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THE TRUST FUND RECOVERY PENALTY

The Trust Fund Recovery Penalty (“100% penalty”) is frequently encountered when a business suffers from cash-flow problems. If customers or clients are slow to pay, accounts receivable may increase, causing a corresponding decrease in available cash to pay vendors and suppliers necessary for daily operations. At such times, the responsible person may decide to pay creditors with the trust fund taxes that are due the government. In essence, the responsible person makes the government a short-term lender, with the expectation that receivables will increase before the government notices and has the opportunity to act.

While the responsible person may feel, at the time, as though he or she is proceeding under a prudent course of action, the government will impose personal liability for the unpaid employment taxes. Rather than borrowing the trust fund taxes, the responsible person should negotiate payment terms with vendors if possible, and pay the trust fund taxes to avoid personal liability. If the business fails, shareholders usually will not be liable for the corporation’s debts. If the trust fund taxes are not paid, the business may still fail and the shareholders will be held liable for the unpaid trust fund taxes.



RESPONSIBLE PERSONS AND WILLFULNESS

The government bears the burden of proving that an individual was a “responsible” person who willfully failed to collect, account for, and pay employment taxes. The IRS will assess the penalty against every person it deems “responsible”, and seek to recover the amounts due, jointly and severally, from those persons. Once the IRS determines who are responsible, the burden shifts to the individuals to prove that they did not willfully fail to collect, account for, and pay the employment taxes. Civil and criminal penalties may also apply.

Courts have broadly interpreted the term “responsible person” to include those with the ultimate authority of selection and timing of creditor payments, control of the decision-making process regarding creditor payments, and authority over the financial affairs of the corporation. The existence of “significant control” over the disbursement of funds is sufficient, and under certain circumstances, lenders and employees of lenders have been held “responsible”.

The term “willfulness” has been defined as a “voluntary, conscious, and intentional decision to prefer other creditors to the United States.” Neither a bad motive nor a specific intent to defraud the government is a necessary element; knowledge of the duty has been held to satisfy the willfulness requirement. Although at least one U.S. Circuit Court of Appeal (the 10th) has recognized a “reasonable cause” defense, no taxpayer has yet prevailed with it in that Circuit.

The I.R.S will attempt to collect the taxes from responsible persons if the tax liability is not satisfied by the business. Further, the I.R.S. is not always required to attempt collection from the business before assessing a responsible person because the trust fund penalty is separate and distinct from the tax liability of the business.

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We can help you establish reasonable payment terms with the I.R.S., while you concentrate on increasing revenues. In some cases, we can help you establish another business. We can always help you stay in compliance with federal tax laws and regulations, which is the best way to exist harmoniously with the I.R.S.

If you think you may become a target for the Trust Fund Recovery Penalty, call us as soon as possible. The sooner we become involved, the better off you will be.

For more information about this topic or other business-related issues, please call TOLL FREE, 866-607-8260.

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