



Personal Liability for Arizona Withholding and Sales Taxes

In this month's state and local tax (SALT) column, Busby cautions that owners, directors, officers and possibly even accountants and other persons charged with remitting withholding tax (collected from employees) and sales tax (collected from customers) could be held personally liable for these taxes if they do not remit them to the DOR.

In a 2008 decision, Arizona's Supreme Court observed that the state imposes personal liability for Arizona income tax withheld from employees but not paid to the DOR, and specifically addressed the personal liability of corporate officers and directors for sales tax collected from customers but not remitted to the DOR.

Personal Liability for Withholding Tax

As a tax that employers are required to collect from employees, account for and pay over to the DOR, Arizona income tax withheld from employees' income is an example of a trust fund tax. Other examples of trust fund taxes include federal income tax, social security tax, and Medicare tax — which businesses must collect from employees, account for and pay to the IRS.

Although personal liability for Arizona withholding tax was not at issue in this case, the court observed that the state imposes personal liability for Arizona income tax withheld from employees but not paid over to the DOR. For a trust fund tax, that was not surprising.

Personal Liability for Sales Tax

The court's analysis focused on whether a closely held corporation's shareholders, officers and directors were personally liable for amounts the corporation collected from its customers to pay Arizona sales tax but failed to remit before the corporation filed for bankruptcy protection.

As a starting point, the court observed that liability for Arizona's sales tax falls on vendors, not on vendors' customers. Vendors may pay the tax from their own funds, or they may impose a separate charge to cover the tax. If vendors impose a separate charge to cover the tax, they must remit all money collected as tax to the DOR even if they collect more money than they owe as tax.

Then the court explained that while Arizona's sales tax is not technically a trust fund tax, when a vendor imposes a separate charge to cover the tax — given the provisions of Arizona law outlined earlier — Arizona law treats it much like a trust fund tax.

The court held that, when corporate officers or directors collect amounts designated as "tax" from their customers rather than pay the tax using the corporation's own funds, those who hold, maintain control over, or have responsibility for the money collected separately as tax assume a duty to remit the tax that is not otherwise statutorily imposed. The benefit of collecting such money from customers as tax, according to the court, comes with the burden of personal liability for failing to remit the money.



by James G. Busby, Jr., CPA

James G. Busby, Jr., CPA, is a state and local tax attorney at The Cavanagh Law Firm. Busby previously worked in the SALT departments at Arthur Andersen and Deloitte & Touche. Before entering private practice, Busby was in charge of all transaction privilege (sales) tax audits at the Arizona Department of Revenue. If you have any questions, please contact the author. He can be reached at (602) 322-4146 or JBusby@CavanaghLaw.com.

Notably, although it was not at issue and therefore not part of the holding in this case, the court observed that personal liability may even extend to accountants or anyone charged with remitting the tax collected from customers.

Finally, the court concluded that personal liability for sales tax collected from customers in Arizona only extends to the amount collected, and not to any penalties or interest that may apply for failure to pay or timely remit the tax.

Practice Tip

Business owners and other responsible parties should be careful not to “borrow” money collected from employees or customers to cover withholding or sales taxes to use for other purposes because, if they do not pay the taxes, they may be held personally liable for the taxes. This is particularly true in Arizona, where personal liability may extend to not only the business’s owners, officers and directors, but also to accountants and others charged with remitting the tax to the DOR. ■