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ADMINISTRATION OF CERTAIN COLLECTED TAXES

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Mr. BYRD, from the Committee on Finance, submitted the following

R E P O R T

[To accompany H. R. 8865]

The Committee on Finance, to whom was referred the bill (H. R. 8865) relating to the administration of certain collected taxes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. GENERAL STATEMENT

This bill is designed to secure greater compliance with present law on the part of employers and others in paying over to the Government trust fund moneys withheld from employees, or collected from customers. It provides that where an employer in the future is required to collect and pay over income or social-security taxes withheld from an employee, or where a person in the future is required to collect and pay over excise taxes on facilities or services (admissions, club dues, communications, transportation, etc.), and he fails to do so, he can by a notification from the Internal Revenue Service be instructed to collect such taxes and deposit them in a special trust account for the United States Government. Persons who after this notification fail to comply with this provision are, unless they qualify under 1 of 2 exceptions, guilty of a misdemeanor and upon conviction will be fined not more than \$5,000, or imprisoned not more than 1 year, or both (together with the costs of prosecution). The exceptions are for cases where the failure was due to reasonable doubt as to the requirements under law, or where the lack of compliance was due to factors beyond the person's control. This bill in the case of the employment taxes is to be effective only for notifications with respect to pay periods beginning after the date of enactment of this bill, and in the case of the excise taxes only with respect to taxes imposed after the date of enactment of the bill.

II. REASONS FOR THE BILL

Although the great majority of employers fully comply with the withholding and collection requirements of the internal-revenue laws, the Government continually has been faced with the problem of a relatively few employers and collection agents who fail to collect and pay over trust-fund moneys representing withheld income and social-security taxes and excise taxes on facilities and services. As of December 31, 1956, the delinquent withheld income and social-security taxes alone amounted to \$279 million. This represents the accumulation of delinquent accounts over the last 6 years and is approximately one-fifth of 1 percent of the total of these taxes collected over this period. Although the delinquencies are a relatively small proportion of the amount collected over this period, to permit their continuance places an unfair burden on law-abiding employers and the taxpaying public generally. As a result your committee has concluded that remedial action should be taken to eliminate these delinquencies to the fullest extent possible.

Present law in section 6672 provides a civil penalty of 100 percent for any person who willfully fails to collect or truthfully account for and pay over an internal-revenue tax for which he is responsible. However, this civil penalty is ineffective where the employer has lost the employees' funds in a business venture or where he did not have them in the first place. The latter, which presents one of the most difficult enforcement problems, can be illustrated by a secondary contractor who is without funds, but obtains from the prime contractor just enough to meet his net payroll. The prime contractor in this case, since he is responsible for the completion of the job, is willing to provide the net wage payments, but since he is not the "employer" cannot be required to provide the taxes to be withheld by the "employer." The secondary contractor who is the "employer," apart from the net wage payments, does not have any funds in these cases to set aside as withheld taxes.

A criminal penalty is also provided by section 7202 of present law. This provides a penalty of up to \$10,000, or imprisonment for up to 5 years, or both, for willful failure to collect, or truthfully account for or pay over the taxes. This criminal penalty also has proved to be of limited usefulness because of the difficulty of proving willfulness, which to a lesser extent has also been a problem in the case of the civil penalty. The courts, for example, in the criminal cases generally have refused to treat as "willful" those cases where the employer failed to pay over amounts withheld because they used the funds in business ventures which were not successful and no longer had such amounts available to be paid over to the Government.

The criminal penalty added by this bill does not require proof of "willfulness" before it applies. Moreover, the penalty is less severe than that now imposed under existing law for "willful" failure. As a result, it is believed that the new penalty can be applied to many of the delinquency cases where the present "willful" failure provision has been ineffective. Nevertheless, it is designed so that it can have no application to the vast majority of taxpayers, since the penalty applies only in the case of failures to make deposits in a special trust fund for the United States, and the requirement that deposits be made in such a trust fund must be based on a notification delivered by hand and a

failure to comply with such notice after it is delivered. In addition, your committee has provided two safeguards to give assurance that the penalty will not be applied in an arbitrary manner to those who have previously failed to comply with the laws and are, therefore, required to make the special trust fund deposits. The penalty is not to apply where there was a reasonable doubt that the law required the collection of the tax or that the person in question was required to collect the tax. It also does not apply where it can be shown that the failure to comply was due to circumstances beyond the control of the person in question.

III. EXPLANATION OF THE BILL

The bill adds two new sections to the Internal Revenue Code. The first section of the bill adds a new section 7512, which provides in certain cases for the separate accounting for certain collected taxes, etc., to the end of chapter 77, relating to miscellaneous administrative provisions. Section 2 of the bill adds a new section 7215, which provides a penalty where persons do not comply with the separate accounting requirements of the new section 7512, to the end of part I of subchapter A of chapter 75, relating to general provisions concerning crimes, other offenses and forfeitures.

The new section 7512, relating to separate accounting for certain collected taxes, etc., is divided into three subsections: subsection (a) providing the conditions under which the separate accounting will be required, subsection (b) specifying the requirements which must be met as to this accounting, and subsection (c) providing the conditions under which persons may be relieved of this separate accounting.

Subsection (a) provides that when any person, who is required to collect, account for, and pay over certain specified taxes, fails to do so at the time and in the manner provided by law or regulations (or fails to make deposits, payments, or returns of such taxes under the depository receipt system) and is notified of any failure of this type, then the requirements of subsection (b) as to separate accounting are to apply.

The specified taxes to which this provision is applicable are the employment taxes imposed by subtitle C, including withheld income taxes, and also the excise taxes on facilities and services imposed by chapter 33. Although the employment taxes imposed by subtitle C include both the taxes imposed with respect to employers and also taxes collected by employers from their employees, it is only this latter category, namely, the collected taxes, to which this separate accounting provision is applicable. The excise taxes to which this provision is applicable include the so-called collected taxes imposed by chapter 33. These are the taxes on admissions (not including the cabaret tax which is not a collected tax), club dues, communications, transportation, and safe-deposit boxes.

The notification which must occur after the failure of a person to comply with the requirements of subsection (a) and before the separate accounting requirements of subsection (b) become applicable, must be in the form of a notice delivered personally by a representative of the Internal Revenue Service to the person who has failed to comply with subsection (a). In the case of a corporation, partnership, or trust, it will be sufficient if this notification is delivered in hand to an officer, partner, or trustee. Such delivery will be deemed to be a

delivery to all officers, partners, trustees, or employees of the organization.

Subsection (b) of the new section 7512 specifies the requirements as to the separate accounting which must be complied with by those to whom a notice has been delivered in the manner provided by subsection (a). The separate accounting provisions are to be applicable only with respect to taxes which become collectible after the delivery of the notice. In the case of the employment taxes, including the withheld income taxes, this means that the separate accounting provisions are to be applicable only with respect to wages paid after the receipt of the notice. The separate accounting is not to be required with respect to any withholding or collection of taxes which should have occurred prior to the receipt of the notice, although the employer in such cases will still be required to pay these taxes to the Government and will still be subject to all other applicable penalties of law if he fails to do so. The separate accounting would be required, however, with respect to wages earned by employees prior to the notification where payment of the wages occurs after such notification, since the deduction and withholding of the employment taxes are related to the payment of wages.

The accounting procedure provided by subsection (b) makes three requirements with respect to those to whom this subsection is applicable. They are: (1) required to collect the specified taxes, (2) deposit them in a separate account in a bank not later than by the end of the second banking day after the taxes are collected, and (3) keep the deposits in this separate account until payment over to the United States. The account in which the funds are to be deposited is to be designated as a special fund in trust for the United States and is to be payable by the employer or collecting agent only to the United States. This account can be in any bank selected by the employer or collecting agent which meets the definition of the term "bank" as provided in section 851 of the code. The definition in this section provides that it must be a bank or trust company incorporated and doing business under the laws of the United States, any State or any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts and of exercising fiduciary powers which is subject to supervision and examination by State, Territory, or Federal authority having supervision over banks. The definition also includes domestic building and loan associations.

Subsection (c) of the new section 7512 provides a procedure whereby a person who has been subject to the separate accounting requirements of subsection (b) can be relieved of these requirements. This subsection provides that the Secretary of the Treasury or his delegate may cancel the notification which made the separate accounting provisions applicable if he is satisfied that the person involved will henceforth meet the requirements of law and regulations with respect to the specified taxes.

Section 2 of the bill adds the new section 7215, relating to offenses with respect to collected taxes. This new section is divided into two subsections, the first providing a penalty and the second specifying certain exceptions where the penalty will not be applicable.

That penalty imposed by subsection (a) of section 7215 provides that any person to whom the separate accounting provisions of section 7512 (b) are applicable who fails to comply with these requirements is to be guilty of a misdemeanor and upon conviction is to be

fined up to \$5,000, or imprisoned for up to 1 year, or both, together with the costs of prosecution. This penalty is to be in addition to any other penalties provided by law. Thus, the 100 percent civil penalty provided by section 6672 for persons who willfully fail to collect, or truthfully account for, and pay over an internal revenue tax, may also be applicable. This is also true of the criminal penalty provided by section 7202, which provides a fine of not more than \$10,000, imprisonment for not more than 5 years, or both, together with the costs of prosecution. The new feature of the penalty provided by the new section 7215 is that it is not limited to the "willful" failure cases to which these other penalties are applicable.

Subsection (b) of the new section 7215 provides that the penalty provided by subsection (a) is not to be applicable in two types of situations. First, it is not to be applicable if the person in question shows that there is reasonable doubt as to whether the law required the collection of the tax or if he shows that there is reasonable doubt that he was the one who was required by law to collect the tax. Thus, the penalty would not apply, for example, in the case of the employment taxes where the person whose status is questioned shows that there was reasonable doubt as to whether he was an employer or engaged in a contract with an independent contractor. The penalty also would not apply, for example, in the case of the excise taxes described in chapter 33, where the person in question can show that there is reasonable doubt as to whether he is the proper collection agent.

The second exception to the penalty in subsection (a) is provided in those cases where the person involved can show that the failure to collect, to deposit and keep the taxes in the separate account was due to circumstances beyond his control. For this purpose, however, a lack of funds immediately after the payment of wages (whether or not resulting from the payment of the wages) is not to be considered circumstances beyond a person's control. This can be illustrated by an employer subject to the requirements of section 7512 (b) who has gross payroll requirements of \$1,000, with respect to which he is required to withhold \$100 of income taxes. If such an employer had on hand only \$900 and paid out this entire amount in wages, withholding nothing, the fact that the net wages due equaled this amount would not relieve him of the penalty imposed by section 7215 (a).

A lack of funds occurring after the payment of wages (so long as it was not immediately after) would, however, qualify under this exception if it were due to circumstances beyond the person's control. Examples of factors which might result in a lack of funds constituting circumstances beyond the control of the person after (but not immediately after) the payment of wages and within the period before the person was required to deposit the funds are theft, embezzlement, destruction of the business as the result of fire, flood, or other casualty, or the failure of a bank in which the person had deposited the funds prior to transferring them to the trust account for the Government. However, lack of funds arising after payment of wages resulting, for example, from the payment of creditors will not be considered circumstances beyond the person's control.

Section 3 of the bill is concerned with clerical amendments relating to the table of sections for chapter 77 and part I of subchapter A of chapter 75.

Section 4 of the bill provides an effective date. This section provides that the notification provided by section 7512 (a) in the case of the employment taxes can be made only with respect to pay periods beginning after the date of enactment of this bill and in the case of the excise taxes only with respect to taxes, the payment of which is required after the date of enactment of this bill. In the case of the employment taxes, therefore, the notification will not be effective with respect to wages paid after the date of enactment of this bill if the pay periods, with respect to which the wages are paid, began before the date of the enactment of this bill. Since the notification in section 7512 (a) must occur before the separate accounting required by section 7512 (b) becomes applicable, and since the penalties provided by section 7215 are applicable only with respect to failures to meet the requirements specified in section 7512 (b), the separate accounting requirement and penalty applicable thereto also can only apply with respect to failures occurring after the effective date of the bill.

It is anticipated that the passage of this bill will substantially improve revenue collections, but the extent of this improvement is difficult to forecast in advance of experience under these provisions.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no change is proposed is shown in roman):

Internal Revenue Code of 1954

CHAPTER 75—CRIMES, OTHER OFFENSES, AND FORFEITURES

SUBCHAPTER A. Crimes.

SUBCHAPTER B. Other offenses.

SUBCHAPTER C. Forfeitures.

SUBCHAPTER D. Miscellaneous penalty and forfeiture provisions.

Subchapter A—Crimes

Part I. General provisions.

Part II. Penalties applicable to certain taxes.

PART I—GENERAL PROVISIONS

- Sec. 7201. Attempt to evade or defeat tax.
- Sec. 7202. Willful failure to collect or pay over tax.
- Sec. 7203. Willful failure to file return, supply information, or pay tax.
- Sec. 7204. Fraudulent statement or failure to make statement to employees.
- Sec. 7205. Fraudulent withholding exemption certificate or failure to supply information.
- Sec. 7206. Fraud and false statements.
- Sec. 7207. Fraudulent returns, statements, or other documents.
- Sec. 7208. Offenses relating to stamps.
- Sec. 7209. Unauthorized use or sale of stamps.
- Sec. 7210. Failure to obey summons.
- Sec. 7211. False statements to purchasers or lessees relating to tax.
- Sec. 7212. Attempts to interfere with administration of internal revenue laws.
- Sec. 7213. Unauthorized disclosure of information.
- Sec. 7214. Offenses by officers and employees of the United States.
- Sec. 7215. *Offenses with respect to collected taxes.*

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SEC. 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.

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CHAPTER 77—MISCELLANEOUS PROVISIONS

- Sec. 7501. Liability for taxes withheld or collected.
- Sec. 7502. Timely mailing treated as timely filing.
- Sec. 7503. Time for performance of acts where last day falls on Saturday, Sunday, or legal holiday.
- Sec. 7504. Fractional parts of a dollar.
- Sec. 7505. Sale of personal property purchased by the United States.
- Sec. 7506. Administration of real estate acquired by the United States.
- Sec. 7507. Exemption of insolvent banks from tax.
- Sec. 7508. Time for performing certain acts postponed by reason of war.
- Sec. 7509. Expenditures incurred by the Post Office Department.
- Sec. 7510. Exemption from tax of domestic goods purchased for the United States.
- Sec. 7511. Exemption of consular officers and employees of foreign states from payment of internal revenue taxes on imported articles.
- Sec. 7512. *Separate accounting for certain collected taxes, etc.*

SEC. 7501. LIABILITY FOR TAXES WITHHELD OR COLLECTED.

(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 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.

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SEC. 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 by 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 by 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 or his delegate 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.

