PERSPECTIVE

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Payroll Companies Ensure Taxes Are Paid... Unless They Don't

By Robert W. Wood

When you have employees, you must withhold taxes from their pay, file payroll tax returns, and promptly remit the tax money to the IRS. That is one of many reasons that some companies prefer paying independent contractors. The hassle is less, and you might even avoid the agency liability that exists when your employees commit torts or other actions that cause the employer liability.

Of course, the line between independent contractors and employees is policed — by the IRS and by others. And there are frequent disputes as well as litigation on these issues. But even companies that are aggressive with the contractor vs. employee line almost always have *some* employees. Employees mean payroll taxes.

One answer for all the difficult withholding, reporting and remittance rules is to hire a payroll company to take care of all of these worrisome details for you. There are numerous companies doing this. And trade groups will tell you that, in most cases, the payroll companies are honest and do their best to keep you out of trouble.

But what if they are not honest, and don't keep you out of trouble? Not long ago, an attorney who owned a Pennsylvania payroll company was sentenced to eight years in prison, plus ordered to pay nearly $5.3 million to the IRS. Robert McAndrew Jr. pleaded guilty to tax crimes involving his defunct payroll company.

Although he was sentenced to eight years in federal prison after he pleaded guilty, he could have faced prison for much longer. In fact, he could have faced over 100 years of prison in all, given the 21 counts of tax evasion he was facing. His company was called NEPA Payroll Services.

Both taxpayers and the IRS alike were defrauded. In fact, the withheld tax money was *never* sent to the IRS. Moreover, the victims were still on the hook for their tax debts, plus penalties and interest. When McAndrew was sentenced, the judge set his repayment schedule initially at $25 per quarter, followed by $150 a month to begin during three years' supervised release following his incarceration.

Is it likely much of the $5.3 million will actually be paid back? With more than $5 million owed, it is highly unlikely that McAndrew will ever put a dent in the monies he owes. If there were other so-called responsible persons in the company, they might have been personally on the hook for the taxes too. We'll address responsible persons below.

One tool the IRS has is criminal prosecution. The trust fund money belongs to the government, and any failure to pay is serious. Payroll services are one common answer, so the employer does not have discretion to use the money to pay vendors, or for anything else.

As in the McAndrew criminal case, the possibility that a *payroll service itself* might somehow abscond with your tax money is pretty scary. That horrific possibility also featured prominently in a report from the watchdog known as the Treasury Inspector General. *See* TIGTA Report No. 2015-40-023, Processes Are Needed to Link Third-Party Payers and Employers to Reduce Risks Related to Employment Tax Fraud (March 2, 2015).

When a tax shortfall occurs, the IRS will usually make personal assessments against all responsible persons who have ownership in or signature authority over the company and its payables. The IRS can assess a Trust Fund Recovery Assessment, also known as a 100-percent penalty, against every responsible person under Section 6672(a). You can be liable even if have no knowledge the IRS is not being paid.

If you are a responsible person — or if you are someone that the IRS claims holds that status unless you can prove them wrong — 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 penalty can be assessed against multiple responsible persons, allowing 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 also wants to make sure this kind of bad tax situation doesn't continue, and doesn't occur again.

For that reason, the government can shut down the business, or in extreme cases, may seek criminal penalties. More commonly, the government can seek an injunction to stop the bleeding, so the government gets its tax money. Where a business gets deeper and deeper into tax debts, the practice is sometimes referred to as pyramiding.

If a company is making minimal payments of tax debts, the IRS may try to induce voluntary compliance. In some cases, the Justice Department will seek an injunction to require timely deposits and payments of all withheld employment taxes and to timely file all employment tax returns. Whatever your situation, try to steer clear of these issues. And if you fall behind, get help early.

It is still good advice to consider using a payroll service. That way, you can avoid having any choice whether to use the payroll tax money for something else. But when you select a payroll service, check them out, and make your selection carefully.

Finally, even if you use a payroll service, check the taxes. You should be able to verify that way that your taxes have been deposited through the Electronic Federal Tax Payment System. Employers can register on their own, even if their payroll firm has registered, to make sure the payments are being made on time. Be careful out there.

Robert W. Wood *is a tax lawyer with www.WoodLLP.com, and the author of "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This is not legal advice.*