

## Client Memorandum

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### **THE IMPORTANCE OF PROPERLY HANDLING PAYROLL TAXES (AND OWNER/OFFICER LIABILITY FOR FAILING TO DO SO) ©**

Penalties for failure to remit payroll taxes may include both the civil penalty of the taxes, interest and penalties, as well as a criminal penalty that may result in imprisonment. These penalties can apply to a "responsible person" both in a for-profit entity, as well as in a non-profit institution. Consider the following recent cases:

*In a recent U.S. Court of Appeals decision from the 10th Circuit, the IRS successfully secured the conviction of a business owner who willfully failed to pay over payroll taxes withheld from his employees. In this case, Crabbe v. United States, No. 08-1393, 2010 U.S. App. LEXIS 1931 (10th Cir. Jan. 28, 2010), the Court of affirmed the conviction and 37-month sentence of the business owner, even though he was not active in the day-to-day management.*

*Also, in a recent 5th Circuit decision involving the Chairman of a non-profit hospital in Beaumont Texas (Verret v. U.S., 542 F.Supp.2d 526, *aff'd* 312 F. Appx 615 (C.A. Tex, 2009)), the court held the Chairman personally liable for \$408,000 of unpaid payroll taxes under the theory that the chair was a "responsible person" under the payroll tax statutes and could be held personally liable if the institution did not pay such taxes. Under the facts of this case, the court found that the chair had or should have had knowledge that the taxes were unpaid and should be held personally accountable.*

Payroll taxes withheld from employee paychecks are trust fund taxes, meaning they are the property of the U.S. government immediately at the time they are withheld or due to be withheld, and are held in trust by employers until such time as they are deposited with the government. If a business fails to deposit payroll taxes, the IRS will seek to recover these funds from any "responsible person" of the employer, which may include officers, directors, owners, or even bookkeepers with signature authority over a bank account. In other words, this liability is not necessarily limited to the President, Treasurer, or the person who writes company checks, but may include any officer, owner or director. The personal liability of such individuals can be substantial, and in addition to liability for the taxes, interest and penalties, may include criminal liability under § 7202 of the Internal Revenue Code for the "willful" failure to "collect, account for, and pay over" payroll taxes.

It is all too easy for a business owner who has a temporary cash flow issue to fail to remit payroll taxes, viewing it as a temporary loan. The problem arises when the cash flow problems continue, and all too often a business owner gets behind by several or more months on the remittance of the taxes, at which point it becomes very difficult to recover. A review of case law shows that it is only the rare case that starts out with the owner failing to pay over the taxes due to intentional fraud or an attempt to evade taxes. However, the criminal (and civil) intent requirement is usually met merely by a showing that the owner (or other responsible person) knew the taxes were due, and knew the taxes were not being remitted. In addition, it is important to note that unlike some taxes (such as income taxes), payroll trust fund taxes are NOT dischargeable in bankruptcy.

Until recent years, criminal prosecutions for failure to withhold and remit payroll taxes were relatively rare, with the IRS generally being content seeking civil penalties against violators and recovering the tax. In terms of criminal prosecution, it is not relevant that there was no intentional criminal motive in failing to remit the funds; rather, the criminal intent is deemed to arise from intentional or knowing failure to remit the taxes that are due, regardless of the reasons behind the owner or other responsible person's failure to do so. In 2008, for example, the IRS secured the conviction and 30-month sentence of a business owner who failed to pay over a portion of the payroll taxes he collected from his employees to the IRS, because he claimed he needed to money to meet the operating expenses of his business. See United States v. Easterday, 539 F.3d 1176 (9th Cir. 2008). As the growing number of convictions shows, the IRS is escalating its pursuit of criminal cases against individuals, and business owners must ensure they are properly withholding and remitting payroll taxes to the government as required by law, even if the owner has delegated this task to others in the business.

The importance of timely collecting, paying and filing payroll taxes and payroll tax returns cannot be overemphasized.