

Personal Liability for Employment Taxes Can Spoil Your Day

By Robert W. Wood

We all have to pay taxes, but we often don't take responsibility for anything but our own personal income taxes. That can be a mistake. Indeed, if you're in practice with a firm or even as a solo practitioner with just one employee, you should be aware of employment tax responsibilities and liabilities. That's so even if you farm that work out to others or to a payroll service.

The same is true for in-house counsel working for a company, particularly if you are a corporate officer. In fact, employers of all sizes need to know about personal liability for payroll taxes. It is the employer's responsibility to withhold federal and state income and employment taxes from payroll. All types of employers — corporations, partnerships, LLCs and even proprietorships — have these obligations.

Withheld tax monies are "trust fund" taxes belonging to the state and federal government. "Trust fund" can sound pleasing to the ear, as in "trust fund babies." But here it has a decidedly negative ring. You shouldn't use the money for something else, no matter how desperately you may need to pay creditors.

Inevitably, some businesses get into trouble by withholding the tax money but not sending it to the Internal Revenue Service and the state. If the business is failing, is it okay to pay the rent, vendors and utility bills to keep the lights on? Keeping the business open is more important than paying the IRS, right? Besides, the IRS will get its money later before they figure it out....

Needless to say, this is very dangerous. Nevertheless, thousands of businesses fall into this trap every year, especially in a rocky economy. When trust fund taxes don't show up, the IRS will pursue the business to collect. The IRS can even padlock the business to stop the bleeding.

This can be one good reason to use a payroll service. A payroll service normally will deduct your payroll in full from your business bank account when it cuts payroll checks. That way you avoid the temptation of ever getting your hands on withheld tax monies. The payroll service will send it directly to the IRS and state.

If a business fails to pay payroll taxes, it isn't only the business that is liable. The IRS can assess a trust fund recovery assessment, also known as a 100 percent penalty, against each and every "responsible person." Typically, the IRS continues trying to collect from the company and tries to collect the 100 percent penalty from every officer. The assertion of personal liability against the owners and managers of a business is a potent IRS weapon.

If there are six officers, the IRS will simultaneously try to collect the tax plus 600 percent in penalties from these six responsible persons. Some responsible persons try to sic the IRS on other more solvent or more visible responsible persons. That can be a clever strategy for executives caught within the "responsible person" net. You might be able to show that other wealthier and more liquid (or more culpable) officers are waiting in the wings. Fortunately, the IRS can collect only once. Thus, there can be scrambles to avoid liability that end up looking like a rugby scrum.

The IRS position is that every officer is responsible, and that some non-officers with signature authority are too. Trying to show you simply weren't responsible is usually a losing battle. You might consciously pay someone else ahead of the IRS to keep the business afloat. You might have no actual knowledge the IRS is not being paid. Either way, if you had signature authority and *could* have paid the IRS, you're responsible. Some people in this precarious situation demand written assurances



from their company that payroll taxes are being timely deposited with the IRS and the state. Others might resign from their jobs over this issue, especially upon discovering that there is an outstanding liability and that they have had signature authority in the past, even if they did not exercise it and had no knowledge of the payroll tax default.

Resigning may sound extreme, but it's not an overreaction. If you've ever been in one of these disputes, you probably will not want to be in another. In a tough economy, it's even more important to be vigilant.

Suppose you didn't even know you had a payroll? You knew (or thought you knew) that your workers were independent contractors so you didn't have to withhold. It turns out your independent contractors are really employees, so you did have a payroll after all. Since you failed to withhold and pay the trust fund taxes to the IRS, you're on the hook personally.

The IRS and the state are both cracking down on the use of independent contractors, and with good reason. It's vastly cheaper for companies to have independent contractors than to have employees. When taxing jurisdictions find that businesses have inappropriately avoided payroll taxes, the taxes, interest and penalties can be severe. Moreover, these worker status problems lead directly into payroll tax problems, and that can mean personal liability.

Suppose a law firm treats 10 lawyers as independent contractors, so it pays them via gross checks with no income or employment tax withholding. Then suppose the IRS recharacterizes them, ruling them to be employees. Since the firm didn't withhold or pay any taxes on these wages, there will be an assessment against the firm for taxes, penalties and interest. If the firm does not or cannot pay — or is simply slow in do-

ing so — the IRS can assess a 100 percent penalty (equal to the entire amount of trust fund taxes) against each responsible person. That may include all partners, and would certainly include officers.

Thus, personal liability for trust fund taxes can sneak up on you. You're likely to know that payroll taxes for employee wages must be sent to the IRS. You may be a partner or officer and have legal responsibility, even though you have someone within your organization who actually handles such matters. Thus, you may be unaware that money isn't going to the IRS or the state and is instead going to other creditors. You may not even know what lines are drawn between independent contractors and employees. Nevertheless, you can end up with personal liability.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.



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Five Tips for Suppliers Selling to Europe

By Christopher J. Kunke

For a U.S. supplier looking to "go global," Europe is often an attractive market. When selling products to Europe, however, a supplier must heed the European Union's strict competition laws. Practices such as retail price maintenance and exclusivity, which may be acceptable in the United States, are prohibited in the European Union.

The European Union is a trade bloc comprised of 27 European countries and nearly 500 million people. A primary goal of the European Union is to remove trade barriers among member countries. To that end, the European Union's principal treaty generally prohibits agreements that hinder free trade, and various E.U. laws and guidelines specify the types of prohibited agreements. Violations of E.U. laws can lead to stiff fines, some of which are calculated based on the supplier's global turnover.

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A U.S. supplier typically cannot circumvent E.U. laws by agreeing with its European agent or distributor that California law will govern the parties' contract. As a result, a supplier should carefully consider the following five issues and revamp its standard U.S. contract before shipping its goods to Europe.

Consider whether to use an agent or distributor: The first question a supplier should ask is: Who should market and sell my products in the target market? Assuming the supplier does not have a presence (e.g., a subsidiary or a branch) in the European target country, the supplier needs to find someone with a presence in the local market to generate product interest and to sell the products. The local insider should be familiar with sales channels, effective advertising practices, competing products, local laws, etc. The two most common types of such insiders are agents and distributors. An agent negotiates orders on behalf of the supplier and submits the orders to the supplier for fulfillment. A distributor purchases the products and resells them. A supplier's obligations to agents versus distributors differ dramatically under E.U. law.

The European Union's Commercial Agents Directive governs suppliers' obligations towards agents. Most significantly, a supplier must pay its agent upon termination of the relationship, even upon the expiration of the parties' agreement or the death of the agent. Agents have the right to either an "indemnity" or "compensation" upon termination based on each E.U. country's law implementing the Commercial Agents Directive. An indemnity is remuneration for the increased customer base and good will generated by the agent. The indemnity is capped at one year of the agent's commission based on the average commission earned in the preceding five years (or less if the agent's duration is under five years). In addition to the indemnity, the agent is entitled to damages if the supplier breaches the parties' contract in connection with the termination. Compensation is a payment for all damages incurred by termination of

the agreement. Compensation is not limited to a certain time period or amount — the agent is entitled all damages caused by the termination. Compensation accounts for anticipated commissions, the inability to amortize marketing costs, etc. Generally, a supplier will pay less by providing an indemnity upon termination in the agency agreement.

Agents have significant additional rights under the Commercial Agents Directive. An agent has the right to a written agreement. If the agreement does not state the agency's duration, the agent is entitled to a minimum notice period prior to termination. If the agreement does not state the agent's commission, the agent is entitled to a reasonable commission. The agent is entitled to be paid its commission by the last day of the month after the quarter year in which the agent earned the commission. The agent is entitled to payment unless the purchaser will not pay the supplier and the supplier is not to blame. The agent is also entitled to a commission for certain sales completed after termination.

The Commercial Agents Directive does not apply to distributors, but labeling an agreement "Distribution Agreement" and selling the products to the distributor does not ensure that a local European court will not apply the Commercial Agents Directive. If a supplier has too much control over the distributor, the court may construe the relationship as an agency and apply the Commercial Agents Directive. Therefore, a supplier should refrain from insisting on the control of advertising practices, the right to the distributor's customer list, the right to fulfill Internet orders, the right to the distributor's intellectual property related to the products, etc.

The Commercial Agents Directive favors suppliers who engage agents in one regard: An agency agreement may prohibit the agent from selling competing products in the agent's territory for two years after termination of the agency. As discussed below, E.U. laws on vertical restraints, which apply to distributors but not agents, generally prohibit noncompete obligations after termination.

In sum, a supplier should carefully consider the potential financial rewards and liability associated with an agent as opposed to a distributor.

Do not (directly or indirectly) dictate the resale price: The European Union's vertical restraint laws prohibit a supplier from dictating its distributor's resale price. Similarly, if a supplier sells through an agent directly to a retailer, the supplier may not dictate the retail price. Also, a supplier may not indirectly dictate the distributor's or retailer's resale price by offering incentives or intimidating the distributor or retailer to sell at a minimum price. Even suggesting a resale price can be a coercive act if the distributor or retailer believe that failure to follow the suggestion will lead to retribution from the supplier.

Do not prohibit all sales outside the distributor's territory. Under E.U. law, a supplier may only restrict a distributor from making "active" sales outside the distributor's assigned territory. A distributor is free to sell to purchasers outside of the territory who approach the distributor (i.e.,

"passive" sales). For example, the supply agreement may not prohibit a French distributor from selling the products at a Paris trade show to an Italian buyer. E.U. guidelines clarify that online sales are "passive" sales. Therefore, a supplier cannot prohibit a distributor from selling online to purchasers outside the assigned territory. Similarly, a supplier cannot mandate that its distributors' Web sites route purchasers to the local distributors' Web sites.

Limit any noncompete obligation: A supplier typically wants to prohibit the distributor from selling competing products. Under E.U. law, with respect to a distributor, a noncompete obligation may not exceed five years and may not automatically renew. If the supplier has engaged an agent, the supplier may prohibit the agent from marketing or selling competing products for two years after termination.

Protect any personal data received: A supplier occasionally needs or wants the personal data of certain customers, subagents or subdistributors, employees, etc. The European Union's Data Protection Directive prohibits the transfer of personal data out of the European Union unless the recipient country ensures adequate protection of the data. The U.S. Department of Commerce has developed a "safe harbor" for U.S. companies to receive such data. If a U.S. company complies with the privacy requirements of the safe harbor, the company can receive a certification of adequate protection for compliance with the Data Protection Directive. In addition, the parties can implement their own safeguard that may satisfy the Data Protection Directive by agreeing in the contract to specific measures to protect the privacy of the data transferred.

In addition to these E.U. laws, a supplier needs to comply with local laws including consumer product, labeling, product testing, health and other laws. Dealing with the morass of E.U. and member state laws is intimidating, but knowledge of the basic competition and sales laws is a thorough contract can prevent exposure to legal liability, government scrutiny, fines and damages. Perhaps more importantly, however, a supplier should spend time vetting potential agents and distributors to find a local representative with the necessary expertise to make the supplier's venture into Europe a success.



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