

Business Law

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Federal Taxation

Marilyn Barrett

Employment Taxes

Ability to pay not necessary to uphold criminal conviction for failure to pay payroll taxes.

U.S. v Easterday (9th Cir 2008) 539 F3d 1176

In this case, the Ninth Circuit ruled that, under criminal tax statutes, the government did not have to prove that Jack Easterday had the ability to pay delinquent payroll taxes in order to find that he had “willfully” failed to pay the tax due.

Easterday operated a number of nursing homes in Northern California through a parent corporation, Employee Equity Administration (EEA). Between 1998 and 2005, EEA accrued payroll tax liabilities of more than \$44 million. Easterday filed correct payroll tax returns but paid only about \$26 million of the tax due. The IRS sent Easterday numerous notices of tax due, including notices of intent to levy, and filed liens against EEA’s corporate accounts. Easterday was reportedly cooperative with the IRS and, as the responsible officer, took responsibility for the nonpayment, but he did not pay the amount due and the IRS eventually filed criminal charges in 2005. These included 109 counts of failure to pay taxes in violation of IRC §7202, with each count representing a different quarter in which the taxes of EEA and its subsidiaries were delinquent.

Easterday defended his failure to pay on the ground that he lacked the financial ability to do so. His witnesses testified that Easterday used the company’s money to pay other bills to keep nursing homes operational. Easterday asked the court to instruct the jury that, in order to prove willful failure to pay, the court must prove that, at the time the taxes were due, the taxpayer had the funds and hence the ability to pay the taxes due. He relied on *U.S. v Poll* (9th Cir 1975) 521 F2d 329 for the proposition that, for a taxpayer to be found to have “willfully” failed to pay tax, the government must prove that the taxpayer had sufficient funds to pay the tax or that the lack of sufficient funds was created by a voluntary and intentional act, without justification in light of the taxpayer’s financial circumstances. The district court declined to give this instruction. The court instructed the jury that the government had the burden of proving that the defendant did not have a good faith belief that he was complying with the tax laws and that the defendant’s belief could be in good faith even if it was unreasonable; further, that the “tax laws do not permit an employer to choose to use the monies held in trust for the United States for other purposes, such as to pay business expenses.” 539 F3d at 1178.

Easterday was found guilty on 107 of the 109 counts and sentenced to 30 months imprisonment followed by 3

years’ supervised release. He appealed the judgment and sentence.

His principal contention on appeal was that, under the *Poll* case, he was entitled to a jury instruction on the ability-to-pay element of IRC §7202 and he was entitled to present evidence to negate that element. He argued that the district court abused its discretion when it declined to give the jury that instruction.

The Ninth Circuit disagreed. After the *Poll* decision, the U.S. Supreme Court decided *U.S. v Pomponio* (1976) 429 US 10, 50 L Ed 2d 12, 97 S Ct 22, in which the Court clarified that “willfulness” means a voluntary, intentional violation of a known legal duty and does not require proof of evil motive or any other motive. Since *Poll* is not consistent with *Pomponio*, *Poll* is superseded.

Easterday also claimed that, notwithstanding *Pomponio*, the Ninth Circuit was bound by *Poll* because it had been decided by a three-judge panel and, under previous cases, a Ninth Circuit panel opinion has been held binding on subsequent panels until overruled by an en banc decision. See *In re Complaint of Ross Island Sand & Gravel v Matson* (9th Cir 2000) 226 F3d 1015.

The Ninth Circuit disagreed. In *Miller v Gammie* (9th Cir 2003) 335 F3d 889, the Ninth Circuit ruled that an en banc review is not required to overturn a case when “intervening Supreme Court authority is clearly irreconcilable with our prior circuit authority.” 335 F3d at 900. *Poll* was not reconcilable with *Pomponio* and therefore did not have to be followed.

COMMENT: The IRS has taken the position for years that a taxpayer cannot justify nonpayment of taxes on the grounds that the taxpayer needs the money to keep the business going, particularly when the taxes are trust fund taxes (*i.e.*, the share of payroll taxes withheld from employees’ paychecks). The IRS appears to have given Easterday a great deal of leeway to come up with a payment plan and he failed to do so. This case shows the peril of ignoring the IRS for too long. The case is also a reminder that, when a corporation fails to pay payroll taxes, its responsible officers can be held personally liable for the trust fund portion of the payroll tax liability under IRC §6672.

The case does not discuss whether the IRS and Easterday discussed alternative payment arrangements, such as installment payments. There are courses of action that a taxpayer can pursue that would reduce the risk of indictment. These include negotiation of an installment payment arrangement, submission of an offer in compromise, or filing bankruptcy. Trust fund taxes generally are not dischargeable in bankruptcy, but payment plans are often obtained.

Finally—the things you find with Google!—the Ninth Circuit decision describes Easterday as cooperative and, while reading it, I was left with the impression that Easterday was a well-meaning entrepreneur struggling to keep his nursing homes afloat. I later Googled the name of the case and came across a press release issued by the California Advocates for Nursing Home Reform shortly after this decision that paints a far different picture. The press release claims that, during 2006 congressional hearings