

IRS Can Impose a 100 Percent Penalty On Employment Taxes

By Robert W. Wood

If you ever took a tax class — or even if you didn't — you probably know the old quote from Judge Learned Hand: "Any one may so arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes." See *Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935).

Whether you are Donald Trump or just an ordinary Joe, everyone likes to save money. And no one likes to pay more in taxes than they have to. But sometimes, you have to pay up. Perhaps you can think of it as paying retail, even though you try to avoid that.

If you think that paying taxes can't get any worse, you would be wrong. Arguably the *least* satisfying of all taxes would be paying taxes that are not even yours. That might be how some people view some "responsible persons" who are stuck paying their employer's taxes. Let's start with the basics.

If you have employees, paying employment taxes is inevitable. That is one reason why the IRS (and the Franchise Tax Board and California Employment Development Department) carefully monitor the line between independent contractors and employees. You pay employment taxes on employees. You don't on pay to independent contractors — provided that they are *truly* independent contractors.

Having employees comes with costs. You withhold taxes from employee pay and send the tax money — promptly — to the IRS. Ideally, you never want to become delinquent in paying taxes, *especially* employment taxes. The IRS is vigorous in going after these payroll taxes.

They are withheld from wages, and are to be promptly paid to the government. In fact, this is trust fund money that *belongs* to the government. No matter how good a reason the employer may have for using the money for something else, the IRS is strict. If you are in business, it can be tempting to figure that you have to keep the lights on, the rent paid and the supplies ordered. You might think that the IRS won't miss the payroll tax money if you just divert it temporarily.

No matter how good the reason, though, this practice is dangerous. It is one reason that in cases where the IRS catches the problem early, the IRS often encourages the use of a payroll service. If the payroll service *automatically* takes out and remits all the payroll taxes, the business won't have the discretion to divert the money, even briefly.

When a tax shortfall does occur, the IRS will usually make personal assessments against all responsible persons who have ownership in or signature authority over the company and its payables. That could be *many* individuals. The IRS can assess a Trust Fund Recovery Assessment, also known as a 100-percent penalty, against every "responsible person" under Section 6672(a).

It can be pretty scary. In fact, you can be liable even if have no knowledge the IRS is not being paid. If you're a responsible person, the IRS can pursue you personally

for payroll taxes if the company fails to pay. The 100 percent penalty equals the taxes not collected. The fact that the penalty can be assessed against multiple responsible persons allows the IRS to pursue them all to see who coughs up the money first.

"Responsible" means officers, directors, and anyone who makes decisions about who to pay or has check signing authority. When multiple owners and signatories all face tax bills, they generally do their best to direct the IRS to 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, while another may pay nothing. Meanwhile, the government will still try to collect from the company that withheld on the wages. The IRS can move to collect, too, including via a levy on your bank accounts. But before a levy can be issued the IRS must provide notice and an opportunity for an administrative Collection Due Process hearing.

A Collection Due Process hearing is only available for certain serious IRS collection notices. Among other things, it allows you the opportunity to ask for an installment agreement, an offer in compromise or another collection alternative. There are special rules in the case of a predecessor employer. That is, this procedural safeguard won't apply if you are a predecessor employer.

Here is what the IRS evaluates to determine if one business is a predecessor of another:

- Does it have substantially the same owners and officers?
- Are the same individuals actively involved in running the business, regardless of whether they are officially listed as the owners/shareholders/officers?
- If the taxpayer's owners or shareholders are different, is there evidence they acquired the business in an arm's-length transaction for fair market value?
- Does the business provide substantially the same products, services, or functions as the prior business?
- Does the business have substantially the same customers as the prior business?
- Does the business have substantially the same assets as the prior business?
- Does the business have the same location/telephone number/fax number, etc. as the prior business? See IRC Section 6330(h).
- A business won't be treated as a predecessor if there was a genuine change in control and ownership, as where the business was acquired in an arm's-length transaction for fair market value, where the previous owners have ceased all involvement. The IRS's guidance lists examples of predecessor status and explains how to determine if a business requesting a Collection Due Process hearing for employment taxes is a "predecessor." There's no right to a Collection Due Process hearing to resolve the employment tax liabilities if you already had your chance.

What's the bottom line? Employment tax disputes can be high stakes and are nearly always worrisome. Although it is rare, some employment tax cases even become criminal ones. There have been recent suggestions that the IRS may move further in that direction in the future, so be careful.

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