STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
TERRENCE P. O'REILLY	:	DECISION DTA NO. 818564
for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Years 1992 through 1998.	:	

Petitioner Terrence P. O'Reilly, 92 New Chalet Drive, Mohegan Lake, New York 10547, filed an exception to the determination of the Administrative Law Judge issued on January 9, 2003. Petitioner appeared by DeGraff, Foy, Holt-Harris, Kunz & Devine, LLP (James H. Tully, Jr., Esq., of counsel). The Division of Taxation appeared by Mark F. Volk, Esq. (Margaret T. Neri, Esq., of counsel).

Petitioner filed a brief in support of his exception and the Division of Taxation filed a brief in opposition. Petitioner filed a reply brief. Oral argument, at petitioner's request, was heard on November 19, 2003 in Troy, New York.

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

ISSUE

Whether petitioner was liable for a penalty pursuant to Tax Law § 685(g) as a person required to collect, truthfully account for and pay over withholding tax, with respect to a law firm with which he was affiliated, who willfully failed to do so.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. These facts are set forth below.

Petitioner, Terrence P. O'Reilly, was admitted to practice law in the State of New York in 1967. From 1967 to 1973, petitioner was an assistant district attorney in the New York County District Attorney's Office. In 1973, petitioner joined the law firm of Foley, Hickey, Gilbert and Power. John Power and Richard Hickey were the active partners in the firm at such time, with Mr. Foley having died shortly before petitioner's association with the firm, and Jacob Gilbert, a retired Congressman, having little active involvement in the firm. The firm, which at that time consisted of approximately six attorneys, carried on a general practice of law, including corporate and commercial work, trusts and estates, and related litigation. Petitioner was hired as the firm's litigator to replace Mr. Foley.

In 1979, after six years with the firm, petitioner approached the two partners, John Power and Richard Hickey, and demanded to be made a partner in the firm. In turn, at some point in 1980, petitioner was advised that he had been made a full partner in the firm, and that his compensation would be a draw of $500.00 per week against five percent of the firm's annual gross income.

During the same time period, the formerly amicable relationship between Richard Hickey and John Power was deteriorating. The dispute between the two individuals continued to worsen, and ultimately, petitioner sided with Richard Hickey such that, at the end of 1981, the matter came to a head and John Power was voted out of the firm. Petitioner noted that his vote was driven by his belief that the majority of the firm's clients would remain with Richard Hickey

(and petitioner) as opposed to John Power. In 1981, the name of the firm was changed to Foley, Hickey, Gilbert and O'Reilly,[1] and petitioner was made an authorized signatory on the firm's two bank accounts (a regular checking account and a special account).

Petitioner stated that there was no written partnership agreement for the firm at any time, and that he simply relied on Richard Hickey's word that he was a full (i.e., 50%) partner in the firm and that he was receiving 50 percent of the firm's income, gain, loss and deductions. The firm employed an accountant, and for the years 1979 through 1985, petitioner received copies of the firm's partnership tax return (Form 1065) and his own accompanying Schedule K-1 (Partner's Share of Income, Credits, Deductions, Etc.) for such years. Petitioner was listed as a 50 percent partner on these forms. Petitioner did not involve himself in meetings with the firm's accountant and Richard Hickey.

In 1985, Richard Hickey terminated the firm's accountant upon the stated reason that the firm could no longer afford his services. Mr. Hickey handled the firm's finances and books from such time forward. When checks for disbursements, court fees and the like were needed, petitioner would ask Richard Hickey for the necessary amounts, and Mr. Hickey would, in turn, cut the required checks.

Petitioner did not receive or see a copy of either Form 1065 for the firm, or Schedule K-1 for himself, for any of the years 1986 through the mid-1990s, notwithstanding his demands that Richard Hickey provide the same. Instead, petitioner was furnished, annually, with a half-sheet of paper showing his income amount from the firm. Petitioner, in turn, filed his own tax returns

[1] Jacob Gilbert died in the mid-1970s.

using the amount shown on this half-sheet of paper as partnership income, allegedly doing so because he did not know how else to file.

During the years in issue, the firm had several employees. Both petitioner and Richard Hickey had secretaries, and there was also a receptionist. From time to time, the firm would also hire associate attorneys. Petitioner drafted and placed advertisements for such associates, and conducted the initial interviews of such prospective firm employees, making hiring recommendations thereafter to Richard Hickey.

During the period 1977 through 1994 the firm, and most directly petitioner, was involved in litigating a complicated partnership accounting case in Supreme Court, Kings County, on a 50-percent contingency fee basis. Petitioner anticipated a substantial payment under this arrangement and the trial court initially awarded the firm's client over four million dollars, of which petitioner anticipated the firm would receive 50 percent. However, the matter was remanded on appeal and, after a new trial, the firm's client received only approximately $35,000.00. Despite having time records representing fees in excess of one million dollars for the case, the firm's contingency agreement with its client resulted in very small legal fees for the firm.

The impact of the foregoing litigation put a severe cash flow strain on the firm. Petitioner never saw the firm's bank statements or payroll tax returns during the years in issue, never asked to see such tax returns, and never inquired as to whether withholding taxes were being paid. Petitioner stated that since Richard Hickey had not shown him any partnership tax returns, he never expected that Mr. Hickey would show him any payroll tax returns. Nonetheless, petitioner stated, in testimony, that "I assumed he [Richard Hickey] was doing the right thing." Petitioner

remained with the firm throughout the period in question and until the present time. He remained initially in anticipation of the ultimately unrealized substantial payment from the accounting action and thereafter because he believed his options to go elsewhere were limited.

The Division of Taxation ("Division") determined that withholding tax returns had not been filed and withholding taxes had not been remitted by the firm for any of the years 1992 through 1998. As a result, on May 15, 2000, the Division issued to petitioner a total of 14 notices of deficiency asserting penalties equal to the unpaid New York State and New York City withholding tax owed by the firm: [2]

YEAR	NYS TAX	NYC TAX
1992	$6,499.56	$1,046.28
1993	$6,724.44	$1,492.12
1994	$8,450.64	$2,221.56
1995	$5,409.72	$1,761.00
1996	$6,521.76	$1,997.64
1997	$7,041.84	$1,848.24
1998	$6,352.32	$2,426.52

Only limited records, in addition to the firm's checkbook, were available upon audit. The record does include wage and tax statements (Forms W-2) for the firm's employees for each year, listing specific wages and deductions for each employee, together with Forms W-4 (Employee's Withholding Tax Allowance Certificate) for some of the listed employees. These records reveal that the number of firm employees for the years in issue were as follows:

[2] The amount columns list the penalty equal to the amount of unpaid New York State and New York City withholding tax for the years 1992 through 1998. They do not include interest asserted due.

YEAR	NUMBER OF EMPLOYEES
1992	4
1993	6
1994	4
1995	4
1996	3
1997	7
1998	7

The respective wage amounts listed on these records bear out that some, though not all, of the firm's employees were short-term or part-time employees. Neither Richard Hickey nor petitioner were listed as employees on these forms.

The Division also presented Records of Employment and Earning for some of the firm's employees for the years 1996, 1997 and 1998, listing specific amounts of weekly wages and deductions. No such records were presented for the earlier years in issue (1992 through 1995).

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

In his determination, the Administrative Law Judge noted the penalty imposed by Tax Law § 685(g) on a person required to collect, truthfully account for, and pay over withholding tax who willfully failed to do so. The Administrative Law Judge also observed that a person subject to the section 685(g) penalty includes a member or employee of any partnership who is under a duty to perform the act in respect of which the violation occurs.

The Administrative Law Judge cited applicable case law which has established criteria for determining whether a person is under a duty to collect and pay over withholding taxes. The Administrative Law Judge provided that if petitioner is a person under a duty to collect, account

for and pay over withholding taxes, it must then be decided whether his failure to do so was willful. The Administrative Law Judge noted that merely because one is determined to be a person under such a duty, it does not automatically follow that a failure to withhold and pay over income taxes is "willful" under Tax Law § 685(g). The Administrative Law Judge cited relevant case law concerning the criteria which determine willfulness.

The Administrative Law Judge held that petitioner was properly held responsible for the withholding tax obligations of the partnership. The Administrative Law Judge found that petitioner was a partner in the firm, despite his arguments to the contrary. The Administrative Law Judge noted that while petitioner apparently took little involvement in the firm's ongoing business operations, he was one of the two partners in the firm during the years at issue and clearly had the authority and responsibility to determine whether or not the firm's withholding obligations were being met.

The Administrative Law Judge found that petitioner did not exercise the authority he had as a partner and as a signatory on the firm's bank accounts. The Administrative Law Judge rejected petitioner's position that he did not have or could not have exercised sufficient authority and control over the firm's affairs, was misled by reasonable reliance upon the advice of Richard Hickey as to the conduct and status of firm matters, and was thwarted in his efforts to act.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that he had no authority to act on behalf of the partnership and, therefore, was not a person under a duty to collect and pay over withholding taxes. Petitioner maintains that he had no more authority when he was given the title of "partner" than he did when he was an associate. Petitioner asserts that he was deliberately denied access to the

firm's financial information and, therefore, was not a responsible person for collecting and paying withholding tax. Petitioner insists that even if he was a person under a duty to collect and pay over withholding tax, he did not willfully fail to carry out this duty because he lacked actual knowledge that the tax was unpaid and he was precluded from obtaining the necessary information regarding the tax. Petitioner also argues that even if there was a partnership in existence, it was dissolved in 1996 when petitioner filed for personal bankruptcy.

The Division, in opposition, argues that the Administrative Law Judge correctly determined that petitioner was a person responsible for collecting and paying over withholding tax on behalf of the partnership and that his failure to do so was willful.

OPINION

Tax Law § 685(g) provides:

> [w]illful 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.

Tax Law § 685(n) makes the following "persons" subject to the section 685(g) penalty:

> an individual, corporation, partnership or limited liability company or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, or a member, manager or employee of a limited liability company, who as such officer, employee, manager or member is under a duty to perform the act in respect of which the violation occurs.

In ***Matter of Levin v. Gallman*** (42 NY2d 32, 396 NYS2d 623), the Court stated that 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 . . . . 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***, 396 NYS2d, at 624-625).

We noted in ***Matter of Gallo*** (Tax Appeals Tribunal, September 9, 1988) that:

> 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 Gallo***, ***supra***, ***citing Matter of Capoccia v. New York State Tax Commn***, 105 AD2d 528, 481 NYS2d 476; ***Matter of Ragonesi v. New York State Tax Commn***., 88 AD2d 707, 451 NYS2d 301).

We have held that the fact-based inquiry of whether a petitioner was a person within the definition of Tax Law §685(n) is similar to that used to determine responsibility for sales tax purposes (***see, Matter of Cohen v. State Tax Commn.***, 128 AD2d 1022, 513 NYS2d 564). The question to be resolved in any particular case is whether the individual had or could have had sufficient authority and control over the affairs of the corporation to be considered a responsible officer or employee. In ***Cohen***, the court noted a variety of factors as indicative of responsibility, including: status as an officer, director, or shareholder; 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 for the corporation; and whether the individual had an economic interest in the corporation. However, the holding of corporate office alone does not, in and of itself, warrant the imposition of liability (***see***, ***Chevlowe v. Koerner***, 95 Misc 2d 388, 407 NYS2d 427).

In proceedings before the Division of Tax Appeals, the petitioner carries the burden of proof by clear and convincing evidence (***see, Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679; ***see also, Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451; ***Matter of Tavolacci v. State Tax Commn.***, 77 AD2d 759, 431 NYS2d 174; Tax Law § 689[e]). To prevail in this case, petitioner was required to establish by clear and convincing evidence that he was not a partner or employee having a duty to act on behalf of the partnership; i.e., that he lacked the necessary authority or he had the necessary authority, but he was thwarted by others in carrying out his partnership duties through no fault of his own (***cf., Matter of Moschetto***, Tax Appeals Tribunal, March 17, 1994; ***Matter of Turiansky***, Tax Appeals Tribunal, January 20, 1994).

First, we consider petitioner's position that he was not an actual partner in the law firm. Pursuant to Partnership Law § 10, a "partnership" "is an association of two or more persons to carry on as co-owners a business for profit." Pursuant to Partnership Law § 11, the receipt by a person of a share of the profits of a business is prima facie evidence that he is a partner in the business. Further, the testimony of petitioner establishes that he believed that he had been made a 50% partner in the law firm by Richard Hickey in 1981. Moreover, for several years petitioner received a partnership Schedule K-1 and petitioner reported his income from the law firm throughout the period at issue as income from a partnership.

Despite the fact that there is no evidence of a written partnership agreement and no evidence of a capital contribution by petitioner to the partnership, we agree with the Administrative Law Judge that a partnership existed between Richard Hickey and petitioner for the years at issue. As for petitioner's argument that even if a partnership existed, it was dissolved on the bankruptcy of petitioner in 1996, Partnership Law § 62(5) provides that a

partnership is dissolved by the bankruptcy of any partner. However, Partnership Law § 61 provides that on dissolution, the partnership is not terminated but continues until the winding up of partnership affairs is completed.

Petitioner testified that in 1981, he was made an authorized signatory on the firm's two bank accounts (a regular checking account and a special account). However, there is no evidence that he ever wrote a single check or engaged in a single transaction on either of those accounts during the course of the years at issue. Petitioner testified that he never saw a bank statement, that Richard Hickey controlled the checkbook and wrote all checks on behalf of the partnership himself, keeping the checkbook locked in his desk. Petitioner testified that Richard Hickey even controlled access to the mail, opening all mail before it was given to petitioner.

Petitioner testified that from the time that Richard Hickey terminated the accountant for the law firm in 1985, he "never from that day on saw a single partnership document although I demanded them from Hickey many times" (Tr., p. 14). Further, petitioner testified that:

> I can't write checks. I have no authority whatsoever over hiring or firing of staff. I don't write payroll checks or any other kind of checks.
>
> And I have never ever filed or signed a tax return on behalf of the firm, whether it's a payroll tax return or any other kind of return.
>
> In short, I have never signed a paper, a check or any other document other than an affirmation and a motion where I say that I'm a member of the firm. Because I don't know what else to call myself.
>
> I have absolutely no authority to act on behalf of that firm. Nor have I been permitted to (Tr., pp. 20-21).

The audit report contains no information regarding petitioner's responsibilities at the law firm, no copies of checks signed by petitioner, no tax returns signed by petitioner or any evidence whatsoever linking petitioner to the financial administration or tax reporting responsibilities of the law firm. Instead, the auditor's notes simply identify Richard Hickey as

the "tax matter person per [IRS Form] 1065. He was also the one that the auditor dealt with and the one who signed the consent" (Exhibit "E," p. 1).

In spite of this, however, petitioner was aware as early as 1985 that the partnership was undergoing financial difficulties. As a partner, at that point in time, petitioner should have inquired as to the financial situation of the partnership, its solvency and its tax compliance status. Petitioner knew that he was no longer receiving a Schedule K-1 from the partnership detailing his annual distribution. This irregularity should have put him on notice that not only was Richard Hickey failing to provide him with evidence of the partnership's profits but that such information may not have been provided to the IRS as well.

A partner does not have a liability under Tax Law § 685(g) merely because of his status as a partner. However, where a partner is presented with information indicating the strong likelihood that taxes are not being paid, such partner ignores this situation at his or her peril. A partner is jointly and severally liable for the debts and obligations of the partnership (***see,*** Partnership Law § 26). Under Article 4 of the Partnership Law, all partners have equal rights in the management and conduct of the partnership business (***see,*** Partnership Law § 40[5]), are entitled to access the partnership books, to inspect and copy them (***see,*** Partnership Law § 41), are entitled to full and true information regarding the partnership (***see,*** Partnership Law § 42) and an accounting as to partnership affairs (***see,*** Partnership Law § 44). Petitioner's acquiescence in Richard Hickey's refusal to share partnership information with petitioner does not eliminate his liability. By failing to exercise his rights as a partner to inquire into the partnership affairs as they were being conducted by Richard Hickey, petitioner allowed himself to be exposed to the unpaid tax liability of the partnership.

Petitioner did not testify that he was misled by Richard Hickey or that he was shown false documents indicating that tax returns were being filed and taxes were being paid. Rather, petitioner inquired and was refused information that would have allowed him to realize that the partnership was not in compliance with its tax reporting obligations. After being refused information regarding the partnership, petitioner did nothing. By failing to exercise his remedies under the Partnership Law, petitioner acquiesced in this situation. Although he may not have had a duty to personally file tax returns and remit taxes to the Division on behalf of the partnership, he was under a duty to see that the partnership did so and he was in a position to carry out this duty, even if it required legal action against Richard Hickey.

In order for petitioner to be held liable, his actions must also be "willful" as that term is used in Tax Law § 685(g). Just as in the case of personal responsibility, the resolution of the issue is driven by the facts and circumstances of each case. 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 (***see, Matter of Gallo***, ***supra, citing Matter of Capoccia v. New York State Tax Commn.***, ***supra***; ***Matter of Ragonesi v. New York State Tax Commn***., ***supra***). As one of two partners in the law firm, petitioner's admitted failure to inquire as to whether withholding taxes were being paid to the State cannot be condoned as benign neglect. Rather, it constitutes a reckless disregard of his partnership responsibility and was willful within the meaning of Tax Law § 685(g).

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Terrence P. O'Reilly is denied;

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

3. The petition of Terrence P. O'Reilly is denied; and

4. The Notices of Deficiency dated May 15, 2000 are sustained.

DATED: Troy, New York
May 17, 2004

/s/ Donald C. DeWitt
Donald C. DeWitt
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner