

PRESIDENT/CEO OF PARENT CO. NOT LIABLE FOR TRUST FUND TAXES OF SUBSIDIARY

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Is the President/CEO of a parent, holding company, who had check signing authority of subsidiary's checks, responsible for the trust fund recovery penalty for nonpayment of the subsidiary's withholding taxes? The Third Circuit District Court, in *Kilraine v. U.S.*, 105 A.F.T.R.2d 2010-745 (D.N.J), said no; the holding company, as an independent legal entity, will not be imputed to have knowledge of information conveyed by the IRS to the subsidiary's representatives.

Taxpayer, Joseph Kilraine, was not liable for the trust fund recovery penalty assessed against him for unpaid withholding taxes from two companies, Ambric and Shah. Kilraine was the President and CEO of GA Group, the holding company of Ambric Group ("Ambric") and Shah Associates Engineering ("Shah"). He also served as a consultant to Ambric and Shah after they filed for Chapter 11 bankruptcy protection. The nature and extent of Kilraine's duties with regard to Ambric and Shah was disputed by the parties. The Government asserted that Kilraine was very involved in the management of the companies and helped decide which bills to pay, while Kilraine asserted that he had no role in the day-to-day activities of Ambric and Shah.

At some point Kilraine learned that Ambric and Shah were delinquent in paying the withholding taxes to the IRS. It is disputed as to when he gained that knowledge; Kilraine claimed that he first heard of the delinquency in March 2003 when he received a call from an IRS agent. The Government asserted that Kilraine was notified of the payroll tax delinquency on May 31, 2000 when the IRS informed Ambric and Shah's counsel through a filing in the bankruptcy proceeding. Additionally, the Government asserted that he "should have known" of the delinquency far earlier.

Citing *Quattrone v. IRS*, 895 F.2d 921, 928 (3rd Cir. 1990), the court reasoned that to be held liable under IRC § 6672, a person must (1) be a responsible person required to collect, truthfully account for, or pay over the trust fund taxes; and (2) willfully have failed to collect, account for, or pay over the trust fund taxes. See also IRC § 6672. The court declined to decide whether Kilraine was a responsible person or not because the issue was brought before the court by a motion for summary judgment, and there were material issues of fact which could not be resolved on summary judgment.

But the court did say that responsibility under Section 6672 is a matter of status, duty, or authority, not knowledge, "...A person may be deemed responsible where he has significant control over the disbursement of corporate funds." The Court cited *United States v. Vespe*, 868 F.2d 1328, 1332 (3rd Cir. 1989) as the source of this proposition. The court identified seven factors that the Third Circuit considers in determining whether an individual has the requisite amount of control to be considered a responsible person. The factors are: (1) the contents of the corporate bylaws, (2) ability to sign checks on the company's bank account, (3) signature on the employer's federal quarterly and other tax

returns, (4) payment of other creditors in lieu of the United States, (5) identity of officers, directors, and principal stockholders in the firm, (6) identity of individuals in charge of hiring and discharging employees, and (7) identity of individuals in charge of the firm's financial affairs. In practice, the IRS assesses the trust fund recovery penalty against all persons in the organization who have check signing authority. Significantly, the court here suggested that check signing authority may be discounted if it was "purely ministerial in nature."

Ultimately, the court determined that Kilraine was not liable for the trust fund penalty because the facts did not support the assertion that he acted willfully. The Government maintained that Kilraine acted willfully because he allowed other creditors to be paid with reckless disregard for whether the mandatory payroll taxes had been paid to the IRS. Under Third Circuit precedent, reckless disregard is established when the taxpayer: (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easily. See *Vespe*, 868 F.2d at 1335. The Government contended that its filing in Ambric's bankruptcy court proceeding requesting additional information to determine if pre- and post-petition employment taxes had been paid supports the reckless disregard theory of liability. The request was served on Ambric's outside debtor's counsel. The Government stated that, ***given his position as President and CEO of GA Group***, Kilraine should have known that there was a grave risk that taxes were not being paid based on the bankruptcy filing. The court refused to impute knowledge to Kilraine saying "Nothing in the record demonstrates that GA Group, as an independent legal entity, can be imputed to have knowledge conveyed by the IRS to Ambric's outside legal counsel." The court's footnote 2 cited two cases supporting its theory of separate legal entities. This holding is significant since established IRS procedure is to routinely hold officers of a parent company liable for trust fund taxes by imputing knowledge to officers due to their positions of authority in the parent company.

The Government next contended that Kilraine had knowledge, or should have had knowledge, of the bankruptcy request because he was employed as a consultant at this time for Ambric. There was no demonstration that Ambric's legal counsel informed Ambric's employees of this particular filing in the bankruptcy court, and the court found that to be significant.

The Government made two more claims stemming from Kilraine's position as President and CEO of the parent company. Kilraine signed the payroll tax payment checks and gave them to an employee for mailing. The checks, evidently, were never mailed. The Government pointed to these facts to prove Kilraine's willfulness stating that Kilraine was obligated to ensure that the employee walked the checks to the mailbox, "Kilraine's position as President and CEO ... placed him in a position to put in place a procedure to ensure the payroll tax deposits were mailed out" More importantly, the Government further attempted to show Kilraine's "reckless disregard" by stating, in an argument used routinely in practice, that Kilraine could have checked Ambric and Shah's monthly operating reports at any time to verify that the payroll tax checks cleared.

The court found the Government's arguments insufficient to show that Kilraine "clearly ought to have known that there was a grave risk of nonpayment:"

The facts in the record speak to the contrary ... Kilraine either considered the taxes to be paid or at worse, was negligent in failing to realize that the employee was not mailing the checks. Regardless, neither of these states of mind fit the definition of "willfulness," since willfulness is more than negligence.

Kilraine's position as President and CEO of GA Group was not enough to impute knowledge about the subsidiary to him. He, as President and CEO, also was not obligated to put in place a procedure to ensure the payroll tax deposits were mailed out. Lastly, Kilraine was not required to check the subsidiaries' monthly operating reports to verify that the payroll checks cleared. Willfulness requires the Government to demonstrate that Kilraine clearly ought to have known of a grave risk that the withholding taxes were not being paid. Kilraine was at most negligent in his failure to pay the withholding taxes. A negligent failure to pay is excusable, and Kilraine was not liable for the trust fund recovery penalty, according to the Third Circuit District Court.

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