Personal and Transferee Liabilities

By Robert W. Wood • Wood & Porter • San Francisco

Employers of all sorts know that a failure to pay wages owed to employees is nothing to joke about. Especially in these economic hard times, wage obligations must be taken seriously, and personal liability can even attach. The Ninth Circuit recently ruled in *Boucher v. Shaw*, Docket No. 05-15454 (9th Cir. July 27, 2009), that the employees of a bankrupt company can pursue their claim that three company managers were personally liable for unpaid salaries.

The employer in *Boucher* was the Castaways Hotel in Nevada, which filed for Chapter 11 bankruptcy protection. The Chapter 11 petition was converted to a Chapter 7 liquidation. Eventually, however, the plaintiffs filed lawsuits against the CEO, CFO and labor relations manager of the company.

The plaintiffs were seeking to collect their unpaid wages (for themselves as well as for a class of employees). As you might expect, the managers defended on a variety of grounds. The Ninth Circuit, however, ruled that the managers were liable for unpaid wages.

Trust Fund?

Talk of liability for wages may make you think instinctively of payroll tax obligations. That's an even more obvious place where personal liability can attach. In the case of tax liabilities, most company executives know that IRS trust fund tax liabilities are nothing to fool around with. Here's a situation where "trust fund"—which ought to sound pleasing to the ear, as in "trust fund babies"—has a decidedly negative ring.

When you pay wages to employees, you withhold income tax and employment tax. Axiomatically, you should pay that amount over the IRS immediately. Some employers, on the other hand, may prefer to pay vendors or suppliers with this money rather than remitting it directly to the IRS. They may do so consciously, to keep the business afloat, or they may have no actual knowledge that the IRS is not being paid.

Either way, the situation can be very dangerous. It can lead to assessments under Code Sec. 6672, providing for a Trust Fund Recovery Assessment, a.k.a. 100-percent penalty. The IRS can assess such 100-percent penalties against all "responsible persons."

Typically, the IRS continues to try to collect from the company that did the tax withholding at the same time it is seeking to collect the 100-percent penalty against any and all officers. That can mean that the IRS is simultaneously seeking to collect the tax from the company as well as 700 percent or 800 percent (in the case of seven or eight responsible persons) of the tax from those individuals! The IRS can collect only once, of course, and there can sometimes be scrambles not unlike a Rugby scrum.

Some responsible persons try to sic the IRS on the other more solvent or more visible responsible persons. That can be a reasonable strategy for executives caught within the "responsible person" net. You try to show *you* were not responsible (tough) and that other more culpable (and more wealthy, and more liquid) responsible persons are waiting in the wings. It can be a Machiavellian business.

Pass the Liability, Please

Transferee liability is another matter. The IRS can pursue transferees where a taxpayer does not pay its tax and the transferee receives assets. Thus, in the recent case of *Frank Sawyer Trust of May 1992,* 133 TC No. 3, Dec. 57,911, the Tax Court considered an IRS collection action against a trust.

The IRS sought to collect the unpaid tax liabilities of several corporations that the trust had previously owned. There were numerous procedural niceties and nuance in this case. Basically, though, the IRS was given a green light to pursue its transferee liability action.

Watch out

With all of these issues, watch out for your own liability. In economic tough times, it's even more important to be vigilant.

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