Forbes

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THE TAX LAWYER

Nov. 11 2010 — 8:43 am |

Beware Personal Liability For Employee Taxes

Employers of all sizes know failing to pay wages to employees is nothing to joke about. Especially in these tough economic times, wage obligations must be taken seriously. Company officers can even face personal liability. For example, in *Boucher v. Shaw*, the Ninth Circuit Court of Appeals held employees of a bankrupt company could pursue claims against three managers for unpaid salaries. Despite the company's bankruptcy, the plaintiffs were able to sue the CEO, CFO and labor relations manager personally for unpaid wages.

Maybe this is unusual, but you know what is not? Managers facing personal liability for ***taxes*** the company withholds from payroll checks but fails to pay to the IRS. Businesses must withhold income tax and Social Security tax from paychecks and should send the money right away to the IRS. But if the business is failing, is it OK to pay the rent, vendors and utility bills to keep the lights on? Hey, that's more important than the IRS, right? Besides, the IRS will get its money later before they figure it out. . . .

Trust Fund Taxes. Needless to say, this is very dangerous, yet thousands of businesses fall into this trap every year. These withheld taxes are "trust fund" taxes. "Trust fund" ought to sound pleasing to the ear, as in "trust fund babies." But here it has a decidedly negative ring. When trust fund taxes don't show up, the IRS will pursue the business to collect. The IRS can even padlock the business to stop the bleeding.

Personal Liability for Responsible Persons. Plus, personal liability for the owners and managers is a potent IRS weapon. The IRS can assess a Trust Fund Recovery Assessment, also known as a 100-percent penalty, against ***each and every*** "responsible person." Typically, the IRS continues trying to collect from the company and to collect the 100-percent penalty from ***every*** officer. If there are six officers, that can mean the IRS is simultaneously trying to collect the tax plus 600 percent from individuals!

The IRS can collect only once and there can sometimes be scrambles not unlike a rugby scrum. Some responsible persons try to sic the IRS on other more solvent or more visible responsible persons. That can be a clever strategy for executives caught within the "responsible person" net. Try to show ***you*** were not responsible (tough) and that other more culpable (or wealthier and more liquid) officers are waiting in the wings. It can be a Machiavellian business.

I'm Not Responsible! Trying to show you weren't responsible is usually a losing battle. You might consciously pay someone else ahead of the IRS to keep the business afloat, or you might have no actual knowledge the IRS is not being paid. Either way, if you had signature authority and ***could*** have paid the IRS, you're responsible. The IRS position is that ***every*** officer is responsible, and that some non-officers with signature authority are too.

Some people in this precarious situation demand written assurances from their company every week that payroll taxes are being sent in. Some people also resign from their jobs over this issue. It's not an overreaction. If you've ever been in one of these disputes, you won't want to be in another. In a tough economy, it's even more important to be vigilant.

For more on the 100-percent penalty and trust fund taxes, see:

Employment Taxes And The Trust Fund Recovery Penalty

What Is The Trust Fund Recovery Penalty?

Internal Revenue Bulletin 2005-24

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