

PODIUM

# Volunteerism Can Be Taxing

*President Bush calls the spirit of volunteerism 'a thousand points of light.' But for volunteers, when the IRS gets involved, the result may lead to financial and emotional devastation.*



Martin Kozlowski

**P**RESIDENT BUSH'S call for volunteers to serve communities across America is by now a part of political lore. During last year's presidential campaign, Mr. Bush repeatedly hailed the volunteer spirit, referring to it as a "thousand points of light." And to carry his plans out, Mr. Bush, on June 22, 1989, urged Congress to earmark \$25 million for the creation of a foundation that would coordinate community volunteerism. More recently, Mr. Bush has recorded public service messages for NBC-TV and ABC Radio, urging Americans to volunteer, and glorifying volunteers as the "unsung Americans."

At the same time, though, the Internal Revenue Service is attempting to hold uncompensated, volunteer officers and directors of non-profit organizations personally liable for the employee withholding and FICA taxes administrators of the organizations fail to pay. Unless President Bush is willing to seek some protection for volunteers, the result may be financial and emotional devastation for volunteers. Even worse, volunteers may determine their tasks are potentially too taxing.

Section 6672 of the Internal Revenue Code allows the IRS to hold "responsible persons" personally liable for unpaid employee withholding and FICA taxes. In order to be held a responsible person, the individual

must be someone required to collect, truthfully account for and pay over any tax. He or she must also have willfully failed to collect, truthfully account for and pay over the tax.

On Aug. 30, the Wall Street Journal reported: "Employers that don't turn in taxes withheld from employees — but use the cash, say, to pay other debts — are major IRS targets. Ultimately, the IRS tries to recoup its losses, plus interest, by seizing personal assets of responsible officials who willfully fail to remit taxes. At June 30, 1987, payroll-tax delinquencies were \$15.2 billion; the IRS had assessed \$5.6 billion against individuals."

It is unknown what percentage of the \$5.6 billion assessed against individuals is directed against volunteers. It is evident, however, the IRS applies the same standard to volunteers as to non-volunteers.

The standard, whether the person constitutes a "responsible person," is almost purely a question of fact. Although most states have enacted the Model Business Corporation Act, which protects members of a board of directors when they rely in good faith on reports of corporate employees, federal law probably pre-empts state law in this context. Accordingly, the IRS and potentially responsible volunteers are left with the task of developing facts for a judge or jury.

Clearly, the volunteers are at an economic disadvantage before the litigation even begins. For one thing, the volunteer bears the burden of proof. Accordingly, counsel for the volunteer invariably spends countless hours on depositions and affidavits. The vol-

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# Taxing the Spirit of Volunteerism

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unteer also bears the cost of his or her counsel. The United States, by comparison, has virtually unlimited resources.

It doesn't end there. If the volunteer prevails at trial, it can be a shallow victory. In order to recover attorney fees under I.R.C. 7430, the volunteer must prove the IRS was not substantially justified in its in-court litigation position. Generally, this has evolved into a test of reasonableness.

In a factually intensive case, the courts rarely rule on summary judgment. Therefore, most such disputes typically settle or go to trial. If a case settles or goes to trial on the facts, however, it is unlikely a court will hold the IRS took an unreasonable in-court litigation position. The result? The volunteer's request for attorney fees will invariably be denied.

On the other hand, if the volunteer loses at trial, the volunteer may be held personally liable for the full amount of any unpaid taxes. Regardless of the number of responsible persons, the IRS can selectively pursue and collect the full amount of the taxes from any responsible person it chooses. Fortunately, the total amount of unpaid taxes may only be collected once.

**T**HE INTERESTS of the United States in collecting unpaid taxes and promoting volunteerism are diametrically opposed. Right now, the collection of unpaid taxes is accorded the greater respect. The IRS has I.R.C. Sec. 6672. Volunteers have only fanfare (and an impotent I.R.C. Sec. 7430). The social value of volunteerism may justify an adjustment for volunteers.

Admittedly, the U.S. has a strong, even justified, interest in collecting \$15.2 billion in delinquent payroll taxes. The president and Congress search for funds to bail out the savings and loan industry, build stealth bombers, provide disaster aid and to fight drugs, homelessness and acquired immune deficiency syndrome. Public debate rages over the budget deficit and a national debt approaching \$3 trillion.

But when President Bush spoke of a "thousand points of light" he undoubtedly struck a chord in many Americans. Volunteerism and patriotism are synonymous terms for many Americans.

America was built on volunteerism. People helping people is one of the great cornerstones of our nation. "In America, the definition of a successful life must include service to others," Mr. Bush says.

Volunteerism goes by many names. In rural America, it is known as "community spirit." In our hospitals, schools and houses of worship, it is known as the "human spirit."

Only a few courts have addressed the conflict between the interest to collect taxes and to promote volunteerism. In *Holley v. U.S.*, 89-1 U.S.T.C. Sec. 9196 (E.D. Wis. 1989), the court identified the conflict, then held for the volunteers on the facts. Similarly, in *Simpson v. U.S.*, 88-2 U.S.T.C. Sec. 9474 (E.D. N.Y. 1987), the volunteers prevailed on summary judgment as a matter of law.

In *Holley*, Judge Evans of the Eastern District of Wisconsin was faced with the prospect of holding volunteers of a child development center liable for \$8,770.07 unpaid taxes. As government funding was reduced and financial records became in disarray, the child development center fell in tax arrears. After the child development center closed, the IRS relentlessly pursued the volunteers.

Judge Evans eloquently prefaced his opinion as follows:

In the early 1980's, the federal government started to cut back on

social programs. To take up the slack, it promoted volunteerism. The theory was that volunteers would fill in (and do a better job) where government programs left off. It was a return to an earlier age. This case demonstrates, however, that being a volunteer can be risky business.

Perhaps it is not the worst case imaginable. U.S. District Judge H. Lee Sarokin of New Jersey seems convinced that he has the worst case, and I understand what he means when he says:

This matter portrays the government at its heartless, rigid, and Orwellian bureaucratic worst. The plaintiffs in this action were engaged in selfless, dedicated charitable activity. They gave of their time and themselves to assist those in need. They received no personal gain other than the satisfaction derived from their charitable endeavors.

With unveiled sarcasm, Judge Sarokin continues:

The compassionate federal government, and particularly the well-known, warmhearted Internal Revenue Service, has chosen to reward them with personal liability for the nonpayment of withholding taxes

It was Judge I. Leo Glasser of the Eastern District of New York, in *Simpson*, however, who squarely identified the greater social value. The IRS was attempting to assess the board of trustees of a non-profit hospital for \$989,671.70 taxes the administrator failed to pay. Although Judge Glasser was satisfied members of the board of trustees were not responsible persons under established precedent, he added:

What is more, the precedent is amply justified by public policy. If the government's reading of "responsible person" were adopted, no rational individual would volunteer to serve on the board of a not-for-profit corporation, unless, at least, he were covered by a substantial insurance policy. There is a sufficient social value in having individuals agree to serve on the boards of hospitals, schools houses of worship, and the like that society ought to "be willing to permit such service to be unhindered by the risk of massive personal tax liability."

The opinions of Judges Evans and Glasser, unfortunately, will not slow the onslaught of the IRS. Because the responsible-person standard remains factually intensive, the IRS will continue to attack new cases with a vengeance.

**H**ERE'S AN example of how the IRS stance affects real lives:

The town of Mooreland is a rural community of approximately 1,400 people in northwestern Oklahoma. It could be a rural community in any other state.

In the 1940s, the Northwest Community Hospital Association was established there. The hospital was a non-profit corporation, which served patients across a five-county region.

By the late 1970s, the hospital was experiencing financial difficulties. Changes in Medicare reimbursement and competition from a new hospital in neighboring Woodward were taking its toll.

The board of directors of the Hospital was composed of seven uncompensated volunteers and one representative of the Mooreland Town Board. The board of directors of the hospital met on a monthly basis. Although their primary function was to act as community liaisons, they were also responsible for hiring the hospital administrator.

On Aug. 4, 1980, the board of directors

became dissatisfied with the hospital's performance and hired a new administrator, James Eker. Mr. Eker served as the administrator from Aug. 4, 1980, until Feb. 23, 1982.

During the term of Mr. Eker's administration, nine volunteers served on the hospital board of directors. The volunteers included Wayne Bouma (rancher), John Winters Jr. (farmer), Leland Hensley (pipeline employee), Aletha Clayton (retired teacher), Tom Clark (pipeline employee), Clarence Hunter (Baptist minister), Loreita Weber (housewife), Betty Hunt (housewife) and Timothy Schnoebelen (proprietor).

On Dec. 10, 1984, under pressure from the IRS, the hospital closed. It is insolvent and has not reopened.

On Dec. 17, 1984, the IRS proposed assessments against each of the volunteer directors who served during Mr. Eker's tenure as the hospital administrator. The proposed assessments ranged from \$51,610.66 to \$210,018.06 for employee withholding and FICA taxes that Mr. Eker failed to pay.

Ultimately, each of the nine volunteers paid a small portion of the proposed assessments. After claims for refunds were denied by the IRS, each of the volunteers brought suit against the United States in federal district court. As expected, the United States counterclaimed for the full amount of the proposed assessments.

The ensuing litigation took a financial and emotional toll on the volunteers. The IRS attached the volunteers tax refunds and filed tax liens against their properties, restricting their ability to convey their property or obtain credit. Meanwhile, the volunteers faced mounting legal fees.

On Jan. 13, 1989, the nine volunteers offered the United States collectively \$30,000 in complete settlement. The remote possibility of recovering attorney fees, if successful, made it advisable to attempt to settle for less than future additional legal fees.

The settlement offer was readily approved by the Dallas office of the Department of Justice. Unfortunately, however, the Washington, D.C., office rejected the offer on March 30, 1989.

On May 1, 1989, counsel for the volunteers responded to the United States' motion for summary judgment and filed a cross motion for summary judgment (with 13 affidavits) on behalf of each of the volunteers. The court denied each of the motions.

On June 13, 1989, the volunteers repeated their \$30,000 settlement offer. Again, the settlement offer was readily approved by the Dallas office of the Department of Justice. The Washington, D.C., office finally accepted the offer on Aug. 15, 1989 — more than seven months after the first settlement offer.

Three days after the settlement offer was finally accepted, Mr. Clark telephoned counsel to discuss the payment arrangement. He indicated he would have trouble paying if the IRS would not release his \$1,800 1987 federal tax refund, which the IRS had previously attached; Mr. Clark was reassured his tax refund would be taken into account.

Less than four hours later, Mr. Clark died of a massive heart attack. With the nearest open hospital over 20 miles away, he never had a chance.

**T**HE HOSPITAL case is settled now, but the issue remains. Greater respect is accorded the collection of taxes than the promotion of volunteerism. If America really wants volunteers, it should adjust the responsible person standard of I.R.C. 6672 or make the recovery of attorney fees under I.R.C. 7430 a realistic possibility for volunteers. Otherwise, volunteers may consider their tasks as potentially too taxing.