

# Collection

## A Cautionary Tale of the Disregarded Entity Owing Employment Taxes

By *Patti Logan*

As previously reported, the IRS has changed the rules for the limited liability company with only one member who owes employment taxes. Prior to January 1, 2009, an LLC with only one member was considered a disregarded entity for employment tax purposes. Notice 99-6<sup>1</sup> allowed the employer either to calculate, file and pay the employment taxes under the owner's name and EIN or under the LLC's name and EIN. But in either case, the owner of the LLC was treated as the employer for purposes of the employment tax liability. So, whether or not the assessment was made in the name of the owner or the disregarded LLC, the ultimate responsibility for payment of the taxes was the owner's.

For wages paid after January 1, 2009, a single member/owner LLC no longer has the two options for paying and filing employment taxes. The LLC is now responsible for any employment taxes paid after January 1, 2009, even if the entity is considered a disregarded entity for all other federal tax purposes.<sup>2</sup>

When reviewing this change, the application of a trust fund recovery penalty immediately comes to mind. For employment taxes paid prior to January 1, 2009, the owner of the single-member LLC is held liable for the taxes, penalties and interest assessed against the LLC. However, for employment taxes on wages paid after January 1, 2009, a trust fund recovery penalty must be assessed against the owner in order to collect the trust fund portion of the taxes.<sup>3</sup>

The IRS has several computer systems. One is the IDRS system, which controls most of the active collection cases. The information from this system then feeds the IRS Masterfile, the ACS computers



CCH

a Wolters Kluwer business



**Patti Logan, EA**, specializes in taxpayer representation before the Collection Division. As a former Revenue Officer, she brings a unique expertise to the inner workings of the Special Procedures Branch. She can be reached at [patti@thetaxgroup.com](mailto:patti@thetaxgroup.com).

and the revenue officers Integrated Collection System (ICS). IDRS is not programmed to discern between a single-member LLC with wages paid prior to January 1, 2009, and those paid after January 1, 2009. If the tax returns were filed under the LLC's employer identification number, IDRS will report any delinquencies under the EIN with no indication whether the owner or the disregarded entity owes the taxes.

The IRS has issued interim guidance<sup>4</sup> instructing service employees to identify the liable taxpayer and then to input an indicator that will identify the liable taxpayer (owner or LLC) on IDRS. A transaction code (TC) 971 with a certain action code (AC) is to be input to IDRS on each module once the identity of the liable taxpayer is determined. The transaction code for each module will be input as shown in Table 1.

**Table 1.**

TC	AC	Explanation
971	364	LLC is the liable taxpayer for this period.
971	365	Single member/owner is the liable taxpayer for this period.
971	366	Liable taxpayer changed during this tax period.

If the transaction code was requested in error, then a TC 972 with the original action code reverses it. Then the correct TC 971 will be input.

The difficulties do not end with the input of transaction codes. When an LLC files a balance due employment tax return without payment, one option may be to enter into an installment agreement to pay the taxes. The problem arises when the unpaid taxes span a period beginning prior to January 1, 2009, but includes tax periods ending after that date. If the tax returns were originally filed under the LLC's employment tax identification number, then, as noted above, the computer will not automatically indicate who is liable. The computer can not systemically accommodate separate closing actions for various tax periods under the same EIN. So, there is no systemic mechanism for inputting or monitoring an installment agreement that encompasses periods where both the owner and the LLC are liable parties.

Interim guidance has been issued to collection employees assigned disregarded limited liability companies.<sup>5</sup> As part of the investigation, the appropriate

transaction code 971 with action codes 364, 365 or 366 should be input to the system. Collection information statements should be secured. If owner is determined to be the liable party, then a Form 433A is needed; if the LLC is liable then a *Collection Information Statement for Businesses*, Form 433B, is appropriate.

The collection employee is instructed to base the installment agreement payment on a combination of the payment ability demonstrated by the separate collection information statements. Once approved the installment agreement letter will include an attachment as shown in Exhibit 1.

### Exhibit 1.

Attachment to SMO/LLC Installment Agreement  
Employer Identification Number xx-xxxxxxx (LLC EIN)

This agreement is between the Internal Revenue Service and (Single Member/Owner name and LLC name.)

The monthly payment amount is \$XXX. The monthly payment is based on (SMO name)'s collection information statement amount of \$XXX plus the (LLC name)'s collection information statement amount of \$XXX. Payments will be accepted from (SMO name) or (LLC name) (collectively the taxpayers) and will be applied in the best interest of the government regardless of liable party.

In the even of default, enforcement action will be taken against (the SMO name) for tax periods(s) ending MM/DD/YYYY and against (the LLC name) for tax period(s) ended MM/DD/YYYY (list).

The above described agreement seems to defy Code Sec. 6672 regarding collection of taxes. The trust fund recovery penalty authorized by Code Sec. 6672 is assessed against willful and responsible parties for the amount of the taxes collected from employees' paychecks and not paid over to the government as required. This penalty allows the government to collect from the assets of those parties who should have paid over employment or excise taxes but failed to do so.

If the income of the single member/owner is included in the computation of the installment agreement amount for periods where employment taxes are the liability of the LLC, then, in effect, the IRS is collecting from the owner for periods where a trust fund recovery penalty is applicable but without assessing the penalty.

Although the regulation moving the liability for employment taxes paid by a single-member LLC may be beneficial for the owner, it certainly has opened a can of worms for the administration of the tax law when considering collection of the taxes.

---

**ENDNOTES**

---

- <sup>1</sup> Notice 99-6, 1999-1 CB 321.
- <sup>2</sup> Reg. §301.7701-2(c)(2)(iv).
- <sup>3</sup> Code Sec. 6672.
- <sup>4</sup> Memorandum SB/SE-05-1208-063 dated Dec. 3, 2008.
- <sup>5</sup> Memorandum SB/SE-05-0509-020 dated May 26, 2009.

This article is reprinted with the publisher's permission from the JOURNAL OF TAX PRACTICE & PROCEDURE, a bi-monthly journal published by CCH, a Wolters Kluwer business. Copying or distribution without the publisher's permission is prohibited. To subscribe to the JOURNAL OF TAX PRACTICE & PROCEDURE or other CCH Journals please call 800-449-8114 or visit [www.CCHGroup.com](http://www.CCHGroup.com). All views expressed in the articles and columns are those of the author and not necessarily those of CCH.



**CCH**

a Wolters Kluwer business