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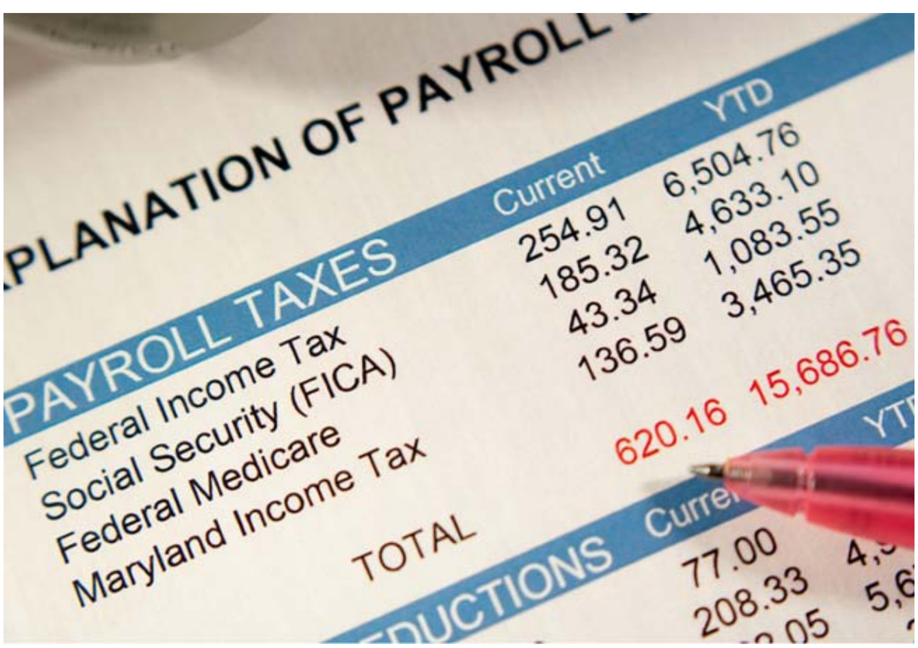
CEO Faces 5 Years For Spending $6.8M Withheld IRS Employment Taxes

It is *income* tax time, but forgetting about *employment* taxes–*ever*–would be a major mistake. A business owner from Germantown, Tennessee named Larry Thornton was withholding taxes from employees, but 'forgot' to pay them to the IRS. Now, he has pleaded guilty to failing to pay the taxes over to the IRS. Mr. Thornton, age 66, was the majority owner and CEO of Software Earnings Inc., a Memphis company that produced and installed check processing.

He was also the 100% owner and CEO of First Touch Payment Solutions LLC, a Memphis company that provided merchant services for credit card processing. Mr. Thornton admitted that he was responsible for collecting and paying taxes that were withheld from the wages of his employees. Beginning in 2007, Thornton caused one company to stop paying the taxes withheld from employee paychecks to the IRS. Beginning in 2010, Thornton caused his other company to also stop paying the taxes.



Between 2007 and 2011, Mr. Thornton collected more than $6.8 million in employment taxes from his employees' paychecks, but failed to pay them to the IRS. He also failed to pay his companies' matching share of FICA taxes during those years. As he was shorting the IRS by millions, he was spending on himself. He racked up over $6.2 million on personal expenses, including house and condominium payments; vehicle, yacht and motorcycle loan payments; personal travel; and start-up funding for his wife's beauty boutique.

As part of his guilty plea, Mr. Thornton admitted that his fraudulent conduct caused a tax loss of more than $8.9 million to the IRS. Thornton faces a statutory maximum sentence of five years in prison, three years of supervised release, a fine and restitution. Under the terms of the plea agreement, Thornton has agreed to pay more than $10 million in restitution to the IRS. His sentencing is set for July 22.

The IRS can be tough on collecting income taxes, but is even tougher where payroll taxes are concerned. The money is withheld from employee wages, and is supposed to be paid over to the IRS. This is trust fund money that belongs to the government. No matter how good a reason the employer has for using the money for something else, the IRS is strict. Any failure to pay—or even late payment—is serious, regardless of how or why the employer or its principals use the money.

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% penalty, against every "responsible person" under Section 6672(a). You can be liable even if have no knowledge the IRS is not being paid. The 100% 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 occur again. The government can move to shut down the business so the situation doesn't get worse. In extreme cases, the government may seek criminal penalties. More commonly, the government can seek an injunction. The idea is 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 taxes and timely employment tax returns. But the IRS can and does prosecute too. And lavish personal spending in the face of tax debts is a good way to become a target.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.