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Tax Tips For You! Minding 'Trust Fund Money'

By Robert W. Wood

Most of us remember a number of "Seinfeld" episodes. There are many great ones, but few more memorable than the Soup Nazi. The "Seinfeld" character was based on a real person named Ali Yeganeh, who ran a real-life soup dispensary called Soup Kitchen International in mid-town Manhattan.

Eventually, the real business would become a small soup empire with franchised outlets. There were even some ready-made soup varieties sold in grocery stores. But as with all real-life businesses, there were real-life taxes to pay.

The Soup Nazi himself has not been accused of a crime. However, Robert N. Bertrand, CFO of the Soupman, Inc. chain, has been indicted for tax crimes. *See United States v. Bertrand*, 17-CR-186 (RRM) (E.D.N.Y.). Soupman is based in Staten Island, and licenses the name and recipes of Yeganeh. The indictment alleges 20 counts of failure to pay Medicare, Social Security and federal income taxes.

No crime has yet been proven, and Bertrand has pleaded not guilty to the charges. But there is no question that the charges are serious. And they contain lessons for every business.

According to the indictment, Bertrand made payments to Soupman employees in cash and stock. Prosecutors claim that he did not report them properly, despite objections voiced by the company's external accountant. These off-the-books payments added up to $2.85 million, which prosecutors claim cost the government approximately $594,000 in lost taxes from 2010 to 2014.

Since payroll taxes must be reported every quarter, this five-year period added up to a whopping 20 quarters. It led to Bertrand being charged with 20 felony counts of tax evasion, one for each three-month period. If he is convicted, he could be sentenced to five years in prison.

All taxes are serious, and all tax returns must be signed under penalties of perjury. But in a number of respects, payroll taxes are more deadly serious than income taxes. Employers are required to withhold taxes from employee wages, and to account for and remit the money to the Internal Revenue Service.

Taxes for Medicare, Social Security and federal income taxes are withheld from the pay of employees, and the employer holds it as a kind of trustee. But prosecutors claim that Bertrand was cutting corners in a big way. Apart from unreported cash amounts, the indictment claims that Bertrand compensated certain employees in large unreported stock awards.

Bertrand never reported this employee compensation to the IRS, and never paid trust fund taxes on the cash payments or the stock awards. The indictment suggests that it may be difficult for Bertrand to claim ignorance. Prosecutors cite a 2012 warning to Bertrand from an external auditor that these payments *should be* reported to the IRS.

Noting the dollars at stake to the federal government, the authorities have also mentioned the potential loss of future Social Security and Medicare benefits for the employees of Soupman. The IRS does not like it when employers withhold taxes from employee pay but fail to send it to the IRS. The IRS calls this "trust fund money." To the IRS, if an employer fails to hand it over to the IRS, it is like theft.

The IRS tends to push hard in such situations, especially when payroll tax failures reflect a pattern. The IRS can close a business, and sometimes even take court action to make it doubly clear that the IRS does not want a repeat performance. If you are in business, it can be tempting to figure that you have to keep the rent paid and supplies ordered, and that the IRS won't miss the payroll tax money if you just divert it temporarily.

No matter how good the reason, the practice is dangerous. It is one reason that in cases where the IRS catches payroll tax problems early, the IRS often encourages use of a payroll service. With a payroll tax service, the taxes can automatically be paid over to the IRS without temptation.

The business may have to lay off employees, but it is better to only pay wages to employees if you can simultaneously send the withheld taxes to the IRS (and the state). Any failure to pay — 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's view.

Payroll services remove employer discretion to use the money to pay vendors or for anything else. But what if the payroll service takes the money? That horrific possibility can happen too, and is one reason to vet payroll tax services carefully.

It isn't just the business entity that is responsible for payroll taxes. You might expect that the owners, or at least the signers on checks and tax returns, could also be pursued. They can. In fact, 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.

It does not matter if some or all of these people did not personally benefit. The IRS can assess a Trust Fund Recovery Assessment, also known as a 100 percent penalty, against every "responsible person" under Section 6672(a) of the tax code. You can even be liable if have no knowledge that the IRS is not being paid.

If you're a responsible person, the IRS can pursue you personally. The 100 percent penalty equals the taxes not collected, and the penalty can be assessed against multiple responsible persons. This allows 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.

As of this all isn't frightening enough, what if the business has "independent contractors" that are really employees if all the facts were to come out? You guessed it. That can make the employment tax problems bigger and worse.

Robert W. Wood *is a tax lawyer with www.WoodLLP.com, and the author of "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This is not legal advice.*