

No. 17-630

In the Supreme Court of the United States

ROBERT KARBAN, JR., PETITIONER

v.

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT*

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether petitioner, a person responsible for paying over to the United States trust-fund taxes withheld from the wages paid to the employees of his wholly-owned corporation, “willfully” failed to pay over those taxes within the meaning of 26 U.S.C. 6672(a), where petitioner knew that taxes were owed to the United States but chose to pay other creditors instead.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-6a) is not published in the Federal Reporter but is available at 2017 WL 5202101. The opinion of the district court (Pet. App. 7a-18a) is not published in the Federal Supplement but is available at 2016 WL 1696668.

JURISDICTION

The judgment of the court of appeals was entered on March 27, 2017. A petition for rehearing was denied on July 27, 2017 (Pet. App. 19a-20a). The petition for a writ of certiorari was filed on October 24, 2017. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Employers are required to withhold federal income taxes from their employees' wages and to remit those funds to the United States. 26 U.S.C. 3102(a), 3402(a). Until the taxes withheld from employee wages

can be remitted to the United States, employers hold the taxes in trust for the United States. 26 U.S.C. 7501(a); *Slodov v. United States*, 436 U.S. 238, 243 (1978). Unfortunately, troubled businesses sometimes find the taxes that they collect on behalf of the United States to be “a tempting source of ready cash.” *Slodov*, 436 U.S. at 243.

Section 6672 of the Internal Revenue Code, 26 U.S.C. 6672, addresses misuse of trust-fund taxes. If an employer withholds trust-fund taxes but fails to pay them over to the government, the government may collect the amount of unpaid tax from a “responsible person”—that is, “[a]ny person required to collect, truthfully account for, and pay over any tax”—who “willfully fails” to make the required payments. 26 U.S.C. 6672(a); see *Slodov*, 436 U.S. at 244-246 & n.7.

2. Petitioner was the sole owner of MasterCasters, Inc., a corporation that manufactured aluminum die castings primarily for automotive uses. He bought the corporation in 1996 with financing from Foothill Financial Corporation. Pet. App. 25a-27a. The loan agreement is not in the record, but petitioner testified on deposition that the corporation had agreed to certain covenants, violation of which would permit Foothill to “close the loan,” “call for immediate full payment,” and “take over control of the business.” *Id.* at 31a. Petitioner refers to this type of loan arrangement as a “lockbox agreement.” *Id.* at 30a.

After the purchase, petitioner was the chief executive officer and chairman of the corporation. He was the “top person there,” whose day-to-day responsibilities were “[t]o run the business” and make the final decisions. Pet. App. 28a, 30a. Each week, the accounting staff provided him with a list of creditors, together with

information about the funds available for payment. *Id.* at 35a. Petitioner decided which creditors to pay and how much, and he then signed checks prepared by the accounting staff. *Ibid.*

In early 1998, the corporation violated the Foothill loan covenants by overdrawing its checking account. Pet. App. 30a. Foothill notified the corporation's customers that payments were to be sent directly to Foothill. *Id.* at 31a.

Even after Foothill began funding checks to creditors, however, petitioner remained the person who determined which creditors would be paid. Petitioner continued to receive weekly lists of accounts payable from the corporation's accounting staff. He testified that he "would go through it and try to limit it to what was available, and set the priorities that I thought had to be made, and then I would submit that list to Foothill." Pet. App. 36a. Foothill reviewed and then returned the lists, sometimes with changes. *Ibid.* Petitioner then directed the accounting staff to prepare checks, which he signed and sent. *Ibid.*

Petitioner admitted that despite the approval list, he "could really write anything * * * and send it out" without additional review. Pet. App. 49a. He also admitted that "a couple times" (*ibid.*) he had yielded to pressure from certain suppliers and had paid an insistent creditor more than the amount approved by Foothill, taking the difference from another creditor on the approved list (*id.* at 49a-50a). Those checks cleared through Foothill, although Foothill warned him that it would stop the loan if he continued to change the pre-approved amounts. *Id.* at 50a. Petitioner admitted that he had considered paying the trust-fund taxes instead of other creditors, but that he had not done so because Foothill

“told me not to.” *Id.* at 51a-52a. During the third quarter of 1998, the corporation withheld \$183,564.37 in trust-fund taxes from the wages of its employees but did not pay them over to the United States. *Id.* at 58a.

3. The Internal Revenue Service (IRS) made an assessment against petitioner under Section 6672 in the amount of the unpaid taxes, determining that he was a person responsible for paying over the taxes who had willfully failed to do so. Pet. App. 60a. Petitioner paid a divisible portion of the assessment and filed an administrative claim for refund. After that claim was denied, he filed this suit for refund. D. Ct. Doc. 1 (Mar. 20, 2014). The government counterclaimed for the unpaid balance due. D. Ct. Doc. 9 (May 22, 2014).

The district court granted summary judgment to the government, concluding that petitioner was a “responsible person” within the meaning of Section 6672(a) and that he had acted willfully. Pet. App. 7a-18a. It rejected petitioner’s contention that the Foothill financing agreement had tied his hands, noting that petitioner had written the checks and that Foothill had no opportunity to approve or deny checks once they were written. *Id.* at 17a. The court viewed the facts here as similar to those in *Bell v. United States*, 355 F.3d 387 (6th Cir. 2004), where the court had held that “[v]oluntary contractual obligations * * * do not encumber funds so as to prevent a willful failure to pay trust fund taxes.” Pet. App. 12a (citation omitted).

4. The court of appeals affirmed. Pet. App. 1a-6a. Citing its opinion in *Bell*, the court rejected petitioner’s argument that the loan agreement with Foothill had negated his control over the trust-fund taxes. The court explained that, even if Foothill had “complete dominion” over the company’s finances, the funds still could

not be considered encumbered because petitioner had voluntarily entered into the loan agreement, ceding to Foothill whatever authority Foothill claimed. *Id.* at 4a (citation omitted). In holding that petitioner had acted willfully in failing to pay the taxes, the court relied in part on petitioner’s admissions that (i) after Foothill approved his lists of accounts payable, he would write checks without further review, and (ii) he had occasionally paid insistent suppliers more than the amount approved by Foothill. *Id.* at 5a.

After the court of appeals issued its decision, another panel of the Sixth Circuit “adopt[ed] the Second Circuit’s ‘reasonable cause’ exception to § 6672(a) liability, such that ‘a responsible person’s failure to cause the withholding taxes to be paid is not willful if he believed that the taxes were in fact being paid, so long as that belief was, in the circumstances, a reasonable one.’” *Byrne v. United States*, 857 F.3d 319, 329 (2017) (quoting *Winter v. United States*, 196 F.3d 339, 345 (2d Cir. 1999)). Petitioner obtained leave to file a late petition for panel rehearing, in which he argued that he had “reasonable cause” for failing to pay over the taxes. Pet. for Panel Reh’g 2-3. The court denied the petition, stating that petitioner had not “cited any misapprehension of law or fact that would alter the court’s prior order.” Pet. App. 19a-20a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or another court of appeals. Further review is not warranted.

1. The court of appeals correctly applied Section 6672 to the facts of petitioner’s case. Section 6672 im-

poses civil liability on any individual who (1) was “responsible” for collecting, truthfully accounting for, or paying over trust-fund taxes to the United States government; and (2) “willfully” failed to pay those taxes. See 26 U.S.C. 6672; *Slodov v. United States*, 436 U.S. 238, 245 (1978).

a. Petitioner does not dispute that he was “responsible” for paying over the withheld taxes during the taxable quarter in suit. Petitioner had significant authority over which of MasterCasters’ bills would be paid and when MasterCasters would pay them. Pet. App. 28a, 30a, 35a. Even after MasterCasters breached the loan agreement with Foothill and the “lockbox” provisions of the loan agreement took effect, petitioner continued to control payments to creditors. *Id.* at 36a, 46a, 49a-50a. Petitioner therefore was a responsible person under Section 6672. See, e.g., *United States v. Carrigan*, 31 F.3d 130, 133 (3d Cir. 1994) (“A responsible person need not have exclusive control over the company’s finances, he need only have significant control. A person has significant control if he has the final or significant word over which bills or creditors get paid.”) (citation and internal quotation marks omitted); *Purcell v. United States*, 1 F.3d 932, 937 (9th Cir. 1993) (similar); *Hochstein v. United States*, 900 F.2d 543, 547 (2d Cir. 1990) (similar).

b. Petitioner argues that he did not “willfully” fail to remit the withheld taxes to the United States. Pet. 7 (citation omitted). The court of appeals correctly rejected that contention. Under Section 6672, a person acts “willfully” when he pays other creditors with corporate funds while knowing that the trust-fund taxes owed to the United States remain unpaid. 26 U.S.C.

6672. The statute does not require a showing of fraudulent intent or bad motive on the responsible person's part. See, e.g., *Thosteson v. United States*, 331 F.3d 1294, 1300-1301 (11th Cir. 2003), cert. denied, 540 U.S. 1105 (2004); *Vinick v. Commissioner*, 110 F.3d 168, 173-174 (1st Cir. 1997); *Buffalow v. United States*, 109 F.3d 570, 573 (9th Cir. 1997); *United States v. Rem*, 38 F.3d 634, 642-643 (2d Cir. 1994); *Barnett v. IRS*, 988 F.2d 1449, 1457 (5th Cir.), cert. denied, 510 U.S. 990 (1993).

Applying that rule, the Sixth Circuit correctly held that petitioner had acted willfully because he knew of the unpaid taxes but chose to pay other creditors instead. Pet. App. 5a-6a. Petitioner admitted that he had known the taxes owed to the United States remained unpaid. *Id.* at 51a. Petitioner also admitted that he had considered paying the taxes but had chosen not to do so. *Ibid.* And despite petitioner's assertions that Foothill would not have allowed petitioner to pay Master-Casters' tax bill, petitioner acknowledged that he "could really write anything" on a check "and send it out." *Id.* at 49a. Indeed, petitioner stated that "a couple times" (*ibid.*) he had yielded to pressure from certain suppliers and had paid an insistent creditor more than the amount approved by Foothill, taking the difference from another creditor on the approved list (*id.* at 49a-50a). Although Foothill had expressed disapproval of that behavior, each of those checks had cleared the bank. *Id.* at 50a.

2. Petitioner contends (Pet. 8) that the decision below conflicts with decisions of other courts of appeals. Four circuits have held that the determination whether a responsible person "willfully" failed to pay over trust-fund taxes depends in part on whether the responsible person had "reasonable cause" for his failure to pay.

See, e.g., *Byrne v. United States*, 857 F.3d 319, 328-329 (6th Cir. 2017); *Conway v. United States*, 647 F.3d 228, 234 (5th Cir. 2011), cert. denied, 566 U.S. 936 (2012); *Winter v. United States*, 196 F.3d 339, 345-346 (2d Cir. 1999); *Finley v. United States*, 123 F.3d 1342, 1346-1348 (10th Cir. 1997) (en banc).^{*} Two other circuits have stated that the willfulness inquiry under Section 6672 does not turn on the presence or absence of “reasonable cause” for the non-payment. See *Harrington v. United States*, 504 F.2d 1306, 1315-1316 (1st Cir. 1974); *Monday v. United States*, 421 F.2d 1210, 1216 (7th Cir.), cert. denied, 400 U.S. 821 (1970). Those courts have expressed concern that the term “reasonable cause” may “tend to evoke notions of evil motive or bad purpose which properly play no part in the civil definition of willfulness.” *Monday*, 421 F.2d at 1216; see *Harrington*, 504 F.2d at 1315 (similar). They have held that “an act is ‘willful’ within the meaning of Section 6672 if it is voluntary, conscious and intentional.” *Harrington*, 504 F.2d at 1316; see *Monday*, 421 F.2d at 1216 (endorsing proposed jury instruction that, under Section 6672, “[a]n act is willful if it is voluntary, conscious, and intentional”). Contrary to petitioner’s contention, however, the decision below does not conflict with decisions that

^{*} Those courts of appeals have sometimes described “reasonable cause” as an “exception” to liability under Section 6672. See, e.g., *Byrne*, 857 F.3d at 329; *Winter*, 196 F.3d at 345. For the most part, however, those courts have treated the “reasonable cause” standard as a gloss on the statutory term “willfully.” See, e.g., *Byrne*, 857 F.3d at 329 (“adopt[ing] the Second Circuit’s ‘reasonable cause’ exception to § 6672(a) liability, such that ‘a responsible person’s failure to cause the withholding taxes to be paid is not willful if he believed that the taxes were in fact being paid, so long as that belief was, in the circumstances, a reasonable one’”) (quoting *Winter*, 196 F.3d at 345).

treat “reasonable cause” as part of the willfulness inquiry under Section 6672.

a. The court of appeals did not specifically address whether petitioner had “reasonable cause” for his failure to pay over trust-fund taxes, perhaps because, except for isolated sentences in his reply brief, petitioner did not frame his argument in those terms until his petition for rehearing. The court below stated that, under Section 6672, “[w]illfulness is established when a responsible person ‘had knowledge of the tax delinquency and knowingly failed to rectify it when there were available funds to pay the government,’ or deliberately or recklessly disregarded facts and known risks that the taxes were not being paid.” Pet. App. 4a-5a (quoting *Gephart v. United States*, 818 F.2d 469, 475 (6th Cir. 1987) (per curiam)). The court held that petitioner had acted “willfully” under that standard because he “was a responsible person, knew that the trust-fund taxes were not being paid, and still wrote checks to cover other liabilities of the company.” *Id.* at 5a. That holding is consistent with each of the purportedly conflicting decisions that petitioner cites. See *Byrne*, 857 F.3d at 327 (a responsible person acts willfully when he “becomes aware of a past due withholding tax liability” and “fails to use all unencumbered funds that come into his possession thereafter to pay the delinquent taxes”) (citations omitted); *Conway*, 647 F.3d at 234 (a “responsible person acts willfully if he knows the taxes are due but uses corporate funds to pay other creditors”) (citation and internal quotation marks omitted); *Winter*, 196 F.3d at 345 (“a responsible person acted willfully within the meaning of § 6672(a) if he (a) knew of the company’s obligation to pay withholding taxes, and (b) knew that

company funds were being used for other purposes instead”) (citation omitted); *Finley*, 123 F.3d at 1345 (“willfulness for purposes of imposing civil liability under § 6672 is a voluntary, conscious and intentional decision to prefer other creditors over the Government”) (citation and internal quotation marks omitted).

The courts of appeals have uniformly held that a responsible party’s decision to pay other creditors with knowledge that taxes owed to the United States remain unpaid constitutes a willful breach of duty for purposes of Section 6672. See, e.g., *Caterino v. United States*, 794 F.2d 1, 6 (1st Cir. 1986), cert. denied, 480 U.S. 905 (1987); *Hochstein*, 900 F.2d at 548 (2d Cir.); *Greenberg v. United States*, 46 F.3d 239, 244 (3d Cir. 1994); *Erwin v. United States*, 591 F.3d 313, 325 (4th Cir. 2010); *Logal v. United States*, 195 F.3d 229, 232 (5th Cir. 1999); *Gephart*, 818 F.2d at 475 (6th Cir.); *Garsky v. United States*, 600 F.2d 86, 91 (7th Cir. 1979); *Colosimo v. United States*, 630 F.3d 749, 753 (8th Cir. 2011); *Phillips v. United States IRS*, 73 F.3d 939, 942-943 (9th Cir. 1996); *Denbo v. United States*, 988 F.2d 1029, 1033 (10th Cir. 1993); *Thibodeau v. United States*, 828 F.2d 1499, 1505 (11th Cir. 1987) (per curiam). The decision below therefore is consistent with the decisions of other circuits that have treated “reasonable cause” for non-payment as negating willfulness under Section 6672.

b. The justifications that petitioner proffers for his failure to pay the trust-fund taxes would not constitute “reasonable cause” as other circuits have used that term. In *Finley*, for example, the Tenth Circuit held that a corporate president had not acted “willfully” under Section 6672 when the president ordered the treasurer of the corporation to pay outstanding trust-fund taxes and discovered that his order had not been carried

out only after funds were no longer available to make the payment. 123 F.3d at 1343-1344, 1348. On those facts, the Tenth Circuit held that the president had “reasonable cause” for his failure to remit taxes to the United States because “(1) the taxpayer ha[d] made reasonable efforts to protect the trust funds, but (2) those efforts ha[d] been frustrated by circumstances outside the taxpayer’s control.” *Id.* at 1348.

Unlike the corporate president in *Finley*, 123 F.3d at 1349, petitioner knew that the taxes were not being paid during the period that he authorized other uses of corporate funds. Pet. App. 43a. Petitioner also did not comply with *Finley*’s requirement that he take reasonable steps to protect the trust funds. 123 F.3d at 1348. Rather, petitioner simply acceded to Foothill’s pressure to pay only the creditors that it had approved (Pet. App. 51a), except for “a couple times” when he paid more than the approved amount to an insistent supplier and less to another creditor (*id.* at 49a-50a). The Tenth Circuit’s decision in *Finley* does not suggest that these circumstances would negate the element of willfulness by establishing “reasonable cause” for petitioner’s failure to pay the trust-fund taxes that he knew the company owed.

The Second Circuit has stated that a responsible person may avoid liability under Section 6672 if he reasonably believed that the trust-fund taxes were actually being paid. *Winter*, 196 F.3d at 345. After its decision in this case, the Sixth Circuit adopted that formulation of the reasonable-cause exception. See *Byrne*, 857 F.3d at 329; p. 5, *supra*. That formulation would not cover the facts of this case, however, because petitioner knew that the trust-fund taxes had not been paid and were not be-

ing paid in a timely manner. Although petitioner asserts (Pet. 18-19) that Foothill promised to pay the trust-fund taxes at some unspecified future time, that promise could not negate petitioner's willfulness in failing to pay the taxes when they were due.

The Fifth Circuit has recognized the possibility that a showing of reasonable cause could negate the willfulness element of Section 6672. See *Bowen v. United States*, 836 F.2d 965, 968 (1988) ("Although we have recognized conceptually that a reasonable cause may militate against a finding of willfulness, no taxpayer has yet carried that pail up the hill."). But the Fifth Circuit's understanding of "reasonable cause" does not encompass petitioner's contention (Pet. 4) that he did not act willfully because Foothill assured him that it would establish a reserve account for the trust-fund taxes and would pay them later. To the contrary, the Fifth Circuit has "repeatedly rejected the argument that a taxpayer's good faith belief that payment for the taxes had been arranged is a defense to personal liability under § 6672." *Conway*, 647 F.3d at 237 (citing *Mazo v. United States*, 591 F.2d 1151, 1157 (5th Cir.), cert. denied, 444 U.S. 842 (1979)). In *Bowen*, for example, the Fifth Circuit held that a banker's advice and assurance that a loan would be forthcoming when the IRS demanded payment did not constitute "reasonable cause." 836 F.2d at 968. There is no reason to believe that the Fifth Circuit would view petitioner's purported reliance on Foothill's promise of later payment as negating willfulness under Section 6672.

3. Petitioner argues (Pet. 16-21) that the decision below undermines *Slodov* because it imposes "strict liability" on responsible persons, in contravention of this Court's statement in *Slodov* that Section 6672 "was not

intended to impose liability without personal fault.” Pet. 17 (quoting *Slodov*, 436 U.S. at 254). Petitioner further argues (Pet. 21-23) that the Court should craft a limited “lock-box” exception to liability in order to “sav[e]” *Slodov*. Pet. 21. Petitioner misapprehends the decision in *Slodov* and the common understanding of “strict liability.”

In *Slodov*, the taxpayer bought the stock, and assumed the management, of three food-vending corporations. By the time he acquired them, the corporations had become delinquent in paying over taxes withheld from the employees’ wages, and the trust funds collected for that purpose had been dissipated. 436 U.S. at 240. After the taxpayer assumed control, the corporations acquired funds sufficient to pay the taxes, but he used the money to pay wages, rent, suppliers, and other creditors instead. *Ibid.* This Court concluded that, because the collected trust funds had already been dissipated when *Slodov* assumed control of the corporations, *Slodov* had not willfully failed to pay over the taxes that had previously been collected. *Id.* at 259. The Court explained that a responsible party would not violate Section 6672 “by willfully using employer funds for purposes other than satisfaction of the trust-fund tax claims of the United States when at the time he assumed control there were no funds with which to satisfy the tax obligation.” *Id.* at 259-260.

The Court limited the reach of its decision, however, by stating that, “[w]hen the same individual or individuals who caused the delinquency in any tax quarter are also the ‘responsible persons’ at the time the Government’s efforts to collect from the employer have failed, * * * there is no question that § 6672 is applicable to

them.” *Slodov*, 436 U.S. at 245-246 (citation and internal quotation marks omitted). Accordingly, the “personal fault” analysis in *Slodov* is satisfied where, as here, the responsible person “presided over the corporation every day during which taxes were [collected] and dissipated to satisfy corporate needs, at the expense of the public fisc.” *Davis v. United States*, 961 F.2d 867, 874 (9th Cir. 1992), cert. denied, 506 U.S. 1050 (1993); see *Mazo*, 591 F.2d at 1154 (“Where there has been no change in control, * * * responsible persons are subject to a duty to apply any available unencumbered funds to reduction of accrued withholding tax liability.”). Because petitioner was responsible for collecting and paying over the trust-fund taxes to the United States during the entire taxable period at issue here, the court of appeals’ decision holding him liable under Section 6672 is consistent with this Court’s decision in *Slodov*. And because the decision below was premised on petitioner’s deliberate choice to pay substantial sums to other creditors with the knowledge that the trust-fund taxes remained unpaid, that decision did not subject him to “strict liability” (Pet. 17) or liability without “personal fault” (Pet. 21).

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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