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Personal Tax Liability When A Business Goes Under

Some liabilities for employment taxes are personal. When companies withhold payroll taxes, these “trust fund” taxes belong to the IRS. These days many businesses are badly squeezed and end up using the money for something else—like keeping the lights on. Business owners might even convince themselves they’ll pay the IRS before the money is missed.

That’s a dangerous game. If you are a company officer, owner or are otherwise a “responsible person,” you have personal liability. See [Beware Personal Liability For Employee Taxes](#).

Independent Contractor Problems Too. It’s well known that the IRS is cracking down on worker status disputes. See [White House On Contractor Vs. Employee: There Will Be Blood](#). It’s vastly cheaper for companies to have independent contractors than employees. See [All Lawyers Need to Know: Independent Contractor Basics](#). When taxing jurisdictions find businesses have inappropriately avoided payroll taxes, the taxes, interest and penalties can be severe. See [Construction Industry Fair Play Act](#). In some cases, there can even be criminal liability. See [Criminal Penalties For Misclassifying Independent Contractors?](#)

Can these two sets of serious tax liabilities run together? Yes, and it can be a double whammy. Take the recent Second Circuit case of [United States v. Hudson](#). Mr. and Mrs. Hudson ran a real estate rental business and treated their workers as independent contractors. That meant no withholding of income or employment taxes.

The IRS recharacterized the workers as employees. Since the company hadn't withheld or paid any taxes on the wages, the company was liable for taxes, penalties and interest. Unfortunately, the business was in trouble and ended up bankrupt.

Who do you think the IRS went after? Mr. and Mrs. Hudson, who else? Under [Section 6672](#), the IRS can assess a 100% penalty equal to the entire amount of trust fund taxes.

IRS Shotgun. The IRS can make this 100% penalty assessment against **every** responsible person, seeking to collect the full amount from each. It can be like watching rats on a sinking ship. But Mr. Hudson wasn't done maneuvering yet. He personally filed for bankruptcy, but the IRS made a claim in his bankruptcy too.

Sneak Attack. Personal liability for trust fund taxes can sneak up on you. You're likely to know that when payroll taxes are deducted the money must be sent to the IRS. Many people labeled as "responsible persons" might be unaware the money isn't going to the IRS but still end up with personal liability.

But suppose you didn't even **know** you had a payroll? You **knew** (or **thought** you knew) your workers were independent contractors so you didn't have to withhold. It turns out 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.

For more about personal liability for tax debts, see [Beware Personal Liability For Employee Taxes](#).

For more about independent contractor versus employee mischaracterization, see:

[Criminal Penalties For Misclassifying Independent Contractors?](#)

[Who Cares About Contractor v. Employee Status? 10 Zones of Danger](#)

[10 Reasons To Worry About Worker Status Disputes](#)

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