State & Local Tax Insights

Are You A Responsible Person?

Personal Liability for Sales, Use and Excise Tax in a Post-Wayfair World

Exposure to personal liability for unpaid sales taxes is at an all-time high since the U.S. Supreme Court issued its 2018 South Dakota v. Wayfair decision. In this landmark sales tax case, the court removed physical presence as the primary means for establishing nexus in a state.

Since that decision, all but two states that collect sales tax have enacted their own economic nexus standards for remote sellers. Most states provided a grace period for businesses to register and become compliant, but those periods have expired.

With each passing month, companies are racking up **increasing tax liabilities** if they have not complied by **registering, collecting** and **remitting sales taxes** in all the states where they now have nexus.

Businesses defining their approach to sales tax compliance should know that states have the ability to make individuals personally liable for uncollected or unremitted sales taxes. If a company is unable to pay its sales tax liabilities, some states may pursue collection from the owners, officers, shareholders, directors or even employees whose responsibilities included preparing returns and remitting sales tax collections.

Sales Taxes Are Trust Taxes

Companies that register for a sales tax permit assume a role as trustee of the state. Sales taxes collected by a seller are monies held in trust for the benefit of the state and its constituents. The failure to properly collect and remit sales tax can result in tax assessments on the company, its corporate officers, owners or key employees. These assessments often are significantly higher than the taxes would have been for an organization in compliance.

Can Individuals Be Held Accountable?

In short, yes. Two primary groups of individuals can be required to pay the sales tax debts of their organizations.

The first group includes owners, partners, directors, shareholders and officers of the business. These individuals are typically the first to be named as the liable party on a tax assessment. Agencies assume that these individuals have the most influence and control over the collection and payment of sales taxes.

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For example, a Texas administrative law judge found the president and sole owner of a ready-mix concrete business should be held personally liable for the unpaid sales tax of the business because he had control over and supervised the payments of the business. He was found liable for tax, penalties and interest totaling approximately $289,000.[1]

The second group includes general managers, other members of the "C-suite" and employees who oversee sales tax compliance for the business. The closer this group of individuals are to having control of payments, the ability to bind the company in contracts, or directing the sales tax compliance function, the more likely they are to be found personally liable for the sales tax debts of their organization.

In Ohio, if any corporation, limited liability company, or business trust required to file returns and to remit tax due to the state, fails for any reason to make the filing or payment, then any of its *employees having control or supervision of or charged with the responsibility of* filing returns and making payments, or any of its officers, members, managers, or trustees who are responsible for the execution of the corporation's, limited liability company's, or business trust's fiscal responsibilities, shall be personally liable for the failure.[2]

In one case, the Ohio Board of Tax Appeals affirmed the determination that a taxpayer was a responsible party due to his representations to auditors that he was the owner of the business and responsible for filing sales tax returns during an audit. During the hearing, the taxpayer indicated he did not have actual ownership in the business and was just working part time for his father. The Board rejected the taxpayer's argument that his liability should be limited based on other individuals who were "more properly assessed." Ultimately, the taxpayer was unable to prove he was not a responsible person, and was held jointly and severally liable for the outstanding sales taxes due.[3]

Four Common Misconceptions About Personal Liability

1. I am protected by the "corporate veil."

Establishing a limited liability company or other business entity structure is a smart move to help prevent the liabilities of a business from becoming the personal liabilities of its owners. However, in the case of trust fund taxes, such as sales tax, corporate entity protections often do not apply.

2. I am not likely to be discovered.

Now that economic nexus rules are in place, states are beginning to ramp up discovery and enforcement efforts in order to find tax monies owed to them by remote sellers. States have tools to help them find noncompliant taxpayers. They may share information with other jurisdictions, use information discovered during taxpayer audits, or monitor news articles and press releases to help them find out who is selling into their state.

3. I do not oversee tax return filing.

Even owners and corporate officers who do not have direct supervision over sales tax compliance can be held personally liable. Therefore, if you do not properly deem yourself as a "responsible person" and you do not take action to make sure your company is in compliance, it could cost you more than you would have originally owed. Another cost to consider is the expense of defending yourself in your attempt to prove you are not a "Responsible Person," if you think that is the case.

4. I can charge this off in bankruptcy.

Sales taxes are considered a trust tax which are not subject to charge off through bankruptcy or closing down a business. The taxes will follow the owner or other Responsible Persons.

[2] Ohio Rev. Code § 5739.33

[3] Kattola v. McClain, Ohio BTA, Dkt. No. 2017-2292, 11/19/2019

Criminal Prosecutions

It is one thing to take a personal financial hit for the sales tax debts of a business, it's another thing to potentially face criminal charges. In Florida, any person who is required to collect, truthfully account for, and pay over any tax due and 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 such tax or the payment thereof; shall be liable to a penalty equal to twice the total amount of the tax evaded or not accounted for or paid over.[4] As heavy-handed as this sounds, it does not stop there. Collecting sales taxes and failing to remit those monies to Florida could be a punishable offense of committing "theft of state funds" if deemed that the taxes were collected and failure to remit was "with intent to unlawfully deprive or defraud the state of its moneys or the use or benefit thereof." In fact, as of October 1, 2019, the offense for such actions could range from a misdemeanor of the second degree to a felony of the first degree. Any amount of stolen revenue of $1,000 or more is considered a felony. In Indiana, it is a Class D felony for a responsible officer to knowingly fail to remit taxes to the state. As provided in Ind. Code § 35-50-2-7 "a person who commits a Class D felony shall be imprisoned for a fixed term of two (2) years, with not more than two (2) years added for aggravating circumstances; in addition, he may be fined not more than ten thousand dollars ($10,000.00)."[6]

In Texas, a person commits an offense if the person intentionally or knowingly fails to remit to the Comptroller collected sales taxes. Once the amount reaches $20,000 or more the offense becomes a felony.[7]

Uncollected Sales Tax

Exposure to sales tax liability for responsible persons is not limited to monies collected from customers. When a state performs a sales tax audit of a business, any tax amounts that are not accounted for accurately and remitted timely are included in the tax assessment. It is a responsible person's obligation to ensure that not only are all taxes collected by the business remitted to the state, but also that the correct amount of tax has been collected.

For example, in Georgia, a responsible person can be held personally liable for an amount equal to the amount evaded, not collected, not accounted for, or not paid over.[8]

North Carolina imposes personal liability on responsible persons for uncollected sales taxes "if the person knew, or in the exercise of reasonable care should have known, that the tax was not being collected."[9]

Under the new Wayfair economic nexus standards, it is the responsibility of each business — and its responsible persons — to identity where sales tax nexus exists, then begin reporting and paying the applicable taxes.

Failure to Register and File

Most states have a statute of limitations of between three and four years for pursuing delinquent sales taxes due. The tolling of a statute of limitations typically occurs when the tax return is filed. Failing to file a tax return, however, can expose the business to future tax assessments, sometimes indefinitely. If a business has not registered or filed a return, the state can pursue the business and its responsible persons at any point in the future, even after the business has closed or gone into bankruptcy.

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[4] Fla. Stat. § 213.29
[5] Fla. Stat. § 212.15(2)
[6] Ind. Admin. Code r. § 45-2.2-9-4
[7] Tex. Tax Code § 151.7032
[8] Ga. Code Ann. § 48-2-52
[9] N.C. Gen. Stat. § 105-242.2(b)(2)

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Business owners and corporate officers who were previously not required to collect sales taxes on remote sales into states without a physical presence may be reluctant to commit the time and expense needed to become compliant because of the complexity and cost. The costs may include investments in tax software, accounting system upgrades, in-house accounting staff additions and outsourced professional tax expertise. Although these barriers may seem daunting, taking the “ostrich” approach can land a responsible person in hot water down the road.

Sales Tax Compliance Due Diligence

When a potential merger or acquisition is being evaluated, companies should expand the scope of their due diligence to encompass sales tax compliance in a post-Wayfair world. Buyers must understand where the business has economic nexus and whether and when the company must collect and remit taxes. These are important questions that both buyers and sellers should ask:

Has the business recently performed a nexus study?

A nexus study will indicate where the business has an obligation to register and file sales tax returns. The business’ sales should be analyzed in light of each state’s sales tax statutes and nexus laws.

Does the business have a good grasp of the taxability of its products and services?

A taxability study determines which tax laws apply to the business’ activities in various states. Fully understanding taxability will help ensure the business is collecting sales taxes appropriately in all applicable jurisdictions. Understanding whether a target has a good grasp of its sales taxability in each state in which it operates can give you a good idea as to whether there could be hidden liabilities.

Has the business collected and maintained properly executed exemption and resale certificates?

This question is especially important for wholesalers and distributors. Most sales transactions for these businesses are nontaxable or exempt from sales tax, as long as a resale or exemption certificate is received and maintained. Timely collection, organized storage and proper execution of the certificate is imperative to avoid being assessed sales tax on wholesale transactions during an audit.

Does the business have unpaid sales tax liabilities?

If funds have not already accrued, a contingent liability should be set up for tax amounts that could become due in the future. Items to review include open sales tax audits, jurisdictions where tax returns remain unfiled, and unpaid audit assessments.

Does the business have any uncertain tax positions?

Sales tax statutes and their application to a business’ activity can be open to interpretation. For targeted businesses that have taken an aggressive approach on a particular sales tax issue, a contingent liability may need to be set up in order to offset the related tax exposure. The target may be in the middle of a sales tax dispute with a jurisdiction. In these cases, understanding the financial impact of a ruling going against the business should be quantified and considered in the transaction.

Business owners who are considering selling their business in the future should spend time before the sale to evaluate their sales tax compliance. Waiting until a deal is imminent to find out there is an issue can be costly and may impede the closing of the transaction.

Take Steps to Comply

It is time to take action. Here are some steps you can take to become sales tax compliant in the post-Wayfair world:

1. Review business activity to determine where nexus exists.
2. Register to file sales tax returns in states where your business has a reporting obligation.
3. Submit a voluntary disclosure of back taxes due to avoid penalties and interest.
4. Review products and services for taxability to be certain you are collecting tax correctly in each state.
5. Ensure accounting systems are correctly calculating sales tax on customer invoices. If necessary, use specialized software for sales tax calculations.
6. File tax returns, collect and pay taxes in a timely manner.
7. For wholesalers, ensure that you collect from your customers and retain properly completed exemption and resale certificates for support in the event of a state tax audit.

Enforcement of economic nexus laws across the states has begun. It is time for Responsible Persons to review business operations for potential sales tax issues.

Addressing the many issues can seem overwhelming, and we can help. Weaver's state and local tax professionals have broad experience helping companies manage these risks and comply with state sales tax laws across all states nationwide. If you have questions or would like a free consultation, please **contact Weaver** or **visit our website** for more information.

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