

DEFENDANT'S EXHIBIT

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USA
v.
Amodeo

Date Identified: MAY 13 2009

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COMMENTS: Updated Tax Memorandum is attached.

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MEMORANDUM

To: Frank Amodeo
20 North Orange Avenue
Suite 1400
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From: Elena Wildermuth

Re: Third Party Liability for non-payment of payroll taxes pursuant to I.R.C.
§6672¹

I. FACTUAL BACKGROUND

On May 3, 2001, Presidion Solutions, Inc., a Florida corporation ("Presidion") acquired all of the issued and outstanding stock in five privately held entities; Sunshine Staff Leasing, Inc., Sunshine Companies Inc., Sunshine Companies, II, Inc., Sunshine Companies, III, Inc. and Sunshine Companies Inc. IV (herein referred to as the "Sunshine Entities" or "Sunshine"). All of these entities were also Florida corporations and had their own federal identification numbers.

The Sunshine Entities were licensed as Employees Leasing Companies in the State of Florida and were operated as such. The Sunshine Entities would enter a co-employment agreement with various clients, and pursuant to that agreement, the worksite employees of the client would fill out employment forms and tax withholding information with the Sunshine Entities. The client would then reimburse Sunshine for the wages, taxes and insurance.

The Sunshine Entities would then report the wages and taxes under the Sunshine Federal ID number by whom that employee was employed. The client would pay his invoice into one of the Sunshine Entities' bank account through which all payroll and taxes were paid. The clients of the Sunshine Entities never made any payments to a Presidion's bank account and no wages or taxes relating to such clients were ever disbursed from the Presidion's account. All revenue, wages and taxes were handled solely through the Sunshine bank accounts and all wages and taxes were reported and remitted under the Sunshine's federal identification numbers.

It is important to note that in order to perform employee leasing service such as conducted by the Sunshine Entities, it is required that you obtain and maintain a license

¹ The I.R.C. is also referred to as title 26 U.S.C.

with the state of Florida to do so, including submitting individual financial statements showing a positive net worth and working capital. At all time relevant to this situation, only the Sunshine Entities, and not Presidion, were licensed to conduct these operations.

On December 31, 2004, Presidion sold all of the common stock in the Sunshine Entities to Wellington Capital Partners, Inc. ("Wellington"). Wellington does not have ownership interest in Presidion and it did not have any ownership interest in the Sunshine Entities prior to December 31, 2004.

The Internal Revenue Services has alleged that the Sunshine Entities have a balance due for federal employment taxes for 2003 and 2004.

The issue presented is whether the IRS may impose responsible party liability under I.R.C. § 6672 on Presidion for the alleged tax deficiencies of the Sunshine Entities.

II. BRIEF ANSWER

Corporate and individual liabilities for nonpayment of employment taxes are separate and distinct. The language of Section 6672(a) imposes liability only on responsible individuals, not entities. Although some courts have held the term "person" includes entities, they can be distinguished from our situation.

III. RELEVANT STATUTORY AUTHORITY

26 U.S.C. § 6672 (a) - FAILURE TO COLLECT AND PAY OVER TAX OR ATTEMPT TO EVADE OR DEFEAT TAX.

(a) 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 truthfully account for and pay over such tax, or willfully attempts in any manner to evade 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...

26 U.S.C. § 6671(b) - PERSON DEFINED- The term "person" as used in this subchapter, 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 duty to perform the act in respect of which the violation occurs.

26 U.S.C. § 7701(a)(1)- When used in this title [26], where not otherwise distinctly expressed or manifestly incompatible with the intent thereof -

- the term PERSON shall be construed as to mean and include an individual, a trust, estate, partnership, association, company or corporation.

IV. ANALYSIS

A. BACKGROUND OF THE ISSUES REGARDING PAYROLL TAXES.

Corporate employment taxes include the following:

- (1) The employees' Federal income taxes. I.R.C. § 3401 and 3402;
- (2) The employees' shares of Federal Insurance Contributions Act (FICA) taxes. I.R.C. § 3101;
- (3) The employer's share of FICA taxes. I.R.C. § 3111;
- (4) The employer's Federal Unemployment Tax Act (FUTA) taxes. I.R.C. § 3301.

Employers are liable for deducting and withholding from their employees' salaries or wages the employees' share of Federal income and FICA taxes. I.R.C. §§ 162(a), 3102(a), 3402(a), 3403. The withheld Federal income and FICA taxes are reported quarterly on Form 941. Treas. Reg. § 31.6011(a)-i (a)(1), §31.6011 (a)-4(a)(1). FUTA taxes are required to be reported annually on Form 940, Treas. Reg. § 31.6011 (a)-3.

The liability imposed by I.R.C. § 6672 is separate and distinct from that imposed upon the employer under I.R.C. § 3403. *See, Malone v. U.S.*, 87-2 USTC ¶ 9641 at 5; *Monday v. U.S.*, 421 F.2d 1210, 1218.

When an employer fails to pay taxes withheld from its employees' wages, the IRS may assess penalties against individual officers or employees of the employer personally responsible for effectuating the collection and payment of trust-fund taxes who willfully failed to do so. I.R.C. §6672.

B. JUDICIALLY IMPOSED TEST FOR PURPOSE OF I.R.C. § 6672.

Courts imposed a two-prong test establishing liability under Section 6672: "Any person" may be held liable for unpaid withholding taxes if:

- (1) He or she is a "responsible person" for collection and payment of the employer's trust fund withholding taxes, *see United States v. McCombs*, 30 F.3d 310, 317 (2d Cir.1994); *Fiataruolo*, 8 F.3d at 938; *Godfrey*, 748 F.2d at 1574 & n. 4; and
- (2) He or she "willfully" failed to comply with the statute. *McCoinbs*, 30 F.3d at 317; *Fiataruolo*, 8 F.3d at 938; *Hochstein v. United States*, 900 F.2d 543, 546 (2d Cir. 1990), *cert. denied*, 504 U.S. 985, 112 S.Ct. 2967, 119 L.Ed.2d 587 (1992).²

² It is well settled that an IRS assessment under I.R.C. § 6672 is presumptively correct; and, the person against whom the IRS assesses the Section 6672 tax penalty has the burden of

The narrow inquiry for purposes of this memorandum is whether "any person" encompasses solely individuals and not whether such person met the test of Section 6672(a). Therefore, the following analysis addresses specifically that issue.

C. INTERNAL REVENUE CODE DEFINITION OF "PERSON" IMPLIES AN INDIVIDUAL.

Pursuant to 26 U.S.C. § 7701(a)(i), when used in this title [Title 26] and where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, the term "PERSON" shall be construed as to mean and include an individual, a trust, estate, partnership, association, company or corporation.

Here, in Section 6671(b), we have "otherwise distinctly expressed" the different definition of "PERSON" applicable only to Subchapter A of Chapter 68 of the I.R.C. (which includes I.R.C. § 6672). Section 6671(b) defines "person" to include "an officer or employee ... who, as such officer, employee or member, is under a duty to perform the act in respect of which the violation occurs." This definition implies that only an individual can be penalized pursuant to I.R.C. § 6672.

D. INTERNAL REVENUE SERVICE'S STANDARD FOR DETERMINING THE "RESPONSIBLE PERSON" UNDER I.R.C. § 6672.

Pursuant to the Internal Revenue Manual ("IRM"), a determination of responsibility under I.R.C. § 6672 is dependent on the facts and circumstances of each case. Responsibility is a matter of status, duty and authority to insure compliance with the employer's tax withholding obligations. IRM 5.7.3.3.1(1).

In the same IRM 5.7.3.3.1(2), the agency gives a list of potential "responsible persons" under I.R.C. § 6672, which includes the following:

- Office or employee of a corporation

disproving, by a preponderance of the evidence, the existence of one of these two elements. *McCombs*, 30 F.3d at 318 ("In the context of section 6672, however, courts have extended the presumption of correctness not merely to the amount of the assessment itself but also to the existence of the two elements, responsibility and willfulness, that underlie the imposition of this type of tax liability"); *see also United States v. Rem*, 38 F.3d 634, 643 (2d Cir.1994); *Fiataruolo*, 8 F.3d at 938; *Hochstein*, 900 F.2d at 546 (taxpayer "bears the burden of proving by a preponderance of the evidence that one or both of these elements [willfulness and responsibility] is not present"); *Lesser v. United States*, 368 F.2d 306, 310 (2d Cir.1966) (en banc); *United States v. Lease*, 346 F.2d 696, 701 (2d Cir.1965); *Rizzuto v. United States*, 889 F.Supp. 698, 704 (S.D.N.Y.1995) (burden of proof is on the taxpayer; IRS is presumed to be correct); *Skouras v. United States*, 854 F.Supp. 962, 971 (S.D.N.Y.1993) (tax assessment pursuant to section 6672 creates a prima facie case of liability).

- Partner or employee of a partnership
- Corporate director or shareholder
- Another Corporation
- Employee of a sole proprietorship
- Surety lender
- Other person or entity outside the delinquent business organization.

At first glance, it looks like the IRS interpreted the term of "responsible person" under the I.R.C. § 6672 to be an individual and/or an entity that would meet the test of responsibility and willfulness. However, if we start applying this test, it would be very difficult to establish an element of scienter (willfulness) with respect to a corporation, that acts through its officers and directors and is incapable of expressing any intent as being a bloodless entity. See, *US. v. Hill*, 368 F. 2d 617, 624 (5th Cir. 1966) (where the Court refers to the *amicus curiae* brief by The Texas Bankers Association). Corporations cannot act "willfully, they act through people, their agents against whom this penalty is specifically imposed."³

Furthermore, more careful reading of the IRS Manual would imply that despite the broad inclusion of the term "responsible person," the practical implication is that only an individual can be a "responsible person" for purposes of I.R.C. § 6672. The following analysis would illustrate that conclusion.

First, in its IRM 5.19.7.2, titled "Trust Fund Recovery Penalty" (hereinafter referred to as "TFRP"), it is stated that "TFRP under I.R.C. § 6672 applies to individuals or entities (representatives of a business with authority and responsibility) who did not pay the government: withheld income taxes, withheld social security ..., or collected excise taxes." As you can see from the foregoing quote, the Manual itself explains the term "entities" as representatives of a business with authority and responsibility, which implies specific individuals within such entities.

Second, in the same IRM 5.19.7.2(4), it is expressly stated that "TFRP may be assessed against several individuals" even though the total liability (not necessarily under I.R.C. § 6672) can be collected only once from either the [delinquent] business, one or more responsible individuals or the [delinquent] business and one or more responsible individuals (see also, IRM 1.2.1.5.14(1)); thus, implying that the ultimate responsible for the TFRP under I.R.C. § 6672 can be only imposed on the individual in his or her various capacities.

Third, in its IRM 1.2.1.5.14 (known as Policy Statement P-5-60 (02-02-1993)), it

³ A corporation is a legal entity which can only act through its agents, officers and employees. See, *Cedar Hills Properties Corp. v. Eastern Federal Corp.*, 575 So. 2d 673 (1st DCA Fla. 1991); see also *City of St. Louis v. Praprotnik*, 485 U.S. 112 (1988) (where the Court noted that a corporation is incapable of doing anything except through the agency of human beings).

is stated in section (5): "An individual will not be recommended for assertion if sufficient information is not available to demonstrate he or she was actively involved in the corporation at the time the liability was not being paid." The Policy Statement did not mention anything with respect to assertion of TFRP on an entity. Thus again, it is implicitly stated that the TFRP assessment can only be asserted against individuals.

Fourth, in its IRM 5.17.7.1.1, which also includes "another corporation" in the list of "persons" included under Section 6672, the IRS expressly stated the following: "Regardless of a person's corporate title, a person will not held liable for TFRP [I.R.C. § 6672] unless he or she has a duty to account for, collect, and pay over the trust fund taxes to the government." IRM 5.17.7.1.1(2). This provision unequivocally implies that a person can be only an individual.

Fifth, on December 18, 1991, a General Counsel for the IRS published a General Counsel Memorandum regarding the relationship between Section 6672 and other penalty provisions in the Code. *See*, GCM 39868 (1991). In describing the purpose of Section 6672, the General Counsel stated that "Section 6672 encourages the payment of trust fund taxes by imposing personal liability on responsible officers in the event the trust fund taxes are not paid by the corporation." GCM 39868, p. 3 (1991). "Section 6672 only applies to persons responsible for collection of these trust fund taxes." GCM 39868, p. 2 (1991). Therefore, even the General Counsel for IRS agrees with our position that the liability under Section 6672 lies with individuals, not entities.

Sixth, in its IRM 5.7.3.3.1, titled "Establishing Responsibility," the IRS instructed its officers that in order "to determine whether a person has a status, duty and authority to ensure that the trust fund taxes are paid, consider the duties of the officers as set forth in the corporate by-laws as well as the ability of the individual(s) to sign checks." IRM 5.7.3.3.1(4). "In addition, determine the identity of the individuals who: are officers, directors, or shareholders of the corporation; hire or fire employees; exercise authority to determine which creditors to pay; sign and file Form 941, Employer's Quarterly Federal Tax Return; Control the corporation's voting stock; make federal tax deposits." *Id.* Thus, again it is implicitly stated that the TFRP assessment can only be asserted against individuals.

It is also important to note that pursuant to IRM 5.7.3.3.1(5), the TFRP determination must be made on an LLC classified as partnership because under state law the members of an LLC classified as a partnership are not liable for the debts of that LLC (partnership). Thus, the IRM specifically instructs the IRS' officers that they have to make the TFRP determination if they want to place responsibility on members (investors) of the delinquent entity. Under Florida law (same in all jurisdictions), shareholders of a corporation are not generally liable for the debts of that corporation. As a result, the IRS cannot make assessment on Presidion for the taxes owned by the Sunshine Entities based solely on the fact that Presidion was a sole shareholder of the Sunshine Entities.

Seventh, in its IRM 4.24.9.5, the IRS emphasized that Section 6672 is used solely as a collection device and thus, does not establish a separate liability. Specifically, it is

stated that "Section 6672 penalty should not be assessed against the [collecting] agency, even if the agency willfully failed to pay the tax, since the penalty is used solely as a collection device." IRM 4.24.9.5(4)(a). If appropriate the tax should be assessed against collecting agency under Section 7501(a). *Id.* The penalty under Section 6672 should be assessed against the responsible officers. *Id.* This provision unequivocally implies that a person (under Section 6672) can only be an individual.

Eight, in the Revenue Ruling 84-83, which became the IRS' authority for broad inclusionary rule under 6672 and 6671, the issue was whether a volunteer (an individual) of a board of trustees of a charitable organization may be personally liable under the I.R.C. § 6672. The IRS held that such an individual was liable (as long as he had met the test of responsibility and willfulness) because pursuant to the IRS's own interpretation, "the term 'person' includes an officer or employee, but does not exclude others... Section 6672(a) addressed to those persons who have responsibility for payment of the withheld taxes, who have knowledge of the tax delinquency and who have authority over the decision to pay or not to pay the taxes. Rev. Rul. 84-83.

Ultimately, the IRS held that a person's corporate title or lack thereof would not determine the responsibility under Section 6672, but rather it would be that person's specific responsibility, knowledge and authority. Judging by the language of the entire written opinion, this holding applies only to individuals because the pronoun "who" (in grammatically correct English language) refers only to living breathing beings and not to entities. There is no indication in that Revenue Ruling that its holding would apply to business entities in addition to individuals. Therefore, the IRS interpretation was consistent with the Code's definition even though it expended on it (applying "substance over form" doctrine). *See also*, Rev. Proc. 84-78, which updates procedures for appeals of penalty assessments arising under Section 6672, (where the IRS' definition of persons implicitly includes solely individuals).

Therefore, we can argue that the IRS Manual provides the IRS' field officers with a general idea (a checklist) of what to look for when making a determination of possible "responsible persons". If you look at the Manual this way, it explains why it has such a broad list of potential "responsible persons." That what Manuals do; they provide employees with a course of action in any specific situation that may occur. Subsequently, when the scope of potential "responsible persons" is determined, the officers would look for individuals in such entities who would satisfy the requirements of the "responsible persons" under Section 6672.

Finally, the IRS Manual is not a legal authority. The provisions in the Manual are not codified in the Code of Federal Regulations. Even if they were, they would not be "mandatory" because their purpose is to govern the internal affairs⁴ of the IRS. *US. v.*

⁴ In a situation when the IRS failed to follow its own rules, designed for purpose of preserving the taxpayer's constitutional rights, the Courts would construe them as mandatory. However, this is not the case in our situation.

Home, 714 F. 2d 206, 207. They do not have the force and effect of law. *Id.*

E. COURTS INTERPRETATION OF A "PERSON" UNDER I.R.C. §6672.

1. *Legal authority in support of solely individual liability.*

There is a whole body of case law that holds and implies that the definition of a "person" pursuant to Section 6672 encompasses only individuals.

In *In re Professional Security Services*, 162 BR. 901 (Bankr. M.D. Fla 1993), the Court held that a corporate debtor did not qualify as "responsible person" for failing to pay over employment taxes for purposes of Section 6672. (However, a debtor may be liable for the employment taxes as primary employer. *Id.*) The Court stated that although there may be one or more persons within the Debtor corporation who have general control over the business affairs and who have ultimate authority over the funds used to pay the FICA and FUTA obligations, the IRS has not pointed to a particular individual as required by Section 6672 and defined by Section 6671(b). Under the authority of Sections 6672 and 6671 of the Internal Revenue Code, an entity, i.e. a corporation, does not qualify as a person. *Id.* at 905. Therefore, even though, a corporation may be liable to IRS for the FICA and FUTA taxes under other Sections of the Internal Revenue Code,⁵ it can not be liable under Section 6672.

In *Botta v. Scanlon*, 288 F. 2d 504, (2d Cir 1961), the Court stated: "As additional proof that the penalty is addressed [only] to specific individuals, it applies solely to those who 'willfully' fail to collect and/or pay over." *Id.* at 506 (emphasis added).

In *US. v. Hill*, 368 F. 2d 617 (5th Cir. 1966), the Court held that an entity (a bank) which loaned to defaulting corporation funds to complete jobs in progress and which did not manage internal affairs of corporation which was under no duty to file corporate tax returns and which withheld no taxes from corporate employees was not liable under Section 6672. *Id.* at 622. There is strong evidence that Congress has not intended that Section 6672 should apply to entities, unless they are charged with the responsibility to withhold and pay over the payroll taxes. *Id.*

Finally, in virtually every reported case, where liability under Section 6672 has been upheld, the responsible person has been an active officer and individual shareholder of the company against whom the tax was originally assessed, or one of that company's employees with the broad agency powers. In *Slodov v. United States*, 436 U.S. 238 (1978),

⁵ For example, in *U.S. v. Total Employment Co. Inc.*, 305 B.R. 333 (Bankr. M.D. Fla. 2004), the Court held that if a company is determined to be an "employer" under Section 3401(d) as it was in control of the payment of wages, such company is liable to IRS for the employment taxes owned by the other company under 3102.

a Supreme Court case, which remains the leading authority on the application of Section 6672, the Supreme Court has stated: "The fact that the provision imposes a 'penalty' and is violated only by 'willful failure' is itself strong evidence that it was not intended to impose liability without personal fault." *Id.* at 254 (emphasis added). See also, *Farkas v. US.*, 57 Fed. Cl. 134 (2003); *US. v. Sotelo*, 436 U.S. 268 (1978); *Jean v. U.S.*, 396 F.3d 449 (1st Cir. 2005); *Godfrey v. US.*, 748 F.2d 1568 (Fed. Cir. 1984); *Taylor v. I.R.S.*, 69 F. 3d 411 (Okla. 1995); *Plitt v. US.*, 2001-1 USTC P 50,419 (Not reported in F.Supp.2d); *U.S. v. Carrigan*, 31 F.3d 130 (N.J. 1994). (there are many more cases, citations to which are omitted in the interest of time and which are available upon request).

2. **Legal authority in support of imposing liability on entities pursuant to Section 6672 in specific situations.**

There are a few cases that imply that the definition of a "person" pursuant to Section 6672 encompasses entities. See, *Pacific Nat Ins. Co. v. US.*, 422 F. 2d 26 (5th Cir. 1970); *Adams v. U.S.*, 504 F. 2d 73 (7th Cir. 1974); *US. v. North side Deposit Bank*, 569 F. Supp. 948, 960 (D. Pa 1983); *In re Quattrone Accountants, Inc.*, 100 B.R. 235 (W.D. Pa. 1989)

However, the foregoing cases can be distinguished from our situation for several reasons:

First, in *Pacific Nat. Ins. Co. V. US.*, 422 F. 2d 26 (9th Cir. 1970), the entity (Pacific) that was found liable under Section 6672 was a surety which wrote payment and performance bonds on government contracts awarded to the defaulting corporation. Since Pacific would be liable for the amount of the payroll taxes under Section 3505 (as surety) anyway, the Court did not see any problems with finding liability under 6672. (See also, *US. v. North side Deposit Bank*, 569 F. Supp. 948, 960 (D. Pa 1983) where the Court also established the liability under Section 3505). In the instant situation, Presidion was not a surety of the Sunshine Entities. Presidion was just a sole shareholder of the Sunshine Entities and did not guaranty any contracts entered into by the Sunshine Entities.

Second, in *In re Quattrone Accountants, Inc.*, 100 BR. 235 (W.D. Pa. 1989), the court found an entity liable under Section 6672 because such entity was hired for purpose of performing the payroll functions of the delinquent corporation, which prepared and filed and signed all of the delinquent corporation's returns. Since that entity was charged with the responsibility to collect, account for and pay over taxes, the Court applied the broad definition of Section 6672. Presidion never performed such services for the Sunshine Entities or on their behalf.

On the other hand, in *SCDF Investment Corp. v. US.*, 901 F. Supp. 1164 (W.D. La 1995), even though the Court agreed that a bank can be "responsible person" within the broad definition of Section 6672, the Court also stated that the status of "responsible person" is affixed to only those parties that involve themselves to such a degree of control as to merit such an imposition. *Id.* at 1169. The Court has to look at the actual supervision

applied by the bank versus the supposed level of control regarding the loan and paper relationship between the parties. *Id.* In the *SCDF Investment* case, the Court held that the bank was not "responsible party" under Section 6672 because even though the bank had the authority to sign company's checks, the bank did not have the requisite authority to make decisions as to the disbursements of funds and payment of creditors as required for purposes of Section 6672.

V. CONCLUSION

Accordingly, from the facts provided, it would be very unlikely for the IRS to impose liability on Presidion for the payroll taxes of the Sunshine Entities pursuant to Section 6672.

P.S.

The cited documents are in the file and available upon request.

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