

*Tax & Business Alert – April 2022*

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**Abstract:** There's a harsh tax penalty that business owners could have to pay personally if they own or manage a business with employees. It's called the Trust Fund Recovery Penalty and it applies to the Social Security and income taxes required to be withheld by a business from the wages of its employees. This article looks at the risk and explains how business owners, managers and other involved parties can avoid incurring the penalty.

## **Could you be hit with the Trust Fund Recovery Penalty?**

There's a harsh tax penalty that you could be personally responsible to pay if you own or manage a business with employees. It's called the Trust Fund Recovery Penalty. It applies to the Social Security and income taxes required to be withheld by a business from the wages of its employees.

Because taxes are considered property of the government, the employer holds them in "trust" on the government's behalf until they're paid over. The penalty is also sometimes called the "100% penalty" because the person liable and responsible for the taxes can be penalized 100% of the taxes due. Accordingly, the amounts the IRS seeks when the penalty is applied are usually substantial, and the IRS is aggressive in enforcing the penalty.

### **A wide-reaching penalty**

The Trust Fund Recovery Penalty is among the more dangerous tax penalties because it applies both to a broad range of actions and to a wide range of people involved in a business.

Here are some questions and answers to help you avoid incurring the penalty.

**What actions are penalized?** The Trust Fund Recovery Penalty applies to willful failures to collect or truthfully account for and pay over Social Security and income taxes required to be withheld from employees' wages.

**Who is at risk?** The penalty can be imposed on anyone "responsible" for collection and payment of the tax. This has been broadly defined to include corporate officers, directors and shareholders who are under a duty to collect and pay the tax, and a partnership's partners or any employee of the business with such a duty. Even voluntary board members of tax-exempt organizations, who are generally exempt from responsibility, may be subject to this penalty under certain circumstances. In some cases, responsibility has even been extended to family members close to the business, and to attorneys and accountants.

According to the IRS, responsibility is a matter of status, duty and authority. Anyone with the power to see that the taxes are (or aren't) paid may be responsible. There's often more than one responsible person in a business, but each is at risk for the entire penalty. You may not be

directly involved with the payroll tax withholding process in your business. But if you learn of a failure to pay over withheld taxes and you have the power to pay them but instead you make payments to creditors and others, you become a responsible person.

Although a taxpayer held liable can sue other responsible people for contribution, this action must be taken after the penalty is paid, entirely on his or her own. It isn't part of the IRS collection process.

**What is considered “willful?”** For actions to be willful, they don't have to include an overt intent to evade taxes. Simply bending to business pressures and paying bills or obtaining supplies instead of paying over withheld taxes that are due to the government is willful behavior. The IRS specifically defines “willfully” in this instance as “voluntarily, consciously and intentionally” paying other expenses instead of the withholding taxes.

Just because you delegate these responsibilities to someone else doesn't necessarily mean you're off the hook. Your failure to deal with the task yourself can be treated as the willful element.

### **Never borrow from taxes**

Under no circumstances should you ever fail to withhold taxes or “borrow” from withheld amounts. All funds that have been withheld from employee paychecks should be paid over to the government in full and on time. Contact us with any questions about making tax payments.