

Anthony P. Curatola, Editor

The Liability of Partners for Partnership Employment Tax | BY DAVID G. JAEGER

Can partners be held liable for a partnership's employment taxes if no assessment of the tax has been made against the individual partners? Let's take a look at two recent developments that provide answers to this question. First, the Supreme Court recently rendered an opinion regarding judicial collection proceedings

against individual partners. Second, in response to that decision, the Internal Revenue Service (IRS) announced its position regarding collection from partners through administrative methods.

Internal Revenue Code §6203 provides that an assessment shall be made by recording the liability of the taxpayer. Under §6501(a), the IRS must assess any tax due within three years after a return is filed. If the assessment isn't made in this time period, no court proceeding can be made to collect the tax. If an assessment is made within the three-year period of limitation, however, §6502(a) provides that the tax may be collected by levy or court proceeding. This is true provided the levy is made or the judicial proceeding is begun within the 10-year period after the tax is as-



sessed. Thus, an assessment within the three-year period effectively extends the collection period for 10 years.

These statutory provisions don't specifically address the ability of the IRS to collect a partnership's employment taxes from the individual partners, but the following developments provide taxpayers with guidance regarding this issue.

Judicial Collection

In *U.S. v. Galletti* (124 S.Ct.1548), the taxpayers were all general partners in a partnership that hadn't paid a substantial amount of employment taxes over several years. The IRS had made a timely assessment of the employment taxes against the partnership, but it didn't assess the tax against the individual partners. Four years after the assessment against the partnership, the individual partners all entered bankruptcy proceedings.

The IRS filed a claim in the bankruptcy court against the individual partners for the unpaid employment taxes owed by the partnership. This was done based on the general partners' liability for the debts of the partnership (including taxes) under state law. The bankruptcy court, as well as the district court and the Ninth Circuit, all held that the IRS couldn't collect from the partners. These lower courts all agreed that a proper assessment of the tax liability against only the partnership didn't extend the period to collect the tax from the individual partners for 10 years.

On appeal, the Supreme Court reversed the decision of the Ninth

Circuit and held that the IRS could collect the partnership's unpaid employment tax liability from the individual partners. According to the Court, §6203 refers to assessment of the liability of the taxpayer. Regarding employment taxes, §3402(a) requires every employer making payment of wages to deduct and withhold employment taxes. Also, §3403 states that the employer shall be liable for the payment of the tax that is required to be deducted and withheld. In the case where an employer fails to pay employment taxes, it is therefore clear that the liable taxpayer is the employer (in this case, the partnership). Thus, where an assessment is made against the partnership, the requirement of §6203 has been met since the liability of the taxpayer (the employer) has been assessed.

The Court also pointed out that under §6501 and §6502 it is the tax that is being assessed, not the taxpayer. Once a tax is properly assessed, nothing in the Code requires the IRS to duplicate its efforts by separately assessing the same tax against individuals or entities who are not the actual taxpayer but are, under state law, liable for payment of the taxpayer's debt. The assessment of the employment tax liability against the partnership is sufficient to extend the statute of limitation to collect the tax in judicial proceedings from the general partners, who are liable for the payment of the partnership's debts. In short, no assessment of the employment tax liability against the individual general partners is required.

By way of footnotes, the Court limited its opinion to situations where the IRS was attempting to collect the partnership's tax liabilities from the general partners in a

judicial proceeding. The Court pointed out that it wasn't addressing the question of whether an assessment only against the partnership is sufficient for the IRS to commence administrative collection of the partnership's tax debt from the partners by way of lien or levy. Also, the Court declined to address whether an assessment against the partnership is sufficient to create liability against the partners for interest and penalties absent a separate notice and demand on them individually.

Administrative Collection

In response to the Supreme Court decision in *Galletti*, the IRS issued Chief Counsel Notice 2005-003. The Notice states that the *Galletti* holding doesn't alter the Service's position regarding administrative collection of a partnership's tax liability from the partners. The position of the IRS is that it can enforce the tax lien and take administrative levy action against a general partner based on the assessment, notice, and demand for payment directed only to the partnership.

Section 6321 states that if any person liable to pay a tax fails to do so after demand, a federal tax lien arises on that person's property and rights to property. According to the IRS, since state law makes a general partner derivatively liable for the debts of the partnership, the general partner is considered a person liable to pay the partnership's tax. Once the IRS makes an assessment against the partnership and gives a notice and demand for payment to the partnership, the notice and demand is imputed to all of the general partners. The property of the individual general partners, since they are liable for the tax, is then

subject to the tax lien arising from the assessment of the partnership tax.

The IRS may then levy on a general partner's property and rights to property in order to collect the partnership's employment tax liability. The IRS feels that this can be done based on §6331(a), which states that if any person liable to pay any tax fails to pay, the Service may levy upon that person's property and property rights. Since the IRS views a general partner as a "person liable to pay" the partnership tax, the partner's individual property can be seized under the levy provision.

Clearly, the IRS takes the position that assessment of employment taxes against the partnership is all that's necessary to extend the 10-year administrative collection period during which it can collect from the partners. No assessment against the individual partners is required for this extension. Despite this position, the Notice does point out that the partners do have certain rights regarding notice before administrative collection can occur.

Section 6320(a)(1) requires that written notice of the right to a Collection Due Process (CDP) hearing be given to any person described in §6321 (any person liable to pay the tax who is described in a Notice of Federal Tax Lien). Since general partners are liable to pay the partnership tax liabilities, the IRS states that separate CDP notices should be given to the partnership as well as to all the general partners.

Also, under §6330(a)(1), written notice of the right to a CDP hearing must be given to a person liable to pay the tax prior to any levy on that person's property. Where there is

the intent to levy on property of a general partner to collect the partnership's employment tax liability, separate CDP notices should be given to both the partnership and the general partner whose property the IRS intends to levy upon.

In conclusion, general partners should be aware that they may be held liable for a partnership's unpaid employment taxes during the extended 10-year collection period. This liability exists provided the IRS has made a valid assessment against the partnership. After Galletti, it is clear that no assessment against the individual general partners is necessary if the Service employs judicial collection methods. If, instead, the IRS attempts to collect from the partners through administrative means, the Supreme Court opinion leaves open the question of whether

the Service must assess the tax liability against the individual partners. But taxpayers should be aware that the IRS continues to take the position that it can still collect from the partners using lien and levy procedures in situations where the tax liability has only been assessed against the partnership. ■

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concern about the difficulty of implementation arising from the FASB's new definition of market value and about the complexity of having auditors develop values and offer opinions on them. I would argue that there is an imbalance in the regulation-setting process. In the push to move the business from an income-reporting mentality to a balance-sheet focus, there is a bias toward theoretical purity that seems to ignore the practical implications of usefulness, simplicity, objectivity, and, most importantly, the cost of implementation. We need to continue to challenge the status quo and make our voices heard.

What do you think? Please share your thoughts with me at bbrower@imanet.org. ■