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Resources

Recent Decisions Serve as a Reminder that Officers Can Be Held Responsible for Corporate or LLC Trust Fund Taxes

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Recently, the United States Courts of Appeals for the Federal Circuit and the Tenth Circuit ruled that chief executive officers (CEOs) were responsible persons liable for the trust fund recovery penalty under Section 6672 of the Internal Revenue Code (the Code). In the Federal Circuit, the Court held that the majority owner, CEO, and principal financier of a publishing corporation was a responsible person who had a duty to collect, account for, and pay the trust fund taxes, and that he willfully failed to do so (*Jenkins v. U.S.*, 109 AFTR 2d 2012-XXXX, (CA Fed. Cir.), 06/08/2012). Similarly, the United States Court of Appeals for the Tenth Circuit ruled that the CEO of a limited liability company was individually responsible for the payment of payroll taxes (*Birbari v. U.S.*, 10th Cir., No.11-8046, unpublished 06/11/2012). These two rulings serve as vital reminders that payroll taxes (i.e., trust fund taxes) are one of several types of taxes for which a company officer or owner can be held **personally responsible** if funds are not remitted to the government. What's more, in many instances, even if individuals are aware of the federal rule imposing personal responsibility, they often overlook the state and local tax regimes that may impose personal liability.

Responsible Person: Federal Trust Fund Taxes

The Code provides a vehicle, under Section 6672, by which the tax liability of an employer is shifted to each individual responsible for the nonpayment of trust fund taxes. Generally, the law classifies a "person required to collect, truthfully account for, and pay over any tax" as a "responsible person." In that regard, the Internal Revenue Service (IRS) uses Section 6672 as a collection device since it cuts through the normal state law protections generally afforded corporations and limited liability companies. Thus, the IRS may attempt to impose liability upon individuals that may or may not be responsible for failure to withhold and pay over required taxes. In many cases, a functional test is applied for determining "responsible person" status. This functional test focuses on whether the individual exercises control over the financial affairs of a business and disbursements of funds (and priority of payments) to creditors.

Courts have articulated the above referenced functional test in a variety of ways when analyzing whether an individual is a responsible person, including whether the individual:

- Has the power to avoid a default in the payment of the tax;
- Has the power to control the decision-making process regarding the allocation of funds to creditors;
- Controls the corporation's financial decisions;
- Has the final word regarding what bills or creditors are paid, and when; and
- Has the power to compel or prohibit the allocation of corporate funds.

In analyzing responsible person cases, courts have varied in their application of the functional test. For example, the Sixth Circuit has placed great weight on whether the individual has the ultimate authority over the expenditure of funds. See, *Gephart v. U.S.*, 818 F.2d 469 (6th Cir. 1987). The Federal Circuit and the Court of Claims also apply a functional test. See, *Godfrey v. U.S.*, 748 F.2d 1568 (Fed. Cir. 1984); *Barrett v. U.S.*, 580 F.2d 449 (Ct. Cl. 1978).

Court of Appeals for the Federal Circuit: *Jenkins v. U.S.*, 109 AFTR 2d 2012-XXXX, (CA Fed. Cir.), 06/08/2012

In the Federal Circuit, the Appeals Court found that the lower court did not clearly err when it held that the taxpayer had a duty to collect, account for, and pay the trust fund taxes, and that he willfully failed to do so. The Court held that the majority owner, CEO, and principal financier of a publishing corporation was a responsible person liable for the trust fund recovery penalty. The lower court had held that the CEO willfully failed to collect, account for, and remit withholding taxes owed by his corporation. The CEO wrote himself at least 13 checks, one of which was a check for nearly $17,000, in an attempt to recoup his investment in the corporation. The Court of Federal Claims had said that every time a check was signed, the CEO should have wondered, based upon the corporation's history of delinquency and the lack of improvement in its bottom line, whether he was signing over to creditors and himself money that belonged to the United States.

Tenth Circuit Decision: *Birbari v. U.S.*, 10th Cir., No. 11-8046, unpublished 06/11/2012

In *Birbari*, the Tenth Circuit ruled that the CEO of Red Canyon Holdings LLC, which operated a Wyoming gas station, was individually responsible for the payment of payroll taxes for quarters from 2004 and 2005. During the relevant periods the company failed to remit employee withholding taxes to the IRS. The IRS ultimately pursued the CEO, who owned and operated the LLC with two other individuals. In this case, the Judge dismissed the CEO's appeal as frivolous. The appellate court accepted the district court's determination that the government had presented evidence that the CEO was a responsible party to pay the taxes and that the CEO had failed to present evidence that he was not responsible. The CEO failed "to identify any evidence in the record to show that he is not responsible for the taxes".

States May Apply Responsible Person Liabilities For Both Trust Fund And Other Taxes

States often will also impose some variation of officer liability to recover both trust fund taxes and more general, non-trust fund taxes. Michigan, for example, uses a standard for determining whether a person is personally responsible for a corporation or LLC's taxes that is lower than the federal standard. See, e.g., MCL 205.27a. Under this provision, the government makes its prima facie case that a person is individually liable for a business' taxes generally by proving that (1) the individual functioned as an officer of the taxpayer entity, and (2) the individual signed a tax return or check to pay a tax.

Recommendations for Individuals who may be Responsible Persons

If the IRS or a state could determine that you (1) are responsible for collecting or paying withheld income and employment taxes, or for paying collected excise taxes, and (2) willfully fail to collect or pay them, you should consider:

- Periodically confirming that trust fund tax liabilities have been satisfied. This is of particular importance if you are aware of the organization's financial difficulties and satisfaction of accounts payables are being delayed. If the organization is delaying payments to creditors as a matter of course, ensure that any trust funds are timely remitted.
- Reviewing the organization's compliance to confirm that you will not be subject to the threat of personal liability if you are hired into an organization where you may have responsibility for trust fund taxes.

If the IRS or state revenue agency determines you are a responsible person, they typically will send you a letter or other notice. Any potentially responsible person should discuss his or her rights with a tax professional if such a notice is received. If trust fund payments have already been missed, a potentially responsible person should contact a tax professional immediately to discuss how the situation can be rectified. Dykema's Taxation Group members are available to assist taxpayers in a broad array of tax matters, including dealing with potential individual liability assessments of trust fund and other taxes under federal or state law.

Please contact **William Lentine**, **Steve Grob** or **Tony Ilardi** if you have questions about minimizing exposure to potential liability as the person responsible for your organization's corporate, LLC or trust fund taxes; if you have general inquiries about other tax matters; or if you would like to learn more about Dykema's Taxation practice.

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