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Payroll Tax Violators Get Penalties Or Jail, And IRS Is Watching

During tax filing season, there are many stories about tax convictions and indictments. They are scary just as it comes time to file your taxes. 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. If the IRS doesn't get it, the losses can mount quickly.

The IRS is especially vigorous in going after payroll taxes. They are withheld from wages and are to be promptly paid to the government. 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.

Any failure to pay—or even late payment—is serious, regardless of how or why the employer or its principals use the money. Using the money to pay suppliers and keep the business open isn't a good reason in the IRS view. Payroll services are one common answer, so the employer doesn't have discretion to use the money to pay vendors or for anything else. But what if the payroll service takes the money?

That horrific possibility features prominently in a report from the Treasury Inspector General. So be careful who you hire too. 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’re a responsible person the IRS can pursue you personally for payroll taxes if the company fails to pay. The 100% 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 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 employment taxes and to timely file all employment tax returns. Whatever your situation, try to steer clear of these issues. Get help early.

Stay ahead of payroll taxes. Consider using a payroll service that doesn’t allow you the choice whether to use the payroll tax money for something else. And choose wisely.

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