

Criminal Tax Manual

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18.01 STATUTORY LANGUAGE: 26 U.S.C. §§ 7215 & 7512

§7215. *Offenses with respect to collected taxes*

(a) *Penalty.*--Any person who fails to comply with any provision of section 7512(b) shall, in addition to any other penalties provided by law, be guilty of a misdemeanor, and, upon conviction thereof, shall be fined* not more than \$5,000, or imprisoned not more than one year, or both, together with the costs of prosecution.

(b) *Exceptions.*--This section shall not apply--

(1) to any person, if such person shows that there was reasonable doubt as to (A) whether the law required collection of tax, or (B) who was required by law to collect tax, and

(2) to any person, if such person shows that the failure to comply with the provisions of section 7512(b) was due to circumstances beyond his control.

For purposes of paragraph (2), a lack of funds existing immediately after the payment of wages (whether or not created by the payment of such wages) shall not be considered to be circumstances beyond the control of a person.

* As to offenses committed after December 31, 1984, the Criminal Fine Enforcement Act of 1984 (P.L. 98-596) enacted 18 U.S.C. § 3623 [FN1] which increased the maximum permissible fines for both misdemeanors and felonies. For the misdemeanor offense set forth in section 7215, the maximum permissible fine for offenses committed after December 31, 1984, is increased to at least \$100,000 for individuals and \$200,000 for corporations. Alternatively, if any person derives pecuniary gain from the offense, or if the offense results in a pecuniary loss to a person other than the defendant, the defendant may be fined not more than the greater of twice the gross gain or twice the gross loss.

§ 7512. *Separate accounting for certain collected taxes, etc.*

(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 p

(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 become 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 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.

(c) *Relief from further compliance with subsection (b).*--Whenever the Secretary is satisfied, with respect to any notification made under subsection (a), that all requirements of law and regulations with respect to the taxes imposed by subtitle C or chapter 33, as the case may be, will henceforth be complied with, he may cancel such notification. Such cancellation shall take effect at such time as is specified in the notice of such cancellation.

18.02 GENERALLY

It is a crime under section 7215 to fail to comply with any provision of section 7512(b) of the Internal Revenue Code, which requires employers (among others), upon notice, to collect employment taxes and deposit the withheld taxes in a special bank account held in trust for the United States. *United States v. Erne*, 576 F.2d 212, 215 (9th Cir. 1978); *United States v. Paulton*, 540 F.2d 886, 888 (8th Cir. 1976); *United States v. Merriwether*, 329 F. Supp. 1156, 1159 (S.D. Ala. 1971), *aff'd*, 469

F.2d 1406 (5th Cir. 1972).

Employment taxes are based on an employer-employee relationship, and they include the following:

1. Old-Age, Survivors, and Disability Insurance taxes and Hospital Insurance taxes, all commonly known as social security or F.I.C.A. taxes, which are levied as a tax against the wage income of an employee and as an excise tax against the wages paid by an employer. 26 U.S.C. §§ 3101 & 3111. The taxes are to be paid by the employer, who is required to deduct the employee's share of social security taxes from the employee's wages, and add to this amount the employer's share of the tax. 26 U.S.C. § 3102.
2. Federal unemployment taxes, commonly known as F.U.T.A. taxes, which are levied as an excise tax against the employer, based on the total wages paid with respect to employment. 26 U.S.C. § 3301. The actual F.U.T.A. tax ordinarily is inconsequential, because contributions to state unemployment funds are credited against F.U.T.A. taxes, up to 90 percent of the latter. 26 U.S.C. § 3302.
3. Employees' income taxes deducted by an employer from the wages paid to employees, for payment by the employer to the Internal Revenue Service. 26 U.S.C. §§ 3402, 3403.

Employers are required, under the above-noted provisions of the Internal Revenue Code, to: (1) withhold social security, unemployment, and income taxes from the wages of employees; (2) make quarterly returns of their withholdings on Forms 941; and (3) pay over to the Internal Revenue Service the amounts of taxes withheld and the amounts paid by the employer. If an employer is delinquent with respect to his obligations regarding withholding, the Internal Revenue Service may invoke the provisions of section 7512.

18.03 ELEMENTS OF "TRUST FUND" CASES

To establish a violation of section 7215, the government must prove the following elements beyond a reasonable doubt:

1. The defendant was a person required to collect, account for, and pay over income tax withholding on wages and F.I.C.A. taxes.
2. The defendant was served with the statutory notice prescribed by section 7512(a);
3. The defendant failed to comply with the notice, while not entertaining a reasonable doubt as to whether the law required the defendant to do so, and the failure was not due to circumstances beyond the defendant's control.

United States v. Erne, 576 F.2d 212, 213 (9th Cir. 1978);
United States v. Polk, 550 F.2d 566, 567 (9th Cir. 1977);
United States v. Hemphill, 544 F.2d 341, 343-44 (8th Cir. 1976).

18.04 PERSON REQUIRED TO COLLECT, ACCOUNT FOR, AND PAY OVER

18.04[1] *Person Required -- "Employer"*

Although the cases often use the term "employer," technically section 7215 refers to "person" and does not use the term "employer." Section 7343 of Title 26 defines the word "person" for purposes of section 7215. *United States v. McMullen*, 516 F.2d 917, 921 (7th Cir.1975); *United States v. Stevenson*, 540 F. Supp. 93, 95 (D. DE. 1982); *United States v. Merriwether*, 329 F. Supp. 1156, 1159 (S.D. AL 1971), *aff'd*, 469

F.2d 1406 (5th Cir. 1972). Section 7343 states that "person" includes "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." 26 U.S.C. § 7343. [FN2]

The Seventh Circuit stated, in *McMullen*, that the term "person" includes all those with significant control over the financial decision-making process within a corporation. *McMullen*, 516 F.2d at 921. Thus, if a defendant had such control, then the defendant is a person who has the legal duty to collect, truthfully account for, and pay over the withholding taxes of the employer's entity. *McMullen*, 516 F.2d at 920.

The court in *McMullen* further stated that the fact that the defendant's signature did not appear on some payroll checks was immaterial and was no basis for not admitting these checks into evidence -- "responsibility for withholding taxes does not turn on the ministerial act of signing checks but on authority to control the disposition of funds." *McMullen*, 516 F.2d at 921.

In *Stevenson*, 540 F. Supp. 93, the defendants, who were the president and vice-president of a corporation, moved to dismiss the indictment on the grounds that it charged them individually with failing to make the required deposits and did not charge the corporation, which was the actual employer. The court held that the defendants were "persons" under section 7215 because they were under a duty to make the required deposits. Therefore, the indictment was sufficient to charge an offense, even though the corporation was not charged. *Stevenson*, 540 F. Supp. at 95-96.

In *Merriwether*, 329 F. Supp. 1156, the court took a different approach to the issue of corporation versus officer, but reached the same result on criminal liability. The court first concluded that in the case of a corporation, it was the corporation that was the "person" required to collect taxes from the wages of its employees and not the corporate officers. The corporation was not charged, but the court found the defendant, who was the president and principal officer of the corporation, guilty of violating section 7215 on the grounds that:

[T]he Government has proven facts showing that defendant, Merriwether, aided and abetted Dixie Engineering Corporation, a person within the purview of Section 7501, in its failure to collect and pay over withholding taxes. It is well settled that an aider and abettor is guilty and punishable as a principal. 18 U.S.C.A. Section 2.

An aider and abettor may be indicted directly with commission of the substantive crime, and such a charge may be supported by proof that he only aided and abetted in its commission. *Nassif v. United States*, 370 F.2d 147 (8th Cir. 1966). One need not be charged as an aider and abettor to be held as one. *Yeloushan v. United States*, 339 F.2d 533 (5th Cir. 1964). Evidence showing an offense to have been committed by a principal is necessary, although it is not required that the principal be convicted, or even that identity of the principal be established. *Pigman v. United States*, 407 F.2d 237, 239 (8th Cir. 1969).

Merriwether, 329 F. Supp. at 1159-60.

For a lengthy discussion on who is a person required to collect, truthfully account for, and pay over withholding taxes, see *Pacific National Insurance v. United States*, 422 F.2d 26, 29-32 (9th Cir.), a civil case under section 6672 of the Internal Revenue Code. See also *United States v. Carrigan*, 31 F.3d 130 (3d Cir. 1994)

18.04[2] **Employees**

To establish the requirement for withholding taxes, the government must prove that the taxes in issue relate to employees of the defendant or the

defendant's business. On this issue, the jury can consider all of the circumstances surrounding the relationship between the defendant and those individuals pointed to as employees.

The fundamental test is the common law test of the employer's right to control the workers. This right to control must include control of the activity of the workers, not only with regard to the result accomplished, but also the means by which this result is accomplished. *United States v. Polk*, 550 F.2d 566, 567 (9th Cir. 1977). See *Lifetime Siding, Inc. v. United States*, 359 F.2d 657, 660 (2d Cir.). Essentially, the government must prove that the workers were employees and not independent contractors.

18.05 REQUIREMENTS OF SECTION 7512(b)

18.05[1] Notice of Failure to Collect, Account For, and Pay Over

In order to establish a violation of section 7215(a), the Internal Revenue Service first must have notified the employer of his failure to collect, truthfully account for, or pay over the covered taxes, or to make deposits, payments, or returns of such taxes, "by notice delivered in hand . . ." 26 U.S.C. § 7512(a)(2). Thus, personal service of the notice is required. In the case of a formal business or legal entity, however, service on any corporate officer will suffice as notice to all other officers. *United States v. McMullen*, 516 F.2d 917, 920 (7th Cir.); *United States v. Stevenson*, 540 F. Supp. 93, 96 (D. Del. 1982).

The Internal Revenue Service uses Form 2481, Notice to Make Special Deposits of Taxes, as the formal notice served pursuant to section 7512. The recipient signs this form as proof of having received notice. A defendant can be prosecuted, however, even if there is a refusal to sign the Form 2481, as long as it is shown that the defendant actually received it. See *McMullen*, 516 F.2d at 919.

Form 2481 sets forth the requirement that the employer open a special trust account in a bank for the benefit of the United States and deposit in that account all taxes withheld from wages within two banking days after the taxes are collected. 26 U.S.C. § 7512(b). Furthermore, the employer must pay over the taxes monthly, instead of quarterly, with the filing of Form 720, Quarterly Federal Excise Tax Return, or Form 941M, Employer's Monthly Federal Tax Return. The requirements set forth in Form 2481 cannot be waived and remain in effect until the employer receives written notice from the District Director canceling these obligations. See *United States v. Gay*, 576 F.2d 1134, 1137 (5th Cir. 1978).

18.05[2] Bank Account For Trust Deposits

The bank account used for the trust deposits must be designated as a special fund in trust for the United States, payable to the United States by the employer as trustee. 26 U.S.C. § 7512(b). The fact that a defendant had three general bank accounts in his own name does not meet this requirement. *United States v. McMullen*, 516 F.2d 917, 920-21 (7th Cir. 1975). As a practical matter, however, unless there are unusual circumstances present, an employer probably will not be prosecuted for failing to establish such a special account, if the employer has paid the required taxes monthly by filing Forms 720 or 941M. In such a situation, the government is receiving its money on a timely basis.

Section 7512(b) requires the employer to make a deposit with each pay period, even though the employer does not have to formally pay over the funds to the United States until the end of each month. Thus, with every pay period that the employer fails to deposit the withheld taxes to the trust account, the employer is committing a violation of section 7215. Otherwise stated, where there is a series of failures to deposit over numerous pay periods, each failure is a separate offense and not part of one continuing offense. *United States v. Paulton*, 540 F.2d 886, 893 (8th Cir. 1976).

It is not necessary for the government to prove the exact amount of each deposit required. The essence of a section 7215 offense is failing to make timely deposits to a trust account. If no deposits were made at all, then the government need only prove that a deposit was due to show noncompliance with section 7512 and, therefore, a violation of section 7215. *United States v. Gay*, 576 F.2d 1134, 1138 (5th Cir. 1978).

18.05[3] **Prior Failures to Pay**

A defendant's earlier failures to pay withholding and F.I.C.A. taxes for periods before those named in the indictment or information have been held admissible as prior similar acts. *United States v. Polk*, 550 F.2d 566, 568 (9th Cir. 1977). In *Polk*, the court stated that such evidence went to the defendant's state of mind and intent, and, as such, was admissible. *Polk*, 550 F.2d at 568. The holding of *Polk* is questionable, however, because intent is not an element of section 7215; it is a strict liability offense. See *United States v. Erne*, 576 F.2d 212 (9th Cir. 1078), and Section 18.07, *infra*. But see *United States v. McMullen*, 516 F.2d 917, 921 (7th Cir.1975) (holding evidence of prior tax deficiencies was necessary and material, because section 7512(b) is triggered by prior failures to properly collect, account for, or pay over taxes).

18.05[4] **Dates of Payroll Checks**

Questions over the dates of employees' checks and the dates that the checks were cashed are inconsequential. "It is not material that [payroll] checks may not have been delivered on the exact dates appearing thereon or that particular employees may not have cashed their checks immediately after receiving them." *United States v. Gay*, 576 F.2d 1134, 1138 (5th Cir. 1978) (quoting *United States v. Paulton*, 540 F.2d 886, 891 (8th Cir. 1976)). The mere fact that some checks were not dated on the actual pay days listed in the indictment or information is inconsequential and a harmless variance. *United States v. McMullen*, 516 F.2d 917, 921 (7th Cir.1975).

18.05[5] **Expert Testimony Excluded**

The Fifth Circuit has approved the exclusion of expert testimony at trial concerning the requirements of section 7512. A defendant's legal obligations under this section are a matter for the court's instructions to the jury on the law and are not properly a subject for testimony by an expert witness. *United States v. Gay*, 576 F.2d 1134, 1137 (5th Cir. 1978).

18.06 **CIRCUMSTANCES BEYOND CONTROL**

Section 7215(b)(2) provides that there is no violation if the defendant "shows" that the failure to collect, account for, or pay over the tax was "due to circumstances beyond his control." Section 7215(b) also provides that a lack of funds existing immediately after the payment of wages, whether or not caused by the payment of the wages, "shall not be considered to be circumstances beyond the control of a person." The scope of this "circumstances beyond control" exception to the statute "was intended to be narrow." *United States v. Randolph*, 588 F.2d 931, 932-33 (5th Cir. 1979).

The legislative history of section 7215 includes examples of acceptable circumstances beyond an employer's control, which would cause a lack of funds after (but not immediately after) the payment of wages. These include theft, embezzlement, destruction of the business from fire or other casualty, and the failure of the bank in which the employer had deposited funds prior to transferring them to the trust account for the government. *Randolph*, 588 F.2d at 933. Conversely, a lack of funds caused by the defendant taking care of other liabilities and paying other creditors is not

considered a circumstance beyond a person's control and is not a viable defense. *United States v. Plotkin*, 239 F. Supp. 129, 131 (E.D. Wis. 1965).

18.07 INTENT

Section 7215 is a strict criminal liability provision. The government is not required to prove any particular mental state, intent, or willfulness, as it must in other criminal tax violations. *United States v. Erne*, 576 F.2d 212, 213-15 (9th Cir. 1978); *United States v. Paulton*, 540 F.2d 886, 890-91 (8th Cir. 1976); *United States v. Dreske*, 536 F.2d 188, 196 (7th Cir. 1976); *United States v. Gorden*, 495 F.2d 308, 310 (7th Cir.1974); *United States v. Stevenson*, 540 F. Supp. 93, 97 (D. Del. 1982). See also *United States v. Evangelista*, 122 F. 3d 112 (2d Cir. 1997) (recognizing that the felony offense of failing to account for and pay over under section 7202 entails the element of willfulness, while the misdemeanor under sections 7215 and 7512 does not).

18.08 DEFENSES

18.08[1] Constitutional Contentions

Sections 7215 and 7512 have been upheld in the face of various constitutional challenges. The argument that section 7512 is unconstitutional because it does not provide for a prior administrative hearing before an employer is required to comply with subsection (b) has been rejected. *United States v. Paulton*, 540 F.2d 886, 889 (8th Cir. 1976); *United States v. Patterson*, 465 F.2d 360, 361 (9th Cir.), cert. denied, 409 U.S. 1038 (1972); *United States v. Plotkin*, 239 F. Supp. 129, 131-32 (E.D. Wis. 1965).

The Eighth Circuit also stated, in *Paulton*, that the exceptions appearing in section 7215(b) do not unconstitutionally place on a defendant the burden of proving his innocence and, therefore, do not impermissibly infringe on a defendant's privilege against self-incrimination. *Paulton*, 540 F.2d at 891-92.

Finally, the contention that a sentence of imprisonment for violation of section 7215 is contrary to the Fifth Amendment of the United States Constitution has been rejected. Defendants have been unsuccessful in claiming that they were being imprisoned for debt because they were unable to pay the taxes. *United States v. Gorden*, 495 F.2d 308, 310 (7th Cir.1974); *United States v. Patterson*, 465 F.2d at 361.

18.08[2] Selective Prosecution

Courts also have rejected claims of selective, discriminatory prosecution. *United States v. Erne*, 576 F.2d 212, 216-17 (9th Cir. 1978); *United States v. Stevenson*, 540 F. Supp. 93, 97-98 (D. Del. 1982). These holdings, rather than being based on the nature of the statute, simply rested on the defendants' failure of proof.

18.08[3] Prior Excess Deposits

Making advance deposits into the trust account, in excess of withheld amounts, for pay periods prior to those charged, is not a defense to the failure to make the proper deposits for the pay periods named in the indictment or information. "To ensure collection of withheld taxes, section 7215 imposes strict compliance with the deposit requirements of section 7512 and any deviation from these provisions constitutes an offense." *United States v. Gay*, 576 F.2d 1134, 1137 (5th Cir. 1978). Note, however, that evidence of overpayment for prior pay periods may be admissible as proof that the

defendant had a reasonable doubt as to his obligation to collect taxes in the charged pay periods, because he may already have deposited any taxes due. *Gay*, 576 F.2d at 1137.

18.08[4] **Late Payment of Taxes**

Evidence of late payments of withholding taxes is no defense, because "the focus of section 7512 is not eventual payment, but timely payment, and an offense under section 7215 has nothing directly to do with payment at all, but with failure to comply with mandatory accounting procedures," which were designed to avoid late payments. *United States v. McMullen*, 516 F.2d 917, 921 (7th Cir.1975).

18.08[5] **Lack of Funds**

The Seventh Circuit has rejected the defense of lack of funds immediately prior or subsequent to the payment of the employer's payroll. *United States v. Dreske*, 536 F.2d 188, 195 (7th Cir. 1976). Section 7215 also specifically rejects "lack of funds existing immediately after the payment of wages (whether or not created by the payment of such wages)" as being an exception to the sanctions of the statute.

18.08[6] **Embezzlement**

Congress has stated that embezzlement is an example of an acceptable circumstance beyond a person's control, which may bring the person within the exceptions to section 7215. *United States v. Randolph*, 588 F.2d 931, 933 (5th Cir. 1979); S. Rep. No. 1182, 85th Cong., 2d Sess. ([1958] U.S. Code Cong. & Ad. News 2179, 2191-92). The court, in *Randolph*, held that there was insufficient proof to support the embezzlement defense, where the evidence consisted only of a co-owner of the defendant having been involved with a competitor. The court noted that in order to assert a viable embezzlement defense, a defendant must prove that the embezzling co-owner or employee lied to the defendant about the bank balances at the time the payroll checks were drawn, or embezzled the funds after the payroll checks were drawn, leaving insufficient funds to make the trust deposits. Embezzlement before payroll checks are drawn would not constitute a defense if the defendant knew or should reasonably have known of the embezzlement. *Randolph*, 588 F.2d at 933.

18.09 **POLICY CONSIDERATIONS**

Trust fund cases under section 7215 are one of the categories of criminal tax cases authorized by the Department of Justice to be referred directly from the Internal Revenue Service to United States Attorneys' offices. USAM 6-4.243. This does not mean that such cases should be treated lightly.

The importance of employer taxes is noted in the Comptroller General's Report to the Congress, *Fictitious Tax Deposit Claims Plague IRS*, GGD-81-45, dated April 28, 1981, at pages 1-2:

In fiscal year 1979, employment trust fund taxes accounted for \$298 billion (65 percent) of the \$460 billion in internal revenue collections. In IRS' 1979 annual report the Commissioner noted that nonpayment of taxes withheld from employee's wages is one of the most serious delinquency problems. IRS initiated collection action against employers for nonpayment of \$2.4 billion in trust fund taxes during fiscal year 1976, the latest year for which data is available.

. . . .

Requiring employers to withhold taxes and periodically deposit them to a Federal bank account facilitates tax collection. In addition, it avoids the hardships to individual taxpayers of making lump-sum payments

at the end of a year and minimizes the potential for individuals to avoid tax payment. One problem, however, is that it gives employers the opportunity to use the withheld taxes for their own benefit if they do not pay them to the Government. Testifying in 1976 before the Oversight Subcommittee of the House Ways and Means Committee, IRS officials expressed concern that employers use the withheld taxes as low-interest loans from the Federal Government.

As noted, the numbers that relate to delinquent employment taxes are in the billions of dollars, and the collection of employee income taxes at their source is one of the most important of all the government's tax-gathering methods. Criminal tax prosecutions of all kinds act as a deterrent to others, and prosecutions under section 7215, in particular, can act as an aid to the proper collection of employment taxes.

18.10 VENUE

The Sixth Amendment of the United States Constitution provides that trials shall be in the "State and district wherein the crime shall have been committed" See also Fed. R. Crim. P. 18.

If a statute does not indicate the location of the crime, "the *locus delicti* must be determined from the nature of the crime alleged and the location of the act or acts constituting it." *United States v. Anderson*, 328 U.S. 699, 703 (1946). In section 7215 prosecutions, venue is proper in the judicial district in which the employer had his place of business or in which he maintained his special trust bank account, if he ever opened such an account.

See also the discussion of venue in Section 6.00, *supra*.

18.11 STATUTE OF LIMITATIONS

The statute of limitations for section 7215 offenses is three years from the date the defendant was required to make the deposit to the trust account and failed to do so. 26 U.S.C. § 6531. According to section 7512(b), the deposit must be made by the end of the second banking day after the taxes are collected. Where proper deposits have been made but the defendant later withdraws the funds from the trust account and uses them for purposes other than payment to the IRS, then presumably the statute of limitations commences to run from the date the defendant made such withdrawal(s).

See also the discussion of the statute of limitations in Section 7.00, *supra*.

FN 1. Changed to 18 U.S.C. § 3571, commencing November 1, 1986.

FN 2. See also *United States v. Neal*, 93 F.3d 219, 222-224 (6th Cir. 1996).