

## THE PERSONAL PERILS OF DIVERTING PAYROLL TAXES

In a down economy, companies can face tight cash flow and the need to re-examine or re-prioritize expenditures. Unfortunately, financial distress leads some companies to divert payroll taxes to fund immediate operating expenses. That is not a wise decision. Under federal law, the government can hold a company's individual officers and employees personally liable for the failure to collect and remit the income and FICA (Social Security and Medicare) taxes the company withheld from employees' wages.

### RESPONSIBILITY AND WILLFULNESS

Withheld income and FICA taxes are known as "trust fund" taxes because the company holds them in trust for the government. If the IRS concludes that a person is "responsible" for collecting, accounting for, or paying trust fund taxes *and* that such person "willfully" failed to do so, it can charge that person a penalty equal to 100 percent of the unpaid trust fund taxes, and possibly interest. Whether a person is responsible depends on his or her status, duty, and authority within the company and, more specifically, the degree of influence and control the person exercises over the company's financial affairs. Sufficient influence and control could include the authority to sign checks, disburse funds, or pay creditors; management of day-to-day operations; or responsibility for signing and filing quarterly tax returns. Under certain circumstances, a responsible person can even be a family member actively involved in, but not formally employed by, the business or a creditor who has assumed certain management functions.

Authorizing or permitting the use of the collected funds for purposes other than paying trust fund taxes is evidence of willfulness. Failing to investigate whether trust fund taxes are being paid in times of financial distress or failing to correct a known trust fund tax delinquency can constitute "reckless disregard," which rises to the level of willfulness.

### PREVENTING LIABILITY

Preventing or limiting personal liability for trust fund taxes requires an understanding of risky situations and diligence in responding to potential problems. Remember the following:

- Diverting trust fund taxes to keep a business afloat is not a defense against personal liability.

- Ownership and corporate title are *not* prerequisites for personal liability.
- The government can hold more than one person within a company responsible and, thus, liable for unpaid trust fund taxes.
- A responsible person cannot divest himself or herself of responsibility by giving the duty to another.
- A responsible person cannot necessarily escape responsibility because someone else has directed him or her not to pay the taxes.
- Neither company nor individual bankruptcy will shield responsible parties from liability.
- Changes in circumstances—such as ownership change or transition in employment responsibilities—might make you a responsible person for some quarters and not others.

Protect yourself by doing the following:

- Supervise employees who maintain books and records, disburse funds, and prepare tax filings.
- Communicate to supervisors any payroll tax delinquencies or concerns over the ability to make future payments. Explain the consequences if the taxes are not paid and/or seek outside counsel.
- Act *immediately* if you learn that your company has not paid payroll taxes. Use available funds—as well as after-acquired funds—to satisfy the outstanding liability first, before paying other creditors.
- Approach the IRS about a plan to satisfy the liability at the company level, such as an installment payment agreement or offer-in-compromise. This could delay or prevent the assessment of liability against individuals.
- Consider applying payments first to the trust fund portion of the total outstanding liability, as opposed to the employer's matching portion of the taxes. This might diminish or eliminate personal liability.

If the IRS discovers unpaid trust fund taxes, it will initiate an investigation of potentially responsible persons. If the agency contacts you, it is a good idea to seek legal counsel. In almost all circumstances, the IRS must provide written notice prior to assessing a penalty, and responsible persons have a chance to contest the proposed assessment.

Personal liability depends on both responsibility and willfulness. These determinations are fact-specific and vary from case to case. Be aware of the risk of personal liability and take steps to prevent it. ■



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