August 07, 2009 Vol. VII Issue 31

Hospital CEO Liable For Unpaid Payroll Taxes

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Officers, directors, and other corporate fiduciaries of healthcare organizations face the same civil (and possibly criminal) exposure for federal payroll tax withholding or deposit failures as all other employers. Recent court cases indicate that the government will pursue healthcare executive leadership individually.

On August 3, 2009, in *Doulgeris v. United States*, No. 8:08-cv-00282 (M.D. Fla.), a federal court held a hospital Chief Executive Officer (CEO) personally responsible for almost $2 million in unpaid payroll taxes. This follows the February 2009 *Verret* decision (*see Health Lawyers Weekly*, vol. 7, no. 14, for an article of this decision), in which the U.S. Court of Appeals held a hospital board chair similarly liable for unpaid payroll taxes. Furthermore, the Internal Revenue Service (IRS) has announced its intention to aggressively pursue payroll tax fraud. Accordingly, executive leadership and compliance/legal advisors should be particularly attentive to the prompt satisfaction of organizational payroll tax obligations—especially given the financial challenges impressed by a recessionary economy. For their own protection, as well as to be good financial stewards for the organization, executive leadership should proactively confirm that employment taxes are being paid on a timely basis.

The most recent development involved an individual (James Doulgeris) appointed by a hospital management company to serve as interim hospital president and CEO while the hospital was undergoing bankruptcy reorganization. In 2003, while the individual served in that capacity, payroll taxes were withheld but not paid. The district court concluded *as a matter of law* that the CEO was personally liable for the outstanding payroll tax liability. The CEO was a "responsible person" with respect to the obligation to pay over payroll taxes and did not show the court by a preponderance of the evidence that the failure to pay was not willful. The facts of the case illustrate what a “liability trap” the payroll tax issue can be even for well-meaning hospital executives and board members, particularly when economic pressures force an organizational prioritization of accounts payable.

Federal law provides that a person who is responsible for paying to the federal government funds withheld for the purpose of payroll taxes and who willfully fails to pay such funds over to the government may be held personally liable for the amount that is not paid over.[1] The first question in the case, then, was whether the hospital CEO was a “responsible person” with respect to payroll tax payment. The decision does not address whether the individual was a responsible person, as the court had previously decided that he was as a matter of law. The IRS routinely assumes that corporate officers are responsible persons, and the courts generally agree that officers are responsible persons in the absence of evidence to the contrary.[2] Responsibility is a matter of status, duty, and authority, rather than knowledge.[3]

The question decided by the *Doulgeris* decision was whether Doulgeris proved he did not act willfully. The government has the burden of demonstrating by the preponderance of the evidence that the specific person was a responsible person; if it succeeds in doing so the burden shifts to the responsible person to prove that he or she did not act “willfully” in failing to make payment.[4]

In this context, “willfully” refers to the voluntary, conscious, intentional use (or causing to be used) of funds withheld for payroll taxes for other purposes.[5] Willful conduct is demonstrated when the facts show that the officer in question elected to use money withheld for payroll tax purposes to pay vendors or other suppliers, even though the officer knew that there was an outstanding payroll tax obligation due the government. Willful conduct also can be deduced from a failure to investigate or correct mismanagement after being notified that an outstanding payroll tax obligation was due and outstanding. As the court noted, an officer with responsibility to assure payroll tax payment can not absolve himself of that responsibility by leaving it to another officer to fulfill; i.e. “buck passing” isn’t tolerated in this scenario.

Here, the withheld taxes in question covered the first two quarters of 2003, when the interim CEO began his term of office. There was no dispute that (a) the hospital properly withheld the taxes; (b) the hospital failed to pay them over to the IRS; (c) the CEO knew of the delinquency; and (d) the CEO had the authority to draw on the hospital bank accounts, including those entitled “payroll” and “taxes,” even though he did not write or sign all hospital checks. Furthermore, it was determined that the CEO co-signed 57 checks on behalf of the hospital totaling over $2.9 million during a period of time the CEO knew the taxes to be delinquent.

The district court found unpersuasive the hospital CEO's arguments that the chief financial officer (CFO) was the executive officer in control of accounts payable and other payment decisions, and that the CFO reported to the president of the management company (and not to the hospital CEO). The undisputed facts made it clear to the court that, by signing the checks, the hospital CEO affirmatively decided to use the payroll tax funds to satisfy other creditors of the organization, knowing that the payroll tax obligation was due and owing. Even if the CEO did not make out the checks he ultimately signed (i.e., even given that the CFO "cut" the checks), the court's view was that his (the CEO's) signature was necessary to give the checks value and thus caused those checks to be used for purposes other than to pay payroll taxes. The court found particularly persuasive the CEO's admission that he had the power to directly transfer hospital funds in order to satisfy payroll tax obligations and that he did so when the CFO was out of town. Just because the CEO generally left financial decisions to the CFO was not enough to absolve the CEO of his basic responsibility, especially given the fact that he had the authority to pay the taxes.

Accordingly, the court concluded that the CEO was indeed a "responsible person" who had acted willfully in failing to pay over withheld payroll taxes during the relevant time period. The CEO was ordered to pay the outstanding amount of $1,935,204.33.

Doulgeris should be read in connection with the recent *Verret* decision, as both serve as powerful reminders of the significance of the payroll tax issue. This is particularly the case in a recessionary environment, where financial officers may be hard-pressed to address accounts payable concerns. To be sure, liability for unpaid payroll taxes is not a "new" legal concept or theory; it has certainly "been on the books" for quite some time. What is new, and significant, is the fact that ensuring the timely withholding and payment of payroll taxes by not-for-profit employers has become an important compliance issue for the IRS. It is also clear that the ultimate responsibility for paying over outstanding taxes rests (at least in the mind of the IRS) in board leadership and the CEO. Regardless of which officer, from a day-to-day management perspective, is delegated payroll tax payment liability, and regardless of whether senior leadership knows that there were previous failures to pay, the IRS has little tolerance for efforts of senior leadership (including uncompensated board members) to absolve themselves of ultimate responsibility in this matter.

Tax and compliance counsel can best serve their clients by educating their clients about the new IRS enforcement posture in this area, and by assisting them in the establishment of appropriate governance and compliance policies, procedures, and internal controls to confirm the timely withholding and depositing of employment taxes.

[1] 26 U.S.C. § 6672.

[2] *See, e.g., Farris, Jr. v. United States*, 84-1 USTC ¶9263 (Cl. Ct. 1984).

[3] *United States v. Marino*, 311 BR 111 (M.D. Fla. 2004).

[4] *Thibodeau v. United States*, 828 F.2d 1499, 1503 (11th Cir. 1987).

[5] *Mallory v. United States*, 17 F.3d 329, 332 (11th Cir, 1994).