LAWYERS BLAMING LAWYERS: A TRUST FUND TAX TALE

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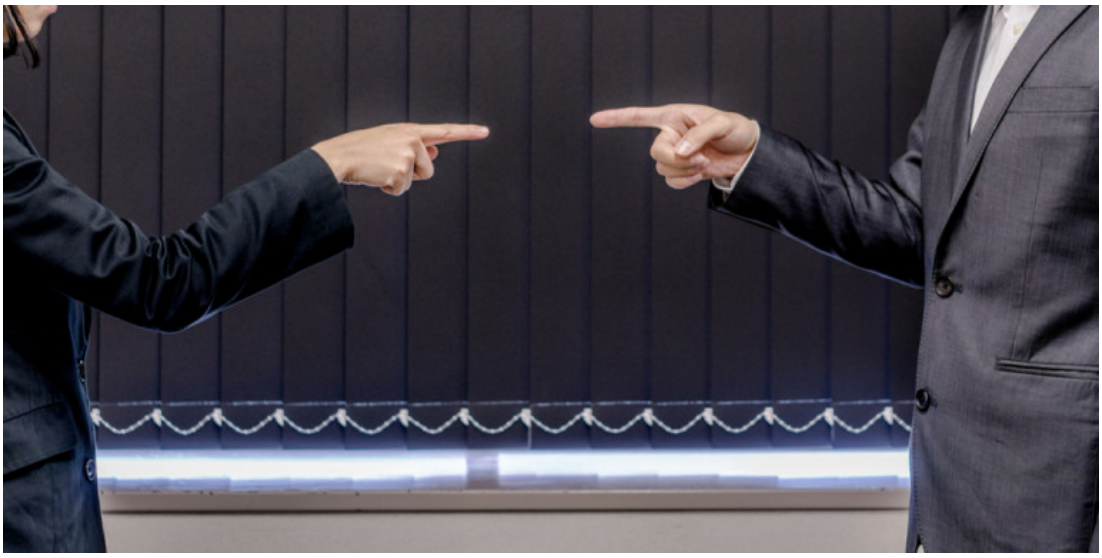

Employers serve as tax collectors under the Internal Revenue Code: In addition to paying its own FICA and FUTA obligations, an employer must withhold FICA and income tax from its employees' pay. *See* I.R.C. §§ 3102 (FICA "shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid"); 3402 ("every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary").

For good measure, Congress included a mechanism to ensure compliance; if an employer fails to withhold and pay over the tax, responsible parties affiliated with the employer can be assessed with the trust fund recovery penalty under section 6672 of the Code, which makes these individuals liable if they willfully fail to assure that the taxes are paid. The determination of who is a responsible party calls for the application of a multi-factor test that varies slightly from circuit to circuit but generally focuses on the ability to make financial decisions over which creditors get paid.

Another common theme in the case law is that you don't have to be the *most* responsible party to be liable. This is nicely illustrated by a recent case from the Southern District of New York involving a law firm. The case arose "from financial decisions made by a law firm during an extended period of financial distress, at least part of which was attributable to larcenous conduct from within." *Spizz v. United States*, No. 15 Civ. 2361 (KPF), 2017 U.S. Dist. LEXIS 198942, *1 (S.D.N.Y. Dec. 4, 2017).

Alex Spizz, Martin Todtman, and Barton Nachamie were shareholders in a law firm organized as a professional corporation, and each held a one-third equity interest in the firm. *Id.* at *3. The firm failed to pay trust fund taxes for three quarters in 2009, two quarters in 2010, one quarter in 2011, and one quarter in 2012. *Id.* at *4.

Todtman was the founder of the firm, and he operated as its managing officer, handling most of its financial matters and signing its tax returns. When the firm fell behind on its trust fund taxes in 2009, the firm's

accountant raised the issue only with Todtman, who replied that "he . . . could not pay his taxes and pay the bills of the firm, so he was making a hard choice." *Id.* at *6.

Spizz was a shareholder holding the title of vice president, and he had authority to sign checks. *Id.* at *7-*8. Prior to June 2010, Spizz only signed checks with Todtman's authorization. *Id.* at *8. On June 10, 2010, Spizz learned that the firm had failed to pay its trust fund tax obligations when a tax lawyer at the firm asked him to sign an offer in compromise designed to resolve the liability. *Id.* at *8-*9. At that point, Spizz conferred with Nachamie, the third shareholder, and they jointly revoked Todtman's managerial authority. *Id.* at *9.

Initially, Spizz and Nachamie jointly managed the firm, but Spizz then left Nachamie in charge. *Id.* This proved to be an unfortunate choice: The firm again fell behind on its tax obligations; moreover, as Spizz would later learn, Nachamie had been stealing from the firm.

On April 13, 2012, Spizz learned that the firm was delinquent on its trust fund taxes again when the firm's accountant copied him on an email to Nachamie; the accountant wrote that he would no longer handle the firm's work because of its failure to pay its taxes. *Id.* at *11. At that juncture, Spizz took over the firm's financial management; he also obtained an affidavit from Nachamie which indicated that Nachamie was responsible for the firm's 2011 and 2012 trust fund taxes. Then in 2013, Spizz noticed a discrepancy in an escrow account, which ultimately resulted in the discovery that Nachamie had stolen almost $1 million from the firm. *Id.* at *12-*13. Nachamie was prosecuted, convicted, and incarcerated. Afterwards, Nachamie filed for bankruptcy; while the firm's judgment against him was non-dischargeable, the IRS accepted an offer in compromise that applied to both his personal tax obligations and his liabilities for trust fund taxes. *Id.*

After being assessed for the trust fund recovery penalty as to all of the firm's outstanding trust fund taxes, Spizz filed a refund case challenging that assessment. The government filed a third-party complaint against both Todtman and Nachamie, although it dismissed Nachamie once his offer in compromise was accepted. *Id.* at *15-*16. Then the government filed a motion for summary judgment; it sought a judgment against Todtman and Spizz, jointly and severally, for the remaining taxes due for 2009 and 2010, and a judgment against Spizz for the outstanding 2011 and 2012 taxes. *Id.* at *16.

The district court readily determined that the government was entitled to prevail against Todtman, but the case against Spizz was more complex. Spizz initially argued that Todtman and Nachamie were the responsible parties, but the court was not persuaded, noting his ownership interest, his position as an officer, and his role in eliminating Todtman's authority. *Id.* at *24-*26. In the court's view, this was not a case where someone with a nominal title lacked sufficient authority to be a responsible party. *Id.* at *26. Accordingly, it concluded Spizz was responsible as well: "What Spizz overlooks are the many cases making plain that '[a] person may be a "responsible person" without being *the most* responsible person.'" *Id.* (quoting *Beeler v. United States*, 894 F. Supp. 761, 770 (S.D.N.Y. 1995)) (emphasis by the court).

The question whether Spizz acted willfully was a much closer call, particularly for the liability that accrued before June 10, 2010, when Spizz first learned that the firm's taxes were not being paid. The court determined that Spizz had established a defense up to that point, recognizing that he could not act willfully if he did not know the taxes were not being paid. The court concluded that Spizz was responsible for the taxes as of June 10, 2010 because the firm had unencumbered funds at that point that could have been applied to the tax liability. *Id.* at *33 (citing *Winter v. United States*, 196 F.3d 339, 345-46 (2d Cir. 1999)).

Spizz had argued that the firm's funds as of June 10, 2010 were encumbered by a lien in favor of its lender and thus could not be applied to the overdue taxes. Although the issue is an open one in the Second Circuit, a number of other courts have taken the view that only a legal prohibition upon use of specific funds, such

as a directive from a lender, will permit an otherwise responsible party to escape responsibility upon learning that trust fund taxes were not paid. The district court elected to follow that approach, holding that a lien alone was not enough. *Id.* at *33-*34.

There is a gap, however, in the court's reasoning: The record disclosed that there were roughly $60,000 in unencumbered funds on June 10, 2010, *id.* at *34-*35, but the failure to apply those funds made Spizz liable for over $500,000 in trust fund taxes he had previously believed were being paid. Many courts take the view that someone who was a responsible party at the time the payroll taxes became due has a duty not only to use unencumbered assets on hand to reduce the outstanding taxes when he learns of the delinquency but to continue to do so on an ongoing basis. *See, e.g., Mazo v. United States*, 591 F.2d 1151, 1157 (5th Cir. 1979). Under this line of authority, Spizz would be responsible to the extent that there were future unencumbered assets sufficient to satisfy the outstanding taxes due. For whatever reason, the court's opinion does not address the issue.

As for the period after he learned of the delinquency, Spizz sought to argue that he reasonably relied on Nachamie, but the court rejected that contention, noting that "courts have found willfulness where a responsible person fails to assure that a company timely remits trust fund taxes after having notice of previous tax delinquencies." *Spizz*, 2017 U.S. Dist. LEXIS 198942 at *36 (citing *Winter*, 196 F.3d at 345). Here, the court's opinion rests on very solid ground.

Much of this seems unfair to Spizz; prior to June 10, 2010, Todtman was obviously more responsible for the delinquencies than Spizz, and Nachamie also appears to be more responsible for the subsequent periods. After all, both of them actually decided to apply tax money to other purposes. While the concern is valid, there are two answers to it:

- *First*, to the extent he pays, Spizz can seek contribution or indemnity from Todtman and Nachamie, although a claim against the latter may well be a waste of time.
- *Second*, section 6672 is not designed to operate fairly, it is designed to operate effectively. As a consequence, the least responsible party can wind up bearing the bulk of the liability.

Spizz v. United States highlights the tough choices an officer faces upon learning that trust fund taxes are unpaid. Spizz had threatened to leave the firm if Todtman did not surrender control over its finances. At this juncture, he probably wishes that he had.

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