ALSB Journal of Employment and Labor Law
Volume 14, 102 - 111, Spring 2013

Who Is Liable for Employee Withholding and Social Security (Fica) Taxes?

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INTRODUCTION

When a contractor or subcontractor is forced to liquidate because of cash flow problems, there may remain a significant financial liability to the federal government for collected, but unremitted, payroll taxes withheld from employees' paychecks but not yet paid to the federal government. By law, employers are required to withhold from employees' salaries certain employee-owed taxes on wages and to pay these funds to the federal government. These include the the Employee Federal Insurance Contribution Act[1] ("FICA") taxes, Medicare, and income taxes, collectively referred to here as "payroll taxes". These funds, withheld from employees' paychecks and owed to the Internal Revenue Service ("IRS"), may have been improperly used to pay the businesses' "more pressing" creditors instead of being paid over to the IRS. While it is clear the actual employer,[2] whether partnership, corporation, or other, is liable for the taxes, other "responsible parties" are also liable. This paper examines many cases involving the courts' determination of who may be considered "responsible parties" for the taxes and penalties, penalties that can be as high as 100% of the taxes due.[3]

RESPONSIBLE PARTY

The construction industry is characterized by a large number of small firms engaging in the many complex aspects of building a complex project. Many decision makers and stakeholders in these small businesses may be surprised to learn who courts have deemed to be "responsible parties." Responsible parties are not just the owners and operators of the business. Outside entities and individuals have been held jointly and severally responsible for the payroll tax liability and penalties. In one case, a contractor was found liable for its subcontractor's unpaid payroll taxes.[4] This case is discussed more fully below.

The root cause of this problematic behavior, raiding the unremitted payroll taxes to pay business debts, is the unfettered access the company has to these funds which are held in a

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[1] 26 USCS prec § 3121.

[2] 26 USCS § 3102.

[3] This paper does not address the issue of the contractor's miscalculation of an employee as an independent contractor, thus rendering the contractor liable for payroll taxes. See Ramirez v. Comm'r, T.C. Memo 2007-346 (T.C. 2007).

[4] United States v. Fred A. Arnold, Inc., 573 F.2d 605, 607 (9th Cir. Cal. 1978).

business checking account. When cash flow issues arise in small businesses, many principals dip into their trust fund payroll tax accounts to pay other creditors. For example, in the case of *Diamond Plating,*[5] the company contended that it should be excused from paying its payroll taxes because of the financial hardship caused when it lost its major customer. The principal may not be acting in malice, but the consequences of using the payroll taxes collected from employees and owed to the government may fall to unintended and unsuspecting individuals.

An understanding of the cases that have arisen in this area and the elements that make up the law will greatly assist small contractors and subcontractors in designing a system that controls this potential liability. Those who may be involved in the business but do not see themselves as responsible for these payroll taxes and penalties can benefit from an understanding of potential liabilities before taking on this risk. For example, in the case of *Hunison v. United States,*[6] Hunison and Vigue were partners and owners of a hotel and bar starting in 1995. The business was managed by the Wickams, who were employees of Hunison and Vigue. The Wickams bought the hotel and bar on December 6, 1996, and became the owners. However, prior to December 6, 1996, Hunison and Vigue, who had control of the business checkbook, failed to pay to the government the payroll taxes withheld on the employees' wages. To complicate matters, the Form 941 tax returns for the second, third and fourth quarters of 1996 and a form 940 unemployment tax return were filed by the partnership but signed by Mr. Wickham as the "manager." These tax forms stated no tax was due but, in fact, over $16,000 in taxes were due on wages dated prior to December 6, 1996. The IRS assessed the taxes and penalties against Hunison and Vigue. As the court said, the problem was a failure of the parties to account for the payroll tax liability in the sale and to make sure the payroll taxes were paid. Hunison and Vigue were liable for failure to turn over to the government the payroll taxes because, at the time the payroll taxes were collected from the employees' paychecks, Hunison and Vigue were the employers. It was irrelevant who signed the tax forms or who bought the business.[7]

Responsible parties include persons[8] charged with the process of actually withholding employee FICA taxes,[9] federal withholding taxes,[10] and payment of the same to the IRS. These

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[5] Diamond Plating Co. v. United States, 390 F.3d 1035 (7th Cir. Ill. 2004). The issue in that case was slightly different than the topic of this paper. In that case, Diamond Plating requested that the court justify its failure to pay the payroll taxes under the theory of financial hardship. Some cases have held that financial hardship may constitute reasonable cause for *abatement* of penalties. *See* Van Camp & Bennion v. United States, 251 F.3d 862, 868 (9th Cir. 2001); East Wind Corp., Inc. v. United States, 196 F.3d 499, 507-08 (3d Cir. 1999); Fran Corp. v. United States, 164 F.3d 814, 819 (2d Cir. 1999). *But see* Brewery, Inc. v. United States, 33 F.3d 589, 592 (6th Cir. 1994) where the court held that the employer's decision to pay other creditors first was not reasonable cause to abate the taxes and penalties. The court in *Diamond Plating* did not find financial hardship in the matter.

[6] Hunison v. United States, 2001 U.S. Dist. LEXIS 22200 (D. Alaska 2001).

[7] Hunison v. United States, 2001 U.S. Dist. LEXIS 22200 (D. Alaska 2001).

[8] The term person under the statute is broadly defined and "includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs." IRC 1954 § 6671(b), 26 U.S.C.A. § 6671 (b). See Drechsler, C.T., Construction, application, and effect, with respect to withholding, Social Security, and unemployment Compensation taxes, of statutes imposing penalties for tax evasion or default, 22 A.L.R.3d 8, footnote 25 for lists of cases holding various corporate officers liable.

[9] 26 U.S.C. § 3102(a).

[10] 26 U.S.C. § 3402(a).

parties are liable for the taxes and penalties for failing to transfer those taxes to the government. However, liability for taxes and penalties can extend to other individuals with certain financial interests and relationships within and even outside the company, for example the general contractor for a subcontractor,[11] managers,[12] partners,[13] consultants,[14] creditors,[15] retired corporate officers,[16] prospective purchasers,[17] lenders,[18] banks,[19] accountants,[20] investors,[21] and anyone who has "the final word" on payments,[22] have all been deemed responsible persons and have had an enormous liability assessed against them. This has led to overwhelmingly negative results for both those who may not have known they were responsible persons and those who were deemed responsible parties by the IRS. If the IRS determines that an individual was responsible for the collection and payment of taxes[23] and acted willfully in the failure to carry out those duties,[24] that person is subject to a 100% penalty, a 5% underpayment penalty,[25] a felony charge, possible imprisonment (five years), and a $10,000 fine.[26]

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[11] United States v. Fred A. Arnold, Inc., 573 F.2d 605, 607 (9th Cir. Cal. 1978).

[12] Ballard v. United States, 17 F.3d 116 (5th Cir. Tex. 1994).

[13] Livingston v. United States, 793 F. Supp. 251 (D. Idaho 1992), Remington v. United States, 210 F.3d 281 (5th Cir. Tex. 2000).

[14] United States v. Bailey, 216 Fed. Appx. 378 (4th Cir. Va. 2007). Lubetzky v. United States, 393 F.3d 76 (1st Cir. Mass. 2004).

[15] Taubman v. United States, 499 F. Supp. 1133 (E.D. Mich. 1978) (creditor knew taxes were not being paid). See 26 USCS § 3505. *Liability of third parties paying or providing for wages*.
(a) Direct payment by third parties. For purposes of §s 3102, 3202, 3402, and 3403 [26 USCS §§ 3102, 3202, 3402, and 3403], if a lender, surety, or other person, who is not an employer under such §s with respect to an employee or group of employees, pays wages directly to such an employee or group of employees, employed by one or more employers, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer.

[16] United States v. Novelli, 381 F. Supp. 2d 1125 (C.D. Cal. 2005).

[17] Melillo v. United States, 244 F. Supp. 323 (E.D.N.Y. 1965) (prospective purchasers took control of the business and had responsibility for payments).

[18] Jersey Shore State Bank v. United States, 479 U.S. 442, 107 S Ct. 782, 93 L.Ed.2d 800 (Supreme Court 1987). The actual issue in that case was whether or not the bank was entitled to a particular notice for the unpaid taxes.

[19] National Bank of Commerce v. Phinney, 1965 U.S. Dist. LEXIS 9039 (S.D. Tex. 1965).

[20] Quattrone Accountants, Inc. v. Internal Revenue Service, 895 F.2d 921 (3d Cir. 1990). Accountant firm had control of bank account of its client together with responsibility to pay the taxes but used the money for other creditors. See also Moulton v. United States, 2003 U.S. Dist. LEXIS 22007 (D. Mass. 2003).

[21] Jenkins v. United States, 2011 U.S. Claims LEXIS 1883 (Fed. Cl. 2011), Moulton v. United States, 2003 U.S. Dist. LEXIS 22007 (D. Mass. 2003). Thurner v. United States, 260 F. Supp. 292 (E.D. Wis. 1966) (investor). See also Moulton v. United States, 2003 U.S. Dist. LEXIS 22007 (D. Mass. 2003).

[22] Hewitt v. United States, 377 F.2d 921 (5th Cir. Tex. 1967) cited in United States v. Brown, 2009 U.S. Dist. LEXIS 120494 (D. Conn. 2009).

[23] 26 U.S.C. § 6672(a); 26 U.S.C. § 7202.

[24] Hochstein v. United States, 900 F. 2d 543 546 (2d Cir. 1990).

[25] 26 U.S.C. § 6656.

[26] 26 U.S.C. § 6672(a).

The common reference to these FICA and withholdings monies as "trust fund taxes" stems from the statutory obligation for an wage payer "to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States."[27]The root problem in most cases is that the employer has access to the government's money while that money is being held in trust prior to remittance to the United States Department of the Treasury ("U.S. Treasury"). The timing of payment of cash from the employee, through the company, to the United States government creates an opportunity for misuse of these government funds.

While the employer is required to collect the payroll taxes from the employee[28] every pay period, these same funds, earmarked through statutory regulation, are not immediately remitted to the government by the employer. The employee is credited as paying those taxes as soon as he receives the net paycheck[29] and it is the employer's obligation to remit these taxes, commonly known as Form 941 Employer Quarterly Payments[30], to the U.S. Treasury. If the employer fails to remit the payroll taxes to the government, the IRS is not able to collect the payroll taxes from the employee. The IRS will use all available resources to identify and collect from individuals and entities who are responsible for the remittance of the payroll taxes to the IRS.

The main recourse the government has in the collection of these taxes is to find any and all "responsible parties," and they find as many parties as possible. A wide net, in essence, is used in the collection and satisfaction of these taxes.

Since there are timing differences between the collection of the taxes and their remittance, substantial amounts of cash can build up between these required quarterly payments. When a business is in financial trouble, an owner, manager, or partner may elect to use these trust fund taxes to pay more pressing obligations like purveyors, supplies, rent, or payroll. However, trust fund taxes due the government are a current expense and postponing payment of trust fund taxes is in no way similar to making a late rent payment or being over 90 days due to a supplier. The United States Congress has established significant monetary penalties for delays in remitting payroll taxes to the U. S. Treasury. The longer it takes to pay that money, the more it will cost in terms of accrued penalties and interest. Decision makers may not intend to misuse government funds and they may not think they are willful in their conduct, but the scope of willfulness and the intent have been defined by both statute and court cases.

Once payroll taxes are taken out of an employee's wages, a contingent liability is created which becomes fixed on the due date. This can be a very tempting source of needed cash to a struggling business. As *Kalb v. United States*[31] determined, withholding taxes are part of the taxes paid to the government by the employer; they are not simply a debt. The employer is surrendering to the government that which does not belong to it.

If the quarterly payments have not been remitted, the IRS will start looking to parties it can hold responsible. Although Internal Revenue Code § 6672 includes officers, partners, and employees, it does not exclude other individuals or firms that can be held liable.[32]

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[27] 26 U.S.C. § 7501(a).

[28] 26 USCS § 3102.

[29] 26 U.S.C. §§ 3102, 3402

[30] Slodov v. United States, 436 U.S. 238, 243(1978).

[31] Kalb v. United States, U.S. Court of Appeals (2nd Cir. 1974).

[32] 26 U.S.C. § 6672(a), United States V. Graham, 309 F.2d 210, 212(9th Cir. 1962).

The IRS will first try to recover payment from the responsible persons with the most liquid assets, but will also concurrently hold as many people as possible liable, [33] each with joint and several liability,[34] for this 100% penalty.[35] There is no presumption of innocence in trust fund tax situations. In *Skouras v. United States*,[36] the court determined the assessment on a responsible party is presumptively correct and issues relating to willfulness could be resolved at the summary judgment level.[37] The individual has the burden of disproving by a preponderance of the evidence, the existence of one or both of the elements of willfulness or responsibility.[38] This process will most likely have significant financial, emotional, and social costs due to the burdens associated with establishing that the parties did not act willfully and/or they were not responsible for the remission of the deducted taxes to government.[39]

The responsibility for the collection and payment of trust fund taxes can fall onto some very surprised parties. Aside from the persons normally thought of as being responsible for these taxes (CEO, CFO, President, Secretary, Treasurer, partner), the courts have given fairly wide latitude as to which entities or individuals the IRS can assign responsibility to. In 1987, the United States Supreme Court affirmed third party liability for trust fund taxes against a *lender* who paid employees' wages with the knowledge the firm did not intend or would not be able to make timely deposits of the trust fund taxes.[40] In 1985, the courts found that a *lawyer*, who had power of attorney from the owner to operate a car dealership, was found liable for the 100% penalty.[41] In another case, the IRS determined that workers were incorrectly classified as independent contractors, and assessed the 100% penalty to the *principals* of the firm.[42] In a 1984 Revenue Ruling, the IRS stated that a *volunteer* member of a board of trustees for a charitable organization can be held liable for the 6672 penalty.[43] In 1978, the United States Ninth Circuit Court of Appeals determined that a *general contractor* was responsible for the trust fund taxes not remitted by a subcontractor.[44] An *accounting firm* was held liable as a responsible party because it had failed to remit a client's trust fund taxes and paid creditors other than the Internal Revenue Service.[45] The IRS deemed the *friend* of a business owner responsible because he paid some utility bills for the company, extended loans or pledged collateral on loans to the company.

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[33] Mazo v. United States, 591 F.2d 1151 (5th Cir.1979).

[34] Brown v. United States, 591 F.2d 1136 (5th Cir.1970).

[35] 26 U.S.C. § 6672(a).

[36] Skouras v. United States, 26 F.3d 13 (2d Cir. N.Y. 1994).

[37] Skouras, *supra*, quoted for this proposition in Gilliam v. United States, 1996 U.S. Dist. LEXIS 13226 (S.D. W. Va. 1996).

[38] Fiataruolo v. United States, 8 F. 3d 930 (2nd Cir 1993); Lesser v. United States, 368 F.2d 306, 310 (2nd Cir. 1968)

[39] Lesser v. United States, 368 F.2d 306,310 (2dCir.1968).

[40] Jersey Shore State Bank v. United States, 479 U.S. 422, 107 S Ct. 782, 93 L.Ed.2d 800 (Supreme Court 1987).

[41] Internal Revenue Service v. Blais, 612 F. Supp 700,707 (D. Mass. 1985).

[42] Le Premier Processors, Inc. v. United States, no. 90-3482 (5th Cir. Dec. 3 1990).

[43] Rev.Rul. 83-84.

[44] United States v. Fred A. Arnold, Inc., 573 F.2d 605(9th Cir. 1978).

[45] Quattrone Accountants, Inc. v. Internal Revenue Service, 895F.2d 921 (3d Cir. 1990).

Imagine the shock when the IRS levied the Individual Retirement Account ("IRA") account of an officer of an S corporation and then included the proceeds of the levied funds in the taxpayer's Adjusted Gross Income for the purpose of determining his earned income. The IRS used the constructive receipt doctrine to conclude the amount levied from an IRA was a disbursement – it had to be included as income. The taxpayer was further constrained from deducting it as a pass through loss or a necessary business expense.[46] This is just a sampling of the many cases involving withholding tax liability and the long arm reach of the IRS' "responsible party" strategy.

How it is that such a variety of parties are deemed liable for the trust fund tax liability? To be held liable under Internal Revenue Code ("IRC") § 6672, two conditions must be satisfied: the first condition is that someone must be responsible for the collection of, truthful accounting for, and payment of the relevant tax.[47] The second condition is willfulness of the responsible person in their failure to collect, account for, and pay the taxes.

Many examples of responsible parties have been discussed - owners, contractors, banks, lawyers and others. What makes a party a responsible party for trust fund tax liability? The term "responsible party" has been broadly defined. "When determining responsible person status under § 6672, courts often consider a non-exhaustive list of factors, including whether the individual:

(1) serves as an officer or member of the board of directors;
(2) owns substantial stock in the company;
(3) manages day-to-day operations;
(4) possesses the authority to hire or fire employees;
(5) makes decisions as to the disbursement of funds and payment of creditors;
(6) controls bank accounts and disbursement of records; and
(7) possesses check-signing authority.[48]

In the case of *U.S. vs. Fred A. Arnold*,[49] the IRS sued a general contractor for FICA taxes its subcontractor had failed to pay. The lower court granted a motion for summary judgment but the case was sent back for trial. In that case, the general contractor agreed to pay the subcontractor weekly and a special account was opened for the subcontractor. The contractor's supervisor had to cosign all withdrawals to ensure the funds were not diverted to other subcontractor jobs. The subcontractor drew on the account for partnership draws and other purposes. The contractor never refused to countersign a withdrawal and did not ensure that there was sufficient money in the account to pay the taxes. Therefore, the contractor was liable for the unpaid taxes. Under the statute, those who "directly" pay employees are liable for the taxes. "The intention of Congress was to prevent sureties, lenders, or other persons from assuming responsibility for net wages, excluding taxes. If payroll responsibility is assumed, it must include responsibility for the taxes tied to the wages."[50]

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[46] Swanton v. Commissioner, TC Memo 2010-140.

[47] 26 U.S.C. § 6672(a).

[48] Oppliger v. United States, 637 F.3d 889, 893 (8th Cir. Neb. 2011), cert.den. 2011 U.S. LEXIS 7826 (U.S. Oct. 31, 2011). Fact the bookkeeper had embezzled money from the company and later committed suicide, did not relieve the sole owners and primary officers of the company from liability for the taxes.

[49] United States v. Fred A. Arnold, Inc., 573 F.2d 605, 607 (9th Cir. Cal. 1978).

[50] United States v. Fred A. Arnold, Inc., 573 F.2d 605, 608 (9th Cir. Cal. 1978).

Referring to the holding in *Raba v. United States*, the first condition of "determination of responsibility is based upon a person's 'status, duty and authority' to ensure compliance with the employer's tax withholding obligations".[51] In *Mazo v. United States*, the Fifth Circuit has held that "responsibility" is "status, duty and authority, not knowledge."[52] Even when ordered not to pay over the taxes by a superior, one can be held 100% liable as being both responsible and acting willful.[53] Another defense the courts have dissolved is the "I'm just the manager. I thought the accountant paid it" defense. A general manager who had check signing authority claimed that he was not a responsible person because he thought the controller was paying the taxes. This held no weight with the Fifth Circuit Court of Appeals and he was deemed a responsible person.[54]

The IRS has another wide net to cast to find responsible persons. It searches for those having "significant control" over the finances of a company. This significant control is meant to hold responsible all those connected closely enough to the business to prevent the tax default from occurring. [55] Although the IRS usually focuses on persons with signing authority, it will search beyond the formal documentation and official titles to find those persons outside that formal structure to hold responsible. Thus, a consultant was held responsible even though he had no check signing authority, had no title, and had no ownership in his name. It was determined, though, that this individual had significant control and a self-serving interest in not being a formal owner.[56] It appears that trying to insulate individuals by not using formal business titles and duties offers no protection from this liability. Additionally, the IRS even pierces further into other entities by holding them responsible, as is evidenced by lender liability[57] and wage provider liability.[58]

Greenburg v. United States determined whether an individual is a person responsible for paying withholding taxes, and suggested that courts consider the following factors:

> (1) contents of the corporate bylaws, (2) ability to sign checks on the company's bank account, (3) signature on the employer's federal quarterly and other tax returns, (4) payment of other creditors in lieu of the United States, (5) identity of officers, directors, and principal stockholders in the firm, (6) identity of individuals in charge of hiring and discharging employees, and (7) identity of individuals in charge of the firm's financial affairs.[59]

WILLFULNESS

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[51] Raba v. United States 977 F.2d 941, 943 (5th Cir. 1992).

[52] Mazo v. United States, 591 F.2d 1151, 1156 (5th Cir. 1979).

[53] Howard v. United States, 711 F.2d 729(5th Cir. 1983).

[54] Mazo v. United States, 591 F.2d at 1156 (5th Cir. 1979).

[55] Hochstein v. United States, 900 F. 2d 543 546 (2d Cir. 1990); Bowlen v. United States, 956 F.2d at 728 (7th Cir. 1992).

[56] William Mahler, et al. v. United States of America, U.S. District Court, D. Connecticut, 2000-2 U.S.T.C. (Sept. 30, 2000).

[57] Jersey Shore State Bank v. United States, 479 U.S. 422, 107 S Ct. 782, 93 L.Ed.2d 800 (Supreme Court 1987).

[58] United States v. Fred A. Arnold, Inc., 573 F.2d 605(9th Cir. 1978).

[59] Greenberg v. United States, 46 F.3d 239,242-43 (3rd Cir. 1994).

The second condition that must be met is that of willfulness, a required element for IRC § 6672 liability. Section 6672 does not imply that willfulness has any bad or sinister motive behind the act; the act must merely be voluntary, conscious and intentional.[60] Merely paying any other debts or creditors in preference to paying the IRS the withholding taxes is a willful act in itself.[61] Remember, these funds belong to the United States Treasury. The employer is only holding them in trust for the government.

The withholding taxes "are part of the wages of the employee, held by the employer in trust for the government"; the employer, as a function of administrative convenience, extracts money from a worker's paycheck and briefly holds that money before forwarding it to the IRS. A delinquency in trust fund taxes thus is not simply a matter between the IRS and an employer, but rather involves employee wages. The significant responsibility of Dyac or any other employer is summed up by then-Judge Cardozo's famous statement that "[a] trustee is held to something stricter than the morals of the market place. Not honesty alone, but the of an honor the most sensitive, is then the standard of behavior."[62]

In analyzing a trust fund tax liability issue from a fraud perspective, it is clear that it is simply larceny with a lapping scheme. The funds do not belong to the firm and the decision makers of that firm have no right to the funds. Larceny is the taking of another's personal property and has four elements that must be present: 1) There was taking or carrying away; 2) of the money or property of another; 3) without the consent of the owner, 4) with the intent to deprive the owner of its use or possession. It is not difficult to point to these elements in trust fund cases. It becomes a lapping scheme when decision makers decide to "rob Peter to pay Paul."

For example, a restaurant may be in dire financial straits so that it is on a cash only basis with its purveyors and has less than enough cash to meet the current week's payroll. The owner may tell the bookkeeper (who happens to have check signing authority) to dip into the payroll tax fund for this week's net payroll. He thinks that, with this coming weekend's revenues, he will be able to replenish the funds. This may work a time or two and the manager may become accustomed to using this illegal scheme as a short term loan system. At some point however, the manager will no longer be able to replenish the funds and the business closes without having paid trust fund taxes. Considering that this may a fairly accurate scenario with some start-up restaurants, how many other small businesses have no idea who is responsible and to what extent they are responsible?

Referring to *Mazo v. United States*, and the "responsibility" being "status, duty, and authority not knowledge",[63] it is clear to see why this ruling eliminates any potential defense based on a claim of ignorance. Additionally, this ruling greatly expands IRS ability to seek payment, and to identify potential criminal tax evasion schemes.

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[60] Mazo v. United States, 591F.2d 1154 (5th Cir. 1979).

[61] Monday v. United States, 421 F.2d 1210, 1217 (5th Cir. 1970).

[62] Bell v. United States, 355 F.3d 387, 392 (6th Cir. Ohio 2004) citing Meinhard v. Salmon, 249 N.Y. 458, 164 N.E. 545, 546 (N.Y. 1928).

[63] Mazo v. United States, 591F.2d 1154 (5th Cir. 1979).

Some courts have found no willfulness if funds are "encumbered" by legal obligations, such as a statute,[64] which impede the freedom of a company to use its funds to fulfill its trust fund tax debts. In the *Huizinga*[65] case, Huizinga had stepped down from the position of president of AMS, a plumbing and heating contractor about 5 years before the problems leading to his eventual liability to the IRS for unpaid payroll taxes. Because of severe financial problems in the company, AMS's bank persuaded Huizinga to take over the company again.

Shortly after taking over the company, Huizinga learned that AMS had not paid the IRS the payroll taxes. At that time there was no money in AMS's bank account. AMS opened a new bank account and over the next few months approximately $550,000 was deposited into that account from owners paying AMS for services. The current, but not past due, payroll taxes were paid to the IRS. However, the company was not able to recover and filed bankruptcy. The IRS assessed a tax penalty of over $1 million dollars against Huizinga for his failure to remit tax money collected to the IRS.

Huizinga claimed he was not liable for the unpaid past due payroll taxes, or at least some of them, because the state's Builders Trust Fund Act,[66] which required that money paid by owners in the state requires the paid contractor to use the funds to first pay laborers, subcontractors and materialmen on the owner's specific project. The contractor cannot use that money to pay, for example, past due payroll taxes to the IRS. The court agreed.[67]

However, contractual encumbrances are not avenues one can use to avoid liability. [68] In *Bell v. United States*[69] the taxpayer had entered into a loan agreement with the lender that restricted the company's use of the loan proceeds. This restriction did not relieve the taxpayer from responsibility for paying over the collected payroll taxes. "Voluntary contractual obligations, such as [an agreement with a lender restricting a company's use of loan proceeds], do not encumber funds so as to prevent a willful failure to pay trust fund taxes… [T]o permit corporate

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[64] Huizinga v. United States, 68 F.3d 139 (6th Cir. Mich. 1995). Michigan's Builders Trust Fund Act imposed a liability on the funds collected so that those funds could not be used to pay delinquent payroll taxes. Official Committee of Unsecured Creditors of the IT Group, Inc. v. Anderson Equipment Company (In re IT Group, Inc.), 332 B.R. 673 (Bankr. D. Del. 2005) (holding that payments made under a New York lien law were part of a statutory trust and could not be avoided as preferential).

[65] Huizinga v. United States, 68 F.3d 139 (6th Cir. Mich. 1995). Michigan's Builders Trust Fund Act imposed a liability on the funds collected so that those funds could not be used to pay delinquent payroll taxes.

[66] Mich. Comp. Laws §§ 570.151-570.153. "The Michigan Building Contract Fund Act imposes a 'trust' upon the building contract fund paid by any person to a contractor or subcontractor for the benefit of the person making the payment, contractors, laborers, subcontractors and materialmen." In re Johnson, 691 F.2d 249, 252 (6th Cir. 1982) (citation and footnote omitted). "The contractor or subcontractor receiving the payments is the 'trustee.'" *Id.* (citation omitted). "The statute imposes a duty upon the trustee to use the money in the building contract fund to first pay laborers, subcontractors and materialmen on the particular project for which the funds were deposited before he uses the fund for any other purpose." *Id.* (citations and footnote omitted).

[67] The government and Huizinger had already agreed to a partial settlement through which Huizinger would pay some of the back taxes to the government. The parties had agreed that the extent of Huizinger's liability would rest with the appeal court's determination of whether the state's trust fund act trumped the duty to pay the IRS for the *back* payroll taxes.

[68] Bell v. United States, 355 F.3d 387, 396 (6th Cir. 2004). See also: *Purcell v. United States*, 1 F. 3d 932, 939 (9th Cir. 1993) (setting forth an alternative standard without adopting it) (internal citations omitted) and. Newbill v. United States, 2010 U.S. Dist. LEXIS 124317, 22-23 (E.D. Va. 2010) (discussed only, did not apply).

[69] Bell v. United States, 355 F.3d 387, 396 (6th Cir. 2004).

officers to escape liability under § 6672 by entering into agreements which prefer other creditors to the government would defeat the entire purpose of the statute."[70]

SUMMARY

These illustrations are valuable lessons to all levels of management and business consultants. Many more managers, partners, and private lenders should be asking questions about their respective liabilities and what safeguards the company has in place to ensure trust fund taxes are paid to the government. Lower level business decision makers are especially susceptible to being held liable, as established lines of credit and other financial safety nets have not been established.

These cases describe a few of the powerful methods available to the IRS has to recoup unpaid trust fund taxes. Personal liability can extend as far as spouses and heirs, some of whom may be extremely surprised to see their accounts levied. As shown, the IRS can successfully find, define, and collect from various responsible persons. The IRS will expend its resources in a strategic and judicious manner to find as many parties as possible, responsible ones.

It is simple: the potential adverse consequences to responsible parties are high enough that it is well worth ensuring compliance to the law by helping clients understand what is required of them and who can be held responsible. It then becomes management's responsibility to incorporate such a system that safeguards the withholding taxes for the U.S. Treasury, as well as safeguarding themselves from potential liability.

[70] Kalb v. United States, 505 F.2d 506, 510 (2d Cir. 1974), *cert. denied*, 421 U.S. 979, 44 L. Ed. 2d 471, 95 S. Ct. 1981 (1975).