



# LGT

---

## FINANCIAL FOCUS



Lane Gorman Trubitt, L.L.P.  
Accountants & Advisors

## Your Accounting for a New Economy

# Restaurant Entrepreneur Liable for Trust Fund Penalty: The Case of Charles Erwin

By Erica Grammont, Marcum, LLP

In the recently decided United States Court of Appeals Case of Charles Erwin, the court found that despite the outsourcing of its payroll function, the company was liable for the unpaid trust fund balances that the payroll company neglected to pay. This decision allowed the IRS to collect 100% of the unpaid trust fund taxes and the interest penalties that ensued from the responsible party's failure to pay.

Under the Internal Revenue Code, employers are mandated to withhold social security and federal excise taxes from employees' paychecks. Withholdings, while in the possession of the employer, are considered to be trust fund taxes since the employer is acting as a trustee on behalf of the government until the funds are submitted.. It is unlawful for employers to willfully fail to remit trust fund taxes (commonly referred to as payroll taxes) to the IRS. A person can be held personally liable for the trust fund taxes if they were responsible for the accounting, collection, and payment of these taxes. Nevertheless, the responsible person concept does not only apply to the person performing payroll duties, but it extends to those key individuals who have a legally imposed duty to make tax payments. This duty is generally found in corporate officers who have authority over the financial affairs of the company. Some factors considered when determining responsible party include:

- serving as an officer or director of the company
- controlling of the company's payroll
- determining which creditors to pay and when to pay them
- participating in the day to day management of the company
- ability to hire and fire employees
- authority to write checks

In the case, *Erwin V. US*, the Court of Appeals for the Fourth Circuit found Erwin personally liable for the company's unpaid trust fund taxes. When deciding, the courts took into consideration the fact that Charles Erwin

served as the director, vice president, secretary, and treasurer for a restaurant franchise of which he owned one-third of the interest. In addition, Mr. Erwin negotiated the payments to creditors and participated in the company's business operations; including the hiring and firing of employees.

This decision became precedent. The Circuit court is cited as stating that once a responsible party becomes aware of unpaid taxes, the duty falls on them to use all current and unencumbered funds to pay the taxes before any of its operational expenses are paid.

In December 1998, it was brought to the attention of Erwin and his partners that the trust fund taxes for the third quarter of 1998 were not paid. At that point Erwin and his partners made a capital contribution to cover the cost of the tax deficiency. The accounting company hired to handle the restaurant payroll was instructed to make all tax payments in a timely fashion. However, the accounting company neglected to pay out the trust fund taxes for the first three quarters of 1999. Once again, the partners made a capital contribution to help minimize the outstanding tax bill but this contribution did not eliminate the debt. As the company continued to thrive, with sales revenue reaching \$5 million, the company paid rental and vendor expenses but the tax owed to the IRS for the delinquent payroll bill was never repaid.

Despite the fact that Erwin and his partners outsourced the company's payroll duties, in the opinion of the courts, Erwin was still found personally liable for the trust fund taxes.

As a result of this decision, it is imperative for corporate officers to confirm that the trust fund taxes of the corporation are actually paid. Since, penalties and unexpected costs may be incurred if the trust fund taxes are not paid in a timely fashion, employer(s) should make note of when the trust fund taxes are due. For more information on the trust fund taxes and due dates visit <http://www.irs.gov/businesses/small/article/0,,id=98818,00.html>.

**Source: Marcum, LLP**

Jason Leary  
Marketing Manager

**Lane Gorman Trubitt, L.L.P.**