

Lessons from the Tax Court: Mercy on unpaid payroll taxes

The trust fund penalty is one of the most onerous tax provisions on the books. Essentially, if someone who is a “responsible person” willfully fails to pay federal payroll taxes that were withheld from employee paychecks (so-called trust fund taxes), he or she may be held *personally liable* for 100% of the amount that was not paid. Thus, this penalty is often called the “100% penalty.”

Who is a responsible person? Under the latest IRS guidance, a “responsible person” is defined as a person or group of people who has the duty to perform and the power to direct the collecting, accounting and paying of trust fund taxes.

What is a willful failure? The IRS says the responsible person must have been, or should have been, aware of the outstanding trust fund taxes and either intentionally disregarded the law or was plainly indifferent to its requirements. No evil intent or bad motive is required. Using available funds to pay other creditors while not paying trust fund taxes indicates willfulness.

The courts often come down hard on taxpayers. However, in a recent decision, the court showed some leniency.

Facts of the case: The taxpayer, a now-deceased physician and owner of a family medical practice in Houston, was assessed a \$4 million trust fund penalty by the IRS. But the taxpayer in this case had a good excuse. The failure resulted from the actions of the medical practice’s chief financial officer (CFO). Unbeknownst to the taxpayer, the CFO was stealing money from the practice.

The Fifth Circuit Court of Appeals gave the physician's widow some leeway in fighting the 100% penalty assessment. In remanding the case back to the Texas district court that issued the original anti-taxpayer decision for reconsideration, the Fifth Circuit said the physician was only liable for unencumbered funds that he loaned to the practice after he became aware that trust fund taxes had not been paid.

Another question: The taxpayer further claimed that the penalty should be limited to the \$100,000 that he personally loaned to the practice to pay the staff. The case was remanded back to the Texas district court to resolve this issue. (*Gail McClendon v. U.S.*, Fifth Circuit, 2018)