In God We Trust, All Others Must Deposit With Us—Payroll Tax Trust Funds
March 18, 2006

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Payroll Tax Trust Funds

The IRS and Social Security Administration, in the March issue of the *SSA/IRS Reporter*, have an article on employer's responsibilities when outsourcing—an article that was very timely given the recent case of *Pediatric Affiliates, P.A., Plaintiff v. United States of America, et al., Defendants* (2006-1 USTC ¶50,201) that was decided in the United States District Court in New Jersey where an employer was held liable for the amounts that a payroll tax service had failed to pay over to the IRS.

As well, we're going to look at the more general issue of the trust fund recovery penalty under §6672.

Trust Fund Penalties

The general trust fund penalties are found in §6672(a) which provides:

> **6672(a) GENERAL RULE.** —Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such

> tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

The key question that arises is when is the failure "willful" since that gives rise to a personal liability.

In a recent case decided in the United States District Court for the Eastern District of California (*Savage v. United States*, 2006-1 USTC ¶50,202) the court looked at that very issue and, as we'll find, had a problem when the person, once discovering there were unpaid trust fund taxes, attempted to "take back" the funds he had advanced the corporation to pay its debts—in essence, he became a creditor of the corporation whom, it was deemed, he then paid instead of paying the trust fund taxes over. However, his liability was not limited just to the funds he had been repaid, which indicates a major problem in this area, especially where the Ninth Circuit's views on this matter apply.

Payroll Services

Many of our clients use payroll services, such a Paychex and ADP, to pay their payroll taxes. In that arrangement, generally the payroll tax provider takes on the responsibility of assuring that payroll tax deposits are made.

However, a number of cases have arisen where various fly by night payroll services have failed to make the payroll tax deposits even though they went ahead and took the funds from their clients—perhaps even running a scam where they had no intention of ever making a payroll tax deposit.

The article noted above indicates the IRS and SSA's position that in a such a case the employer is still responsible for paying the taxes—and so may need to pay twice. The *Pediatric Associates* opinion arrives at the same conclusion. The article in the *SSA/IRS Reporter* contains some advice on steps employers may wish to take in order to help assure they do not run into this problem. Such steps include:

- Make sure the address of record for the account remain that of the employer and not be changed to the payroll service provider. A provider may suggest allowing that to happen would be more convenient, but it also means the employer may not find out until there is a substantial debt built up that there is a problem
- Ask the provider if they have a fiduciary bond in place. I would note that just asking may not do much if a fraud is being run, since just saying "yes we have one" is fairly easy if the goal is to get the money from the ~~sucker~~ client.
- Ask the payroll service to use EFTPS to deposit the taxes and have the taxpayer confirm that payments are made.

I would add it makes to do some background checking on the payroll service provider since the employer is entrusting them with not only their funds, but also a significant amount of

highly sensitive information that could be very valuable to those wanting to steal identities.

Section 6672

SEC. 6672. FAILURE TO COLLECT AND PAY OVER TAX, OR ATTEMPT TO EVADE OR DEFEAT TAX.

6672(a) General Rule. —Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 or part II of subchapter A of chapter 68 for any offense to which this section is applicable.

6672(b) Preliminary Notice Requirement. —

6672(b)(1) In general. —No penalty shall be imposed under subsection (a) unless the Secretary notifies the taxpayer in writing by mail to an address as determined under section 6212(b) or in person that the taxpayer shall be subject to an assessment of such penalty.

6672(b)(2) Timing of notice. —The mailing of the notice described in paragraph (1) (or, in the case of such a notice delivered in person, such delivery) shall precede any notice and demand of any penalty under subsection (a) by at least 60 days.

6672(b)(3) Statute of limitations. —If a notice described in paragraph (1) with respect to any penalty is mailed or delivered in person before the expiration of the period provided by section 6501 for the assessment of such penalty (determined without regard to this paragraph), the period provided by such section for the assessment of such penalty shall not expire before the later of —

6672(b)(3)(A) the date 90 days after the date on which such notice was mailed or delivered in person, or

6672(b)(3)(B) if there is a timely protest of the proposed assessment, the date 30 days after the Secretary makes a final administrative determination with respect to such protest.

6672(b)(4) Exception for jeopardy. —This subsection shall not apply if the Secretary finds that the collection of the penalty is in jeopardy.

6672(c) Extension of Period of Collection Where Bond Is Filed. —

6672(c)(1) In general. —If, within 30 days after the day on which notice and demand

of any penalty under subsection (a) is made against any person, such person —

6672(c)(1)(A) pays an amount which is not less than the miminum amount required to commence a proceeding in court with respect to his liability for such penalty,

6672(c)(1)(B) files a claim for refund of the amount so paid, and

6672(c)(1)(C) furnishes a bond which meets the requirements of paragraph (3),

no levy or proceeding in court for the collection of the remainder of such penalty shall be made, begun, or prosecuted until a final resolution of a proceeding begun as provided in paragraph (2). Notwithstanding the provisions of section 7421(a), the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court. Nothing in this paragraph shall be construed to prohibit any counterclaim for the remainder of such penalty in a proceeding begun as provided in paragraph (2).

6672(c)(2) SUIT MUST BE BROUGHT TO DETERMINE LIABILITY FOR PENALTY. —If, within 30 days after the day on which his claim for refund with respect to any penalty under subsection (a) is denied, the person described in paragraph (1) fails to begin a proceeding in the appropriate United States district court (or in the Court of Claims) for the determination of his liability for such penalty, paragraph (1) shall cease to apply with respect to such penalty, effective on the day following the close of the 30-day period referred to in this paragraph.

6672(c)(3) BOND. —The bond referred to in paragraph (1) shall be in such form and with such sureties as the Secretary may by regulations prescribe and shall be in an amount equal to $1^1/_2$ times the amount of excess of the penalty assessed over the payment described in paragraph (1).

6672(c)(4) SUSPENSION OF RUNNING OF PERIOD OF LIMITATIONS ON COLLECTION. —The running of the period of limitations provided in section 6502 on the collection by levy or by a proceeding in court in respect of any penalty described in paragraph (1) shall be suspended for the period during which the Secretary is prohibited from collecting by levy or a proceeding in court.

6672(c)(5) JEOPARDY COLLECTION. —If the Secretary makes a finding that the collection of the penalty is in jeopardy, nothing in this subsection shall prevent the immediate collection of such penalty.

6672(d) RIGHT OF CONTRIBUTION WHERE MORE THAN 1 PERSON LIABLE FOR PENALTY. —If more than 1 person is liable for the penalty under subsection (a) with respect to any tax, each person who paid such penalty shall be entitled to recover from other persons who

are liable for such penalty an amount equal to the excess of the amount paid by such person over such person's proportionate share of the penalty. Any claim for such a recovery may be made only in a proceeding which is separate from, and is not joined or consolidated with —

6672(d)(1) an action for collection of such penalty brought by the United States, or

6672(d)(2) a proceeding in which the United States files a counterclaim or third-party complaint for the collection of such penalty.

6672(e) EXCEPTION FOR VOLUNTARY BOARD MEMBERS OF TAX-EXEMPT ORGANIZATIONS. —No penalty shall be imposed by subsection (a) on any unpaid, volunteer member of any board of trustees or directors of an organization exempt from tax under subtitle A if such member —

6672(e)(1) is solely serving in an honorary capacity,

6672(e)(2) does not participate in the day-to-day or financial operations of the organization, and

6672(e)(3) does not have actual knowledge of the failure on which such penalty is imposed.

The preceding sentence shall not apply if it results in no person being liable for the penalty imposed by subsection (a).

Savage Case

David S. Savage, Plaintiff v. United States of America, Defendant. United States of America, Counterclaim-Plaintiff v. David S. Savage and Phyliss Savage, Counterclaim-Defendants.

U.S. District Court, East. Dist. Calif.; CIV. S-04-2316 WBS KJM, February 22, 2006.

MEMORANDUM AND ORDER RE: MOTION FOR SUMMARY JUDGMENT

S HUBB, District Judge: Plaintiff David Savage filed suit against the United States seeking a refund of $24.14, paid in partial satisfaction of a tax penalty assessed against him as the person responsible for Precision Construction, Inc.'s ("PCI") failure to pay its payroll taxes. The government responded with a counterclaim against plaintiff and Phyliss Savage to reduce PCI's overdue assessments to a judgment against the named parties. The government now moves for summary judgment on its counterclaim against David Savage pursuant to Federal Rule of Civil Procedure 56.

I. *Factual and Procedural Background*

Plaintiff served as PCI's President and Chief Executive Officer ("CEO") from 1974, when he acquired the company, through December 1998. (Savage Decl. ¶¶2-3.) However, citing health problems including obesity, diabetes, high cholesterol, and gout, plaintiff resigned his position as president on December 31, 1998. (*Id.* ¶4.) Concurrently, John Allison took over as President [1] and counterclaim defendant Phyliss Savage assumed responsibility for PCI's finances as the new Chief Financial Officer ("CFO").

Plaintiff's health problems were not resolved quickly. He suffered a heart attack in February 1999 and an angina attack in September 2000. (*Id.* ¶¶6-7.) On the advice of his doctors, he began an "intensive diet treatment program" that helped him trim down significantly by September 2001. (*Id.* ¶8.) During this time, he was frequently absent from work and did not participate in the day-to-day management of the business. (*Id.* ¶¶6-10.) He did, however, retain the right to sign checks and occasionally exercised this power despite being only marginally involved in the business. (*Id.* ¶5.)

PCI struggled financially during plaintiff's absence. Plaintiff learned in March 2001 that the company suffered a "large net operating loss for the year 2000." (*Id.* ¶11.) He also learned at some point that CFO Phyliss Savage failed to pay federal payroll taxes for the last two quarters of 1998 and the first three quarters of 1999. (*Id.*) Eventually, she resolved these liabilities, but then "began to miss payroll tax payments [again], beginning with the third quarter of 2000 through the end of 2001." (*Id.* ¶¶11, 13.)

Plaintiff received multiple notices regarding this second round of delinquent payroll taxes;

however, Phyliss assured him that the taxes had actually been paid. (Savage Decl. ¶15.) Her accounting books and records, showing that the taxes had been paid in full, were reviewed by PCI's CPA. (*Id.*) Phyliss also "provided a letter, purportedly from the IRS, but later found to be a forgery, stating that the tax[es,] [through December 31, 2000, were] fully paid." (*Id.* ¶16.) Based on this evidence, plaintiff was persuaded that the matter had been resolved and was under control. (*Id.* ¶17.)

Meanwhile, plaintiff resumed active control of the business in August 2001. (*Id.* ¶18.) Discouraged by continuing losses, plaintiff decided to shut down PCI and began selling company assets and settling outstanding accounts. (*Id.*) As part of this process, he learned in December 2001 that PCI's payroll company, Paychex, had stopped making federal tax deposits "in September" because PCI had insufficient funds. (*Id.* at 19.)

Between August, 2001 and January 9, 2002, plaintiff loaned PCI $230,000 of his personal funds to pay off existing debts. (*Id.* at 18.) Two days later, after a visit from Revenue Officer Mike Flath, plaintiff realized that PCI's delinquent payroll taxes dated back to September 2000, not 2001 as he mistakenly believed, based on Paychex's statement in December 2001 that it stopped paying the taxes "in September." (Pl.'s Stmt. of Disputed Facts ¶¶10-11.) Shortly after the discussion with Officer Flath, plaintiff repaid himself $70,000, which the government, as the preferred creditor, objected to as violative of 26 U.S.C. §6672. (Def.'s Mot. to Dismiss 10.)

The government now estimates that PCI's unpaid assessments total $126,103.62. (Reynolds Decl. ¶8.) Plaintiff paid $24.14 on April 23, 2004 and concurrently filed for a refund, alleging that the a portion of the assessment made against him, $27,332.43, was erroneous and illegal. [2] (Compl. ¶8.) Several months later, plaintiff filed suit in federal court pursuant to 26 U.S.C. §6532(a)(1) [3] to collect the refund and abate the tax assessment. (Id. ¶11.) The government answered with a counterclaim, seeking to reduce PCI's overdue assessments to a judgment against plaintiff and Phyliss. The focus of the government's instant motion for summary judgment is its counterclaim.

II. *Discussion*

A. *Legal Standard*

Summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). A material fact is one that could affect the outcome of the suit, and a

genuine issue is one that could permit a reasonable jury to enter a verdict in the non-moving party's favor. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). The party moving for summary judgment bears the initial burden of establishing the absence of a genuine issue of material fact and can satisfy this burden by presenting evidence that negates an essential element of the non-moving party's case. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986). Alternatively, the movant can demonstrate that the non-moving party cannot provide evidence to support an essential element upon which it will bear the burden of proof at trial. *Id.*

Once the moving party meets its initial burden, the non-moving party must "go beyond the pleadings and by her own affidavits, or by 'the depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Id.* at 324 (quoting Fed. R. Civ. P. 56(e)). The non-movant "may not rest upon the mere allegations or denials of the adverse party's pleading." Fed. R. Civ. P. 56(e); *Valandingham v. Bojorquez*, 866 F.2d 1135, 1137 (9th Cir. 1989). However, any inferences drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986).

The substantive law governing a case determines the materiality of a fact. *T.W. Elec. Serv., Inc. v. P. Elec. Contractors Ass'n*, 809 F.2d 626, 630 (9th Cir. 1987). Here, the applicable tax law provides, pursuant to 26 U.S.C. §6672(a), that a person may be liable for penalties assessed against a company that are "equal to the total amount of tax evaded, or not collected, or not accounted for and paid over." A "person" for the purposes of §6672 includes "an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs." 26 U.S.C. §6671(b). Additionally, such individuals must be "responsible" and act wilfully in failing to collect or pay over the withheld taxes. *Davis v. United States* [92-1 USTC ¶50,292], 961 F.2d 867, 869-70 (9th Cir. 1992).

B. *Analysis*

The government here seeks to hold plaintiff personally liable for $126,103.62 [4] as a "responsible person" who wilfully failed to comply with §6672. (See Decl. of Richard Reynolds, Ex. FF (Certificates of Assessment and Payment showing the extent of PCI's overdue taxes)). Plaintiff does not dispute the existence or amount of this assessment. Hotly contested however, are the government's assertions that plaintiff was both a "responsible person" and a willful offender.

1. *Plaintiff as a "Responsible Person"*

The Ninth Circuit has consistently identified persons who have "the final word as to what bills should or should not be paid, and when" as "responsible" persons under §6672. *Purcell v. United States* [93-2 USTC ¶50,460], 1 F.3d 932, 936 (9th Cir. 1993) (quoting *Wilson v. United States* [57-2 USTC ¶10,040], 250 F.2d 312, 316 (9th Cir. 1958)). A person has the final word if that person had "the authority required to exercise significant control over the corporation's financial affairs, regardless of whether he exercised such control in fact." *Purcell* [93-2 USTC ¶50,460], 1 F.3d at 937. In other words, responsibility is a matter of status, duty, and authority, not knowledge. *Davis* [92-1 USTC ¶50,292], 961 F.2d at 873 (upholding the trial court's finding of "responsible person" based on the plaintiff's position as the president, member of the board, and major shareholder, even though the plaintiff had no knowledge of the tax default). "Authority turns on the scope and nature of an individual's power to determine how the corporation conducts its financial affairs; the duty to ensure that withheld employment taxes are paid over flows from the authority that enables one to do so." *Purcell* [93-2 USTC ¶50,460], 1 F.3d at 936.

Plaintiff contests any characterization of himself as a "responsible person" during the relevant time frame, and rather casts himself as passive investor who was plagued by health issues that prevented him from participating in the management of PCI. (Pl.'s Opp'n to Mot. for Summ. J. 7.) Indeed, as a result of his recurring health problems and an intensive weight loss program, plaintiff's physical presence at PCI's corporate office was limited and sporadic. [5] (Savage Decl. ¶¶7-10.) Plaintiff's frequent absences forced the day-to-day management of the company into the hands of Phyliss Savage and John Allison. (Pl.'s Opp'n to Mot. for Summ. J. 2.) However, regardless of these absences, plaintiff does not dispute that, through his title as CEO, he retained significant formal authority in the management of PCI. (Id. at 7-8.) "Courts must look beyond official titles to the actual decision-making process," but they need not ignore them altogether. See Jones [94-2 USTC ¶50,448], 33 F.3d at 1140.

Moreover, plaintiff also describes several instances when he exercised his formal authority to control PCI's financial affairs during the time period at issue. First, plaintiff, as a signatory on the corporate checking account, wrote and signed 27 checks during the relevant 18 month period. [6] (Savage Decl. ¶5.) Second, starting in "mid-2001," plaintiff instructed his CFO to pay some creditors ahead of others. (Latterell Decl. Ex. AA (Pl.'s Resp. to Def.'s Interrog. No. 8).) Third, plaintiff secured a $100,000 loan against his personal residence to fund PCI and, on two other occasions, infused personal funds into PCI that were acquired through the sale of his personal property. [7] (Savage Decl. ¶12.)

In these instances, plaintiff's authority exceeded mere nominal authority. By exercising his ability to write and sign checks, prefer one creditor over another, and supplement corporate accounts with personal funds, plaintiff determined how PCI would conduct its financial affairs. *See Hochstein v. United States* [90-1 USTC ¶50,205], 900 F.2d 543 (2d Cir. 1990)

(holding that the controller of a business who had check-signing authority, made the initial determination of the order in which bills were to be paid, and who requested funds on behalf of the business, is a "responsible person" under §6672). It is of no consequence that this power was exercised infrequently as long as the plaintiff possessed this power during the relevant period. *Purcell* [93-2 USTC ¶50,460], 1 F.3d at 937 ("That an individual's day-to-day function in a given enterprise is unconnected to financial decision making or tax matters is irrelevant where that individual has the authority to pay or to order the payment of delinquent taxes."). Plaintiff thus undisputedly *possessed* the authority required to exercise significant control over the corporation's financial affairs at different times throughout the period at issue. [8] These facts thus establish that plaintiff was a "responsible person" under §6672 for all six quarters. Cf. Schlicht v. United States, No. 03-1606, 2005 WL 2083103, at *3 (D. Ariz. Aug. 25, 2005) (holding that a corporation's president, who "was charged with 'general active management' ..., had check signing authority, hired and fired employees, and on at least one occasion ... paid trust fund taxes" was a responsible party even though he did not exercise his authority over finances on a regular basis).

2. *Plaintiff's Willfulness*

Willfulness, under §6672, has long been defined as "a voluntary, conscious and intentional act to prefer other creditors over the United States." *Purcell* [93-2 USTC ¶50,460], 1 F.3d at 938 (quoting *Davis* [92-1 USTC ¶50,292], 961 F.2d at 871). Willfulness does not require the intent to defraud the government or any other bad motive. *Davis* [92-1 USTC ¶50,292], 961 F.2d at 871. "Once a responsible person gains knowledge of a payroll tax deficiency, he is liable for all periods during which he was a responsible party, regardless of whether those periods precede or follow the date he gained that knowledge." *Schlicht*, 2005 WL 2083103, at *4 (citing *Davis* [92-1 USTC ¶50,292], 961 F.2d at 873). Accordingly, a deliberate decision to use corporate funds after receiving knowledge of a payroll tax deficiency "falls within the literal terms of this Circuit's definition of willfulness." *Davis* [92-1 USTC ¶50,292], 961 F.2d at 871; *see also Thomsen v. United States* [89-2 USTC ¶9575], 887 F.2d 12 (1st Cir. 1989) (holding that once a person is aware of the liability to government, that person has a duty to ensure that the taxes are paid before any payments are made to other creditors (citing *Mazo v. United States* [79-1 USTC ¶9284], 591 F.2d 1151, 1157 (5th Cir. 1979)).

Plaintiff contends that his physical ailments raise a genuine issue of material fact as to whether he could exert control over the payroll taxes and intentionally withhold payment. (Pl.'s Opp'n to Mot. for Summ. J. 10.) Likewise, plaintiff contends there is a genuine issue of material fact as to whether Phyliss Savage successfully misled him into a reasonable belief that there was no payroll tax deficiency. (*Id.* at 11.) Because these circumstances could bear on whether plaintiff willfully, voluntarily, or intentionally ignored his duty to pay PCI's taxes, factual questions remain as to whether, prior to January 11, 2002, plaintiff

acted willfully. *See United States v. Rem* [94-2 USTC ¶50,537], 38 F.3d 634, 644 (2d Cir. 1994) ("Where ... the individual's position makes his claim of ignorance of nonpayment plausible and there are no other indicia of knowledge, the matter of his willfulness is an issue to be tried.").

However, these arguments are not material to plaintiff's willfulness after January 11, 2002, given that plaintiff was undisputably aware of the unpaid employment taxes from that day forward. (Savage Decl. ¶19.) Significantly then, despite this knowledge, plaintiff, who had personally loaned the corporation $230,000, repaid himself $70,000 "*after* [he] became aware that [PCI] had tax problems." (Latterell Decl. Ex. CC (David Savage Dep. 88:5-18, Aug. 18, 2005) (emphasis added).) Through this act, plaintiff consciously and intentionally preferred himself, as a creditor, over the United States.

These facts are determinative of plaintiff's liability because once a responsible person consciously and intentionally prefers another creditor over the United States, factual issues as to prior ignorance of non-payment are irrelevant. *Teel v. United States* [76-1 USTC ¶9190], 529 F.2d 903, 905-06 (9th Cir. 1976) (holding that the use of funds received from the sale of old inventories and the sale of new merchandise, after knowledge of arrearages in employee tax payments, forecloses an inquiry into prior ignorance regarding the willfulness element of §6672). Plaintiff therefore cannot rely on his previous physical inability to pay the deficient taxes or his previous ignorance of the deficient taxes to evade liability, even assuming that he could prove these theories at trial. As a matter of law, plaintiff acted willfully in accordance with §6672. [9] Pursuant to Davis, this finding of willfulness extends to all quarters where plaintiff was a responsible person, or all six quarters in issue.

At oral argument, plaintiff's attorney vigorously took the position that plaintiff should at most be liable for $70,000, rather than the full amount of the tax delinquency, because he only willfully preferred other creditors by this amount. (*See also* Pl.'s Opp'n to Mot. for Summ. J. 12 n.10.) The court is aware that some courts have limited a responsible person's liability to the extent that the corporation had funds available to pay the government when that person first learned of the delinquency. *See, e.g.*, *Kinnie v. United States* [93-1 USTC ¶50,311], 994 F.2d 279, 285 (6th Cir. 1993); *Ross v. United States* [97-1 USTC ¶50,247], 949 F.Supp. 536, 543 (D. Ohio 1996) (citing *Gephart v. United States* [87-1 USTC ¶9319], 818 F.2d 469 (6th Cir. 1987)). Under this approach, the fact that the court only has evidence that $70,000 was available to pay PCI's debts on January 11, 2002 would be significant.

However, in *Davis* [92-1 USTC ¶50,292], 961 F.2d at 871, the Ninth Circuit noted that the taxpayer "had sufficient income to satisfy in full [the corporation's] tax delinquency" but also stated that the decision "to pay commercial creditors rather than *to diminish* [the corporation's] tax debt falls within the literal terms of the Circuit's definition of willfulness." (emphasis added); *see also Sorenson v. United States* [75-2 USTC ¶9694], 521

F.2d 325, 328 n.3 (9th Cir. 1975) (suggesting that inability to pay is not relevant in a §6672 willfulness assessment). Thus, the Ninth Circuit has declined to take the approach of limiting liability for willfulness to the amount available to the corporation at the time other creditors were preferred over the government. [10]

Allowing plaintiffs to discount their liability based on the amount they actually wrongfully divert to other creditors would seem to be inconsistent with the language of the statute, which punishes *any* attempt to evade payment of the tax owed with "a penalty equal to *the total amount* of the tax evaded[] or not collected ...." 26 U.S.C. §6672(a) (emphasis added). Moreover, although it is often the case that the assets wrongly and willfully diverted to creditors other than the United States would have been sufficient to cover the corporation's entire §6672 tax liability, the court is not aware of any case where a responsible party preferred other creditors and escaped liability for the total amount owed because the corporation, at the time, could not have paid its *entire* debt anyway. *But cf. Alabama v. King*, No. 91-B-2121-S, 1995 WL 423171, at *7 (N.D. Ala. Mar. 29, 1995) (holding plaintiff liable for the full amount owed even though, at the time plaintiff preferred other creditors, the company only had "*nearly* the sufficient unencumbered funds with which [plaintiff] could have paid the state and federal tax liabilities" (emphasis added)).

III. *Conclusion*

As a matter of law, plaintiff is a "responsible person" who willfully avoided federal tax obligations under §6672. In accordance with that section, plaintiff can be personally liable for the outstanding assessments owed by PCI, in the amount of $126,103.62, plus interest accrued during the pendency of this motion until paid, pursuant to 26 U.S.C. §§6601, 6621-22 and 28 U.S.C. §1961(c).

IT IS THEREFORE ORDERED that defendant's motion for summary judgment on its counterclaim against plaintiff be, and the same hereby is, GRANTED.

[1] Pursuant to PCI's articles of incorporation, the same officer serves as both President and CEO. (Def.'s Mem. in Supp. of Mot. for Summ. J. Ex. A-3 at 10 (Articles of Incorporation).) However, as part of the "reorganization" approved at the annual meeting on December 31, 1998, Allison assumed only the role of President and plaintiff stayed on as CEO. (*Id.* Ex. A-10 at 2 (Minutes of the Board of Directors and Shareholders).)

[2] In his complaint, plaintiff states that on March 15, 2004, the government made an assessment against him of only $27,332.43, which represents the amount owed for the quarter ending on June 30, 2001. However, the government, through its counterclaim and this motion for summary judgment, seeks to recover from plaintiff the entire amount owed, $130,974.98, which includes missed payments for the last two quarters of 2000 and all four

quarters of 2001. (Answer & Countercl. ¶¶7-8; Def.'s Mem. in Supp. of Mot. for Summ. J. 12.) The remaining balance due, plus interest, was $126,103.62 as of December 31, 2005. (Reynolds Decl. ¶8.) Although the government's counterclaim seeks recovery from both plaintiff and Phyliss Savage, the government can, and hereby does, move to hold plaintiff liable for the entire amount because liability under §6672 is joint and several. *See Schultz v. United States* [90-2 USTC ¶50,563], 918 F.2d 164, 167 (Fed. Cir. 1990); *Brown v. United States* [79-1 USTC ¶9285], 591 F.2d 1136, 1142 (5th Cir. 1979); *Hartman v. United States* [76-2 USTC ¶9578], 538 F.2d 1336, 1340 (8th Cir. 1976).

[3] 26 U.S.C. §6532(a)(1) provides that:

[A] suit ... for the recovery of any internal revenue tax, penalty, or other sum, shall [not begin] before the expiration of 6 months from the date of filing the [refund] claim ... unless the Secretary renders a decision thereon within that time, nor after the expiration of 2 years from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of the part of the claim to which the suit or proceeding relates.

[4] This figure does not account for applicable interest that has accrued since December 31, 2005. (*See* Reynolds Decl. ¶8 (prospectively calculating interest through the end of the year).)

[5] Plaintiff's absences are allegedly due to an angina attack, a drastic weight loss program necessary to prevent its recurrence, and knee surgery. (Savage Decl. ¶¶7-10.) According to the plaintiff, these maladies forced prolonged absences and, when his health permitted, 20 hour work weeks. (*Id.* ¶7.)

[6] Plaintiff asserts that his prolonged absences and deficiencies in computer training impeded his check-writing ability. (Savage Decl. ¶5). However, in light of plaintiff's admitted successful exercise of check writing power, this argument is irrelevant.

[7] Plaintiff's deposition testimony further reveals that he "participated any time a vehicle was bought", that he was responsible for signing loan security agreements from 1999 through 2001, and that he paid a property tax bill for PCI in March, 2001. (Savage Decl. Ex. 2 (David Savage Dep. 53: 14, 20-23 and 59:9-16).)

[8] Significantly, plaintiff does not offer any evidence that he lacked the *authority* to pay PCI's taxes. *See Alsheskie v. United States* [94-2 USTC ¶50,387], 31 F.3d 837, 839 (9th Cir. 1994) (distinguishing the district court's finding that the plaintiff was not a responsible party from a case where "the record contained no evidence that ... the responsible party[] was without authority to pay the taxes."). His arguments regarding his responsibility focus almost entirely on his inability to *exercise* his authority during his health-related absence. (Pl.'s Opp'n to Mot. for Summ. J. 9). This argument misses the mark. The "responsibility"

prong of the liability analysis addresses only the existence of authority; the "willfulness" prong considers the ability of the individual to act upon his authority. *See Phillips v. IRS* [96-1 USTC ¶50,057], 73 F.3d 939, 943 (9th Cir. 1995) (addressing the absence caused by an individual's paralysis as part of the "willfulness" element in §6672); *Keith v. United States*, No. BK-76-1342, 1978 WL 1160, at *8 (E.D. Va. Feb. 21, 1978) (plaintiff's medical excuse did not negate wilfulness).

[9] Plaintiff argues for an application of the exception to §6672 liability recognized by the Supreme Court in *Slodov v. United States* [78-1 USTC ¶9447], 436 U.S. 238 (1978). That exception, however, applies only in situations where new management of a corporation assumes control after the failure to collect and withhold employment taxes has occurred. *Slodov* [78-1 USTC ¶9447], 436 U.S. at 259-60. Moreover, at the time the new management assumes control, there can be no funds available to satisfy the obligation to the government and subsequently generated funds cannot be directly traceable to the withheld employment taxes. *Id*. In the instant case, plaintiff remained in management as a responsible person from the time the withholding tax obligation arose until the time it was willfully avoided. "In the case of individuals who are responsible persons both before and after withholding tax liability accrues ... there is a duty to use unencumbered funds acquired after the withholding obligation becomes payable to satisfy that obligation; failure to do so when there is knowledge of the liability ... constitutes willfulness." *Purcell* [93-2 USTC ¶50,460], 1 F.3d at 938 (quoting *Davis* [92-1 USTC ¶50,292], 961 F.2d at 876).

[10] If there were any doubt about this result, it has been made explicit in an unpublished decision which this court is not permitted to cite, in which the Ninth Circuit expressly rejected a request to limit liability to the amount available to the corporation at the time the plaintiff willfully preferred other creditors.

Pediatric Associates Case

Pediatric Affiliates, P.A., Plaintiff v. United States of America, et al., Defendants.

U.S. District Court, Dist. N.J.; CIV. 05-3108 (MLC), February 23, 2006.

MEMORANDUM OPINION

C OOPER, District Judge: Defendants move pursuant to Federal Rule of Civil Procedure ("Rule") 12(b)(6) to dismiss the complaint seeking a redetermination of the plaintiff's tax liability. The Court, for the reasons state herein, will grant the motion.

BACKGROUND

Plaintiff, Pediatric Affiliates, P.A. ("Pediatric"), is a New Jersey professional corporation that provides pediatric medical services. (Compl., at ¶1.) Around 1994, Pediatric hired PAL Data ("PAL") to service Pediatric's payroll accounting needs. (*Id.* at ¶9.) Pediatric, not PAL, however, paid its quarterly payroll taxes directly to the Internal Revenue Service ("IRS"). (*Id.* at ¶11.) Pediatric asserts that around 1998, the IRS changed its payroll tax regulations to require businesses to electronically transfer their tax payments to a depository service or independent payroll tax service. (*Id.* at ¶13.) Then, the service would submit the tax payments to the IRS. [1] (Id.) Pediatric retained PAL to pay its payroll taxes. (Id. at ¶17.)

Unknown to Pediatric, Menachem Hirsch ("Hirsch"), the founder of PAL, embezzled the tax payments that Pediatric and other clients transferred to PAL. [2] (Id. at ¶14.) Hirsch would prepare and send to Pediatric a tax form that reflected Pediatric's actual tax liability. (Id. at ¶15.) Pediatric then, would transfer money in the amount of its tax liability to Hirsch. (Id.) Hirsch, however, would also prepare a tax form that reflected an understated tax liability. (Id. at ¶15.) He sent the understated form and amount to the IRS, and invested the difference between the amount he received from Pediatric and the amount sent to the IRS in a personal hedge fund. (Id.)

Pediatric received notice from the IRS in 2002 that it had underpaid its payroll taxes in 1999 and 2000. (*Id.* at ¶19.) Pediatric (1) reviewed its withdrawal records, (2) found that there was no discrepancy between the amount of funds transferred and its tax liability, and (3) concluded that the IRS notice was an error. (*Id.* at ¶¶19-20.) The IRS then sent second and third notices of delinquency to Pediatric. (*Id.* at ¶¶21, 24.) Again, Pediatric checked its records and found no discrepancy between the amount owed and amount paid. (*Id.* at ¶21-26.) The IRS finally sent Pediatric documents that reflected a discrepancy that was not apparent based on the information Pediatric was given by PAL. (*Id.* at ¶27.) Pediatric contacted Hirsch and was told that Hirsch had misappropriated the funds Pediatric had transferred to Hirsch. (*Id.* at ¶30.)

The United States brought criminal charges against Hirsch in the United States District Court for the Southern District of New York in December 2004. (Pl. Ex. A.) He was charged with wire fraud and tax evasion. (*Id.*) The indictment alleged that Hirsch converted over $ 2,314,000.00 of over 50 clients' funds, and filed over 160 false and fraudulent tax forms. (*Id.*) Hirsch (1) pled guilty to both counts, (2) was assessed monetary penalties, and (3) sentenced to serve thirty-seven months in prison. (Pl. Ex. 3.)

Pediatric brought an action in the District of New Jersey against PAL and Hirsch, on July 25, 2002. [3] (Dkt. no. 02-3589 (GEB).) Pediatric asserted claims for fraud and violations of the Racketeering Influenced and Corrupt Organizations Act ("RICO"), and sought monetary damages. (Compl., dkt no. 02-3589.) Default judgment was entered in Pediatric's favor in the amount of $1,204,183.21, on August 21, 2003. (Dkt. no. 02-3589, entry no. 25.)

The IRS sent Pediatric notices of its intent to levy on Pediatric's assets on March 24, 2003. (Compl., at ¶46.) The IRS sought the taxes Pediatric still owed from 1999 and the first quarter of 2000 due to Hirsch's underpayment. (*Id.*) Pediatric requested a Collection Due Process Hearing ("CDPH") in August 2004. (*Id.* at ¶47.) It asserted that it was not liable for past due payroll taxes, or the interest charges it was assessed, because Hirsch embezzled its tax payments. (*Id.* at ¶¶47-48.) Following the hearing, the Appeals Office of the IRS determined that the levy notice was proper, and Pediatric was liable to pay the taxes owed and interest. (*Id.* at ¶¶53-54.) Pediatric brought an action in this Court, on June 17, 2005, seeking a redetermination of the IRS collection action resulting from the CDPH.

DISCUSSION

Defendants argue the complaint should be dismissed because Pediatric is liable to pay (1) the taxes it owes as a matter of law, and (2) the interest it owes on its taxes because Pediatric's tax deficiency is not attributable to an error or delay of the IRS. (Defs. Br., at 1-2.) Pediatric argues that it is not responsible for the tax or interest at issue because (1) it paid the taxes it owed to PAL, (2) Pediatric is not responsible for Hirsch's subsequent embezzlement of those funds, and (3) the United States is judicially estopped from recovering payroll taxes from Pediatric. (Pl. Br., at 16-17.) It argues that the government's "recovery" in this matter was the conviction and incarceration of Hirsch. (*Id.*) To enforce Pediatric's tax liability in addition to incarcerating Hirsch would amount to a double recovery for the United States. (*Id.*)

I. Jurisdiction of the District Court to Redetermine CDPH Appeals

Section 6330 of the Internal Revenue Code ("the Code") provides a taxpayer with the right to a CDPH before a levy is made on the taxpayer's property or right to property. 26 U.S.C. §6330(a). The district court has jurisdiction to review determinations of a CDPH when the subject matter of the CDPH is not within the jurisdiction of the Tax Court. *Reid & Reid, Inc. v. United States* [2005-1 USTC ¶50,266], 366 F.Supp.2d 284, 287 (D. Md. 2005); *see also Garage v. United States*, No. 04-1133, 2005 WL 3610064, at *2 (D. N.J. Nov. 22, 2005) (noting that the district court's jurisdiction was contingent upon the Tax Court lacking jurisdiction).

Section 6330 provides: "[t]he person may ... appeal such determination (A) to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matters); or (B) if the Tax Court does not have jurisdiction over the underlying tax liability, to a district court of the United States." 26 U.S.C. §6330(d). The Tax Court has jurisdiction over issues related to income taxes, but does not have jurisdiction as to employment or payroll taxes. *See* 26 U.S.C. §7442 (establishing that the Tax Court has jurisdiction as enumerated in chapters 1-4 of the Code which concern income taxes); *John H. Berkey P.C. v. Dep't of Treas.*, No. 00-75149, 2001 WL 1397680, at *2 (E.D. Mich. Sept. 20, 2001) (noting that the Tax Court has jurisdiction over income tax issues but not issues related to withholding taxes, unemployment taxes, or FICA/Social Security taxes).

Pediatric challenges the IRS's determination that it is liable for unpaid payroll taxes. The Tax Court therefore does not have jurisdiction over Pediatric's underlying tax liability, and the exercise of jurisdiction by this Court is appropriate. *See Reid & Reid Inc.* [2005-1 USTC ¶50,266], 366 F.Supp.2d at 287 (noting that the district court's exercise of jurisdiction was proper because the disputed tax liability covered federal unemployment taxes, trust fund taxes, and an excise tax).

II. Standard of Review

A. 12(b)(6) Motion

A complaint may be dismissed for "failure to state a claim upon which relief can be granted." Fed.R.Civ.P. 12(b)(6). On a motion to dismiss, the Court must accept as true all of the factual allegations in the complaint, and draw all reasonable inferences in favor of the plaintiff. *Doe v. Delie*, 257 F.3d 309, 313 (3d Cir. 2001). "Dismissal of claims under Rule 12(b)(6) is appropriate only if it appears beyond doubt that the plaintiff can prove no set of facts in support of [the] claim upon which relief may be granted." *Jakomas v. McFalls*, 229 F.Supp.2d 412, 419 (W.D. Pa. 2002).

The Court, when considering a motion to dismiss, may not "consider matters extraneous to the pleadings." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1426 (3d Cir. 1997). An exception to this general rule is that the Court may consider (1) exhibits attached to the complaint, (2) matters of public record, and (3) all documents that are integral to or explicitly relied upon in the complaint. *Angstadt v. Midd-West Sch. Dist.*, 377 F.3d 338, 342 (3d Cir. 2004) (citation omitted); *Beverly Enters., Inc. v. Trump*, 182 F.3d 183, 190 n.3 (3d Cir. 1999); *Pension Benefit Guar. Corp. v. White Consol. Indus.*, 998 F.2d 1192, 1196 (3d Cir. 1993).

B. Review of Determinations of a CDPH

The district court has the authority to review issues that were raised in a CDPH. *Garage*, No. 04-1133, 2005 WL 3610064 at *3. Issues not raised in a CDPH cannot be considered. 26 C.F.R. §301.6330-1(f)(2)(A-F5). The district court reviews CDPH determinations *de novo* if the underlying tax liability is in dispute. *Garage*, No 04-1133, 2005 WL 3610064, at *3; *see also Tornichio v. United States* [2003-1 USTC ¶50,285], 263 F.Supp.2d 1090, 1095 (N.D. Ohio 2002). If the underlying tax liability is not the subject of the appeal, the district court reviews a CDPH determination for abuse of discretion. *Id.*

Pediatric, in its CDPH, challenged its underlying tax liability, and the interest charges assessed for failure to timely to file its taxes. (Pl. Br., at 9; Pl. Ex. B.) This Court, therefore reviews the IRS determination *de novo*. [4]

III. Pediatric's Tax Liability

A. The Legal Standard

The IRS has (1) determined that Pediatric failed to pay the taxes owed for the tax year 1999, and the first quarter of 2000, and (2) assessed penalties and interest fees associated with the deficiencies. (Pl. Ex. B; *see* 26 U.S.C. §§6601, 6651.) Pediatric argues that it has no remaining tax liability. It paid the taxes it owed in full to Hirsch, and is not responsible for Hirsch's embezzlement of Pediatric's funds and his failure to pay the IRS. (Pl. Br., at 9.)

To be excused for failure to timely pay taxes owed, a taxpayer must show that the failure (1) did not result from willful neglect, and (2) was due to reasonable cause. *United States v. Boyle* [85-1 USTC ¶13,602], 469 U.S. 241, 244 (1985); *see also Am. Biomaterials Corp.*

v. Creative Care Sys. [92-1 USTC ¶50,194], 954 F.2d 919, 923 (3d Cir. 1992). Willful neglect is a "conscious, intentional failure or reckless indifference." *Boyle* [85-1 USTC ¶13,602], 469 U.S. at 245. Reasonable cause exists if the taxpayer exercised "ordinary business care and prudence, but nevertheless was unable to file the return within the prescribed time." *Id.* at 246 (internal quotes omitted); *see also Universal Concrete Prod., Corp. v. United States*, No. 89-7833, 1990 WL 106584, at *3 (E.D. Pa. July 24, 1990) (noting that a company's "failure to implement internal checks and controls over the employee responsible for tax obligations demonstrates a lack of ordinary business care" and is not reasonable cause to excuse tax liability).

1. Reliance on an Agent is not Reasonable Cause

Late filings may be excused when the delay is due to circumstances beyond the taxpayer's control, including postal delays and illness. *Boyle* [85-1 USTC ¶13,602], 469 U.S. at 249. The Supreme Court, however, has established a bright-line rule that reliance on an agent is not a reasonable cause and does not excuse a taxpayer's failure to timely file a tax return. *Id.* at 252. In *Boyle*, the taxpayer relied on an attorney to prepare and file a tax return on behalf of the estate for which the taxpayer was the executor. *Id.* at 242. Holding that reliance on an attorney does not excuse a late filing, the Supreme Court emphasized that Congress has placed the burden on the taxpayer to ensure the timely filing of tax returns. *Id.* at 249. Reliance is not a substitute for compliance with the tax statutes. *Id.* at 251. The situation may differ if a taxpayer relies on the erroneous advice of counsel with respect to a question of law, but no special training or effort is needed to determine a tax deadline, and make sure that the deadline is met. *Id.* at 252.

Reliance on a bookkeeper, controller, or outside payroll service also does not qualify as reasonable cause to excuse the failure to pay taxes. *See Huffman, Carter & Hunt, Inc. v. United States*, 317 F.Supp.2d 816, 822 (S.D. Ohio 2004) (embezzlement by taxpayer's outside payroll tax service was not reasonable cause to abate tax penalties); *Mason Motors Co. v. United States* [98-2 USTC ¶50,763], 8 F.Supp.2d 1177, 1181 (D. Minn. 1998) (bookkeeper's failure to properly submit taxes did not qualify as reasonable cause to excuse liability); *San Diego Drywall Inc. v. United States*, No. 90-0829, 1993 WL 477942, at *3 (S.D. Cal. Sept. 13, 1993) (noting that embezzlement by the comptroller was not reasonable cause to avoid tax liability). When the taxpayer is a corporation, it only acts through its agents and employees, and it "cannot *rely* upon those agents or employees, acting within their scope of authority, to escape responsibility for the nonperformance of nondelegable tax duties." *Conklin Bros. of Santa Rosa, Inc. v. United States* [93-1 USTC ¶50,116], 986 F.2d 315, 318 (9th Cir. 1993); *see also Valen Mfg. Co. v. United States*, 90 F.2d 1190, 1193 (6th Cir. 1996). For example, in *Conklin*, the tax deficiency resulted from the improper conduct of the office manager who was assigned to pay the company taxes. *Conklin Bros.* [93-1 USTC ¶50,116], 986 F.2d at 315. The manager, however, was subject to

supervision by the company president. The Ninth Circuit noted that while it may have been reasonable to not closely monitor the manager, the company is not absolved of liability for failure to pay its taxes. *Id.* at 318-19; *see also Valen Mfg. Co.*, 90 F.3d at 1193 (holding that bookkeeper's "circumvention of institutional controls" did not disable a company from paying the payroll taxes it owed).

A payroll service, while not an "employee" of a company like a bookkeeper or manager, is a third-party agent of the company. The Code allows an employer to designate agents to act on behalf of the employer to perform duties such as payment of employee wages, and company payroll taxes. *See* 26 U.S.C. §3504; 26 C.F.R. §31.3504. Section 3504 provides that "all provisions of law (including penalties) applicable in respect of an employer shall be applicable to a fiduciary, agent, or other person so designated." 26 U.S.C. §3504. An agent, however, is only jointly and severally liable for a company's payroll taxes if the agent actually had "control, receipt, custody, or disposal of, or pays the wages of an employee or group of employees." 26 U.S.C. §3504; *see also Morin v. Frontier Bus. Tech.*, 288 B.R. 663, 671-72 (W.D.N.Y. 2003) (holding that agent was not liable for payroll taxes because it never had actual control over the funds used to pay employee wages). Additionally, the form that a taxpayer must fill out to authorize an agent to make tax payments on its behalf contains an agreement that provides, "I understand that this agreement does not relieve me, as the taxpayer, of the responsibility to ensure that all tax returns are filed and that all deposits and payments are made." (Tax Form 8655, Reporting Agent Authorization.)

2. Embezzlement by an Agent

Reliance on an agent does not constitute reasonable cause even when the agent embezzles a company's tax payments. *See Huffman, Carter & Hunt, Inc.* , 317 F.Supp.2d at 821-22; *Classic Printing Inc. v. United States*, No. 99-2015, 2001 WL 283799, at *8-9 (M.D. Pa. 2001). In *Huffman* the plaintiff contracted with an outside payroll service to fulfill its employment tax obligations. 317 F.Supp.2d at 817. In *Classic Printing*, the plaintiff assigned tax-paying responsibilities to its bookkeeper. No. 99-2015, 2001 WL 283799 at *2. In both cases, the tax-paying agent embezzled money from the taxpayer. Despite the criminal nature of the agents' conduct, the plaintiffs' failure to pay their taxes was not excused. The plaintiffs were responsible for overseeing the acts of their agents, and bore the ultimate responsibility and control over their tax obligations. *Huffman*, 317 F.Supp.2d at 822; *Classic Printing*, No. 99-2015, 2001 WL 283799, at *6 (recognizing that although reliance on a trusted employee was understandable, and the betrayal "sad and unfortunate," the company was not prevented from fulfilling its tax obligations because managerial control over the company did not rest with the employee).

Reliance on an agent or particular employee to properly pay a company's taxes is not

reasonable cause because the agent's failure to do so does not render the company unable to fulfill its tax obligations. *See e.g. Valen Mfg. Co.*, 90 F.3d at 1193 (noting that the company was able to pay its taxes because it immediately paid its taxes, including penalties, after discovery of its bookkeeper's misconduct and failure to pay); *Conklin Bros.* [93-1 USTC ¶50,116], 986 F.2d at 316 (company relied on controller to pay its taxes, but the misconduct did not disable the company from paying its taxes because it had sufficient funds to make tax payments and deposits). The Third Circuit, however, has recognized one situation in which misconduct on the part of the designated taxpaying party incapacitated the company, and rendered it unable to pay its taxes. *Am. Biomaterials Corp.* [92-1 USTC ¶50,194], 954 F.2d at 927. In *American Biomaterials*, the corporation's chief financial officer ("CFO") and chief executive officer ("CEO") were responsible for paying the company's payroll taxes. *Id.* at 922. Instead of paying the taxes, the officers embezzled the money. *Id.* The Third Circuit recognized that the CEO and CFO were the sole people in control of the corporate structure. *Id.* at 923. Unlike a bookkeeper, manager, or payroll service, who is supervised by, or under the authority of, a more senior employee, supervision over the officers was not possible. *See e.g. Valen Mfg. Co.*, 90 F.3d at 1194 (holding company liable for failure of bookkeeper noting that executive officers of the company retained both oversight and ultimate responsibility for tax liabilities). The officers' misconduct and failure, therefore, did disable the company from appropriately paying its taxes. *Am. Biomaterials* [92-1 USTC ¶50,194], 954 F.2d at 922-23; *see also Valen Mfg. Co.*, 90 F.3d at 1194 (noting that the company in *American Biomaterials* was incapacitated by the conduct of its officers because they were "the very two individuals with ultimate control over the company's taxpaying activities"); *Conklin Bros* [93-1 USTC ¶50,116], 986 F.2d at 318 (holding company liable for taxes because its bookeeper's misconduct was not beyond company control, unlike the situation in *American Biomaterials* in which the conduct was beyond the corporation's control because the embezzlement was by corporate officers); *Classic Printing Inc.*, No. 99-2015, 2001 WL 283799, at *8 ("In *Biomaterials*, the criminal conduct committed by the corporate officers ... was beyond the corporation's control because they were the control people in the corporate structure").

B. Application to Pediatric

Pediatric has not shown that its failure to pay its payroll taxes for the year 1999 and first quarter of the year 2000 was the result of reasonable cause. [5] Pediatric entrusted its payroll taxpaying obligations to PAL and Hirsch. As established in Boyle, Pediatric's reliance on Hirsch, and Hirsch's subsequent failure to properly perform the task assigned does not amount to reasonable cause.

Pediatric's situation is analogous to that of the plaintiff in *Huffman*. The plaintiff in *Huffman* relied on an outside payroll service. The service embezzled the plaintiff's funds,

resulting in tax deficiencies and penalties. Similarly, Pediatric relied on Hirsch. Assuming, as the court did in *Huffman*, that Pediatric exercised prudence in selecting and monitoring Hirsch, Pediatric still bears the ultimate responsibility to ensure its taxes are properly paid. Reliance on Hirsch did not render Pediatric unable to fulfill its tax obligations.

Unlike the embezzlers in *American Biomaterials*, Hirsch was not a corporate officer or in a position of authority. He did not have final control over Pediatric's taxpaying duties. Hirsch was only an employee of an outside company who worked for Pediatric. He was an agent of Pediatric hired to "service Pediatric Affiliates' payroll tax needs." (Compl., at ¶17.) Hirsch is not jointly and severally liable because there is no assertion or indication that Hirsch had control, custody, or paid Pediatric's wages. Pediatric's reliance on Hirsch is understandable, and the subsequent misconduct "sad and unfortunate," but such reliance does not absolve Pediatric of its tax obligations. *See Classic Printing*, No. 99-2015, 2001 WL 283799, at *6.

IV. Pediatric's Estoppel Arguments

A. Judicial Estoppel

Pediatric contends that the United States cannot argue that Pediatric is liable for its taxes because the doctrine of judicial estoppel bars such an argument. (Pl. Br., at 16.) Judicial estoppel is an equitable doctrine that is invoked at the discretion of the court. *New Hampshire v. Maine*, 532 U.S. 742, 750 (2001). It is a general rule that "a party to litigation will not be permitted to assume inconsistent or mutually contradictory positions with respect to the same matter in the same or successive series of suits." *Scarano v. Cent. R. Co. of N.J.*, 203 F.2d 510, 513 (3d Cir. 1953) (internal quotes and cite omitted); *see also New Hampshire*, 532 U.S. at 749 ("this rule ... prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument in another phase"). The doctrine should only be applied "in a narrow category of cases because it is an extraordinary remedy that should be employed only when a party's inconsistent behavior would otherwise result in a miscarriage of justice." *Dam Things From Den. Co. v. Russ Berrie Co.*, 290 F.3d 548, 559-60 (3d Cir. 2002). Judicial estoppel is appropriate when (1) a party asserts a later position that is clearly inconsistent with an earlier position, (2) a court accepted the earlier position so that judicial acceptance of the later position would create the perception that one of the courts was misled, and (3) the party seeking to assert an inconsistent opinion would gain an unfair advantage or impose an unfair detriment on the opposing party. *New Hampshire*, 532 U.S. at 750; *see also Dam Things from Den. Co.*, 290 F.3d at 559 (noting that judicial estoppel is appropriate if the party changed its position in bad faith).

Hirsch was charged and pled guilty to wire fraud and tax evasion. The United States asserted that Hirsch "unlawfully, willfully, and knowingly, did attempt to evade and defeat a substantial part of the federal payroll taxes due and owing by the corporate clients of PAL Data." (Pl. Ex. A, at ¶9.) Following Pediatric's CDPH, the IRS determined that Pediatric was liable for its unpaid taxes, interest, and penalties because Hirsch's embezzlement was not a reasonable cause to excuse Pediatric's failure to pay. (Pl. Ex. B.) The United States, in the present motion, also argues that Pediatric is still liable for its taxes despite Hirsch's embezzlement. (Defs. Br., at 2.)

The doctrine of judicial estoppel is not applicable in this case. The United States' assertion that Pediatric is still liable for its unpaid taxes, despite Hirsch's embezzlement, is not "clearly inconsistent" with its assertion in Hirsch's criminal case that Hirsch evaded the payroll taxes that were owed by Pediatric. As discussed at length in Section III.A, *supra*, delegating taxpaying responsibilities to an employee or agent does not absolve the taxpayer of tax liability. Liability for tax evasion, however, is not limited to the taxpayer. "Any person" who willfully attempts to evade or a defeat a tax obligation can be penalized. 26 U.S.C. §7201. Therefore, it is not contradictory for the government to seek to (1) criminally penalize Hirsch for evasion of payroll taxes including those of Pediatric, and (2) be paid the taxes it is owed by Pediatric.

Pediatric argues that it will suffer a detriment because it will be obligated to pay its payroll taxes twice. (Pl. Br., at 17.) This argument, however, is incorrect. Pediatric paid money to Hirsch to cover its tax liability, but due to Hirsch's embezzlement, Pediatric did not appropriately pay the IRS in full. Pediatric is not being forced to pay its taxes twice because the taxes the IRS seeks to collect now were not paid.

It should also be noted that Pediatric has not gone without a remedy. Pediatric brought an action against PAL and Hirsch in this Court in July 2002, (1) asserting RICO and fraud claims, and (2) seeking monetary damages (treble and punitive) including attorneys fees, interest, and costs of suit. (*Pediatric Affiliates P.A. v. PAL Automated Payroll Servs. Inc.*, No. 02-3589 (GEB)). Judgement by default was entered against PAL and Pediatric was awarded $ 1,204,183.21. (8-21-03, Order for Default Judgment, Dkt. no. 02-3589.) [6]

B. Equitable Estoppel

Pediatric also argues that the IRS is equitably estopped from seeking penalties and interest based on representations made by an IRS Appeals Officer during the CDPH. (Pl. Br., at 16 n. 29.) To succeed on an equitable estoppel argument, Pediatric must demonstrate that there was a (1) misrepresentation, (2) upon which it relied, (3) to its detriment, and (4) affirmative misconduct on the part of the government. *Classic Printing*, No. 99-2015, 2001

WL 283799, at *4; *see also Heckler v. Cmty. Health Servs. of Crawford County, Inc.*, 467 U.S. 51, 60 (1984); *Fredericks v. Comm'r of Internal Revenue* [97-2 USTC ¶50,692], 126 F.3d 433, 438 (3d Cir. 1997) (noting that the Third Circuit poses the additional burden of showing affirmative misconduct when seeking estoppel against the government).

Not every form of misinformation by the government is sufficient to estop the government, and not all reliance on government statements is reasonable. *Fredericks* [97-2 USTC ¶50,692], 126 F.3d at 438 (internal cites and quotes omitted). Affirmative misconduct requires more than a mere omission, negligent failure, or erroneous oral advice from an IRS agent. *See, e.g.*, *id.*, (recognizing that the government's conduct did give rise to estoppel because it induced the plaintiff to sign and rely on a form three times in three years); *United States v. Pepperman* [92-2 USTC ¶50,465], 976 F.2d 123, 131 (3d Cir. 1992) (application of equitable estoppel requires affirmative misconduct, not mere omission or negligent failure). Reliance is undermined when it is based on oral advice, unconfirmed by a writing. *Heckler*, 467 U.S. at 65; *see also Fredericks* [97-2 USTC ¶50,692], 126 F.3d at 439 (citing *Heckler*), *United States v. St. John's Gen. Hosp.*, 875 F.2d 1064, 1070 (3d Cir. 1989) (noting that the record was devoid of any reliable evidence to estop the government because the alleged misrepresentation was based on inadmissible hearsay, not written correspondence). To determine if a party has suffered a detriment, the Court must consider whether the government conduct permanently deprived the party of a benefit or right to which it was entitled, and caused the party the change its position for the worse. *Fredericks* [97-2 USTC ¶50,692], 126 F.3d at 445-46.

Pediatric has not shown that the government is equitably estopped from seeking interest and penalties from Pediatric. [7] In the complaint, Pediatric contends that the Appeals Officer said (1) he could not see how it could be determined that Pediatric owed money to the IRS, (2) Pediatric should not be held responsible if the money was stolen, and (3) either Pediatric owed the money or it did not and that he would check with others in the Appeals Office and then advise. (Compl., at 9.) Pediatric, however, provides neither documentation to support these oral statements, nor an indication as to how they induced reliance or what detriment they caused Pediatric.

Even assuming the statements were a misrepresentation, Pediatric's reliance on them was not reasonable. The alleged statements are not documented in a writing. The statements were made in the context of a CDPH. The discussions in the CDPH were preliminary and non-final in nature because the final outcome would be documented in a written determination that could be appealed to an appropriate court. As Pediatric alleges, the Appeals Officer said he would check with others and advise. Even accepting as true the factual allegations in the complaint, the statements of the Appeals Officer are mere erroneous advice, not affirmative misconduct. In the absence of reliance, detriment, and affirmative misconduct, applying equitable estoppel to the government in this action is not appropriate.

CONCLUSION

The Court, for the reasons stated *supra*, will grant the defendants' motion to dismiss. An appropriate order and judgment will be issued.

[1] Pediatric, in the complaint, and brief opposing the present motion provide no citation, or specific reference as to what regulation was changed.

[2] Menachem Hirsch is also known as Samuel Hirsch. (*See* Pl. 2 Ex. A, at ¶1.)

[3] Pediatric also named Sol Hirsch, Menachem's father, as a defendant because it asserted that he was a principal of PAL. (Compl., dkt. no. 02-3589.) Sol Hirsch, however, was terminated as a party on June 6, 2003. (Dkt. no. 02-3589, entry no. 19.)

[4] Pediatric, in the complaint, seeks review of its tax liability, and the interest and penalties assessed against it. (Compl., at ¶58.) However, because Pediatric did not challenge the penalty assessment in its CDPH, this Court therefore cannot consider or review the penalty assessment. (*See* Compl., at ¶48; Pl. Ex. B, Attachment to Letter 3194-Relevant issues presented by the taxpayer.)

[5] The United States does not argue that Pediatric's failure to pay its taxes was the result of willful neglect. Nothing presented to the Court raises an inference of willful neglect. Therefore, for the purposes of this opinion, the Court will (1) assume Pediatric did not willfully neglect its tax liability, and (2) focus on whether Pediatric has shown reasonable cause for its failure to pay.

[6] As to Samuel Hirsch, the action was stayed and administratively terminated because Hirsch filed for bankruptcy protection. (8-21-03, Order, Dkt. no. 02-3589.)

[7] The assessment of penalties is not being considered because the issue was not raised in the CDPH. *See supra* footnote 4.