PERSPECTIVE
Los Angeles | Daily Journal
SEPTEMBER 3, 2025

IRS 100% Payroll Tax Penalties Carry Personal Liability

By Robert W. Wood

Paying employment taxes is inevitable if you have employees. You withhold taxes from employee pay and then send the money to the IRS. The taxes are withheld from wages and are supposed to be *promptly* paid to the government. After all, this is trust fund money that belongs to the government, and no matter how good a reason the employer has for using the money for something else, the IRS is strict. If you are in business, it is not unusual to have to juggle responsibilities and priorities. You may need to pay more critical bills first, and to stall the ones that don't seem so imminent.

Therefore, it can be understandably tempting to assume that you have to keep the rent paid and the supplies ordered to keep your business running. You might well think that the IRS is unlikely to miss the payroll tax money if you just divert it temporarily and are a few days or weeks late. What about a few months? As you might expect, it is a dangerous precedent, and it can be very difficult to get back on track once you start to deviate from a rigid schedule of paying the IRS when you pay your employees.

You never want to become delinquent in paying taxes, especially employment taxes. The IRS is vigorous in going after these payroll taxes. It is one reason that in cases where the IRS catches the problem, the IRS may encourage the use of a payroll service. The idea is to never be tempted to use the trust fund money for any other purpose. If the payroll service *automatically* takes out and remits all the payroll taxes to the government, the business will not have the discretion to divert the money, even briefly.

When a tax shortfall occurs, the severity of the IRS reaction may depend on the amount at stake and the number of quarters involved (payroll taxes are reported quarterly). The IRS reaction may also hinge on how long it has been before the IRS discovers it. Sometimes the IRS spots it early, while in others the IRS is slow to react. But whenever the IRS discovers the delinquency, the IRS is often much harsher with payroll taxes than with income taxes.

First, the IRS makes an assessment against the business, trying to collect. In extreme cases, the IRS may also move to close the business to stop the bleeding of the lost payroll taxes. But in many cases, whatever action the IRS takes against the business itself is not all. Often, the IRS will make personal assessments against all responsible persons who have ownership in or signature authority over the company and its payables.

That can be scary. The IRS can assess a Trust Fund Recovery Assessment, also informally known as a 100-percent penalty, against every "responsible person" under Section 6672(a) of the tax code. 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 if the company fails to pay.

The 100% penalty equals the taxes not collected. The penalty can be assessed against multiple responsible persons, allowing 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. And those IRS collection efforts can be serious.

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.

Predecessor Employers

The IRS also looks for situations where one company owing payroll taxes seems to morph into a "new" company, and there are special rules in the case of a 'predecessor' employer. That is, some procedural safeguards won't apply if you are a predecessor employer. Here's 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.

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