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Who Is a “Responsible Person”?

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Most often someone incurs a tax liability as a result of having income. In other words, those who have little or no income usually don't have tax problems. However, there are certain areas in which someone who never made money can still be liable for substantial tax, interest and penalties. One of those circumstances is where an employee, officer, director or shareholder of a business is held to be a “responsible person” and is liable for sales or withholding taxes not paid by a business.

Case Law

Three recent decisions from the New York State Tax Appeals Tribunal (one Administrative Law Judge Determination and two Appellate-level Tribunal decisions) address the issue of who is a responsible person liable for taxes not remitted to the State by a business in which he or she was involved.

Under both the sales tax¹ and the withholding of income tax,² employees as well as owners of a business may be liable for taxes not paid by the business.³ Originally, these provisions were enacted to ensure collection of “trust fund” taxes which were either collected from customers or withheld from payrolls and held “in trust” for the government. Now, at least in the sales tax area, the person responsible for collection of the tax may be assessed for penalties and interest on amounts not remitted and for sales taxes erroneously *not* collected or use tax owed by the business. The liabilities assessed are personal liabilities of the individual and may not be dischargeable even if the individual files a petition for protection under the Bankruptcy Law.⁴

In order to collect from an employee or other person involved in the business, the failure must be “willful.” The standard applied to willfulness is that the failure to pay the tax at issue was done consciously and voluntarily.⁵ It is not necessary to show an intent to deprive the government of the funds, but rather, that it was something more than accidental nonpayment. Also, the Tribunal has held that where the individual was deceived by others, there can not be a finding of willfulness.⁶

The factors that make a person responsible for the collection of sales tax or withholding tax include: status as an officer, director or shareholder of a corporation; the individual's knowledge of and control over the financial affairs of the business; authorization to hire and fire employees; whether the individual signed tax returns and checks for the business; and whether the individual had an economic interest in the business.⁷

In view of these factors, a close examination of the particular facts in each case is needed to arrive at a determination of which people involved in the operation of a business are “responsible persons” liable for

the tax. The mere holding of a corporate office does not, in and of itself, warrant the imposition of liability. Although, frequently the practice of the taxing authority is to assert liability against all officers in the first instance and sort it out later.

In *Matter of C.E. Fleming Corporation and Charles E. Fleming*,⁸ the answer was easier than most. The case also involved a claim of estoppel against the State for failure to supply withholding tax forms requested by the company; on that issue the Tribunal upheld the ALJ determination that estoppel was not applicable to governmental acts absent extraordinary circumstances deemed not to be present in this case. On the issue of personal liability, the fact that Mr. Fleming was the sole shareholder of the corporation, an employee of the corporation and the sole signatory on the corporate checking account led to the conclusion that he was responsible for the failure to remit withholding taxes that were shown on forms W-2 as withheld from employees wages for a period of ten years. Even assuming that Mr. Fleming had charged others in the organization with the responsibility regarding withholding taxes (the corporation's controller) did not relieve him of liability.

The two other cases decided recently involving responsible person assessments resulted in happier endings for the taxpayers. In each case, it was determined that the taxpayer assessed for the taxes did not have sufficient authority or control to be held personally liable.

The 'Frenette' Case

In *Matter of Roger Frenette*,⁹ a case involving a construction company and a failure to pay over withholding taxes on employees, Mr. Frenette ("Frenette or Petitioner") was an employee of Northwest Associates, Inc. and was asked to become an officer of Classic Carpentry, Inc. when the owners of Northwestern decided to start Classic as a new business. Frenette was asked to be president of Classic because of his good relations with the unions. Classic had no office staff and no office of its own. All of Classic's mail was delivered to Northwestern and the telephone was answered by Northwestern staff. Frenette was the only signatory on Classic's bank account and would sign payroll and other checks; at least some of the checks he signed were blank checks. Petitioner's main function was as a job superintendent on construction sites. He did not hire or fire employees.

Classic's payroll was prepared by an outside payroll service and reviewed by a staff member of Northwestern and, after the checks (including checks for the Federal and State withholding taxes) were signed by Frenette, the checks were left on the desks of the owners of Northwestern. One of the Northwestern staff members was aware that the withholding tax checks were never cashed because she reconciled the bank statements. She never told Frenette and he never asked to see bank statements or financial information.

Once Frenette received a notice from the IRS that withholding taxes had not been paid, he refused to sign any more checks and Classic ceased operations soon thereafter.

Petitioner obtained affidavits from the office staff of Northwestern confirming the facts stated above. Later, the IRS notified him that no further action would be taken against him for the delinquent withholding taxes although there was no formal statement that the IRS found him not to be a responsible person.

The Petitioner also introduced an affidavit of a forensic document examiner who found that several of the signatures on documents purporting to be Frenette's (including some tax returns) were, in fact, forgeries.

The Tribunal found additional facts that Frenette never attended high school, never owned a business and had no capital invested in Classic. He also did not negotiate transactions for Classic or participate in the management of the company. He merely allowed his name to be used to enhance the relationship with the union.

In the proceedings below, the ALJ had found the Petitioner credible but held him liable for the withholding tax because he signed checks, got wages from his employment in Classic, was listed as president and opined “that petitioner had failed to concern himself with whether or not the taxes were being paid and allowed himself to be used by the true owners of the business—individuals he knew or should have known were not trustworthy.” The ALJ also stated that there was no evidence that the IRS had determined Frenette not to be liable and even if there were such evidence, it did not bind the State.

In reversing the ALJ’s determination, the Tribunal found that Frenette was a carpenter with limited education, was not a shareholder, had no capital invested, was deliberately denied financial information and that some signatures were forged. The Tribunal also found that the requirement of willfulness was not met in that a “[l]ack of actual knowledge negates a finding that the act was voluntary or consciously done by petitioner unless it is determined that the officer recklessly disregarded his corporate responsibilities.”

A ‘Front’ for Owners

A similar case of a “front” for the owners of a business being assessed as a responsible person, *Matter of Kathy Rock*,¹⁰ involved sales taxes collected but not remitted. Kathy Rock (“Rock or Petitioner”) was a real estate broker in Plattsburgh, NY who brokered a deal for the lease of a building by two men who lived in Canada. They formed Silverstar Cafe, Ltd., a corporation for the purpose of operating a restaurant and bar. Since the owners were not US citizens, they asked Rock to make the application to the New York Liquor Authority for a liquor license.

Petitioner filed the liquor license application as president of the corporation showing others as owners of the stock. She also signed the application for registration as a sales tax vendor as president, was signatory on the business checking account but only occasionally signed checks when directed by the owners. Petitioner signed several tax returns including sales tax returns and corporate tax returns.

The ALJ held that Rock was not a responsible person under the sales tax law and was not liable for the tax not paid to the State. He based that determination on the fact that the Petitioner did not get any salary from the corporation, did not work for the business, had no ownership interest in the business and had no knowledge of the financial affairs of the business. He found that she, “was president of the corporation in name but had no authority to act for the corporation with respect to its responsibility to collect and pay sales taxes. Other indicia of a responsible person are minimally present in this case, however based on the credible testimony given by petitioner, I believe that she was not an active participant in the business.”

So, what do we learn from these cases? First, the State will assert a responsible person claim against anyone it finds is an officer or employee with check signing or other fiscal responsibility for the business. Second, it can be very expensive to defend against such an assessment and any defense requires extensive credible evidence not only that you are not responsible for the day-to-day activities of the business but also pointing out who has such responsibility. In each case in which the taxpayer was successful, someone else was identified as the one who was “calling the shots”. Third, honorific titles can be very dangerous.

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- ¹ Tax Law Search7RH1133(a).
² Tax Law Search7RH685 (g) and (n).
³ Under the sales tax law there is personal liability for tax, interest and penalties. *Matter of Lorenz v. Div. of Taxation*, 212 AD2d 992 (Third Dept., 1992). However, under the withholding tax law only a penalty equal to 100% of the tax can be claimed from the individual. *Wolfstich v. State Tax Commission*, 106 AD2d 745 (Third Dept., 1984).
⁴ 11 USC Search7RHSearch7RH 523(a)(1)(A) and 507(a)(7).
⁵ *Matter of Levin v. Gallman*, 42 NY2d 32 (Court of Appeals, 1977).
⁶ *Matter of Gallo*, Tax Appeals Tribunal, decided September 9, 1988.
⁷ See, *Matter of Cohen v. State Tax Commission*, 128 AD2d 1022 (Third Dept., 1987).
⁸ New York State Tax Appeals Tribunal, decided July 5, 2001.
⁹ NYS Tax Appeals Tribunal, decided August 23, 2001.
¹⁰ NYS Tax Appeals Tribunal Administrative Law Judge Unit, decided October 11, 2001.

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