

CLIENT ALERT: FEBRUARY 18, 2009

**UNCOMPENSATED DIRECTOR OF TAX-EXEMPT ENTITY
LIABLE FOR UNPAID PAYROLL TAXES**

In a recent case, Jefferson v. United States, the 7th Circuit Court of Appeals affirmed that the president of the board of directors of a nonprofit day care may be held personally liable for the day care's unpaid payroll taxes.

Under federal law, a person responsible for collecting, accounting for and paying payroll taxes who willfully fails to do so may be liable for unpaid payroll taxes. Voluntary board members of tax-exempt organizations are exempt from this liability if they (a) are serving in an honorary capacity, (b) are not participating in the day-to-day or financial operations of the organization and (c) do not have actual knowledge of the violation.

Even though the board president in Jefferson served without compensation and claimed he did not know of the violation, he did not qualify for the exemption. Since the president was a co-signatory on checks, approved financial statements, hired an accounting firm and obtained loans for the day care, the court found that he was a "responsible person" under the federal statute. The president's failure to ensure that payroll taxes were paid was "willful" because he did not investigate whether such taxes were in fact being paid and did not institute appropriate controls, even though he knew of the day care's previous tax delinquency and had access to financial reports that indicated that its financial situation was deteriorating. Ultimately, the board president had too much responsibility to be considered "honorary" under the exemption.

This case highlights the importance of nonprofit board members' performing their fiduciary responsibilities with respect to financial oversight and legal compliance, including actively reviewing the organization's income and expense statements, balance sheets and budget status reports, and asking questions about the materials provided. If you are a nonprofit board member and you become aware that the organization is suffering financial difficulties (in particular, if it fails to pay taxes), then you have a duty to make specific inquiries about the issue and to ensure that the matter is resolved. If the organization is suffering from financial distress and cannot meet its payment obligations, then the board members must ensure that the organization takes immediate action to resolve the matter, such as negotiating a payment plan with the Internal Revenue Service, seeking other funding sources or winding down operations if no alternatives are feasible. For additional information about your duties and obligations as a nonprofit board member, please contact Attorney Elka Sachs.

Links:

- The case (Jefferson v. United States, 546 F.3d 477) can be found under Opinions, Case No. 06-4082:
<http://www.ca7.uscourts.gov/>
- The statute (26 U.S.C. §6672) can be found by entering "26USC6672" in the search box:
<http://www.gpoaccess.gov/uscode/index.html>
- Krokidas & Bluestein articles regarding nonprofit board service:
<http://www.kb-law.com/articles/documents/Sept08-p22-sachs.pdf> and
<http://www.kb-law.com/articles/documents/2007-09-01-wb.pdf>