, 74-1 USTC ¶ 9170 (N.D.Ill. 1973), *aff’d per curiam*, 507 F.2d 682 (7th Cir. 1974).



*de novo* with full discovery attendant to civil proceedings. The rule of law that withholding taxes are held in trust for the federal government is deemed a sufficient rational basis to justify the pre-hearing seizure or attachment of assets requirement. This posture might be defensible if not for the Service's *modus operandi* in pursuing officers and high-ranking employees as a matter of course. Since collectability may well furnish the strongest inducement to bring a taxpayer within the firm grasp of section 6672, innocent persons may have their assets tied up for years while the Service continues its investigation.

### 3. Right to Contribution is Unavailable

Because section 6672 cases often involve multiple persons,<sup>109</sup> the temptation for one person to claim less responsibility than another is substantial.<sup>110</sup> The Service casts a wide net in which even persons with severely limited authority are often caught. Predictably, courts have uniformly held that section 6672 tax liability is joint and several.<sup>111</sup> Efforts to obtain contribution will usually fail. Clearly, under federal law, no such right has been recognized.<sup>112</sup> Specifically, the Sixth Circuit recently rebuffed an attempt to claim state law protection.<sup>113</sup>

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<sup>109</sup> Decided cases affirm the Service's position that several persons usually have some degree of responsibility for payroll and withholding matters, and each such person may become a likely target. *Scott v. United States*, 354 F.2d 292 (Ct. Cl. 1965).

<sup>110</sup> The only § 6672 case to address gradations of culpability is *McDermitt v. United States*, 91-1 USTC ¶ 50,094 (S.D. Ohio 1991). The *McDermitt* Court noted:

Of the three persons responsible for payment of MAC's [Mid-America Constructors, Inc.] withholding taxes, . . . Miranda is probably the least culpable. [He] exercised very little control over the day-to-day corporate finances, including the payment of taxes, of MAC. He did, however, possess and exercise the authority to determine the priority of payments to creditors, and the ability to pay off the tax liability to the IRS. Although he may not have realized the significance of this situation, he knew of the cash flow problems at MAC and the failure of MAC to timely pay over the withholding taxes. Miranda's failure . . . was willful.

Id.

<sup>111</sup> *Builder's Finance v. United States*, 352 F. Supp. 491 (E.D. Mich. 1970). However, it is the Service's policy that they will not recover more than the total amount of the liability. *United States v. Sotelo*, 436 U.S. 268, 279 n. 12 (1978).

<sup>112</sup> *Sinder v. United States*, 655 F.2d 729, 732 (6th Cir. 1981).

<sup>113</sup> *McDermitt*, 954 F.2d at 1252. In asserting a right of contribution claim, *McDermitt* stated that section 6672 "does not . . . foreclose a right to contribution under state law." Id. (quoting *Swift v. Levesque*, 614 F.Supp. 172, 173 (D.Conn. 1985)). Subsection (E) of the applicable section of this code specifically states that the rule of contribution "does not

Although the right of contribution is foreclosed, taxpayers may be able to assert an equal protection claim to defeat the assessment. A district court placed its imprimatur on equal protection claims in *I.R.S. v. Blais*.<sup>114</sup> In *Blais*, the court was required to weigh the terms of the government's settlement of a refund action against another responsible person whose testimony would be used to dispose of the disputed issues at trial. Essentially, the settlement was to be used to assess the credibility of the evidence offered to support the government's remaining claim against *Blais*. The government insisted it had no obligation to provide such evidence, although evidence of the settlement was offered.<sup>115</sup> Further, the government argued that "Congress had given it unlimited and unbridled discretion to settle with taxpayers."<sup>116</sup>

Rejecting the government's argument, the court explained the scope of the equal protection penumbra:

Congress has entrusted the Department of the Treasury and derivatively the Internal Revenue Service with broad power to enforce our revenue laws. The ability of the government to collect each person's fair share of the federal burden is essential to any form of organized government. The power to collect, however, is not an unrestricted power. The government must abide by the laws of the United States including constitutional, statutory, and decisional constraints against equal treatment.<sup>117</sup>

Even though the court ultimately held for the government, the opinion limited the parameters of the Service's authority and required the government to justify its decision to proceed against the taxpayer: "The law abhors power without accountability. Unpoliced power invites abuse and corruption. When the government has the power to affect the rights of third persons, it cannot do so irresponsibly and wholly without accountability."<sup>118</sup>

Generally, the Code permits taxpayers, against whom the Service assesses deficiencies in income, estate and gift taxes, to contest the

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apply to breaches of trust in or of other fiduciary obligations." *Id.* Section 6672 violations fall squarely within this proscription. But see *Cook v. United States*, 765 F. Supp. 217 (M.D. Pa. 1991), where recovery under state law was permitted.

<sup>114</sup> 612 F. Supp. 700 (D. Mass. 1985).

<sup>115</sup> *Id.* at 703.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.* at 703-04.

<sup>118</sup> *Id.* at 704.

liability prior to the payment of the tax.<sup>119</sup> As a result, some taxpayers have advanced an equal protection argument claiming that the classification is constitutionally impermissible under the Fifth Amendment. In *Cohn v. United States*,<sup>120</sup> plaintiffs unsuccessfully asserted this argument. Without any legal authority directly on point, the district court employed a traditional equal protection analysis to dismiss the plaintiffs' argument. Under this analysis, "a legislative classification must be sustained unless it is 'patently arbitrary' and bears no rational relationship to a legitimate governmental interest."<sup>121</sup> Since the government has a strong interest in the "prompt collection of its lawful revenue,"<sup>122</sup> the distinction was justified: "[A]ssessments which provide, statistically, the greatest percentage of revenue should be paid over prior to a suit for refund, especially in view of the fact that such money is held in trust for the Government."<sup>123</sup>

The equal protection analyses are fraught with confusion because no court has articulated an identifiable set of criteria to measure government conduct. Even in *Blais*, notwithstanding its exalted protestations regarding equal protection, the court offered no substantive guidance on equal protection violations. Much like pornography, the court will recognize the appropriate case when it sees it, but such a case has yet to surface.

#### 4. *Delegation of Authority Fails as a Defense*

Once vested with authority to pay taxes for the employer, it is difficult for an individual to convince a court that such authority was delegated to a third person. In *Bedford v. United States*,<sup>124</sup> the district court held that an otherwise responsible employee cannot avoid his responsibility by delegating it to a subordinate employee.<sup>125</sup> Similarly, in *Lawrence v. United States*,<sup>126</sup> the court

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<sup>119</sup> The United States Tax Court possesses exclusive jurisdiction over these disputes. The Code does not confer jurisdiction unless the Service issues a statutory notice of deficiency and the taxpayer files a timely petition for a hearing. I.R.C. §§ 6213, 7421, 7441.

<sup>120</sup> 399 F. Supp. 168 (E.D.N.Y. 1975).

<sup>121</sup> *Id.* at 171 (quoting *Frontiero v. Richardson*, 411 U.S. 677, 683 (1973)).

<sup>122</sup> *Id.* (quoting *Enochs v. Williams Packing & Navigation Co.*, 370 U.S. 1, 7 (1962)).

<sup>123</sup> *Id.* at 172.

<sup>124</sup> 77-1 U.S. Tax Cas. ¶ 9308 (E.D. Wis. 1977).

<sup>125</sup> *Id.* at 86863.

<sup>126</sup> 299 F. Supp. 187 (N.D. Tex. 1969).

held that delegation of responsibility was irrelevant, because the power to revoke the delegation remained with the grantor.<sup>127</sup>

Taxpayers may avoid liability by relinquishing their "responsible person" status prior to the withholding tax problem. In *Dudley v. United States*,<sup>128</sup> Dudley, the president and principal shareholder, sent a check to the Service for the corporation's withholding taxes for the first quarter of 1960.<sup>129</sup> The Service did not present the check to the bank until six weeks later at which time it was dishonored and returned to the Service. Dudley testified that he was not aware that the check had been dishonored until the next month when he went over the books with the company's accountant. There was no evidence that the Service or the bank notified Dudley of the check's status.<sup>130</sup> In addition, Dudley established that his authority, which included his control over the payment of checks, began to diminish the same month the company mailed the check to the Service.<sup>131</sup>

A bench trial found Dudley liable for the unpaid taxes. On appeal, the Ninth Circuit held that, with respect to Dudley's liability for the first quarter of 1960, there was no evidence demonstrating Dudley had knowledge of the tax delinquency: "Dudley may have been guilty of negligence but negligence is not willfulness . . . [W]here the taxpayer had reason to believe the check had been paid, and had not been notified to the contrary, it would under the circumstances found here dispel a finding of willfulness under the statute."<sup>132</sup>

In the majority of cases, the delegation defense addresses the issue of willfulness, not the party's status as a responsible person. Once removed from fiscal affairs and no longer able to direct the corporate funds, the employee was protected from liability. Irrespective of which element of the statute is not satisfied, delegation is more apt to relieve corporate employees who are far removed from fiscal matters, rather than corporate presidents or majority shareholders who possess the general responsibility and authority

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<sup>127</sup> Id. at 190.

<sup>128</sup> 428 F.2d 1196 (9th Cir. 1970).

<sup>129</sup> Id. at 1198.

<sup>130</sup> Id. at 1198-99.

<sup>131</sup> Id. at 1201.

<sup>132</sup> Id. at 1200.

to avoid the default.<sup>133</sup>

##### 5. "Availability of Funds" — A Term of Semantic Confusion

When corporate entities begin to flounder, they often look to new leadership to revitalize the business. In *Slodov v. United States*,<sup>134</sup> the Supreme Court addressed the extent to which successor presidents and managers are liable under section 6672 if the prior "responsible person" dissipates all trust funds. In rejecting the government's argument that the statute imposed a trust on all cash received by the corporation after a taxpayer assumes control of a corporation, the Court determined that:

[A] "responsible person" under § 6672 may violate the "pay over" requirement . . . by willfully failing to pay over trust funds collected prior to his accession to control when at the time he assumed control the corporation has funds impressed with a trust under § 7501, but § 7501 does not impress a trust on after-acquired funds, and the responsible person consequently does not violate § 6672 by willfully using employer funds for purposes other than satisfaction of the trust-fund claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation and the funds thereafter generated are not directly traceable to collected taxes referred to by the statute.<sup>135</sup>

As a result, the Supreme Court limited the successor owner's liability to after-acquired funds which were directly traceable to collected taxes referred to by section 6672 of the Code.<sup>136</sup>

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<sup>133</sup> Cf. *McDermitt v. United States*, 91-1 U.S. Tax Cas. ¶ 50094, at 81377-78 (S.D. Ohio 1991), aff'd, 954 F.2d 1245 (6th Cir. 1992). In *McDermitt*, the constructive majority shareholder, the president, and the secretary-treasurer were similarly assessed. Despite all indicia which demonstrated that McDermitt, the constructive majority shareholder, had superior control over the financial and general affairs of the corporation, the court also held the other two officers liable. Under the previous statutory provision, Int. Rev. Code of 1939 § 2707(d), this type of control vested in a high-ranking official would likely insulate a corporate employee or officer from liability.

<sup>134</sup> 436 U.S. 238 (1978).

<sup>135</sup> *Id.* at 259-60. The legislative history of I.R.C. § 7501 provides: "Under existing law the liability of the person collecting and withholding the taxes to pay over the amount is merely a debt, and he cannot be treated as a trustee or proceeded against by distaint." S. Rep. No. 558, 73rd Cong., 2d Sess. 53 (1934).

<sup>136</sup> Thus, the Court evaded the crucial inquiry: For what funds is the trustee responsible? Professor Vasek adroitly addressed this issue:

If the term "funds" is given the broadest meaning, total assets, the duty of the em-

In *Slodov*, the Supreme Court based its decision in part on the rationale that holding a new “responsible person” liable for the taxes would discourage investors from revitalizing an imperiled business operation and, assuming a successful turn-around, preclude the government from receiving full satisfaction of the corporate debt. On the other hand, an original investor, who is held liable for the entire corporate tax debt, would not hamper a “white-knight” transformation, because the successor “responsible person” would not acquire the withholding tax liabilities of his predecessor unless expressly provided for by the reorganization.

Appellate courts, particularly the Eighth Circuit, have followed the lead of the United States Supreme Court.<sup>137</sup> In *Elmore v. United States*,<sup>138</sup> the court rejected the government’s argument that Elmore should be liable for fourth quarter taxes because he paid wages and costs after the taxes for this period accrued: “[T]he record contains no evidence that the funds used for these purposes were traceable to trust funds or were otherwise anything but acquired after Elmore’s accession to control.”<sup>139</sup>

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ployer to withhold funds would apparently be satisfied as long as the business had assets immediately after the payment of wages equaling the liability for the withheld taxes. The duty of accounting would be satisfied by merely recording on the employer’s books the liability for the unpaid withheld taxes. If the term “funds” were given the meaning of net assets (total assets less total liabilities), the duty to withhold would be satisfied if the business had sufficient net assets to cover the liability for withheld taxes. The choice of the net asset definition could be premised on the theory that withholding taxes requires the withholding of assets in excess of those claimed by other creditors.

Stephen J. Vasek, *The Hidden Tax Trap of I.R.C. Section 6672*, 67 Ky. L.J. 27, 50-51 (1978). Furthermore, *Slodov* failed to resolve whether the responsible person will be liable for “directly traceable” funds to the extent of the directly traceable funds or the entire arrearage. While the latter construction subverts the intent of § 6672, at least one pre-*Slodov* court construed the language in this fashion. *Teel v. United States*, 529 F.2d 903 (9th Cir. 1976).

<sup>137</sup> *Kinnie v. United States*, 994 F.2d 279 (6th Cir. 1993); *Davis v. United States*, 961 F.2d 867, 871-78 (9th Cir. 1992), cert. denied, 113 S.Ct. 969 (1993); *Garsky v. United States*, 600 F.2d 86, 90-92 (7th Cir. 1979).

<sup>138</sup> 843 F.2d 1128 (8th Cir. 1988).

<sup>139</sup> *Id.* at 1134. In *Kenagy v. United States*, 942 F.2d 459 (8th Cir. 1991), the same court expanded on this point:

A responsible person generally may not be penalized with respect to unpaid taxes accruing prior to the date s/he became a responsible person in an amount more than the unencumbered funds of the corporation in existence at that date. Unencumbered funds are those funds available after taking into account outstanding transactions.

*Id.* at 465. *Kenagy’s* definition of unencumbered was not the central issue in the case. *Honey v. United States*, 963 F.2d 1083, 1090 (1992), cert. denied, 113 S.Ct. 676 (1992).

In *Honey v. United States*,<sup>140</sup> the Eighth Circuit refined the definition of “unencumbered funds.” In *Honey*, the court conjectured that the jury did not find the responsible persons willful prior to October 31, 1985, because they were unaware of the unsatisfied tax liability.<sup>141</sup> Relying on *In re Premo*,<sup>142</sup> the court held that “funds are encumbered only where the taxpayer is legally obligated to use the funds for a purpose other than satisfying the preexisting employment tax liability and if that legal obligation is superior to the interest[s]” of the Service.<sup>143</sup>

Applying this test through a two-part analysis, the court concluded that non-segregated funds which are not secured by a prior lien, render the Service’s interest subordinate to “certain perfected security interests in . . . collateral, including inventory.”<sup>144</sup> Having so concluded, the court logically proceeded to the next level and asserted that this perfected security interest did not prevent the use of funds in the corporate account for the payment of the tax obligation.<sup>145</sup> According to the court, “[t]here [was] no evidence that Merchants restricted Phoenix’s ability to use those funds to satisfy the preexisting tax obligation.”<sup>146</sup>

## 6. *Taxpayer’s Debt is Non-Dischargeable in Bankruptcy*

Since the Service does not shut down a company after learning of the tax deficiency, the company continues to operate, usually paying employees and only those creditors necessary to stay in business. Consequently, by the time the company folds, the trust fund liability can be sizeable.

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<sup>140</sup> 963 F.2d 1083 (8th Cir. 1992), cert. denied, 113 S. Ct. 676 (1992).

<sup>141</sup> Id. at 1089.

<sup>142</sup> 116 B.R. 515 (Bankr. E.D. Mich. 1990).

<sup>143</sup> *Honey*, 963 F.2d at 1090.

<sup>144</sup> Id. at 1091 (quoting *Slodov v. United States*, 436 U.S. 238, 257 (1978)).

<sup>145</sup> Id. at 1091-92.

<sup>146</sup> Id. The court rejected the argument that if Phoenix had paid the Service instead of its creditors, the corporation would have folded immediately and no money would have been available to pay back taxes. “[I]t is no excuse that, as a matter of sound business judgment, the money was paid to suppliers and for wages in order to keep the corporation operating as a going concern - the government cannot be made an unwilling partner in a floundering business.” Id. at 1093 (quoting *Collins v. United States*, 848 F.2d 740, 741-42 (6th Cir. 1988)). See also *Thibodeau v. United States*, 828 F.2d 1499, 1506 (11th Cir. 1987); *Mazo v. United States*, 591 F.2d 1151, 1154 (5th Cir. 1979).

In *United States v. Sotelo*,<sup>147</sup> the Supreme Court held that liability under section 6672 was not dischargeable under section 17a(1)(e) of the Bankruptcy Act. "The fact that "funds due [under section 6672] are referred to as a 'penalty'. . . does not alter their essential character as taxes for purposes of the Bankruptcy Act," where, as here, the liability was based on failure to pay over rather than failure to initially collect.<sup>148</sup>

Examining the Bankruptcy Act, the majority recognized that its fundamental purpose was to establish a three-year limitation on taxes that would be non-dischargeable. Section 17a(1)(e) was added to ensure that a responsible person who had collected money from third persons could not be relieved of this obligation after having converted the money for his own use.<sup>149</sup> The court noted: "The overall policy of the Bankruptcy Act of giving a bankrupt a 'fresh start' cannot override Congress' specific intent in § 17a(1)(e) to make a liability . . . nondischargeable, especially since the contrary result would create an inequity between corporate officers and individual entrepreneurs."<sup>150</sup> Moreover, the court refused to extinguish liability on public policy grounds, noting:

[W]e as judges cannot override the specific policy judgments made by Congress in enacting the statutory provisions . . . . The decision to hold an individual 'liable for a tax owed by a corporation,' . . . was made when Internal Revenue Code § 6672 was passed, since it is that section which imposes the liability without regard for the individual's ability to pay.<sup>151</sup>

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<sup>147</sup> 436 U.S. 268 (1978). 11 U.S.C. § 523 provides:

A discharge under section(s) 727 [and] 1141 . . . of this title does not discharge an individual debtor from any debt (1) for a tax or a customs duty — (A) of the kind and for the periods specified in 507(a)(2) or 507(a)(7) of this title.

Section 507(a)(7) includes taxes which the debtor was required by law to withhold but failed to do so, thus rendering him liable for the tax. 11 U.S.C. § 507. See *In re Shank*, 792 F.2d 829 (9th Cir. 1986) (noting that the penalty provision of § 6672 of the Code is not dischargeable in bankruptcy per § 523(a)(7), to the extent [that] such debt is for a fine, penalty or forfeiture payable to and for the benefit of a governmental unit); *In re Madia*, 68 B.R. 11 (Bankr. D.N.J. 1986) (claiming that tax fraud penalties are dischargeable in bankruptcy if imposed more than three years before debtors file their bankruptcy petition). See also *McKay v. United States*, 957 F.2d 689 (9th Cir. 1992); *In re Byrum*, 92-1 U.S. Tax Cas. (CCH) ¶ 50,257 (D. Calif. 1992). However, this exception has not been extended to § 6672 penalties.

<sup>148</sup> *Sotelo*, 436 U.S. at 275.

<sup>149</sup> *Id.* at 276 (quoting H.R. REP. NO. 372, p.6).

<sup>150</sup> *Id.* at 269.

<sup>151</sup> *Id.* at 279.



In a sharp dissent, Justice Rehnquist accused the majority of using a twisted analysis of the Bankruptcy Act to reach its decision.<sup>152</sup> Criticizing the majority for relying on a Treasury Department letter setting forth its position on dischargeability instead of the legislation which Congress enacted,<sup>153</sup> Justice Rehnquist correctly observed that there was an omission in the majority's decision. The initial question should have been whether the amounts for which respondent is liable "is a 'tax' legally due and owing by him."<sup>154</sup> Section 6672 specifically states "penalty", not "tax". Section 17a(1)(e) was not modified to include penalties.<sup>155</sup> Moreover, the majority's opinion, Justice Rehnquist noted, ignores the fundamental goal of rehabilitating bankrupts:

[T]here is unfortunately nothing in the Court's reasoning which would prevent the same liability from surviving bankruptcy in the case of a comptroller, accountant, or bookkeeper who reaped none of the fruits of entrepreneurial success other than continued employment in the corporation, and in some cases possibly not even that . . . . So long as the Government in its zeal for the collection of revenue may persuade a bankruptcy court that a corporate employee comes within the Court's Delphic construction of 26 U.S.C. § 6672 . . . such a person will be denied the "fresh start" which Congress clearly intended to enhance by the 1966 amendments to the Bankruptcy Act.<sup>156</sup>

Compounding this problem is that once corporate bankruptcy is declared, secured claims are given a priority over everything except for administrative expenses allowed under section 503(b) of Title 11.<sup>157</sup> Taxes not dischargeable in bankruptcy such as trust fund taxes are given seventh priority.<sup>158</sup> Money usually left in the bank-

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<sup>152</sup> Id. at 282 (Rehnquist, J., dissenting).

<sup>153</sup> Id. at 282-83 (Rehnquist, J., dissenting).

<sup>154</sup> Id. at 286 (Rehnquist, J., dissenting).

<sup>155</sup> Id. at 290 (Rehnquist, J., dissenting).

<sup>156</sup> Id. at 291 (Rehnquist, J., dissenting).

<sup>157</sup> 11 U.S.C. § 507(a)(2).

<sup>158</sup> 11 U.S.C. § 507(a)(7)(c). Despite repeated efforts by the Service to secure judicial support for a preferred priority status for trust fund taxes, courts have held firm, employing a balancing test between the Bankruptcy Code which favors the rehabilitation of bankrupt entities and the Internal Revenue Code which protects and promotes the tax assessment and collection system. This tension was discussed extensively by the Eleventh Circuit in *United States v. A & B Heating & Air Conditioning, Inc.*, 823 F.2d 462, (11th Cir. 1987), vacated, 486 U.S. 1002 (1988). In *A & B Heating & Air Conditioning, Inc.*, the court, quoting S. Rep. No. 989, 95th Cong., 2d Sess. 13-14 reprinted in 1978 U.S.C.C.A.N. 5787, 5799-800,

rupt's estate is allocated, after payment of secured creditors, to the non-trust fund portion of the corporation's tax liability, i.e. the corporate income tax.<sup>159</sup>

In determining the amount of the 100% penalty to be assessed in connection with employment taxes, any payment made on the corporate account involved is deemed to represent the employer's portion of the liability including assessed penalty and interest unless there was some specific designation to the contrary by the taxpayer.<sup>160</sup>

In June 1990, the Supreme Court held in *United States v. Energy Resources Co.* that bankruptcy courts were empowered to determine whether non-designated payments could be applied to trust fund taxes if a corporation, functioning under Chapter 11, would benefit.<sup>161</sup> This decision is confined to reorganization plans, not liquidation under Chapter 7. In either instance, the potentially responsible person remains "hostage" to unpaid trust funds.<sup>162</sup>

#### IV. WILLFULNESS—THE SECOND AND INDISPENSABLE ELEMENT OF SECTION 6672

##### A. *The Evolution of Willfulness*

Section 6672 liability also requires willfulness. The willfulness requirement originated in *Paddock v. Siemoneit*,<sup>163</sup> a pre-section 6672 case. In that case, the Texas Supreme Court held Paddock liable for the statutory penalty imposed for non-payment of

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observed:

A three-way tension thus exists among (1) general creditors, who should not have the funds available for payment of debts exhausted by an excessive accumulation of taxes for past years; (2) the debtor, whose "fresh start" should likewise not be burdened with such an accumulation; and (3) the tax collector, who should not lose taxes which he has not had reasonable time to collect or which the law has restrained him from collecting. (citation omitted)

Id. at 464.

<sup>159</sup> Bankruptcy Act, 11 U.S.C. § 104(a)(4) (1976).

<sup>160</sup> J. Moore & L. King, *Collier on Bankruptcy* ¶ 64.401, at 2151 (14th ed. 1975).

<sup>161</sup> 495 U.S. 545 (1990). The remaining non-trust fund tax liabilities fall within the priority provisions of the Bankruptcy Code.

<sup>162</sup> For a comprehensive discussion of trust fund taxes as preferences, see Falk, *Trust Fund Taxes in Bankruptcy: Significant Developments in Chapter 7, 11, and 13 Cases*, *Bank. Dev. J.* Vol. 7, 1990.

<sup>163</sup> 218 S.W.2d 428 (Tex. 1949).

taxes.<sup>164</sup> Characterizing the penalty as civil, the court ruled that willful does not require an evil or fraudulent purpose.<sup>165</sup> Rather, a person exercising free will or choice who intentionally disregards the statute or is indifferent to its requirements will be held personally liable.<sup>166</sup>

From *Paddock*, three propositions evolved which federal appellate courts have subsequently used to impose liability on the "responsible person":

1. A civil penalty may co-exist with criminal sanctions even though the civil penalty is more severe;<sup>167</sup>

2. the term "willful", as used in the civil statute, is not synonymous with evil motive contained in criminal statutes and does not require proof of a specific intent to defeat payment of corporate taxes;<sup>168</sup> and

3. the Supreme Court cases of *United States v. Murdock*<sup>169</sup> and *Spies v. United States*<sup>170</sup> support a contextual analysis of willful, a term of many meanings.

For all practical purposes, the Texas Supreme Court's decision in *Paddock* extinguished willfulness as a required element in the civil penalty context. The court made no attempt to assess the import of this decision. More importantly, it made no attempt to review the legislative history of the provision or to determine legislative intent.

Moran characterizes this decision as an "interpretive leap,"<sup>171</sup> one which clearly ignores or rejects *ab initio* the more insightful analysis of willfulness by the lower court:

[W]e believe the severity of the civil penalty here involved requires that we give the term of that portion of the statute the same strict

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<sup>164</sup> Id. at 432-33. The court did admit, however, that C. J. Siemoneit was the disbursing officer of the corporation who decided whether taxes would be paid when due. The court's focus was the corporate officer's conduct with respect to the duty to pay taxes, not his conduct in paying other creditors.

<sup>165</sup> Id. at 434-35.

<sup>166</sup> Id.

<sup>167</sup> Id. at 435.

<sup>168</sup> Id.

<sup>169</sup> 290 U.S. 389 (1933).

<sup>170</sup> 317 U.S. 492 (1943).

<sup>171</sup> Moran, *supra* note 24, at 758.

construction that we would give the portions of the statute which provide for criminal penalties. It is to be noted that the portions of the statute providing for criminal penalties contain the same wording concerning willful failure to pay the tax. It is familiar law that where the same expression appears several times in a statute it will ordinarily be given the same meaning throughout the statute.<sup>172</sup>

*Paddock's* interpretation of "willfulness" was expanded in *In re Haynes*.<sup>173</sup> After characterizing willful as a term of many meanings, the district court concluded that willful is not tantamount to wicked design "but rather that the person acts knowingly and intentionally."<sup>174</sup> This test is reserved for those who, "by reason of a *bona fide* misunderstanding as to . . . the liability for the tax, as to . . . the duty to make a return, or as to the adequacy of . . . records . . . maintained, should become a criminal by mere failure to measure up to the prescribed standard of conduct."<sup>175</sup> In the civil context, if the corporate officer controls the tax fund and appropriates such funds to some other purpose, he acts willfully.<sup>176</sup>

As with *Paddock*, the *Haynes* court elected not to review the interlocking relationships of the civil and criminal penalties. Rather, the court's pronouncement moved decisively in the opposite direction. The court confirmed that section 6672's predecessor was non-penal and was intended to secure the collection of a fund "that has passed into the hands of the employer, which is in the nature of a trust fund, the employer acting as a collecting agency for the United States."<sup>177</sup>

The final encounter with section 6672's precursor provision occurred one year later when the District Court of Connecticut decided *Kellems v. United States*.<sup>178</sup> In *Kellems*, plaintiffs did not withhold any pay from the employees' wages, alleging that the Income Tax Withholding Act was unconstitutional.<sup>179</sup> The court held that "willful," as used in section 2702(a), meant without reasonable

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<sup>172</sup> 214 S.W.2d 651, 659 (Tex. App. 1948).

<sup>173</sup> 88 F. Supp. 379 (D. Kan. 1949).

<sup>174</sup> *Id.* at 385.

<sup>175</sup> *Id.* (emphasis added).

<sup>176</sup> *Id.*

<sup>177</sup> *Id.* at 384.

<sup>178</sup> 97 F. Supp. 681 (D. Conn. 1951).

<sup>179</sup> *Id.* at 682.

cause.<sup>180</sup> Here, Kellems' opposition to the income tax act on political grounds did not constitute proper or reasonable cause for non-compliance.<sup>181</sup> Because plaintiffs "intentionally and deliberately" refused to withhold any pay-over income taxes accruing against their employees, their conduct was willful.<sup>182</sup>

Neither *Paddock*, *In re Haynes* or *Kellems* addressed the nexus between the 100% penalty provision and other felony tax statutes. By treating the penalty as "civil," the courts never came to terms with the effect of its application to corporate officer conduct. The cases which follow demonstrate the harsh consequences of the court's reluctance to examine this nexus. Willfulness, at least in the civil context, became a virtual substitute for strict liability.

### B. *The Bloom Imprimatur*

The Ninth Circuit solidified the holdings of the trilogy in *Bloom v. United States*.<sup>183</sup> In adopting *carte blanche* the prior interpretation of the trilogy, the court stated:

The decision of the appellant as the responsible officer of the corporation not to have the corporation pay over to the government the withheld taxes was a voluntary, conscious, and intentional act to prefer other creditors of the corporation over the United States . . . such conduct was willful within the meaning of Section 2707(a).<sup>184</sup>

*Bloom* contended that proof of criminal intent, motive or purpose to violate the tax law was necessary to establish civil liability.<sup>185</sup> This contention, observed the court, was erroneous.<sup>186</sup> To invoke sanctions under section 2707(a), there need not be an intent to defraud or deprive the United States. Rather, intent is supplied by mere payment to other creditors.

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<sup>180</sup> Id. at 686.

<sup>181</sup> Id. at 684-85.

<sup>182</sup> Id. at 686.

<sup>183</sup> 272 F.2d 215 (9th Cir. 1959).

<sup>184</sup> Id. at 223.

<sup>185</sup> Id.

<sup>186</sup> Id.

C. *The Trilogy Standard Enunciated in Monday v. United States*

*Monday v. United States*<sup>187</sup> surpassed *Bloom* and reduced the term “willfully” to an independent element of civil liability. In *Monday*, the court contrasted criminal willfulness (bad purpose or absence of any justifiable excuse) with civil willfulness (intentional, knowing and voluntary acts), noting that “[t]hese concepts tend to evoke notions of evil motive or bad purpose which properly play no part in the civil definition of willfulness.”<sup>188</sup> Consequently, the court held that a corporate president who had “reasonable cause” or “justifiable excuse” for failure to pay over withholding taxes could not avoid civil liability.<sup>189</sup> Confirming the special status of the tax collection process, the court elaborated:

“[R]easonable cause” and “justifiable excuse” invite consideration of such misleading and improper factors as the financial condition of the business or the demands of creditors . . . . The defenses countenanced by the district court’s use of “reasonable cause” and “justifiable excuse” are inconsistent with the purposes of Congress to protect the sources of revenue by permitting recovery from those individuals charged with the responsibility of transferring withheld funds to the government.<sup>190</sup>

In *United States v. Bishop*, the United States Supreme Court came to grips with the semantic confusion associated with the term willful.<sup>191</sup> In *Bishop*, the taxpayer was convicted of violating sec-

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<sup>187</sup> 421 F.2d 1210 (7th Cir. 1970).

<sup>188</sup> *Id.* at 1216.

<sup>189</sup> *Id.* at 1216. The prevailing view is that once the test is satisfied, consideration of the specific reason for non-payment is not necessary or relevant. *Newsome v. United States*, 431 F.2d 742 (5th Cir. 1970) (an expectation that sufficient funds will become available will not exonerate an otherwise responsible person who voluntarily, consciously and intentionally prefers non-governmental creditors); *Simpson v. United States*, 664 F.Supp. 43, 46 (E.D.N.Y. 1987) (conscious payment of creditors other than the government is willful, even if expenditures are necessary to stay in business); *Teel v. United States*, 529 F.2d 903, 906 (9th Cir. 1976) (mistaken belief by responsible person that tax need not or cannot be paid over does not render failure to pay non-willful).

<sup>190</sup> *Id.*

<sup>191</sup> 412 U.S. 346 (1973). The earlier line of cases included *Spies v. United States*, 317 U.S. 492 (1943), and *United States v. Murdock*, 290 U.S. 389 (1933). In *Spies*, the Court held that the difference between a felony and a misdemeanor under the Revenue Act of 1936 is found in the affirmative conduct implied from the term “attempt” as used in Section 145(b), the felony section: “[I]t would be unusual that Congress, by the felony defined in § 145(b), meant no more than the same derelictions it had just defined in Section 145(a) as

tion 7206(1) which made it a felony when one “[w]illfully makes and subscribes any return . . . which he does not believe to be true and correct as to every material matter.”<sup>192</sup> Bishop requested a lesser-included-offense instruction based upon the misdemeanor provision of section 7207, contending that willful in the misdemeanor provision requires less than the same word in the felony provision.<sup>193</sup> The taxpayer argued that the jury could find the conduct a misdemeanor if his conduct was the result of caprice or careless disregard of duty, not evil purpose.<sup>194</sup>

The district court refused the instruction. However, the Ninth Circuit held that the judge had improperly refused the instruction and remanded the case for a new trial.<sup>195</sup> The circuit court’s ruling, by its very nature, was based on a stricter interpretation of willfulness in the felony context.<sup>196</sup> Within the meaning of section 7206(1), the court held that willfulness required “proof of an evil motive and bad faith.”<sup>197</sup> Under the misdemeanor category, the only proof required was “unreasonable, capricious, or careless disregard for the truth or falsity of income tax returns filed . . . .”<sup>198</sup>

The Supreme Court reversed, holding that the term willful has the same meaning regardless of usage:

Although the described states of mind might be included in the normal meaning of the word “willfully,” the presence of both an express designation and simultaneous requirement that a violation be committed “willfully” is strong evidence that Congress used the word “willfully” to describe a constant rather than a variable in the tax penalty formula.<sup>199</sup>

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a misdemeanor.” *Spies*, 317 U.S. at 497. Willfulness in the criminal offense includes evil motive and want of justification. In *Murdock*, the Court held that “willfully” denotes an intentional, voluntary or knowing act, as distinguished from accidental. But when “willfully” is used in criminal statutes, it means an act done with bad purpose, without justifiable excuse, stubbornly, obstinately, perversely, or conduct marked by careless disregard. When determining misdemeanor willfulness, good faith and actual belief should be taken into account. *Murdock*, 290 U.S. at 396.

<sup>192</sup> 412 U.S. at 348, 350 (quoting I.R.C. § 7260(1)).

<sup>193</sup> *Id.* at 350.

<sup>194</sup> *Id.*

<sup>195</sup> *Id.* at 348.

<sup>196</sup> *Id.* at 351.

<sup>197</sup> *Id.* at 354 (quoting *United States v. Bishop*, 455 F.2d 612, 615 (9th Cir. 1972)).

<sup>198</sup> *Id.* (quoting *United States v. Bishop*, 455 F.2d 612, 615 (9th Cir. 1972)).

<sup>199</sup> *Id.* at 359-60.

In reaching its decision, the Court astutely observed that with the exception of two subsections, all other tax offenses set forth in sections 7201 through 7207 require the acts constituting the offense to be done "willfully."<sup>200</sup> This provided compelling evidence that Congress intended a constant rather than a variable standard in imposing tax offense penalties: "Until Congress speaks otherwise, we therefore shall continue to require, in both tax felonies and tax misdemeanors that must be done 'willfully,' the bad purpose or evil motive described in *Murdock* . . . ."<sup>201</sup>

The *Bishop* analysis omitted any explicit comparison between civil and criminal violations. However, unlike the confused maze of case law that preceded it, the *Bishop* instruction offered a uniform definition of "willful," irrespective of context. In civil cases, appellate courts have not used this unitary definition, and instead have used *Monday's* strained reading of "willfully." The severity of this move may have triggered the Supreme Court's creation of what would soon be characterized as a *bona fide* qualification of willfulness in the civil context, personal fault.

#### D. Personal Fault—Willfulness Reinforced

The Supreme Court relaxed the trilogy's "willful" standard in civil cases in *Slodov v. United States*.<sup>202</sup> *Slodov* presented two issues for consideration: (1) Whether a person is liable under section 6672 for the corporation's unpaid taxes withheld from wages *prior to his control*,<sup>203</sup> and (2) Since the obligations under section 6672 are phrased in the conjunctive, whether a person is subject to the section only if those duties — to collect, truthfully account for, and pay over — are applicable to him with respect to the tax dollars in question.<sup>204</sup>

The Court held that a responsible person does not violate section 6672 by willfully using funds for purposes other than satisfaction of the tax liability.<sup>205</sup> The opinion assumed that at the time he acquired control there were no funds to satisfy the tax obligation,

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<sup>200</sup> Id. at 359.

<sup>201</sup> Id. at 361.

<sup>202</sup> 436 U.S. 238 (1978).

<sup>203</sup> Id. at 240-41.

<sup>204</sup> Id. at 246-47.

<sup>205</sup> Id. at 259.



and that funds generated after the change in control could not be traced to collected taxes.<sup>206</sup> Brennan's opinion was clear:

As noted in the previous section [of the opinion], § 6672 as construed by the Government would, in effect, make the responsible person assuming control of a business a guarantor for payment of the delinquent taxes simply by undertaking to continue operation of the business. That construction is precluded by the history and context of § 6672 and cognate provisions of the Code.

. . . The fact that the provision imposes a "penalty" and is violated only by a "willful failure" is itself strong evidence that it was not intended to impose liability without personal fault.<sup>207</sup>

In a strict sense, the Supreme Court appears to have addressed personal fault as an element of willfulness even though the issue before the Court was the meaning of the term "responsible person." As Professor Moran has noted, the *Slodov* requirement of personal fault was likely "fashioned out of the Court's apparent belief that the facts failed to reveal the degree of fault necessary to impose the very substantial tax penalty sanction."<sup>208</sup> Moreover, the Court also held that the language of section 6672 does not limit liability to people who are required to perform all three duties.<sup>209</sup>

By introducing the personal fault requirement, the Court indirectly overruled *Bloom*. The realization that this may have worked a far less punitive standard into the penalty equation may have compelled the Court to expand section 6672's net at the front end. The predominate concern—that a person required to perform all three duties might easily exculpate himself from liability by terminating his employment prior to the payment date of the withholding taxes—provided the impetus for the Court's posture. The Court made this clear in its discussion of the "pay over" function: "Because the duty to *pay over* the taxes arises only at the quarter's end, a 'responsible person' who willfully failed to collect taxes would escape personal liability for that failure simply by resigning his position and transferring to another the decisionmaking responsibility prior to the quarter's end."<sup>210</sup>

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<sup>206</sup> Id. at 259-60.

<sup>207</sup> Id. at 253-54.

<sup>208</sup> Moran, *supra* note 24, at 790.

<sup>209</sup> *Slodov*, 436 U.S. at 250.

<sup>210</sup> Id. at 247. This pre-occupation of the Supreme Court left an enormous gap yet to be addressed by the appellate courts or the Federal Court of Claims - imposing liability on a

On close examination, the Court's interpretation of willfulness in terms of personal fault may have little practical significance.<sup>211</sup> Although the majority opinion emphasized Slodov's lack of personal fault, the decision to exonerate Slodov was based upon the definition of his legal duties, i.e. that he was not a responsible person until the quarter after the Service found his predecessor to be in violation of section 6672. At the time he became responsible, there were no trust fund taxes available from which to pay the withholding taxes.<sup>212</sup> As a result, Slodov did not even satisfy the traditional test for willfulness: payment to creditors other than the government with knowledge that the trust fund taxes remained unpaid.

Two recent cases are illustrative. In *Godfrey v. United States*,<sup>213</sup> the Federal Circuit reversed the portion of a Claims Court decision finding Godfrey liable.<sup>214</sup> The court held that willfulness must be viewed in light of the taxpayer's personal fault.<sup>215</sup> Despite Godfrey's knowledge of past delinquencies, there was no evidence that Godfrey knew of the company's failure to pay withholding taxes.<sup>216</sup> Focusing on the deliberate nature of the individual's election not to pay the taxes and the circumstances associated with the refusal,<sup>217</sup> the court concluded that Godfrey's failure to pay the taxes lacked the "personal fault, the epitome of willfulness."<sup>218</sup>

In *Heimark v. United States*,<sup>219</sup> after concluding that plaintiff did not meet the status, duty, and authority prongs of the responsible person test, the court stated:

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person, such as a CPA, whose corporate mandate is to truthfully account for the trust fund (recording the numbers, preparing the 941's, etc.) but who has no authority to collect or pay over the taxes. It is questionable that § 6672 might be construed in this fashion since controllers, accountants and even company attorneys would be unable to conform their conduct to the law and avoid liability as a "responsible person." This may raise fundamental due process considerations. See *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972).

<sup>211</sup> See *In re Osborn*, 4 Bankr. 431, 436 (Bankr. W.D. Mo. 1979) (holding that Osborn's conduct not to deposit gross payroll in a separate account per an agreement with the Service was willful under the invalidated *Bloom* test or satisfied the personal fault requirement of the *Slodov* test).

<sup>212</sup> *Id.* at 251.

<sup>213</sup> 748 F.2d 1568 (Fed. Cir. 1984).

<sup>214</sup> *Id.* at 1579.

<sup>215</sup> *Id.* at 1577.

<sup>216</sup> *Id.*

<sup>217</sup> *Id.*

<sup>218</sup> *Id.* at 1579.

<sup>219</sup> 18 Cl. Ct. 15 (1989).

[A] willful act under § 6672 is a “deliberate choice voluntarily, consciously and intentionally made to pay other creditors instead of paying the Government” (citation omitted) . . . .

The primary focus of this test is upon the taxpayer’s diligence in attending to the duty to pay employment taxes. By undertaking all reasonable efforts to fulfill that duty, a taxpayer can show that he did not willfully neglect his duty.<sup>220</sup>

Reasonable efforts included attempts by the taxpayer to remind the CEO of the deficiency and to suggest strategies to pay the taxes despite the corporation’s financial demise.<sup>221</sup> Relying on *Godfrey*, the court reaffirmed that section 6672’s penalty provision will not trigger liability without some type of personal fault.<sup>222</sup> Personal fault imposes liability where one has the power to disperse available funds to the government but fails to do so without compelling reason. The standard does not obviate the need to make a careful analysis of the status, duty, and authority elements of “responsible person”.

#### *E. Flip Side of Willfulness — Reckless Disregard*

In the years following *Monday*, courts remained faithful to the trilogy standard. By the mid-1970’s, the courts had firmly entrenched the mechanical application of the three-part test into the case law, ensuring that trust fund taxes would receive optimum protection. The standard’s continued vitality was never seriously questioned. Beginning in 1981, the courts added a twist: willfulness could now be shown if the taxpayer acts in reckless disregard of facts which establish an outstanding tax obligation.<sup>223</sup> This addition greatly increased the government’s ability to recover trust

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<sup>220</sup> Id. at 24 (quoting *White v. United States*, 372 F.2d 513, 521 (Cl. Ct. 1967)).

<sup>221</sup> Id.

<sup>222</sup> Id. at 25. In *Schultz v. United States*, 19 Cl. Ct. 280, 286 (1990), *aff’d*, 918 F.2d 164 (1990), cert. denied, 111 S. Ct. 1686 (1991), the Claims Court concluded that the plaintiff’s knowledge of the tax delinquency when he signed the third quarter tax return, his execution of five checks to creditors during this period, and his sole control over the business indicated that the preference of other creditors was personal fault.

<sup>223</sup> This is not a pure negligence standard. *Kalb v. United States*, 505 F.2d 506, 511 (2nd Cir. 1974); *United States v. Leuschner*, 336 F.2d 246, 248 (9th Cir. 1964). But in *Leuschner*, where a pattern of negligence with multiple, successive corporate enterprises was discernable, the court classified Leuschner’s actions with respect to the second corporation as a reckless disregard for obvious and known risks, constituting a voluntary, conscious and intentional failure to pay. Id.

fund taxes. It also obscured the boundaries between “responsible person” and “willfulness.”

### 1. *Relying on the Representations of a Third Person*

First, courts have held that reliance upon the statements of a person controlling corporate finances constitutes reckless disregard when the circumstances show that the responsible person knew or should have known that the person making the statements was not reliable. For example, in *Gold v. United States*,<sup>224</sup> Gold, the treasurer and part owner, signed returns and handled disbursements, bills, and payroll taxes.<sup>225</sup> Subsequently, Gold and others affiliated with A & S formed another corporate entity.<sup>226</sup> Gold became the secretary-treasurer and was placed in charge of bookkeeping, coordinating the activities of corporate buildings, and preparing budgets.<sup>227</sup> Though he continued to exercise check signing authority, his powers over CPS’s financial affairs were somewhat less than those exercised at A & S.<sup>228</sup>

Starting with the first quarter of 1972, CPS began to neglect filing and paying taxes.<sup>229</sup> Gold admitted at trial that by late 1972 he knew CPS was delinquent in the payment of taxes.<sup>230</sup> He continued to incur expenses, accept his salary, and voiced no objection when other creditors were paid.<sup>231</sup>

At trial, Gold was found to be a “responsible person” because of his involvement with the corporation’s financial operations, including the payment of creditors.<sup>232</sup> As to willfulness, the court confirmed that mere negligence is inadequate to trigger section 6672 liability.<sup>233</sup> In this case, however, Gold was aware of the corporation’s mismanagement, yet continued to approve payments to creditors rather than to the government. He made no attempt to

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<sup>224</sup> 506 F. Supp. 473 (E.D.N.Y. 1981), *aff’d*, 671 F.2d 492 (2nd Cir. 1991).

<sup>225</sup> *Id.* at 475.

<sup>226</sup> *Id.* at 476.

<sup>227</sup> *Id.*

<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *Id.* at 477.

<sup>231</sup> *Id.*

<sup>232</sup> *Id.* at 478-79.

<sup>233</sup> *Id.*

investigate whether taxes were being paid.<sup>234</sup> Failure by a responsible person to investigate or to correct mismanagement after being put on notice that withholding taxes are delinquent constitutes willfulness.<sup>235</sup>

## 2. *Payment to Creditors Other Than the Government When the Company is Financially Troubled*

Liability also is imposed when a responsible person continues to pay other creditors while knowing that a company's financial position is precarious. If the taxpayer fails to make a reasonable inquiry as to whether money would be available for payment of taxes, and should have done so, willfulness is satisfied. This was the case in *Teel v. United States*.<sup>236</sup> Plaintiffs in *Teel* were at the time of the delinquency subject to an order of distraint by the State of Washington.<sup>237</sup> Despite this, plaintiffs used funds received from the sale of inventory to pay for new merchandise.<sup>238</sup> The court reasoned: "[A]s the cash went into the cash drawer, it became subject to trust or lien in favor of the federal government for the unpaid withholding taxes."<sup>239</sup> By using the funds, "they unwittingly supplied the necessary willfulness."<sup>240</sup>

## V. CONCLUSION AND IMPLICATIONS

One commentator recently noted that "[c]ourts overwhelmingly

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<sup>234</sup> *Id.*

<sup>235</sup> See also *Turbin v. United States*, 970 F.2d 1344 (4th Cir. 1992) (finding that an officer serving as a functionary or courier for mine owner in financial management of the operating company neither knew of nor recklessly disregarded the operating company's trust fund tax deficiency).

<sup>236</sup> 529 F.2d 903 (9th Cir. 1976).

<sup>237</sup> *Id.* at 904.

<sup>238</sup> *Id.* at 905.

<sup>239</sup> *Id.*

<sup>240</sup> *Id.* See also *Ruth v. United States*, 823 F.2d 1091 (7th Cir. 1987). The Seventh Circuit held that in order to preserve the intended reach of § 6672, willfulness may be established by a showing of gross negligence involving a known risk of violations. Relying on *Wright v. United States*, 809 F. 2d 425, 427 (7th Cir. 1987), the court confirmed that a responsible person can be liable if she "(1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) [she] was in a position to find out for certain very easily." *Id.* Ruth knew that the company was encountering tax difficulties, checking accounts were overdrawn, and payroll checks were dishonored. Ruth nonetheless continued to sign checks to creditors other than the Service. This conduct supported the conclusion that Ruth was willful. *Id.*

rely upon democratic institutions to remedy abuses in taxation, rather than exercising a strong hand in judicial review.”<sup>241</sup> A recurrent theme in the application of section 6672 is that courts are loathe to encroach upon or to usurp the legislative domain. While the courts have attempted to harmonize their results with legislative intent, they have avoided or side-stepped two of section 6672’s problematic aspects: (1) section 6672 is a severe statutory sanction which is punitive to individuals; and (2) one’s willfulness is a separate, indispensable element of section 6672 and cannot be conclusively presumed because one is a corporate officer and the corporation pays creditors other than the government during a tax claim delinquency.

Lack of meaningful examination by the courts of the statutory history and of the actual wording of the statute has undermined the congressional intent concerning the “willfulness” aspect of the provision. A careful reading of these two sources reveals that the true target of section 6672 is individuals who have the power to direct available funds to the Service for payment of current withholding taxes but who choose not to exercise that power. Whether the personal fault referred to by the Supreme Court will turn this tide remains an open question. Because the Service and courts have failed to give sufficient weight to personal fault, there has been a renewed emphasis on legislative reform to interject equity and to protect the unwary, ministerial employee from the adverse consequences of section 6672’s pervasive reach. One minor step in the direction of fairness is the pending bill, Taxpayer Bill of Rights II.<sup>242</sup> This bill would modify the penalties for responsible person by exonerating employees who on their own initiative bring their employer’s failure to pay to the attention of the Service. The House of Representatives’ version, the Tax Fairness and Economic Growth Bill of 1992,<sup>243</sup> explains the reason for the proposed change: “Individuals have been held liable for this penalty even after they have brought their employers’ failure to pay to the attention of the IRS.” The proposed modification would extricate from liability a responsible person who satisfies the Service within

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<sup>241</sup> Gale A. Norton, *The Limitless Federal Taxing Power*, 8 *Harv. J. L. & Pub. Pol’y* 591 (1985).

<sup>242</sup> S. 2239, 102nd Cong., 2nd Sess. (1992).

<sup>243</sup> H.R. 4210, 102nd Cong., 2d Sess. (1992).

ten days of the failure to pay over trust fund taxes to the government, so long as satisfaction is made prior to the due date for taxes.<sup>244</sup>

Other reform measures should focus on the need to segregate funds. Corporate and tax revenues should not be commingled because they will be a tempting source of cash when business sours. Imposing a duty to segregate tax funds when payroll is processed would assure that money is available to pay over to the government. This step would fulfill the congressional mandate of collecting trust fund taxes without creating a burdensome administrative bureaucracy.

Section 6672 will continue to impose harsh penalties. These penalties are not dischargeable in bankruptcy. Thus, many of the penalties — staggering in amount<sup>245</sup> and bearing no relationship to the amount of the salary earned by the “responsible person” — will remain on the rolls of the Service, uncollected and uncollectible because the costs and anxieties to innocent people who are beset by section 6672 can easily lead to their personal insolvency. Hence, either the Service,<sup>246</sup> the judiciary or the Congress must return to the historic meaning of section 6672 if crippling and unwarranted penalties are to be avoided.

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<sup>244</sup> H.R. 4210 died in legislative session.

<sup>245</sup> It may be prudent - particularly in light of *Austin v. United States*, 113 S.Ct. 2801 (1993), where the United States Supreme Court held that civil *in rem* forfeiture operates as punishment and is therefore subject to limitations imposed by the Eighth Amendment's Excessive Fines Clause - for courts to examine the impact of the destructively high penalties in section 6672 cases.

<sup>246</sup> The Service could perhaps achieve such an objective either through rulemaking or through greater circumspection in pursuing “the usual suspects.”