

BERMAN, KEAN & RIGUERA, P.A.

MEMORANDUM

Date: February 2, 2006  
To: Frank Amodeo  
From: Elena Wildermuth  
Re: Relationship between current trust fund obligations, after acquired funds and "willfulness" under I.R.C. § 6672

I. BACKGROUND INFORMATION AND SCOPE OF THIS MEMORANDUM

Employers are required to withhold various taxes from the wages of their employees, which the employers hold in trust until the taxes are paid over to the federal government. Failure to forward these "trust fund" taxes by "responsible person" to the government will expose "responsible persons" to liability under IRC 6672, if the IRS will not be able to collect the unpaid taxes from the employers.

The narrow issue for purposes of this memorandum is whether a responsible person can have a valid defense to "willfulness" test if during the time of being a "responsible person under 6672, that person diverts current trust fund tax obligations (withheld on current wages) to other creditors whether secured or not.

II. BRIEF ANSWER

A person is liable under IRC 6672, if that person consciously does not collect, withhold or remit current trust fund tax liabilities incurred during the time from which that person becomes a responsible person.

Corporate funds should not be considered "encumbered" (for purpose of IRC 6672) simply because a *contractual* obligation with a lender or other creditor impacts a company's ability to use its assets, receivables, or loan advances with complete freedom. If this were the case, then nearly every responsible person involved with a failing company in the midst of credit problems or intricate loan arrangements would be able to avoid a finding of willfulness and thus evade liability. Such a result would undermine the purpose of § 6672 in assuring that trust fund taxes are paid to the government. (See *Bell v. United States*, 355 F. 3d 387 (6<sup>th</sup> Cir. 2004) discusses below in Part VI - D).

To permit a "responsible person" to escape liability under section 6672 by entering into agreements which prefer other creditors to the government would defeat the entire purpose of the statute. It is difficult to imagine that in any other context a trustee

could avoid his obligations by entering into an agreement by which funds entrusted to him are used to pay his other obligations.

**III. EXTENT OF RESPONSIBLE PERSONS LIABILITY PRIOR DURING AND AFTER CHANGE OF CONTROL UNDER IRC 6672**

Origination A-B	At Change of Control B	Present B-C
<p>If a Person (P) is found to be Responsible Person (RP) and Willful (W)</p> <p><b>THEN</b></p> <p>Under 6672, the P is 100% liable for ALL "trust fund" amounts not remitted to IRS during the time period of being RP.</p>	<p>If a Person (P) is found to be a Responsible Person (RP) and Willful (W)</p> <p><b>THEN</b></p> <p>Under 6672 the P is liable for the "trust fund" liabilities incurred prior to becoming the RP, <b>ONLY TO THE EXTENT</b> of funds on the corporate books at the time of Change of Control, <b>IF</b> such funds were connected to the "trust funds taxes" that had been dissipated.</p>	<p>If a Person (P) is found to be a Responsible Person (RP) and Willful (W) since Change of Control,</p> <p><b>THEN</b></p> <p>Under 6672, the P is 100% liable for all current "trust fund" amounts not remitted to the IRS since the Change of Control, whether there are secured creditors or not. Present "trust fund taxes" (incurred from wages paid since Change of Control) are property of the US Government/IRS.</p> <p>(same as in A-B)</p>

**IV. METHODS AVAILABLE TO THE IRS TO COLLECT EMPLOYMENT RELATED TAXES.**

When an employer fails to pay taxes withheld from its employees' wages, the IRS has several means at its disposal to effect payment of the taxes past due:

- (1) The IRS may create a lien upon the property of the employer (Section 6321<sup>1</sup>) and levy, distraint and sell the employer's property in satisfaction (Sections 6331 - 6344 "Federal Tax Lien Act");

<sup>1</sup> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or



- (2) The IRS may assess civil penalties against the delinquent employer pursuant to Section 6656;
- (3) The IRS may impose criminal and civil penalties (pursuant to Sections 7202 and 7215) against any person for willful failure to comply with the requirements of 7512;
- (4) Finally, the IRS may, assess penalties against responsible persons for effectuating the collection and payment of trust-fund taxes who willfully failed to do so (Section 6672).

With respect to the first (1) case scenario, the IRS stands in the same position as a secured creditor as of the time of the lien. The analysis is different if we are referring to the fourth (4) case scenario, penalties against responsible persons pursuant to IRC 6672. This memorandum is concentrated on the 4<sup>th</sup> method to collect employment taxes from responsible persons pursuant to Section 6672.

The Federal Tax Lien Act ("FTLA") deals with corporate debts and the priorities of corporate creditors when an entity is not able to satisfy debts of its secured creditors. The Civil penalty against responsible persons statute, IRC 6672, usually deals with the situation after the IRS is not able to recover the "trust funds" from a delinquent entity (sometimes because other creditors have priorities under FTLA). It is an alternative collection device for the IRS.

Regarding the "encumbered funds" defense to the willfulness test of 6672, I think we confuse two separate issues. There is a difference between the issue of having first priority as a secured creditor on assets of the company under the FTLA and being considered liable for non-payment of "trust fund" taxes as a "responsible person" for purposes of section 6672.

The cases that were presented to me were decided on the basis of who had priority as a secured creditor over the delinquent company's assets. Those cases were not decided pursuant to the authority of Section 6672 and therefore have little application in this analysis. The priorities of creditors under FTLA and liability pursuant IRC 6672 for the currently withheld "trust fund tax" obligations are two separate issues.

#### V. JUDICIALLY IMPOSED TEST FOR PURPOSE OF SECTION 6672.

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

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personal, belonging to such person.

- (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. *McCombs*, 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).

## VI. ANALYSIS

### A. WHAT ARE "TRUST FUND TAXES"

The Code requires most employers to withhold Social Security, Medicare, and federal income taxes from their employees' wages. *See* 26 U.S.C. §§ 3102, 3402. Section 7501 provides that the withheld money is held in trust for the United States until paid to the Treasury on a quarterly basis. 26 U.S.C. § 7501(a); *Slodov v. United States*, 436 U.S. 238, 243 (1978). The employer, as a function of administrative convenience, extracts money from a worker's paycheck and briefly holds that money before forwarding it to the IRS. *Gephart v. United States*, 818 F.2d 469, 472 (6th Cir.1987). A delinquency in trust fund taxes thus is not simply a matter between the IRS and an employer, but rather involves employee wages.

Under the system of withholding taxes provided by the Internal Revenue Code, employees are entitled to credit for the amounts of FICA and income taxes withheld from their wages regardless of whether or not the employer turns the funds over to the Government. I.R.C. §§ 1462, 3102(a). Since the Government may actually be out-of-pocket by way of credit or refund for taxes it has never received, Congress has allowed the IRS more stringent protective devices to insure collection of payroll taxes than in the case of many other taxes (§ 6672).

### B. NATURE OF THE "TRUST FUND"; WHOSE PROPERTY IS THE "TRUST FUND?"

Since Sections 3102 and 3402 of the Code, 26 U.S.C. §§ 3102 and 3402, require employers to withhold social security and income taxes imposed on employees from the employees' wages, the withholding taxes are not simply a debt. They are part of the wages of the employee, held by the employer in trust for the government. 26 U.S.C. § 7501<sup>2</sup> ("a special fund in trust for the United States"); *Slodov v. United States*, 436 U.S.

<sup>2</sup> An employee whose taxes are withheld but not actually paid over to the government is credited with payment. Therefore, the government has recourse against the persons responsible for remitting the taxes to the IRS, not just the employer. Congress



238, 243, 98 S.Ct. 1778 (1978); *McGlothlin v. United States*, 720 F.2d 6, 8 (6th Cir. 1983); *Kalb v. United States*, 505 F.2d 506, 509 (2d Cir.1974). In paying the taxes over to the government the employer merely surrenders the property, which does not belong to him. Thus, those funds may not be used as working capital for the business. *Id.*

Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not property of the debtor; and, as a result cannot be transferred to debtor's secured creditors. See, *Begier v. IRS*, 496 U.S. 53 (1990). A debtor creates a trust within the meaning of 26 U.S.C. § 7501 at the moment the money are withheld or collected. The statutory trust extends to the amount of tax "collected or withheld," and the language of §§ 3102(a), and 3402(a)(1) makes clear that the acts of collecting and withholding occur at the time of the employer's payment of wages in the case of the "trust fund taxes."

The fact that the debtor neither put the taxes in a segregated fund nor paid them to the IRS does not mean that the debtor never collected or withheld them in the first place. Mandating segregation as a prerequisite to the creation of a trust under § 7501 would make § 7512's requirement that funds may be segregated in special and limited circumstances superfluous and would mean that an employer could avoid the creation of a trust simply by refusing to segregate. Therefore, the funds can be in the general accounts of the debtor and still be considered as the trust funds.

The common-law rules for creating a trust are of limited utility in the context of the trust created by § 7501. Under common-law principles, a trust is created *in property*; a trust therefore does not come into existence until the settlor identifies an ascertainable interest in property to be the trust res. G. Bogert, *Law of Trusts and Trustees* § 111 (rev.2d ed.1984); 1A W. Fratcher, *Scott on Trusts* § 76 (4th ed.1987).

A § 7501 trust is radically different from the common-law trust, however. That provision states that "the amount of [trust-fund] tax ... collected or withheld shall be held to be a special fund in trust for the United States." Unlike a common-law trust, in which the settlor sets aside particular *property* as the trust res, § 7501 creates a trust in an abstract "amount"—a dollar *figure* not tied to any particular assets—rather than in the actual dollars withheld. The general common-law rule that a trust is not created absent a designation of particular property obviously does not invalidate § 7501's creation of a trust in the "amount" of withheld taxes. The common law of trusts is not binding on Congress. See *Begier* at 62.

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enacted Section 6672 to protect the Government against losses by providing it with another source from which to collect the withheld taxes.

C. LIMITATION OF "ENCUMBERED FUNDS" DEFENSE TO THE "WILLFULNESS" IN THE CASE OF SECURED CREDITORS.

The general rule is as follows: A person responsible to ensure that his corporation pays federal withholding taxes does not act "willfully," within meaning of statutory penalty provision, if he fails to apply funds subject to a prior perfected security interest created in good faith to payment of prior withholding taxes.

However, this defense is applicable only to persons, who took control over the delinquent entity after the trust fund tax liability has already existed.

In *Davis* the court held that the use of after-acquired funds to pay commercial debts by the same persons who were responsible for the failure to collect and pay the withholding taxes in the first instance (as opposed to new management) exposes that person to liability under section 6672. *Davis v. United States*, 961 F. 2d 867 (9<sup>th</sup> Cir. 1992).

Liability as a responsible person attaches each time salaries are paid during the course of a quarter. As the employer withholds taxes from the employees, a contingent liability is created. The liability merely becomes fixed on the date when the payments are due. If a responsible person had no role in the debtor at the time the unpaid taxes were withheld and salaries disbursed and the debtor did not have any funds available with which to pay the tax when the responsible person took over, then that responsible person cannot be held liable for the non-payment of "trust fund" taxes prior to taking control.

The analysis changes from the time the responsible person becomes in control of the debtor. From that time, that person acts "willfully" if it does not remit the withheld "trust fund" taxes on any compensation paid to its employees after the "change of control" date. It does not matter whether there are existing secured creditors. They do not have priority interest in the currently withheld "trust funds." These are not the debtor's funds. They are part of employees' compensation. Following the same logic as with secured creditors, only in reverse, the current trust fund liabilities are "encumbered" by the IRS. These funds cannot go to secured creditors because they are encumbered by the IRS "trust fund" statute and are not the debtor's property, the debtor holds them in trust for the IRS. Any payment to the creditor (even secured) of the current employee tax liabilities would be considered "willful" because such funds belong to the IRS by the definition. The entity, and as a result, the secured creditor does not have any rights to the currently withheld trust funds. They have only priority rights (as opposed to the IRS) to any incoming funds that exceed the amount of the currently accrued "trust fund liabilities".

As an example, a corporation received \$100 on account from a customer. If a corporation has a creditor, who holds a first priority security interest, these \$100 would go to this creditor even if the corporation has prior delinquent tax liabilities.<sup>3</sup> However,

<sup>3</sup> If there is no secured creditor, these \$100 should go to the IRS.



if a corporation would pay salaries to its employees from these \$100<sup>4</sup> and write a check for net compensation of \$80, the remaining \$20 are current withholding taxes and belong to the IRS, not the secured creditor. Payment of the \$20 to the secured creditor would be considered "willful" for purpose of section 6672 and would expose the current responsible persons to the liability for the current withholding obligations.

In reality, if the secured creditor received such money (without knowing its source) and there was no fraudulent conveyance issue, the secured creditor would probably not be required to pay it back to the entity<sup>5</sup>. The IRS will go back after the "responsible person" under 6672 to recover unpaid "trust fund" taxes. It does not matter for the IRS, who will pay the "trust fund" liabilities. If the entity is unable to pay and goes bankrupt, the IRS has the means to go after any and all "responsible persons" until they collect the amount unpaid.

An employer may not simply arrange to pay its employees the net wages due them and, thereby, avoid paying withholding taxes to the government through the strategy of establishing a corporation with all of its funds encumbered or restricted to uses other than the payment of withholding taxes. To permit this would be to allow the corporate promoters to make the government an unwilling financier for their obligations, a potential loser of the taxes due it, but never even a possible participant in the profits. In order to minimize the amount of personal funds placed at risk by "responsible persons," a newly formed corporation may be leveraged so that it operates largely on the basis of borrowed funds, but, responsible persons act "willfully" when they render the corporation unable to pay federal withholding taxes from the start of its operations, a source of funds should be available initially for payment of wages to employees and of withholding taxes to the government. See, *Brown v. U.S.*, 591 F. 2d 1136, 1142 (5<sup>th</sup> Cir. 1979).

#### D. COURTS' INTERPRETATION OF "WILLFULNESS" IN CONTEXT OF OTHER SECURED CREDITORS

In *Bell v. United States*, 355 F. 3d 387 (6<sup>th</sup> Cir. 2004), the court held that agreement with lender did not constitute an encumbrance that relieved a responsible person of liability for 100% of unpaid trust fund taxes because Bell's voluntary commencement of a contractual relationship with a bank that limited, but did not deprive him of, his ability to pay the trust fund taxes and Bell's repeated payments to creditors other than the federal government constituted a willful failure under § 6672(a). Voluntary contractual obligations, such as the lock-box arrangement at issue in *Bell*, do not encumber funds so as to prevent a willful failure to pay trust fund taxes.

The court in *Bell* rejected Bell's argument that encumbrances impeded Bell's ability to remit the trust fund taxes because Bell could have shut down the company,

<sup>4</sup> Instead of paying down the secured creditor or the IRS for the previously incurred tax liabilities (if no secured creditors).

<sup>5</sup> It is a factual issue and would depend on a lot of factors that might lead to the lender's liability or, in the case of bankruptcy, preferential treatment.

suspended operations, filed for bankruptcy, applied for a bridge loan from another lender, or simply violated his contract with the bank instead of failing to fulfill his tax debt. Even though none of these options was attractive or enviable, but in the eyes of §6672(a), they are the only correct choices. As the same court stated in its earlier decision, "[i]t is no excuse that the money was paid to suppliers and for wages in order to keep the corporation operating as a going concern-the government cannot be made an unwilling partner in a floundering business." *Brewery, Inc. v. United States*, 33 F.3d 589, 593 (6th Cir.1994). To hold otherwise would be to allow employers an easy escape from federal taxation responsibilities.

In *Bradshaw v. United States*, 83 F.3d 1175 (10<sup>th</sup> Cir. 995), a creditor bank required a failing company to get authorization before disbursing any company funds by check, and the creditor bank then refused to release funds for payments of taxes. *Id.* at 1180 n. 5. The court held that rather than evade his responsibility to pay the taxes, "Bradshaw could have resigned his position with [the company] or refused to sign any checks and shut down the business." *Id.* at 1181; see also *Hochstein v. United States*, 900 F.2d 543, 549 (2d Cir. 1990) (ruling that adverse consequences, such as losing one's job, "simply are no excuse for failing to collect and pay" trust fund taxes).

Thus, the courts consistently held that payment of net wages in circumstances where there are no available funds in excess of net wages from which to pay withholding taxes is willful failure to collect and pay over, thus subjecting persons required to do so to civil penalty. See *Hochstein v. United States*, 900 F. 2d 543 (2<sup>nd</sup> Cir. 1990), which is discussed below in Part VIII ).

The courts also consistently held that one who was a responsible person when taxes were incurred, and who only later becomes aware that they were not paid, acts willfully by then paying other creditors in preference to the United States, even if the money specifically withheld has been dissipated. See also *Caterino v. United States*, 794 F.2d 1, 6 (1st Cir.1986) ("Any responsible person who knows the taxes are not paid and allows the business to pay other creditors acts willfully.")

Notably one of the factors in determining lack of "willfulness" for purposes of IRC 6672 is ensuring that the payroll taxes that accrued after a new management becomes a "responsible person" are paid to the IRS rather than to other creditors. It has been consistently held that "responsible persons" do not act willfully if they did not know of a tax liability but upon learning of the liability use funds to pay current taxes. The "absence of willfulness can be proved by an affirmative showing that the responsible person[s] did not disregard [their] duties." *Feist v. United States*, 607 F.2d 954, 961 (1979).



E. COURTS' INTERPRETATION OF "EXISTING FUNDS" AND "AFTER ACQUIRED FUNDS" DOCTRINES IN CONTEXT OF OTHER SECURED CREDITORS

1. What are "After Acquired Funds" and "Existing Funds" doctrines.

Under the "after-acquired funds" doctrine, a "responsible person" can be found "willful," and thus subject to personal liability for the tax arrears of a corporation, if that individual was a "responsible person" during the time that the tax delinquency accrued, and if, after becoming aware of the delinquency, the person diverts subsequently acquired, unencumbered corporate funds to other creditors in preference to the IRS.

Under the "existing funds doctrine, a "responsible person" can be found "willful," and thus subject to personal liability for the tax arrears of a corporation, when at the time he assumed control the corporation has funds impressed with a trust under §7501 and the person diverts such existing funds to other creditors in preference to the IRS. *Slodov*, 436 U.S. at 259.

2. Application and Limitations of "After Acquired Funds" and "Existing Funds" doctrines.

In *Muchaud v. United States*, 40 Fed. Cl. 1 (1997), the Court held that the "after-acquired funds" doctrine does not apply to a person who does not become a "responsible person" until after the corporate tax delinquency accrues. The requisite personal fault is required for the imposition of personal liability under the "after-acquired funds" doctrine. Notably, the corporate entity remains liable for all of its corporate tax liabilities.

Two important points flow from this holding. First, a "responsible person" will not be personally liable under the "existing funds" doctrine unless the person "willfully" fails to pay over existing trust funds. Second, under the "existing funds" doctrine, the maximum amount for which a new "responsible person" can be liable under section 6672 is the balance of trust funds existing in the corporate coffers at the time the individual becomes a "responsible person." See *Mazo v. U.S.*, 591 F.2d 1151, 1154 (5<sup>th</sup> Cir, 1979) (reiterating the *Slodov* determination that the duty of "a person assuming corporate control with respect to the accrued withholding tax liability [is] limited to paying any trust funds related to that liability and any other funds directly traceable to those trust funds that had been dissipated.").

If all of the funds withheld from the employees' wages under the debtor's prior management regime had been dissipated by the time the new management ascended to the position of "responsible person," then such persons would not be subject to personal liability under section 6672. The law does not obligate them to "order the impossible" by paying over to the IRS trust fund taxes that were dissipated by a prior "responsible

person." If, on the other hand, the debtor was in possession of funds traceable to withheld "trust fund taxes" at the time new management became a "responsible person," the "existing funds" doctrine must be considered. Each of the "responsible persons" could be liable for the balance of such existing trust funds to the extent that each of them "willfully" diverted those funds to recipients other than the United States.

The Supreme Court's concern in *Slodov* with imposing a trust on all after-acquired funds under all circumstances was that such a theory gave insufficient heed to the necessary nexus between the payment obligation and the after-acquired funds. See *Slodov*, 436 U.S. at 256. However, the *Davis* court held that the continuing responsibility before, during, and after the tax delinquency creates the requisite linkage between subsequently received cash and a duty to satisfy the trust fund tax delinquency.

*Slodov* does not relieve a "responsible person" of the responsibility to reduce accrued withholding tax liability with funds acquired after the funds actually withheld have been dissipated so long as the person responsible has been so throughout the period the withholding tax liability accrued and thereafter. *Garsky v. United States*, 600 F.2d 86, 91 (7th Cir.1979); see also *Purdy Co. v. United States*, 814 F.2d 1183, 1188 (7th Cir.1987).

## VII. CONCLUSION

The priority rules between a third party creditor and the IRS have no practical application in the case where after acquired funds are used to pay current wages and the current withholding obligations on these wages are not being paid to the IRS. With respect to such after acquired funds, the obligation to repay the current "trust fund" taxes remains intact.

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## VIII. LIST AND HOLDINGS OF REVIEWED CASES

### A. CASES RELATING TO THE RESPONSIBLE PERSON LIABILITY UNDER IRC 6672.

1. *Slodov v. United States*, 436 U.S. 238 (1978). The issue discussed in the case was relating to a person who gains control of the corporation after trust fund tax liability have accrued (not during). The issue is whether the person is personally liable under §6672 for the corporation's unpaid taxes withheld from wages prior to his assumption of control. (Note: the current tax obligations were met. The corporation did paid the withheld taxes for the period from which the person assumed control (bought stock)). When the person assumed control of the corporations, such corporations already owed back taxes, were overdue on their supplier accounts and had not cash. The corporation had not "unencumbered assets," which the IRS could use to satisfy its claim by levy and sale. Because the corporation did not have unencumbered funds with which to pay the trust fund tax



liability at the time the person assumed control, that person had not liability for taxes. The Court held that a "responsible person" under §6672 may violate the "pay over" requirement of that statute by willfully failing to pay over trust funds collected prior to his accession to control when at the time he assumed control the corporation has funds impressed with a trust under §7501 does not impress a trust on after-acquired funds, and that the responsible person consequently does not violate §6672 by willfully using employer funds for purpose other than satisfaction of the trust-fund tax claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation and the funds thereafter generated are not directly traceable to collected taxes referred to by that statute. *Slodov v. United States*, 436 U.S. 238, 98 S.Ct. 1778, 56 L.Ed.2d 251 (1978) held that a responsible person "may violate the 'pay over' requirement [of Section 6672] by willfully failing to pay over trust funds collected prior to his accession to control when at the time he assumed control the corporation has funds impressed with a trust under § 7501, but that § 7501 does not impress a trust on after-acquired funds, and that the responsible person consequently does not violate § 6672 by willfully using employer funds for purposes other than satisfaction of the trust-fund tax claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation and the funds thereafter generated are not directly traceable to collected taxes referred to by that statute." 436 U.S. at 259-60, 98 S.Ct. at 1791.

2. Brown v. U.S., 591 F. 2d 1136 (5<sup>th</sup> Cir. 1979). A responsible person is liable for a s 6672 penalty only if he "willfully" fails to ensure that withholding taxes are paid. A voluntary, conscious, and intentional act, such as the payment of other creditors in preference to the United States, constitutes "willfulness." The responsible person also acts willfully if he proceeds with a reckless disregard of a known or obvious risk that trust funds may not be remitted to the government. See, e. g., *Teel v. United States*, 9 Cir. 1976, 529 F.2d 903, 905; *Newsome v. United States*, 5 Cir. 1970, 431 F.2d 742, 746; *Mondav v. United States*, 7 Cir. 1970, 421 F.2d 1210, 1216. The burden of proving lack of willfulness is on the taxpayer. Sibley argues that he did not "willfully" fail to pay withholding taxes because, at the time the taxes became payable, he was no longer in a position to pay the taxes, and he did all he possibly could do to alert Brown to the necessity of paying the taxes. However, Treasury regulations require withheld funds to be deposited during the quarter and do not merely impose a duty to pay them at the end of the period. Sibley's failure to make the withholding deposits required was itself "willful." By not making the deposits, Sibley acted with a reckless disregard for whether or not the United States would actually be paid. Even though Sibley may have hoped, or even intended, that funds would be available to pay the United States when the first quarter liability matured, his use of the withholding trust funds for other purposes in the interim made him liable for a Section 6672 penalty if the tax was not in fact paid. Although a responsible person does not act "willfully" within the meaning of s 6672 if he fails to apply funds subject to a prior perfected security interest created in good faith to payment of withholding taxes, it is doubtful that restrictions on the use of Corporate funds is an



"encumbrance" that will excuse taxpayers from applying such funds to payment of withholding taxes. Withheld taxes that an employer pays to the government on behalf of its employees are part of their compensation. They are not Corporate funds. Thus, payment of current withholding taxes out of the proceeds would have been a payment of the current wages due the corporation's employees, a use expressly permitted by the security agreement. The evidence demonstrates that Sibwin was never adequately capitalized to meet its payroll and other obligations without borrowing funds. This failure to capitalize Sibwin adequately was itself willful. An employer may not simply arrange to pay its employees the net wages due them and, thereby, avoid paying withholding taxes to the government through the ruse of establishing a corporation with all of its funds encumbered or restricted to uses other than the payment of withholding taxes. To permit this would be to allow the corporate promoters to make the government an unwilling financier for their obligations, a potential loser of the taxes due it, but never even a possible participant in the profits. In order to minimize the amount of personal funds placed at risk by "responsible persons," a newly formed corporation may be leveraged so that it operates largely on the basis of borrowed funds, but, responsible persons act "willfully" when they render the corporation unable to pay federal withholding taxes from the start of its operations unless it realizes profits; a source of funds should be available initially for payment of wages to employees and of withholding taxes to the government.

3. Huizinga v. United States, 68 F. 3d 139 (6<sup>th</sup> Cir. 1995). Note: Parties agreed that when the President learned of the taxpayer's omission, there were no funds in the taxpayer's accounts (July, 1984). Funds are considered encumbered only where the taxpayer is legally obligated to use the funds for a purpose other than satisfying the preexisting employment tax liability and the legal obligation is superior to the interest of the IRS in the funds. (NOTE: Court and parties agree that the portion of the "after acquired" funds that was used to pay the "current" federal payroll-withholding taxes must be considered "encumbered." In other words, the federal payroll withholding taxes for the current period are encumbered funds and the taxpayer has a legal obligation to remit them to the IRS.)
4. McGlothlin v. United States, 720 F.2d 6, 8 (6<sup>th</sup> Cir.1983). Withholding taxes are not simply a debt. They are part of the wages of the employee, held by the employer in trust for the government. Congress enacted Section 6672 to protect the Government against losses by providing it with another source from which to collect the withheld taxes. "Despite its denomination as a 'penalty' assessment, the statutory liability imposed by Section 6672 is essentially civil in nature." Monday v. United States, 421 F.2d 1210, 1216 (7<sup>th</sup> Cir. 1970). "While this liability is denominated 'penalty' it is 'to be assessed and collected in the same manner as taxes are assessed and collected.'" Bloom v. United States, 272 F.2d 215, 221 (9<sup>th</sup> Cir. 1959). Section 6672 provides that "any person" who willfully fails to account for and pay over such taxes shall be liable for the full amount not paid over to the Government. Liability attaches if an individual meets two



requirements. He must be a "responsible person" under the statute, and he must "willfully" fail to pay over to the Government the amount due. *Maggy v. United States*, 560 F.2d 1372, 1374 (9th Cir. 1977); *Mueller v. Nixon*, 470 F.2d 1348, 1350 (6th Cir. 1972). *Slodov v. United States*, 436 U.S. 238 (1978) held that a responsible person "may violate the 'pay over' requirement [of Section 6672] by willfully failing to pay over trust funds collected prior to his accession to control when at the time he assumed control the corporation has funds impressed with a trust under § 7501, but that § 7501 does not impress a trust on after-acquired funds, and that the responsible person consequently does not violate § 6672 by willfully using employer funds for purposes other than satisfaction of the trust-fund tax claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation and the funds thereafter generated are not directly traceable to collected taxes referred to by that statute." 436 U.S. at 259-60.

5. *Kalb v. U.S.*, 505 F.2d 506 (2<sup>nd</sup> Cir. 1974). Plaintiff claims that he is not liable for taxes withheld in the second and third quarters of 1960 because the taxes did not become due until August 15, 1960, on which date the company filed a petition under Chapter XI of the Bankruptcy Act. Plaintiff argues that in those circumstances payment of a preexisting debt was impermissible as a matter of law. However, the court held that withholding taxes are not simply a debt. They are part of the wages of the employee, held by the employer in trust for the government. 26 U.S.C. § 7501(a). In paying the taxes over to the government the employer merely surrenders that which does not belong to him. There are no rules prohibiting such payments by a petitioner under Chapter XI. Plaintiff also contends that he is not liable for the penalty for the first quarter of 1961 because the company went bankrupt on January 14, 1961, at which time the payments for the first quarter were not yet due. However, the court held that the fact that the taxes were not yet due is irrelevant. As the employer withholds taxes from employees' wages a contingent liability is created. The liability merely becomes fixed on the due date. Therefore, such payments of trust funds are not prohibited by law. Even adjudication as a bankrupt does not discharge liability for taxes withheld from employees. The court held that filing of the Chapter XI petition and the subsequent bankruptcy of the debtor therefore do not excuse nonpayment of the trust fund liabilities.
6. *Begier v. IRS*, 496 U.S. 53 (1990). After American International Airlines, Inc. (AIA), fell behind in its trust-fund tax payments, the Internal Revenue Service (IRS), pursuant to § 7512, ordered it to deposit all future taxes collected into a separate bank account. AIA established the account, but did not deposit funds sufficient to cover the entire amount of its obligations. Nonetheless, it remained current on the obligations, paying part of them from the separate bank account and part from its general operating funds. In a subsequent liquidation proceeding under the Bankruptcy Code, petitioner Begier was appointed AIA's trustee. Seeking to exercise his power under § 547(b) of the Bankruptcy Code which permits a trustee to avoid certain preferential payments made before the



debtor files for bankruptcy-Begier filed an adversary action against the Government to recover the entire amount that AIA had paid the IRS for trust-fund taxes during the 90 days before the bankruptcy filing. The Supreme Court held as follows:

- (a) Section 547(b) of the Bankruptcy Code permits a trustee to avoid pre-petition preferential transfers of "property of the debtor." Property of a debtor's estate includes all of the debtor's legal or equitable interests in property as of the commencement of the case. Bankr. Code § 541(a)(1). Since a debtor does not own an equitable interest in property he holds in trust for another, that interest is not "property of the estate" and, likewise, not "property of the debtor."
- (b) AIA created a trust within the meaning of 26 U.S.C. § 7501 at the moment the money was withheld or collected. The statutory trust extends to the amount of tax "collected or withheld," and the language of §§ 4291, 3102(a), and 3402(a)(1) makes clear that the acts of collecting and withholding occur at the time of payment of wages in the case of FICA and income taxes. The fact that AIA neither put the taxes in a segregated fund nor paid them to the IRS does not somehow mean that AIA never collected or withheld them in the first place.
- (c) The funds transferred from AIA's general accounts were trust assets. Any voluntary pre-petition payment of trust-fund taxes out of the debtor's assets is not a transfer of the debtor's property and therefore cannot be avoided as preferences.

7. Hochstein v. United States, 900 F. 2d 543 (2<sup>nd</sup> Cir. 1990). Payment of net wages in circumstances where there are no available funds in excess of net wages from which to pay withholding taxes is willful failure to collect and pay over, thus subjecting persons required to do so to civil penalty. Safelon experienced severe financial problems beginning in the early 1970s. Due to its poor financial condition, Safelon entered into a financing agreement (the Agreement) with the firm of Rosenthal & Rosenthal (Rosenthal) in 1979. Under the Agreement, Rosenthal supplied operating funds to Safelon in return for a security interest in Safelon's accounts receivable and physical assets. Although Hochstein had no input into Safelon's decision to enter into the Agreement, he was the primary person who dealt with Rosenthal on behalf of Safelon once the Agreement was in place. Pursuant to the Agreement, Hochstein would request that Rosenthal advance funds to Safelon, indicating the purpose for which he was requesting them. Rosenthal decided whether or not to grant Hochstein's requests based on a formula contained in the Agreement. Rosenthal did not earmark any specific purposes for the funds advanced and did not control the actual use to which the funds were put once they were given to Safelon. The indebtedness created by these advances was reduced by Safelon's accounts receivable: Safelon forwarded all checks and cash that it received directly to Rosenthal. The net effect of this arrangement was that Safelon's only operating funds were those that Rosenthal chose to provide. Nevertheless, the Agreement provided that Safelon remained responsible for making all tax payments. In January 1981, Safelon's financial condition worsened, and Rosenthal refused to fund continuing operations. Safelon was forced to reduce its workforce to a skeleton staff, and operated only to convert the raw materials that remained in inventory into finished



product. In the process, Safelon became heavily indebted to Rosenthal. As a result, Rosenthal decided to liquidate Safelon's physical assets. Thereafter, Hochstein was provided with sharply reduced funds, sufficient only to pay for the bare essentials during the liquidation process; for example, oil for a generator, gasoline for delivery trucks, and net payroll for the remaining employees, including Hochstein. Most creditors went unpaid. Safelon ceased making the withholding and FICA tax payments from its employees' wages in the fourth week of January 1981. After that point, Hochstein requested that Rosenthal provide funds for the taxes, but Rosenthal gave Hochstein only enough money to cover net wages. Hochstein paid these net wages to the remaining employees until he left Safelon in May 1981. He also signed and filed Safelon's payroll tax return for the first quarter of 1981. This return indicates that Safelon remitted payment only for the first three weeks of the quarter. Safelon's physical assets were liquidated some time during the spring of 1981, and the proceeds were used to reduce Safelon's debt to Rosenthal. Safelon ceased operations altogether in the second week of May 1981. The district court went on to hold that, even if Hochstein was a responsible person, his failure to pay was not willful because he did not give priority to other business obligations of Safelon, over the liability to the I.R.S. While the question of willfulness in this context normally is a question of fact, we conclude that the district court erred as a matter of law in holding that Hochstein's failure to pay was not willful. *See Moore v. United States*, 465 F.2d 514, 515-16 (5th Cir.1972) (sustaining charge to jury that conduct was willful as a matter of law). Hochstein's payment of net wages to himself and other employees during the first two quarters of 1981 amounted to a willful failure to pay taxes. A person willfully fails to pay withholding taxes within the meaning of section 6672 when he pays other creditors with knowledge that withholding taxes are due. The individual's bad purpose or evil motive in failing to collect and pay the taxes "properly play no part in the civil definition of willfulness. Hochstein admittedly knew that withholding taxes were not being paid. Indeed, he would be hard pressed to deny this because he was the one who normally paid the taxes. He argues, however, that his failure to collect and pay the taxes was not willful because Rosenthal provided him with funds to pay only net wages. There was no money, he asserts, with which to pay the withholding taxes. Hochstein's duty in this situation, however, was "to prorate such funds as [were] available between the Government and the employees." *Sorenson v. United States*, 521 F.2d 325, 328 (9th Cir.1975); *see Collins v. United States*, 848 F.2d 740, 742 (6th Cir.1988) (plaintiff's decision to pay wages and other suppliers when he knew of tax deficiency made his action willful); *Emswiller v. United States*, 565 F.2d 1042, 1045 (8th Cir.1977) (payment of net wages with knowledge that no funds existed to pay taxes was willful failure); *Schwinger*, 652 F.Supp. at 468 n. 2. For purposes of determining willfulness, an employee to whom the corporate employer owes wages is simply another creditor.

8. Cline v. United States, 997 F. 2d 191 (6<sup>th</sup> Cir. 1993). Sections 3102 and 3402 of the Code, 26 U.S.C. §§ 3102 and 3402, require employers to withhold social security and income taxes imposed on employees from the employees' wages.



The withheld taxes are part of the wages of an employee and are held in trust for the benefit of the United States. 26 U.S.C. § 7501 ("a special fund in trust for the United States"); *Slodov v. United States*, 436 U.S. 238, 243, 98 S.Ct. 1778, 1783, 56 L.Ed.2d 251 (1978). Thus, those funds may not be used as working capital for the business. *Id.*; *McGlothlin v. United States*, 720 F.2d 6, 8 (6th Cir.1983). An employee whose taxes are withheld but not actually paid over to the government is credited with payment. *Slodov*, 436 U.S. at 243, 98 S.Ct. at 1783. Therefore, the government has recourse against the persons responsible for remitting the taxes to the IRS. *Id.* Section 6672 provides that when a "responsible person," the person charged with collecting, accounting for and paying over withholding taxes, "willfully" fails to do so, he is liable for a penalty equal to the amount of the unpaid taxes. *McGlothlin*, 720 F.2d at 8.

9. *Honey v. United States*, 963 f. 2d 1083 (8<sup>th</sup> Cir. 1992). Evidence that the responsible person had knowledge of payments to other creditors, including employees, after he was aware of the failure to pay over withholding taxes is proof of willfulness as a matter of law. See *Olsen v. US*, 952 F. 2d 236 (8<sup>th</sup> Cir. 1991). Definition of "encumbered funds" – where the taxpayer's discretion in the use of funds is subject to restrictions imposed by a creditor holding a security interest in the funds which is superior to any interest claimed by the IRS, the funds are regarded as encumbered if those restrictions preclude the taxpayer from using the funds to pay the trust fund taxes. See *In re Primo*, 116 B.R. 515 (Bankr. E.D. Mich. 1990). As a matter of law, the interests and rights of the general creditors who were paid from Phoenix's funds were not superior to the interests and rights of the IRS to payment of the unsatisfied employment tax liability.
10. *Kenagy v. United States*, 942 F. 2d 459 (8<sup>th</sup> Cir. 1991). A responsible person cannot be penalize with respect to unpaid taxes accruing prior to the date s/he become a responsible person in an amount more than the unencumbered funds of the corporation in existence at that time. For purposes of the responsible person assessment, application of current tax payment to past due taxes is limited by the unencumbered funds rule. To the extent current tax payments are made after becoming a responsible person that exceed unencumbered funds at the dated of becoming a responsible person, the government should generally credit the responsible person for purposes of 6672 with the excess payments before computing the assessment, regardless of how the payments are internally applied. Otherwise, it would effectively circumvent the unencumbered funds rule.
11. *Gerhard v. United States*, 818 F. 2d 469 (6<sup>th</sup> Cir. 1987). The "trust fund taxes" are for the exclusive use of the Government and are not to be used to pay the employer's business expenses, including salaries, or for any other purpose. More than mere negligence is required for "willfulness". A person is not "willful" if as a result of negligence he is unaware of the default in the payment of payroll taxes. However, willful conduct may also include "a reckless disregard for obvious or known risks. *Id.* at 259-60. Willfulness is present if the responsible person had knowledge of the tax delinquency and knowingly failed to rectify it when there



were available funds to pay the government. Plaintiff admitted that he was aware of the unpaid federal withholding tax liability of the debtor, and that, notwithstanding such knowledge, he continued to sign checks in payment of other corporate obligations. This action constitutes willfulness within the meaning of section 6672. Moreover, it is generally held that one who is a responsible person follows the directions of a superior not to pay withholding taxes to the government at his peril. The fact that a superior might well have fired the responsible person had he disobeyed the superior's instructions and paid the taxes does not make that responsible person any less responsible for the payment. Authority to pay in this context means *effective power* to pay. Had the superior fired the responsible person for paying the taxes, that responsible person would at least have fulfilled his legal obligations. *See also Roth v. United States*, 779 F.2d 1567 (11th Cir.1986) (otherwise responsible person does not lose that status even if instructed by superior officer not to pay taxes).

12. Stake v. United States, 347 F. Supp. 823 (D. Minn. 1972). Plaintiff took over the affairs of the corporation after learning of its indebtedness to the United States. Although the signatures of other officers appear on checks written during February of 1966, Stake testified that he alone took control of the corporation and, aided by his attorney, attempted to, "get this straightened out." Plaintiff at that time was fully responsible for corporate disbursements and the holding and paying of taxes. That fact alone is enough to impose liability, regardless of whether plaintiff was a responsible person prior to January, 1966, when the tax obligation arose. Accordingly, the Court finds that plaintiff was a responsible person liable under I.R.C. § 6672. The term "willfully" as used in § 6672 means, "a deliberate choice voluntarily, consciously and intentionally made to pay other creditors instead of paying the Government." Failure of a responsible officer to hold the taxes, by making a voluntary and intentional choice to use the funds to prefer other creditors, is a violation of the trust created under § 7501 and is willful conduct within the meaning of § 6672. The desire to continue in business is not justification for violating the trust by preferring other creditors. Plaintiff became the sole responsible officer of the corporation in January, 1966. As late as February 22, 1966, he countersigned checks to other creditors. Payments were made to and from the corporation intermittently during 1966, but no payments were made to the United States. The court held that the decision of Stake not to pay over to the government the withheld taxes, at a time he admittedly knew of the federal tax liability, was a voluntary, conscious and intentional act to prefer other corporate creditors to the United States. Such conduct was willful within the meaning of I.R.C. § 6672. In summary, the Court found that plaintiff was a person responsible for the collection and payment of corporate taxes; that he willfully failed to pay over such taxes; and that plaintiff is liable under I.R.C. § 6672 to a penalty equal to the amount of the tax not paid over, that is, \$3,366.34.
13. In re Bewley, 191 B.R. 459 (Bankr. N.D. Okla. 1996). If a person did not have control of a corporation during the period when the outstanding trust fund taxes



accrued, that person is not a responsible person. The liquid assets on hand, at the time a potential responsible person assumed control of the corporation should have been paid to the IRS on the trust fund taxes previously accrued. This amount is the full extent of that person liability on the outstanding trust funds taxes. (See *In re Rossiter*, 167 B.R. 919 (Bankr. C.D. Cal. 1994))

14. *In re Cadillac Recreation, Inc.*, 159 B. R. 244 (C.D. Illinois 1993). The IRC requires employers to withhold from their employees' paychecks money representing employees' personal income and social security taxes. 26 U.S.C. §§ 3102(a), 3402(a). These taxes are held in trust for the United States, and therefore are commonly called "trust fund" taxes. 26 U.S.C. § 7501(a). See *U.S. v. Energy Resources Co.*, 495 U.S. 545, 545 (1990). "Once net wages are paid to the employee, the taxes withheld are credited to the employee regardless of whether they are paid by the employer, so that the IRS has recourse only against the employer for their payment." *Slodov v. U.S.*, 436 U.S. 238, 243 (1978). In such a situation where the employer has failed to pay the "trust fund" taxes, the Internal Revenue Code provides the I.R.S. with a remedy against the officers or employees who are responsible for collecting the tax. The "responsible person" is liable for an amount equal to the trust fund taxes that were not paid over to the government.
15. *Muck v. United States*, 3 F.3d 1378 (10<sup>th</sup> Cir. 1993). Proof of willfulness does not require proof of bad motive. Willfulness is present whenever a responsible person acts or fails to act consciously and voluntarily and with knowledge or intent that as a result of his action or inaction trust funds belonging to the government will not be paid over but will be used for other purposes. Once the person in control learned of the prior (of his control) delinquency, he is obligated to apply unencumbered funds to pay the tax liabilities (incurred prior to him becoming in control) as well as any future periods (See, *Kizzer v. US*, 598 F. 2d 1128; *Purdy v. US*, 814 f. 2d 1183). *Slodov* does not relieve a "responsible person" of the responsibility to reduce accrued withholding tax liability with funds acquired after the funds actually withheld have been dissipated so long as the person responsible has been so throughout the period the withholding tax liability accrued and thereafter. See, *Garsky v. US*, 600 F. 2d 86, 91 (7<sup>th</sup> Cir. 1979). Factors to consider in "responsible person" inquiry (from *Muck v. United States*, 3 F.3d 1378, 1382 (10<sup>th</sup> Cir. 1993)):
  - sole shareholder of the corporation, authorized by the bylaws to manage the business affairs of the corporation;
  - power to borrow money for the corporation;
  - check signing authority;
  - authority to order that business be suspended if the taxes could not be paid.
16. *Caterino v. United States*, 794 F. 2d 1 (1<sup>st</sup> Cir. 1986). Non-officer lender can be found liable under 6672.



17. United States v. Beltran, 316 B.R. 371 (S.D. Fla 2004). RP acted willfully when he pays other creditors in preference to IRS.
18. Johnson v. Commissioner, 663 F.Supp. 294 (D.Utah 1987), a case that apparently no other court has followed. In *Johnson*, the district court tracked the argument Davis makes here and extended *Slodov* to corporate officers who, although responsible, did not actually know of the tax diversion until after the fact.

Penalties cannot be imposed upon [responsible officers] based upon their payment of corporate creditors with cash acquired after they learned of failures to pay tax withholdings, so long as the responsible person did not play a "willful" role in that failure. *Id.* at 299. Contrary to the *Johnson* court's holding, neither *Slodov*'s language nor its rationale compels excusing continuing management from liability under section 6672. The *Johnson* approach, moreover, focuses too heavily on corporate officers' actual knowledge, effectively creating two tiers of responsible persons. The first tier consists of corporate officials like Johnson and Davis who meet all of the traditional criteria for responsible status, but who do not knowingly play a role in the failure to collect, or the dissipation of, withholding taxes. The second tier would be those with responsibility *plus* actual participation in the loss of the trust funds--that is, "a person who was responsible throughout the period [and] also acted 'willfully' during that period of time." *Id.* at 298. This scheme is inconsistent with our prior articulations of the responsibility test. *See Teel*, 529 F.2d at 905. Furthermore, *Johnson* ignores the purpose of section 6672, which is to make the federal treasury whole and to encourage diligent compliance with the withholding rules by all those in a position to regulate a corporation's collection and disbursement of money. *See United States v. Graham*, 309 F.2d 210, 212 (9th Cir.1962) ("The statute's purpose is to permit the taxing authority to reach those responsible for the corporation's failure to pay the taxes which are owing."). The *Johnson* approach undercuts this goal by rewarding officers for their ignorance. Davis would be a responsible officer in name only. Although found to have been in a position to prevent ITAC's tax delinquency, Davis would face no sanctions. To the contrary, *Johnson* would permit Davis to continue (as did the officers who actually dissipated the trust funds) to subordinate the public fisc to the corporation's private interests. Despite his responsibility for damage to the federal treasury, *Johnson* would allow Davis to continue to divert funds from the government to other commercial expenses he deems more worthy of the corporate dollar. In the meantime, the federal government's interest in corporate revenues is held hostage to the continued success of the business. The federal government is in effect subsidizing the corporation's recovery by foregoing collectible tax dollars. Numerous courts have admonished against such interpretations of section 6672. *See, e.g., Thibodeau*, 828 F.2d at 1506 ("[T]he government cannot be made an unwilling partner in a business experiencing financial difficulties."); *Mazo*, 591 F.2d at 1154 ("[T]he United States may not be made an unwilling joint venturer in the corporate enterprise."). In sum, we eschew adopting the *Johnson* theory of responsibility without consequences. Instead, we join the Third, Fifth, Seventh,

and Eighth Circuits in refusing to extend *Slodov* to cases where the responsible officer presided over both the initial loss of the trust funds and the subsequent diversion of after-acquired revenues and hold that the district court properly instructed the jury on willfulness. To hold otherwise would ignore *Slodov's* plain language and analytical foundations, as well as frustrate the remedial and deterrent purposes of section 6672.

B. CASES DECIDED UNDER THE FEDERAL TAX LIEN ACT (§§ 6321-6326)

1. Boys v. West suburban Bank of Carol Stream, (not reported) 1992 WL 86186 (N.D. Ill). The rights of private creditors with respect to federal tax liens are determined under 26 U.S.C. §§ 6321-6326. 26 U.S.C. § 6321 provides that a lien arises in favor of the United States upon all property and rights to property of any person, liable for tax, who neglects or refuses to pay the tax after demand. The lien imposed by § 6321 arises at the time the assessment is made and continues until the liability for the amount assessed is satisfied. 26 U.S.C. § 6322. However, a holder of a valid security interest will prevail over a federal tax lien imposed by § 6321 if the security interest attaches before the Government files appropriate notice, i.e. before a notice of tax lien has been filed. See 26 U.S.C. § 6323.
2. Litton Industrial Automation System, Inc. v. Nationwide Power Corp., 106 F. 3d 366 (11<sup>th</sup> Cir, 1997). NOTE: This case did not deal with 6672! Under the Internal Revenue Code, a tax lien arises at the time of assessment, 26 U.S.C. § 6322, on "all property and rights of property, whether real or personal, belonging to" a delinquent taxpayer, *id.* § 6321. The FTLA provides, however, that the tax lien "shall not be valid as against any...holder of a security interest ... until notice thereof which meets the requirements of subsection (f) has been filed." *Id.* § 6323(a). Therefore, any "security interest" which arises prior to the proper filing of a federal tax lien takes priority over the tax lien. See *United States v. McDermott*, 507 U.S. 447, 449, 113 S.Ct. 1526, 1528, 123 L.Ed.2d 128 (1993). The FTLA defines a "security interest" as any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time, the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth.
3. Dragstrem v. Obermeyer, 549 F. 2d 20 (7<sup>th</sup> Cir. 1977). NOTE: does not deal with the analysis of 6672. Re: priority of claims under the Federal Tax Lien Act.