

THE RIGHT THING
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Sunday October 17, 1999
Payroll Tax, Temptation and Trouble

It might be the most often-cut corner in starting up a business: putting off remitting payroll taxes to the Internal Revenue Service. You don't have to talk to many veteran company founders to find one who has tried it – and probably regrets it.

"Entrepreneurs do a lot of things they have to do to keep going," said Gregory Conigliaro, chief executive of Conigliaro Industries in Framingham, Mass., which recycles paper, plastics, metal and glass. If they didn't, there would be a lot fewer companies around right now."

Mr. Conigliaro, who started his company in 1990 when he was 26, fell behind on payroll taxes in 1992. Ultimately, after being notified by the I.R.S., he ended up owing \$14,000, "half of which was interest and penalties," he said. He said he paid that sum and has since been current on all his taxes.

There is much cash-flow pressure on owners of nascent businesses, and the quandaries can be painful: Pay suppliers late and they cut you off, pay the landlord late and risk eviction, pay employees late and they walk out. It often comes down to who is the least likely to squawk – and the I.R.S., which generally doesn't know what you owe until you report it, is often the answer. Months may go by before the tax authorities notice that they haven't heard from you, and by then you'll find the cash to make up the arrears – or at least it's easy to tell yourself so. It's a common self-deception.

On a practical level, taking a Government "loan" this way is dicey. "We try to counsel business owners that the Government is the worst place you can imagine to 'borrow' money from," said Richard M. Colombik, a lawyer with International Tax Associates in Schaumburg, Ill. "You're paying a very high rate – interest plus a penalty. And they're the only creditor in the world that can seize your assets, garnish your bank account, and do it all without a court order."

But there are bigger issues here. The choice not to forward to the Government taxes withheld from employee paychecks, even if the alternatives appear worse, veers onto perilous ethical ground.

Some people distinguish between taking what was never theirs and being slow to relinquish what was once theirs but is no longer – and somehow rate the latter as not quite as bad. That thinking makes it easy to rationalize holding back the tax money a while. But it also shortens the leap to practices like diverting employees' 401(k) contributions or failing to forward their health insurance premiums, actions whose dire consequences fall on the innocent.

Seeing a dangerous precedent, many business owners treat as anathema even the thought of tax money as a source of emergency cash. "For me, it's the same as walking into a store and stealing something," said Christi Christich, who in 1985 founded Cristek Interconnects, a small company in Anaheim, Calif., that makes electronic connectors. "And I'd feel much worse about stealing from my employees."

Facing tough decisions, including ethical ones, is part of the territory for entrepreneurs, and it is only human nature for a business owner to seek the solution of least resistance. Temporarily diverting money withheld from employee paychecks can seem a seductively harmless short-term solution. Though at best this taints the trust between employer and employee, and at worst spares the company one peril by exposing it to another, it can feel hard-hearted to condemn someone in a scramble to keep a company afloat for yielding to the temptation. Only when a revenue officer shows up demanding a reckoning does the wrongness of the decision come into focus.

Then, of course, the only solution is to pay up. "You're holding these funds for the Government, but you didn't give it to them, and the Government does not take kindly to this," Mr. Colombik said, adding that the I.R.S. will aggressively pursue a business owner even if the company folds. But the agency generally doesn't come after employees to make good, he said, and rarely resorts to prosecution. "Most of the time, being a bad business person is not criminal," Mr. Colombik said, "If it was, we'd have a lot more people in jail."

Like many business owners, Mr. Conigliaro has decided to have temptation removed from his hands. "Probably the finest thing I ever did was switch over to a payroll service," he said. "Then you have no choice. The payroll tax comes out first."