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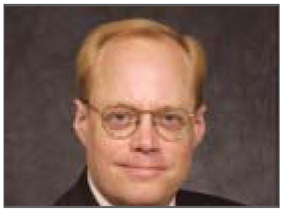

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THE TAX LAWYER

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Responsible + Willful? Two IRS Labels You Don't Want

(Photo credit: Robert S. Donovan)

It's an old story. A business is struggling and employees must be paid. Withheld taxes are earmarked for the IRS, but diverting them ***briefly*** is tempting to get the company back on its feet. Even non-profits have these problems. See Officers Of Nonprofits Face Personal Liabilities For Taxes.

One thing leads to another and the company fails. Regardless of the type of business, guess who ends up with the payroll tax bill? You expect the business owners to have to pay.

More broadly, though, the honor goes to all "responsible persons." That usually means anyone with signature authority. See IRS "Responsible Person" Label Hurts. The IRS has to show you were ***willful*** but is that hard?

Not really. In determining who is a responsible person, the courts generally look at:

1. The duties of these individuals;
2. Their ability to sign checks;

3. The identity of the officers, directors, and shareholders;
4. The persons who hired and fired employees; and
5. The persons in control of the financial affairs of the corporation. See [What Is The Trust Fund Recovery Penalty?]

What about willfulness? You are wilful if you:

1. Pay other creditors after you know the withheld funds haven't been paid to IRS; or
2. Recklessly disregard a known risk that taxes weren't being paid.

Even in the absence of ***actual*** knowledge taxes weren't being paid, you are liable if you act with reckless disregard of the facts and the known risks that withholding taxes aren't being paid. Negligence is not enough, but a failure to investigate after being notified withholding taxes were not being paid? That's willful.

In *Byrne v. United States*, the IRS came after two company officials for hundreds of thousands of dollars. The district court granted summary judgment for the IRS but the Sixth Circuit reversed. Why? Both officers were clearly "responsible persons," but it ***wasn't*** clear they were willful.

The district court ruled they were reckless because they knew *or* ***should have known*** of the risk taxes weren't being paid. However, the case involved a true he-said, she-said about taxes. The officers claimed their accountants advised them the taxes were paid. They even hired employees to manage the payroll taxes.

In short, there was a genuine dispute whether these officers ***should have known*** that trust fund taxes weren't being paid. There was even debate over whether they had control of the company's finances. According to the Sixth Circuit, all of this made summary judgment inappropriate.

The IRS takes payroll taxes very seriously, making these cases tough to win. See IRS Pursues Payroll Tax Pyramiding. This case was a big victory for the two corporate officers who claimed they shouldn't be on the hook. Most are not so lucky.

Robert W. Wood practices law with [Wood LLP,] in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, [Tax Institute),] he can be reached 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.