STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
HERBERT ROUNICK	:	DECISION DTA No. 803076
for Redetermination of a Deficiency or for Refund of Personal Income Tax under Article 22 of the Tax Law for the Period October 1, 1980 through December 15, 1980.	:	

The Division of Taxation filed an exception[1] to the determination of the Administrative Law Judge issued on September 7, 1990 with respect to the petition of Herbert Rounick, 15 West 53rd Street - 38 A/F, New York, New York 10019 for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the period October 1, 1980 through December 15, 1980. Petitioner appeared by Kostelanetz, Ritholz, Tigue & Fink (Jules Ritholz, Esq., of counsel). The Division of Taxation appeared by William F. Collins, Esq. (Herbert Kamrass, Esq., of counsel).

The Division of Taxation filed a brief in support of its exception. Petitioner filed a brief in opposition.

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

ISSUE

Whether the actions of petitioner were willful within the meaning of Tax Law § 685(g).

[1]Petitioner moved to dismiss the Division of Taxation's notice of exception. The motion was denied by the Tax Appeals Tribunal (Matter of Herbert Rounick, Tax Appeals Tribunal, March 28, 1991).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for findings of fact "6" and "18" which have been modified. TheAdministrative Law Judge's findings of fact and the modified findings of fact are set forth below.

On December 23, 1985, the Division of Taxation ("Division") issued a Notice of Deficiency to petitioner, Herbert Rounick, asserting a deficiency of personal income tax for the year 1980 in the amount of $57,338.15. A Statement of Deficiency, which was issued on the same date, explained that the Division was asserting the deficiency against petitioner as a person required to collect, truthfully account for and pay over the taxes withheld from the wages of the employees of Don Sophisticates, Inc. ("DSI") for the period October 1, 1980 through December 15, 1980.

During the period in issue, DSI was in the business of manufacturing women's apparel under the trademark of Charlotte Ford. The garments were sold in department stores and specialty stores in the United States.

Major shareholders of the corporation included Coca-Cola which owned 20 percent, Caressa Shoe Corporation which owned 31 percent, Sumair which owned 4 percent and petitioner who owned 31 percent. The balance of the shares was owned by the general public.

During the period in issue, petitioner was the chairman of the board and chief executive officer of DSI. In this position, his time was consumed in manufacturing, merchandising and sales. Petitioner's duties required him to travel a minimum of 50 percent of the year to such places as India, Brazil, Portugal, Spain, Korea and China.

In the early part of December 1980, it was projected at the board of directors meeting that DSI would have a profit for the year of between $400,000.00 to $500,000.00. After the meeting, petitioner went on a vacation to Mexico. Petitioner returned to New York on or about January 4, 1981. After staying in New York for one or two days, petitioner proceeded to Hong Kong on business of the company.

We modify finding of fact "6" of the Administrative Law Judge's determination to read as follows:

> During the last week of January 1981, Mr. Cohen, who was DSI's chief financial officer, remitted an Employer's Return of Tax Withheld for five consecutive semi-monthly periods commencing October 1, 1980. Each of the returns was accompanied by a check for the amount shown due on the returns.[2]

While he was in Hong Kong, petitioner was advised by Mr. Cohen that there was difficulty with the projection of profits and that a large loss was anticipated. Petitioner immediately returned to New York and on February 2, 1981 went into his office to review the new projected financial position. In the course of a meeting, petitioner specifically asked Mr. Cohen about the prospect of the officers being held liable for withholding taxes. Mr. Cohen responded that all New York State withholding taxes had been paid.

A few days after the first meeting, petitioner and Mr. Cohen had another meeting regarding DSI's financial position. At that time there was no concern about New York State withholding tax because the participants in the meeting felt that the taxes in issue had been paid. However, they did make arrangements to pay Federal taxes.

The board of directors of DSI continued to hold meetings and on February 18th or 19th, 1981 the decision was made to file a petition for relief under Chapter 11 of Title 11 of the United States Bankruptcy Act. When DSI filed its petition, it was given the status of debtor in possession and new bank accounts were opened under the name Don Sophisticates, Inc., Debtor

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[2]The original finding of fact "6" of the Administrative Law Judge's determination read as follows:

> "6. During the last week of January 1981, Mr. Cohen, who was DSI's chief financial officer, remitted an Employer's Return of Tax Withheld for five consecutive periods commencing October 1, 1980. Each of the returns was accompanied by a check for the amount shown due on the returns."

This fact was changed to more fully reflect the record that semi-monthly returns were filed.

in Possession. The new checks had debtor in possession stamped on them. The prior bank account was frozen by the court.

In 1981 Norstar Bank, which was known at that time as State Bank of Albany, received checks in payment of New York State withholding taxes and was responsible for depositing such checks. A check in payment of New York State withholding taxes deposited by the State Bank of Albany in 1981 would ordinarily have reached the Federal Reserve Bank in Utica for processing within one business day after deposit.

Each of the withholding tax returns and checks mailed by Mr. Cohen on behalf of DSI were received by the Division on February 3, 1981 except for the return for the period November 1, 1980 through November 15, 1980 which was received on February 1, 1981. Thereafter, the checks were dishonored because of insufficient funds. Those checks which were available at the time of the hearing show that they were not processed by the Utica office of the Federal Reserve Bank of New York until February 18, 1981. A second date stamp reveals that the Utica office of the Federal Reserve Bank of New York processed the checks for a second time on February 24, 1981.

The dishonored checks were the basis for the Notice of Deficiency which was issued to petitioner.

In or about the end of March 1981, petitioner was discharged by the board of directors of DSI. Petitioner left DSI in April 1981. DSI continued to operate as a debtor in possession until on or about the end of 1983.

On or about April 6, 1981, the Division issued to DSI five notices and demands for payment of New York State and/or New York City withholding tax due. The notices, which were dated April 15, 1981, indicated that the checks which had accompanied the returns for the periods October 1, 1980 through December 15, 1980 had been dishonored. At the same time the Division issued the notices and demands, it issued notices of unpaid remittance to DSI which stated that certain checks had been returned unpaid by the bank because of insufficient funds.

DSI maintained its checking account with Chemical Bank. When DSI drew a check on its account with Chemical Bank, the funds would be provided by Citibank. In practice, Mr. Cohen called upon Citibank to provide funds as needed. Citibank provided the funds because it had standby letters of credit in excess of $2,000,000.00 from Caressa Corporation and approximately $2,000,000.00 from Coca-Cola. It also had petitioner's personal guarantee.

Until DSI filed its petition for bankruptcy, there were sufficient funds in DSI's checking account to cover the checks for withholding taxes which were drafted during the last week of January 1981. Moreover, during petitioner's tenure, DSI never had a check dishonored for insufficient funds.

Petitioner never saw the notices and demands or the notices of unpaid remittances while he was at DSI and, until 1986, he was under the impression that DSI's withholding taxes had been paid.

We modify finding of fact "18" of the Administrative Law Judges determination to read as follows:

> Although he rarely did so, petitioner had the authority to sign checks. Similarly, although he had the authority to sign tax returns, petitioner had no recollection at the time of the hearing of having done so. Petitioner hired DSI's chief financial officer, Mr. Cohen. Mr. Cohen is a certified public accountant and is familiar with the payment of withholding taxes. Prior to working for DSI, Mr. Cohen was an auditing manager for a major accounting firm and had been the audit manager on DSI's account.[3]

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[3]The original finding of fact "18" of the Administrative Law Judge's determination read as follows:

> "18. Although he rarely did so, petitioner had the authority to sign tax checks. Similarly, although he had the authority to sign tax returns, petitioner had no recollection at the time of the hearing of having done so. Petitioner hired DSI's chief financial officer."

This fact was changed to more fully reflect the record.

OPINION

The Administrative Law Judge determined that the notice of deficiency was not barred by the statute of limitations, that petitioner was a "person" under Tax Law § 685(g), and that petitioner's actions were not "willful" within the meaning of Tax Law § 685(g). The Administrative Law Judge granted the petition of petitioner and cancelled the notice of deficiency.

On exception, the Division asserts that: petitioner's conduct was willful because petitioner should have known of the deteriorating financial condition of DSI; his failure to know constituted a reckless disregard of his duties; the tax deficiency was caused by this poor financial condition; the Division did not unreasonably delay in depositing the checks; and there were insufficient funds to cover the checks.

In opposition, petitioner asserts that: he did not act willfully because he specifically inquired about payment of the taxes; his reliance on the chief financial officer's response was reasonable; his reliance on the chief financial officer was justified because the taxes had in fact been paid; and the checks were dishonored solely due to the State's delay in cashing them.

We affirm the determination of the Administrative Law Judge on the issue of willfulness.

Tax Law § 685(g) operates to impose liability on those persons responsible for the collection and remittance of withholding taxes who willfully fail to collect or remit such funds. Section 685(g) provides as follows:

> "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."

Determining liability under section 685(g) requires a two-step analysis. First, it must be established that the party is a "person required to collect . . . account for, and pay over the tax"; i.e., a responsible officer. The Administrative Law Judge found petitioner to be a responsible officer. This finding is not in issue on this exception.

The second step is to establish that the failure to withhold and pay over taxes was willful. The test for willfulness 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" (Matter of Levin v. Gallman, 42 NY2d 32, 396 NYS2d 623, 624). It is not necessary to show an intent to deprive the government, but something more than accidental non-payment must be demonstrated (Matter of Levin v. Gallman, supra). Negligence is not enough. Rather, what must be shown is that the responsible officer was aware of the fact that certain funds were allocated to satisfy withholding tax obligations and that, despite this awareness, the officer nonetheless chose to use those funds for another purpose (Matter of Levin v. Gallman, supra [officer responsible for making and remitting employee income tax deductions allowed the funds to be used for other purposes]; Matter of Dorfman v. Chu, 148 AD2d 917, 539 NYS2d 549 [officer responsible for making and remitting employee income tax deductions used the funds to satisfy other obligations]; Matter of Wolfstich v. New York State Tax Commn., 106 AD2d 745, 483 NYS2d 779 [officer filed returns without payment and issued checks knowing there were inadequate funds to cover them]; Matter of Gardineer v. State Tax Commn., 78 AD2d 928, 433 NYS2d 242 [officer responsible for making and remitting employee income tax deductions used the funds for other purposes]; see also, Matter of MacLean v. State Tax Commn., 69 AD2d 951, 415 NYS2d 492, affd 49 NY2d 920, 428 NYS2d 675 [responsible officer inferred to be aware that withholding taxes were not being paid]).

Determining whether a responsible officer knew that the funds were destined to satisfy withholding tax obligations is a factual inquiry which must be made on a case-by-case basis. In the present case, the Division does not assert that petitioner knew that the withholding taxes had

not been paid. This lack of actual knowledge prevents a finding that petitioner consciously and voluntarily directed government funds to other purposes.

However, a lack of personal knowledge, by itself, may not serve to insulate a responsible officer from liability. Liability may still be imposed if it is determined that the officer's lack of knowledge regarding the non-payment of withholding taxes was the result of a reckless disregard of that officer's duties. Reckless disregard may be due to either personal inattentiveness (see, Matter of Ragonesi v. New York State Tax Commn., 88 AD2d 707, 451 NYS2d 301 [officer delegated payment of withholding taxes to bookkeeper, who failed to remit funds due for one year]; Matter of McHugh v. State Tax Commn., 70 AD2d 987, 417 NYS2d 799 [officers prepared payroll and collected funds to pay employees, yet failed to collect and remit withholding taxes for two years]) or an unreasonable delegation of authority to another individual (Matter of Flax, Tax Appeals Tribunal, September 9, 1988 [officer delegated calculation and preparation of withholding taxes to bookkeeper, who failed to remit funds due for six months]).

This is not to say that every delegation of authority is reckless. Reasonable delegations of authority will avoid a finding of willfulness (see, Matter of Reyers v. New York State Tax Commn., 116 AD2d 880, 498 NYS2d 199 [officer delegated preparation and filing of tax returns to bookkeeper, often inquired as to their status, and relied on skill and judgment of outside accounting firm]; Matter of Lyon, Tax Appeals Tribunal, June 3, 1988 [officer delegated daily operations to the experienced chief operating officer and hired an accountant to prepare and file tax returns]).

Petitioner, as a responsible officer, did not recklessly disregard his duties as chairman of the board and chief executive officer. His delegation of authority to the chief financial officer, Mr. Cohen, was reasonable. Petitioner's duties required him to engage in substantial international travel, spending at least fifty percent of his time abroad. The semi-monthly remittance of the withholding taxes was delegated to Mr. Cohen, an experienced certified public

accountant knowledgeable in the financial affairs of DSI generally, including the handling and payment of withholding tax returns.

Further, petitioner was aware of and satisfied his obligations with respect to the payment of the withholding taxes. Upon learning of the projected loss for DSI, petitioner returned from Hong Kong to New York. In one of several meetings, petitioner specifically inquired as to his potential liability for withholding taxes due. Mr. Cohen replied that all New York State withholding taxes had been paid.

Further investigation would have confirmed Mr. Cohen's assurances, as withholding returns and checks had been mailed for the five outstanding periods. Additionally, DSI had a line of credit of approximately $4,000,000.00 with the bank and never had a check dishonored for insufficient funds.

Mr. Cohen had mailed the withholding tax returns and accompanying checks at the end of January, 1981. All returns were received by the Division by February 3, 1981. The two checks available at the hearing indicate that they were not processed at the Federal Reserve Bank of New York (Utica) until February 18, 1981 (see, Exhibits H-1; H-2). This delay was unusual and was not explained by the Division.

To summarize, petitioner did not willfully fail to remit withholding taxes. Petitioner did not have actual knowledge that the taxes had not been paid. Further, petitioner did not recklessly disregard his duties. His delegation of authority to Mr. Cohen was reasonable in light of Mr. Cohen's experience, and his reliance on Mr. Cohen was justified given the financial arrangements DSI had. Subsequent events beyond the control of petitioner caused the withholding taxes to not be paid.

In its exception, the Division has challenged several factual conclusions made by the Administrative Law Judge. These challenges warrant discussion because some of the challenged facts serve as a basis for our conclusion that petitioner did not willfully fail to pay the withholding taxes.

First, the Division asserts that the findings of fact should be modified to state that the withholding payments at issue were all late. The facts state that the deficiency at issue concerned the period October 1, 1980 through December 15, 1980, and that payment of withholding taxes for this period was made on January 2, 1981. This shows that the payments were late. Therefore, no modification is necessary.

Second, the Division requests as a fact a statement that DSI was experiencing financial difficulty because the taxes and other bills were sixty to ninety days late, suggesting in its brief that DSI's credit arrangements had been withdrawn. The Division also asserts that petitioner's claim that DSI had sufficient funds is contradicted by evidence of its poor financial condition in the fourth quarter of 1980 and the failure to secure an additional line of credit. DSI was experiencing financial difficulty -- the December, 1980 projection of profits was found to be incorrect and a revised projection indicated that a loss was expected. But there was no showing of insufficient funds prior to the petition for Chapter 11 bankruptcy prepared in February, 1981 (see, Exhibit 4).

The Division points to the November 29, 1980 Summary Statement of Assets and Liabilities, noting the absence of cash on hand and bank accounts. This document is evidence of DSI's financial condition as of November, 1980, but it fails to address the credit arrangement which existed between DSI and its banks. Mr. Cohen testified that Citibank would transfer funds to DSI's Chemical Bank account as needed, based upon the credit arrangements DSI had with Citibank (see, Tr., pp. 66-70, 80-81). Mr. Cohen further testified that, as a result of this arrangement with Citibank, there were sufficient funds to cover the withholding tax checks up to the date of filing for bankruptcy (see, Tr., pp. 66-67).

Likewise, there was no showing of financial insolvency or withdrawal of the line of credit prior to the petition for Chapter 11 bankruptcy. The first mention of reduction in credit appears in the bankruptcy petition prepared in February, 1981.

The Administrative Law Judge determined that sufficient funds were available to cover the checks when issued. We agree with the findings of the Administrative Law Judge, which involve, in part, the evaluation of the credibility of Mr. Cohen (see, Matter of AAA Sign Co., Tax Appeals Tribunal, June 22, 1989). Therefore, we find the facts requested by the Division, with respect to the payment of other bills, irrelevant.

Third, the Division has requested a statement that there is no proof of when the bank account may have been frozen by the bankruptcy court, or whether payment was denied by the trustee in bankruptcy. The Division is correct in its assertions. However, we do not see the value of stating what has not been proved, given what has been established. It has already been established that petitioner met his obligations as a responsible officer under Tax Law § 685(g). It has further been established that subsequent events beyond the control of petitioner led to the non-payment of the withholding taxes. Therefore, we decline to add a negative fact that we conclude is irrelevant.

Fourth, the Division requests a fact stating that the affiants who identified the date that the checks were processed were not available for cross-examination. The Administrative Law Judge expressly provided the Division with the opportunity to re-open the hearing based upon the contents of the affidavits submitted (see, Tr., p. 136). The failure of the Division to take advantage of this opportunity renders the fact requested by the Division misleading.

In sum, the Division cannot rely on hindsight to infer wrongful conduct by petitioner. The fact that DSI ultimately went bankrupt is not a valid basis for imposing additional investigatory responsibilities on petitioner. The Administrative Law Judge determined that petitioner satisfied his obligations under Tax Law § 685(g) and that factors beyond petitioner's control resulted in the non-payment of the withholding taxes. After reviewing the entire record, we agree with the determination of the Administrative Law Judge on the issue of willfulness.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Herbert Rounick is granted; and

4. The Notice of Deficiency dated December 23, 1985 is cancelled.

DATED: Troy, New York
October 17, 1991

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Maria T. Jones
Maria T. Jones
Commissioner