

Personal Liability for Employment Taxes Can Spoil Your Day

By Robert W. Wood

We all have to pay taxes, but we often don't take responsibility for anything but our own personal income taxes. That can be a mistake. Indeed, if you're in practice with a firm or even as a solo practitioner with just one employee, you should be aware of employment tax responsibilities and liabilities. That's so even if you farm that work out to others or to a payroll service.

The same is true for in-house counsel working for a company, particularly if you are a corporate officer. In fact, employers of all sizes need to know about personal liability for payroll taxes. It is the employer's responsibility to withhold federal and state income and employment taxes from payroll. All types of employers — corporations, partnerships, LLCs and even proprietorships — have these obligations.

Withheld tax monies are "trust fund" taxes belonging to the state and federal government. "Trust fund" can sound pleasing to the ear, as in "trust fund babies." But here it has a decidedly negative ring. You shouldn't use the money for something else, no matter how desperately you may need to pay creditors.

Inevitably, some businesses get into trouble by withholding the tax money but not sending it to the Internal Revenue Service and the state. If the business is failing, is it okay to pay the rent, vendors and utility bills to keep the lights on? Keeping the business open is more important than paying the IRS, right? Besides, the IRS will get its money later before they figure it out....

Needless to say, this is very dangerous. Nevertheless, thousands of businesses fall into this trap every year, especially in a rocky economy. When trust fund taxes don't show up, the IRS will pursue the business to collect. The IRS can even padlock the business to stop the bleeding.

This can be one good reason to use a payroll service. A payroll service normally will deduct your payroll in full from your business bank account when it cuts payroll checks. That way you avoid the temptation of ever getting your hands on withheld tax monies. The payroll service will send it directly to the IRS and state.

If a business fails to pay payroll taxes, it isn't only the business that is liable. The IRS can assess a trust fund recovery assessment, also known as a 100 percent penalty, against each and every "responsible person." Typically, the IRS continues trying to collect from the company and tries to collect the 100 percent penalty from every officer. The assertion of personal liability against the owners and managers of a business is a potent IRS weapon.

If there are six officers, the IRS will simultaneously try to collect the tax plus 600 percent in penalties from these six responsible persons. Some responsible persons try to sic the IRS on other more solvent or more visible responsible persons. That can be a clever strategy for executives caught within the "responsible person" net. You might be able to show that other wealthier and more liquid (or more culpable) officers are waiting in the wings. Fortunately, the IRS can collect only once. Thus, there can be scrambles to avoid liability that end up looking like a rugby scrum.

The IRS position is that every officer is responsible, and that some non-officers with signature authority are too. Trying to show you simply weren't responsible is usually a losing battle. You might consciously pay someone else ahead of the IRS to keep the business afloat. You might have no actual knowledge the IRS is not being paid. Either way, if you had signature authority and *could* have paid the IRS, you're responsible.

Some people in this precarious situation demand written assurances



from their company that payroll taxes are being timely deposited with the IRS and the state. Others might resign from their jobs over this issue, especially upon discovering that there is an outstanding liability and that they have had signature authority in the past, even if they did not exercise it and had no knowledge of the payroll tax default.

Resigning may sound extreme, but it's not an overreaction. If you've ever been in one of these disputes, you probably will not want to be in another. In a tough economy, it's even more important to be vigilant.

Suppose you didn't even know you had a payroll? You knew (or thought you knew) that your workers were independent contractors so you didn't have to withhold. It turns out your independent contractors are really employees, so you did have a payroll after all. Since you failed to withhold and pay the trust fund taxes to the IRS, you're on the hook personally.

The IRS and the state are both cracking down on the use of independent contractors, and with good reason. It's vastly cheaper for companies to have independent contractors than to have employees. When taxing jurisdictions find that businesses have inappropriately avoided payroll taxes, the taxes, interest and penalties can be severe. Moreover, these worker status problems lead directly into payroll tax problems, and that can mean personal liability.

Suppose a law firm treats 10 lawyers as independent contractors, so it pays them via gross checks with no income or employment tax withholding. Then suppose the IRS recharacterizes them, ruling them to be employees. Since the firm didn't withhold or pay any taxes on these wages, there will be an assessment against the firm for taxes, penalties and interest. If the firm does not or cannot pay — or is simply slow in do-

ing so — the IRS can assess a 100 percent penalty (equal to the entire amount of trust fund taxes) against each responsible person. That may include all partners, and would certainly include officers.

Thus, personal liability for trust fund taxes can sneak up on you. You're likely to know that payroll taxes for employee wages must be sent to the IRS. You may be a partner or officer and have legal responsibility, even though you have someone within your organization who actually handles such matters. Thus, you may be unaware that money isn't going to the IRS or the state and is instead going to other creditors. You may not even know what lines are drawn between independent contractors and employees. Nevertheless, you can end up with personal liability.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.



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