

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
LEOPOLD GALLO	:	DECISION
	:	DTA NO. 800007
for Redetermination of a Deficiency or for	:	
Refund of Personal Income Tax under Article 22	:	
of the Tax Law for the Years 1971, 1972	:	
and 1973.	:	

Petitioner, Leopold Gallo, 1859 Como Park Boulevard, Lancaster, New York 14086. filed an exception to the determination of the Administrative Law Judge issued on December 10, 1987 with respect to a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1971, 1972 and 1973 (File No. 800007). Petitioner appeared by Salvatore M. Latona, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

The petitioner did not file a brief on the exception. The Division filed a letter in opposition to the exception. Oral argument was not requested.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner is liable for the penalty asserted against him pursuant to Tax Law section 685(g) with respect to withholding taxes due from Deplan Contracting, Inc.

II. Whether the Division of Taxation should be precluded from proceeding against petitioner in light of its failure to timely proceed against the bankrupt estate of Deplan Contracting, Inc.

FINDINGS OF FACT

We find the facts as stated in the determination of the Administrative Law Judge and such facts are incorporated in this decision by this reference. These facts are summarized below.

Deplan Contracting, Inc. was incorporated and began doing business in 1955. It was engaged in the business of contracting. Petitioner and three of his brothers each owned twenty-five percent of the shares of the corporation.

On October 28, 1974, the Division of Taxation issued a Notice of Deficiency along with a Statement of Deficiency to petitioner, Leopold Gallo, asserting a penalty equal to the amount of unpaid withholding taxes which the Division of Taxation determined to be due from Deplan Contracting, Inc. ("the corporation"). The notice asserted deficiencies as follows:

<u>Period</u>	<u>Amount</u>
1971	\$ 5,465.97
1972	28,184.81
1973	<u>1,732.40</u>
	\$35,383.18

During the period at issue petitioner was president of the corporation. He, along with his brothers, had authority to sign checks on behalf of the corporation. In connection with his office he signed corporate tax returns, including withholding tax returns. He was not involved in the payment of creditors of the corporation.

Petitioner and his brothers jointly hired an individual named Darwin Martin as office manager for the corporation. Mr. Martin had been employed as office manager for

approximately 14 years prior to the period at issue. This individual was assigned the responsibility of the day-to-day management of the corporation's financial affairs during the period at issue. Included among Mr. Martin's responsibilities were maintenance of corporate books and records and providing information to the corporation's certified public accountants. He was also responsible for the corporation's accounts payable and accounts receivable. Mr. Martin prepared and signed withholding tax returns on the corporation's behalf.

Petitioner was primarily involved in Deplan Contracting, Inc. as a field supervisor. In that capacity, he worked on site managing various construction projects.

Petitioner's annual salary from the corporation was \$46,000.00 during the period at issue.

The corporation also retained the services of an independent certified public accounting firm. This firm conducted a full audit of the corporation's operations on an annual basis during the period at issue and prepared corporate tax returns during this time.

During the period at issue, petitioner and his brothers, as shareholders of the corporation, met two or three times per year with Mr. Martin and the corporation's accountants. At no time prior to early February 1973 did either Mr. Martin or the accountants advise petitioner that the corporation was in financial difficulty or that taxes were not being paid. We modify finding of fact "8" of the Administrative Law Judge's determination by adding the following:

When questioned by petitioner's brother as to whether or not bills and taxes had been paid, Mr. Martin assured him that everything was going all right.

In early February 1973, petitioner was advised by a member of the accounting firm that the corporation was in serious financial difficulty.

We modify the finding of fact "9" of the Administrative Law Judge's determination by adding the following:

The disclosure was an outgrowth of a review of the corporation's finances in connection with its efforts to expand its line of credit with its bank. The events occurred shortly after the auditing firm completed its audit of the corporation's 1972 fiscal year which indicated no problem.

Petitioner subsequently undertook, along with the accountants, to determine the extent of the difficulty. It was determined that, for several years, Mr. Martin had failed to pay an overwhelming amount of the corporation's accounts payable and its withholding taxes. Mr. Martin was subsequently fired from the corporation.¹ The accounting firm had, in its audit of the corporation, failed to discover Mr. Martin's activities.

Upon learning of the extent of the corporation's financial difficulties, it was decided among the shareholders, upon the advice of counsel, to file a petition on behalf of the corporation under Chapter XI of the Bankruptcy Code. Said filing occurred on March 20, 1973. The petition was subsequently transferred to Chapter VII of the Bankruptcy Code and the corporation was duly adjudged bankrupt on May 8, 1973. The final day for filing claims by creditors against the bankrupt's estate was fixed by the bankruptcy court as December 4, 1973. The Department of Taxation and Finance, which had a claim against the bankrupt's estate, i.e., the unpaid withholding tax asserted against petitioner herein, failed to timely file its claim pursuant to the order of the bankruptcy court. The Department's claim was, therefore, rejected. It is undisputed that had the Department timely filed its claim it would have received approximately 78 percent of said claim from the proceeds of the bankrupt estate.

We also find as facts that petitioner, in 1982, commenced an action against the Trustee in Bankruptcy, and as nominal defendants, the Department of the Treasury and the New York State

¹The record indicates that petitioner testified before a grand jury in proceedings concerning Mr. Martin's activities, but does not indicate the result of such proceedings.

Tax Commission to compel the Trustee to pay outstanding Federal and State taxes owed by the corporation from \$100,000 of cash assets of the Deplan Corporation's parent company rather than unsecured creditors. A stipulation discontinuing said action was signed by all parties, including the State of New York.

In addition, \$96,000 was paid into the bankrupt's estate as a result of a settlement of a professional malpractice action brought by the Deplan Corporation against the accounting firm.

OPINION

The Administrative Law Judge determined that petitioner was a person required to collect, truthfully account for and pay over withholding taxes (a "responsible officer") and that petitioner's actions were "willful" within the meaning of Tax Law section 685(g) and that the penalty prescribed by that section should be imposed on petitioner, i.e., a penalty equal to 100 percent of the tax due.

On exception, petitioner concedes his status as a responsible officer, but argues that his action was not "willful" within the meaning of section 685(g). Further, petitioner argues that the State was negligent in failing to timely pursue its rights as a priority creditor against the bankrupt's estate and thus should be precluded from now seeking to recover against petitioner.

We reverse the determination of the Administrative Law Judge on the question of willfulness.

Tax Law section 685(g) penalizes those persons responsible for the withholding and paying over of such funds for willfully failing to so withhold or pay over. This section provides:

"Willful failure to collect and pay over tax. - Any person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other

penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No addition to tax under subsections (b) or (e) shall be imposed for any offense to which this subsection applies. The tax commission shall have the power, in its discretion, to waive, reduce or compromise any penalty under this subsection." (Emphasis added.)

The question of willfulness is related directly to the question of whether petitioner was a responsible officer since an officer responsible for the collection and paying over of the taxes is the one who can consciously and voluntarily decide not to do so. However, merely because one is determined to be a responsible officer, it does not automatically follow that a failure to withhold and pay over income taxes is "willful" within the meaning of that term as used in section 685(g). More is required. The Court of Appeals held in Matter of Levin v. Gallman (42 NY2d 32), the test is "whether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes ... No showing of intent to deprive the Government of its money is necessary but only something more than accidental non-payment is required" (Matter of Levin v. Gallman, supra, at 34 [emphasis added]).

The essence of the willfulness standard is that the person must voluntarily and consciously direct the trust fund monies from the State to someone else. There need not be any particular motive for doing so, only the result that the State has not received the monies held in trust for it. Mere negligence is not enough. The fact that section 685(g) imposes a penalty and is violated only by a willful failure is strong evidence that it was not intended to be imposed without personal fault. (See, e.g., Slodov v. United States, 436 US 238; Brown v. United States, 591 F2d 1136 [5th Cir 1979]; White v. United States, 372 F2d 513 [Ct Cl 1967]; Braden v. United States, 442 F2d 342 [6th Cir 1971] interpreting analogous language in section 6672 of the Internal

Revenue Code.)

Proof of this conscious and voluntary action is by necessity dependent on the facts and circumstances of each case. Here, the petitioner did not know of the failure to pay over the withholding taxes at the time the failure occurred. This lack of actual knowledge negates a finding that the act was voluntarily and consciously done by the petitioner (cf. Matter of Levin v. Gallman, 42 NY2d 32, 34, *supra* and Matter of MacLean v. State Tax Commn., 69 AD2d 951, 952, *affd* 49 NY2d 920 [where actual knowledge supported a finding of willful]).

However, a responsible officer's failure can be willful, notwithstanding his lack of actual knowledge, if it is determined the officer recklessly disregarded his corporate responsibilities including the responsibility to see that taxes were paid. (Matter of Capoccia v. State Tax Commn., 105 AD2d 528, 529; Matter of Ragonesi v. State Tax Commn., 88 AD2d 707, 708; compare, Reyers v. State Tax Commn., 116 AD2d 880; Matter of Lyon, Tax Appeals Tribunal, June 3, 1988.)

In the instant case, petitioner was not a responsible officer who recklessly disregarded his corporate fiduciary responsibilities. Instead, petitioner made a reasonable delegation of responsibility, exercised reasonable supervision over his delegate and reasonably relied on the information provided to him. These facts are similar to those in Reyers v. State Tax Commn. (*supra*, at 201) which the Appellate Division, Third Department found negated a finding of willfulness.

Petitioner delegated authority to pay the withholding taxes to Mr. Martin a professional business manager and an accountant. Mr. Martin had been responsible for running the day-to-day affairs of the corporation for 14 years. The record reveals no evidence to counter the long,

reliable performance of Mr. Martin and to suggest that petitioner's reliance on Mr. Martin was not reasonable.-

Petitioner supervised Mr. Martin's management of the corporation through an annual audit performed by the independent certified public accounting firm. In addition, petitioner met with Mr. Martin and the corporation's accountants periodically to keep abreast of the corporation's finances. In view of Mr. Martin's long, apparently successful, professional experience in managing the corporation, this constituted adequate supervision of Mr. Martin's activities.

At no time prior to early February of 1973 did petitioner receive information from Mr. Martin, directly or indirectly, or from the certified public accounting firm that the corporation was experiencing financial difficulty. The 1972 audit of the corporation, completed early in 1973, indicated no problems. Furthermore, there is no evidence in the record that petitioner was alerted to the financial problems of the corporation from any outside source, including suppliers and other creditors. The Division of Taxation did not give notice to petitioner of the nonpayment of the withholding taxes until October 28, 1974, long after the corporation filed its petition in bankruptcy. Petitioner reasonably concluded from the information provided to him that the financial affairs of the corporation were in order.

Finally, even if petitioner had cause to suspect some financial difficulties in the corporation, petitioner was not in a position to determine that the withholding taxes were not paid. Mr. Martin so effectively concealed his failure to pay the corporation's creditors, including the State, that the 1972 audit by the certified public accountants did not reveal these financial problems. This effective deceit by Mr. Martin negates a finding that the failure to pay the withholding tax arose from petitioner's reckless disregard for his responsibility. Therefore,

petitioner did not willfully fail to collect or pay over tax, within the meaning and intent of section 685(g) of the Tax Law.

In view of the above decision the issue as to whether the Division of Taxation should be precluded from proceeding against petitioner in light of its failure to proceed against the bankrupt estate of the corporation is moot.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the petitioner, Leopold Gallo, is granted;
2. The determination of the Administrative Law Judge is reversed; and
3. The petition of Leopold Gallo is granted and the Notice of Deficiency issued on October 28, 1974 is cancelled.

DATED: Albany, New York
SEP 09, 1988

John P. Dugan
President

Francis R. Koenig
Commissioner