



By Robert Goff

Individuals face liability for income tax, FICA withholding

Most business owners are aware that they are not generally individually liable for company debts and obligations, if the business is operating as a corporation or a limited liability company. As in the case of other company debts, owners and managers are generally not individually liable for wages due to employees or employment taxes.

However, owners and managers may be individually liable for failure to withhold income and Federal Insurance Contributions Act (FICA) taxes and pay such withheld taxes to the IRS.

Employers are responsible for withholding estimated income and FICA taxes from employees' wages. Employers are also responsible for paying matching income and FICA taxes due from the company to the IRS. Owners and managers face personal liability for income and FICA taxes withheld, or that should have been withheld, as well as the employer's matching FICA taxes.

When confronted with a failing business, owners and managers often try to extend the life of the business. This usually results in the business paying only those creditors threatening to cut essential services, such as utilities. Payments due to other creditors such as the IRS are often delayed in hopes of paying them once the business recovers. Thus, taxes withheld, or funds that should have been used to pay tax withholding, are often used to pay other creditors instead. If the business fails to recover there is often substantial debt owed to the IRS for income and FICA taxes.

If taxes withheld or funds that should have been withheld are used to pay creditors other than the IRS, the IRS can collect individually from responsible persons. A responsible person is one who has authority to exercise substantial control over a corporation's financial affairs. Both owners and managers are arguably responsible persons. Managers are generally responsible persons as they control the daily business of a company. Furthermore, it is often the managers of a business who are responsible for the physical acts of disbursing company funds and writing company checks.

Owners with a majority interest or more are also responsible persons because they have the ability to remove and replace the company's managers. A majority owner

can't avoid responsible person status by arguing that he didn't get involved in the daily operations of the company. Even if the majority owner didn't exercise authority over the company's financial affairs, he had the power to exercise control. Thus, the majority owner is still responsible for withholding even if he has delegated his responsibility to a manager.

If a manager has substantial authority over a company's financial affairs, he cannot avoid responsible person status by arguing that an owner or a company officer told him not to withhold income and FICA taxes, or that he didn't need to account for such taxes. In one case, a court found an accountant was a responsible person even though the owner directed him not to pay the withheld taxes to the IRS. The accountant argued that the owner would have fired him had the accountant insisted upon paying the withheld taxes. The court concluded that the accountant should have resigned to avoid responsible person status.

To collect unpaid taxes from a responsible person, the IRS must prove that the responsible person's failure to withhold or pay the taxes was willful. This requires the responsible person to know that taxes were not being withheld or paid to the IRS. If a responsible person has reason to suspect that taxes are not being withheld, but does nothing to ensure that the taxes are paid, his failure to pay will be considered willful.

To reduce responsible person liability, owners and managers can take the following precautions:

- Managers with payroll, accounting or check writing responsibility should make sure that income and FICA taxes are withheld and paid to the IRS.
- Other managers and owners should use proper internal controls or external audits to ensure that income and FICA taxes are paid.
- Owners who receive financial statements or reports should scrutinize the reports to make sure that they report no liability for unpaid income and FICA taxes.
- Once an owner or manager becomes aware of unpaid income or FICA taxes, he should investigate the reason why such taxes have not been paid. Any reason discovered should be corrected immediately.
- An owner or manager with knowledge or suspicion of nonpayment should timely instruct the responsible managers in writing that income and FICA taxes be withheld and paid to the IRS.
- An officer or manager with knowledge or suspicion of nonpayment should follow-up at the end of each subsequent pay period to make sure that income and FICA taxes are being withheld and paid to the IRS.
- If there are unpaid income and FICA taxes, owners and managers should carefully analyze responsible person liability before paying other creditors, including employees.
- If there are unpaid income and FICA taxes, owners and managers should consult with a tax professional to determine how any subsequent payments of employment taxes to the IRS should be allocated to reduce liability.

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Printed in Four Rivers Business Journal (Paducah Sun), April 2011