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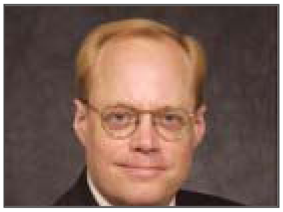

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CEO Held Liable For CFO's Embezzlement

Is it fair for one executive to pay for the transgressions of another? Maybe not, but it happens, especially where payroll taxes are concerned. That's why a company's CEO was held responsible for unpaid payroll taxes even though the CFO embezzled the money. See *Perrenod v. United States*.

The court ruled that the CEO was on the hook after he fired the CFO. The court left open the question whether the CEO was liable while the embezzling CFO was still employed. In happier times, Parallax Design and Construction was owned 1/3 each by George Perrenod, CEO, Martin Romo, VP, and Stanley Thompson, CFO.

Thompson handled payroll, tax returns, accounting, banking, etc. Thompson kept the company's financial records at his home office where he did the majority of his work. In early 2005, Perrenod received complaints that vendors and subcontractors were unpaid. He asked Thompson for an accounts payable report, and Thompson prepared a false one.

When Perrenod asked Thompson to prepare checks to vendors and subcontractors, Thompson wrote checks to himself instead. In April 2005, Perrenod fired Thompson, who then refused to return the financial records. Perrenod then discovered that Thompson had embezzled hundreds of thousands of dollars.

In 2007, Thompson pleaded no contest to felony counts for grand theft and tax fraud. Perrenod took over the finances, hired Wells Fargo to file and pay the employment taxes. Perrenod even paid each subcontractor except one. He dealt with the IRS, but never asked the IRS about 2004.

It was unclear when he first learned that Parallax also hadn't paid payroll taxes for 2004. But much later, in 2010, IRS assessed penalties of $25,764 and $25,151 against Perrenod individually for 2004. Perrenod went to district court asking for relief from the penalties, claiming he was not responsible.

The IRS said it wanted the penalties, plus more for later years. The IRS claimed the CEO had shared responsibility with the CFO. After all, the CEO had authority to co-sign checks. The CEO responded that all day-to-day operations were relevant. The court found all this he-said, she-said was unsuitable for summary judgment.

Perrenod conceded he was a responsible person after April 2005. The IRS said he was also liable for previously incurred tax liabilities. However, the court said it wasn't clear whether Perrenod had actual knowledge of the tax liabilities before he paid creditors. Still, the court said that Perrenod ought to have known Thompson was unreliable when Perrenod discovered creditors were not being paid.

During Perrenod's investigation of Thompson's embezzlement, Perrenod discovered that taxes were unpaid or paid late. Perrenod countered that before 2005, Thompson concealed his malfeasance by exercising total control over all financial records. After Perrenod discovered the embezzlement, Thompson refused to turn over the financial records.

Despite the lack of records, Perrenod said his investigation and efforts to pay creditors were swift and reasonable. Hey, at worst he was negligent, he claimed. The court said that whether Perrenod's actions amount to reckless disregard, negligence, or non-culpable conduct is a question of fact. So it denied summary judgment on this issue.

The lesson of this case? Be careful, have checks and balances, and once you are aware of a problem with taxes (or other payments), investigate thoroughly. And be careful what you sign.

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.