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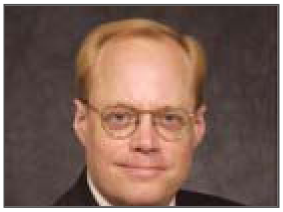

Robert W. Wood
THE TAX LAWYER

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When Payroll Taxes Pyramid It Means Penalties, Even Jail

Does the IRS pursue all taxes equally? Not really. The IRS is especially vigorous in going after payroll taxes withheld from wages that somehow don't get paid to the government. The IRS calls it trust fund money that belongs to the government.

That makes any failure to pay—or even late payment—much worse. In fact, that's so regardless of how the employer or its principals use the money, and regardless of how good a reason they have for not handing the money over to the IRS. When a tax shortfall occurs in this setting, the IRS will usually make personal assessments against all responsible persons who have an ownership interest in the company or signature authority over the company accounts.

The IRS can assess a Trust Fund Recovery Assessment, also known as a 100-percent penalty, against every "responsible person." The penalty is assessed under Section 6672(a) of the tax code, and the IRS uses it liberally. You can be responsible and therefore liable even if have no knowledge that the IRS is not being paid. If there are multiple owners, multiple officers, multiple check signers, they all may draw a 100% penalty assessment.

(Photo credit: Wikipedia)

What happens when multiple owners and signatories all face tax bills? They generally squabble and do their best to sic the IRS on someone else. Factual nuances matter in this kind of mud-wrestling, but so do legal maneuvering and just plain savvy. One responsible person may get stuck paying while another who is even more guilty may get off scot-free.

Meanwhile, the government will still try to collect from the company that withheld on the wages. The IRS also wants to make sure this kind of bad tax situation doesn't occur again. In extreme cases, the government can even seek criminal penalties.

More commonly, the government seeks to enjoin this behavior. That was the approach the government took with Advanced Underground Construction, an Iowa-based company, and its principal, William David Ward II. The Justice Department sought an injunction against both, alleging the company repeatedly failed to pay federal employment taxes withheld from wage checks, the amount now due exceeding $370,000.

The company was using the withheld taxes as working capital, the suit claimed. The government usually succeeds with this kind of argument. In this case, the Federal Court Ordered the Iowa Construction Company to Pay Employment Taxes.

The practice the government was going after is sometimes called "pyramiding." The DOJ noteed that the company had made minimal payments of its tax debts, and that attempts to induce voluntary compliance failed. To stop the bleeding in a case like this, the Justice Department can seek an injunction to require a company and its principals to make timely tax deposits, to pay all withheld employment taxes, and to timely file all employment tax returns.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.