2017-18, 1/24/17).

Feb. 15, 2017

One of the most onerous provisions in the tax code is the trust fund recovery penalty. Essentially, a taxpayer may be held personally liable for 100% of the amount of payroll taxes that have should have been deposited with the IRS. For this reason, it's often called the "100% penalty" by practitioners and commentators.

In a new case, the owner of a defunct S corporation tried to deduct the payment

bookkeepers and clerks.

Similarly, the IRS broadly interprets the requirements for a "willful failure." It doesn't have to be intentional. For instance, the 100% penalty may be assessed if you knew, or should have known, about the taxes that should have been paid.

In the new case, the taxpayer and his wife owned a limited liability company (LLC) and a separate S corporation in Arizona. From 2000 through 2002, the S corporation accumulated unpaid payroll tax liabilities. Subsequently, the trust fund recovery penalty was assessed personally against the taxpayer.

The S corporation didn't file any tax returns from 2003 through 2011. It was administratively dissolved by Arizona in 2007 for failing to file an annual report. The S corp was not registered as an active entity with any state during 2012 and did not provide any services or generate any income in 2012.

In 2012, the LLC sent $215,000 from its bank account to the trust account of the taxpayer's attorney. Then the attorney sent a certified check for that amount to IRS with a letter. In part, the letter stated that the payment represented the unpaid payroll tax liability on behalf of the S corporation.

On its 2012 tax return, the S corp indicated that it was a cash-basis taxpayer, but showed no assets, income, or other tax items for the year, with the exception of a deduction of $180,911 for salaries and wages. This deduction was passed through to the taxpayer as an ordinary business loss. But the S corporation did not pay any salaries or wages in 2012, nor did it have any bank accounts at any point during the year.

The Tax Court held that the S corporation couldn't deduct the payroll tax payment made in 2012 ostensibly on its behalf, because the corporation was not in existence at the time. Furthermore, even if the S corporation did legally exist in 2012, it had not

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