JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **98-07-30-008 / PRECEDENTIAL**
ID: **P9300382**
DATE: **07-30-98**
DISPOSITION: **DENIED**
TAX TYPE: **SALES / WITHHOLDING**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. At all times relevant to this proceeding, Protestant held the office of President for and on behalf of CORPORATION ("Corporation") and was the sole shareholder of the common stock of the Corporation.

2. Protestant was a signatory of the corporate account out of which the creditors of the Corporation were paid and was primarily responsible for the day to day operations of the business.

3. In 1988 or 1989, Protestant's major supplier of inventory and principal creditor, insisted upon a Lockbox Arrangement wherein all proceeds from the business were to be placed. According to Protestant, he had no access to the Lockbox. Further, Protestant testified that MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR contacted his customers and instructed them to send all future payments to the Lockbox.

4. According to Protestant, the funds collected in the Lockbox included sales and withholding taxes.

5. Concerning the payment of creditors, Protestant testified that he was required to make a written request to MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR. MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR would review the request, advise him which creditors he could pay and electronically transfer the funds to the corporate account for such payments.

6. The sales and withholding taxes in controversy cover approximately the last three months the business was open. Up to this time, the taxes for the business had always been filed and paid.

7. Protestant admits that the sales and withholding tax amounts assessed are correct and reflect the amounts reported by him on the sales and withholding tax returns filed for the periods at issue.

8. The amounts assessed against Protestant are as follows:

SALES TAX

Tax:	$19,819.34
Interest(9/30/96):	10,458.07
Penalty:	1,981.93
TOTAL:	$ 32,259.34

WITHHOLDING TAX

Tax:	$ 2,057.17
Interest(9/30/96):	1,071.66
Penalty:	606.17
TOTAL:	$ 3,735.00

9. Protestant notified MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR of the delinquent taxes and demanded payment thereof. MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR refused Protestant's request.

10. The money remaining in the Lockbox upon the closure of the business was applied to Protestant's note with MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR.

ISSUES

Two issues are presented for decision. The first issue is whether under applicable Oklahoma law, a principal officer's liability for the failure to remit sales tax and an employer's liability for the failure to withhold or remit withholding taxes is dependent on a finding of willfulness. The second issue is whether the Lockbox Arrangement with MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR nullifies Protestant's personal liability.

Protestant contends that his failure to remit the sales and withholding taxes was not willful and therefore, personal liability for the taxes should not attach. In support of this contention, Protestant argues that the Lockbox Arrangement imposed by MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR and MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR'S knowledge of his financial condition created a situation of economic duress. Protestant further argues that because of the Lockbox Arrangement he no longer had any significant control over the financial affairs of the Corporation and did not effectively participate in any decisions concerning the disbursement of corporate funds.

The Division contends that Protestant should be held personally liable for the sales and withholding taxes since the applicable Oklahoma statutes do not contain a willfulness component. In support of this contention, the Division argues that the words "willful" or "willfully" do not appear in the Oklahoma statutes. The Division further argues that Protestant should not be exonerated from liability because of the Lockbox Arrangement since all the factors considered in determining personal liability are applicable with regard to Protestant's role with the Corporation.

APPLICABLE LAW

The relevant provisions of the Oklahoma Statutes are Section 1361(A)[1] and Section 2385.3(d)[2] of Title 68. In furtherance of these provisions, Section 253 of the Uniform Tax Procedure Code, 68 O.S. 1991, § 201 et seq., provides:

> When the Oklahoma Tax Commission files a proposed assessment against corporations for unpaid sales taxes, withheld income taxes or motor fuel taxes collected pursuant to Article 5, 6 or 7 of this title, the Commission shall file such proposed assessments against the principal officers of such corporations personally liable for the tax. The principal officers of any corporation shall be liable for the payment of any tax as prescribed by this section if such officers were officers of the corporation during the period of time for which the assessment was made.
>
> The liability of a principal officer for sales tax, withheld income tax or motor fuel tax shall be determined in accordance with the standards for determining liability for payment of federal withholding tax pursuant to the Internal Revenue Code of 1986, as amended, or regulations promulgated pursuant to such section.[3]

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[1] This subsection provides in pertinent part:

> Every person required to collect any tax imposed by this article, and in the case of a corporation, each principal officer thereof, shall be personally liable for said tax.

[2] This section provides in pertinent part:

> Every employer who fails to withhold or pay to the Tax Commission any sums herein required to be withheld or paid shall be personally and individually liable therefor to the State of Oklahoma. The term "employer" ... includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer or employee ... is under a duty to act for a corporation or partnership to withhold and remit withholding taxes....

[3] Amended by Laws 1989, c.249, § 16, eff. July 1, 1989. Prior to the amendment, this section provided:

> When the Oklahoma Tax Commission files a proposed assessment against corporations for unpaid sales taxes and withheld income taxes, the Commission shall file such proposed assessments against the principal officers of such corporations, if such officers are liable under the laws of Oklahoma.

The provision of the Internal Revenue Code which imposes a penalty equal to the total amount of the federal withholding tax evaded, not collected or not accounted for and paid over is found at 26 U.S.C. § 6672(a). Section 6672(a) provides:

> General rule. - Any person required to collect, truthfully account for, and pay over any tax imposed by this title 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 any such 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.

The courts have developed a two prong test for imposition of the penalty under Section 6672. ***In Re Bernard***, 130 B.R. 740, 745 (Bkrtcy.W.D.La. 1991). See, ***Cooke v. United States***, 796 F. Supp. 1298 (N.D. Cal. 1992) and ***Feist v. United States***, 607 F.2d 954 (Ct. Cl. 1979). The first prong requires a finding that the person assessed is a "responsible person". The second prong requires the finding of a willful failure to collect, or truthfully account for, or pay over the tax. The burden of proof on each issue is borne by the taxpayer. ***Id***.

The courts have also developed standards to be utilized in determining whether each prong of the test has been satisfied. Under the first prong, the factors considered by the courts include the individual's status as an officer or director, the individual's duties as outlined in the corporate bylaws, the individual's ownership of shares or possession of an entrepreneurial stake in the company, the individual's role in the day-to-day management of the company, the individual's ability to hire and fire employees, the individual's authority to sign checks of the corporation and the individual's control over the financial affairs of the corporation. See, ***Rizzuto v. United States***, 889 F.Supp. 698 (S.D.N.Y. 1995); ***United States v. Carrigan***, 31 F.2d 130 (C.A. 3rd 1994); ***Hochstein v. United States***, 900 F.2d 543 (C.A. 2nd 1990). Under the second prong, the court considers whether the individual's decision to prefer other creditors over the government was voluntary, conscious and intentional, whether the individual acted with reckless disregard to an obvious or known risk of nonpayment of the taxes, whether individual took independent action to procure payment after being notified of the failure to remit taxes and whether the individual had knowledge of the delinquency. See, ***Denbo v. United States***, 988 F.2d 1029 (C.A. 10th 1993); ***Bussey v. United States***, 800 F. Supp. 1493 (W.D.Mich. 1992); ***Turnbull v. United States***, 929 F.2d 173 (C.A. 5th 1991).

In contrast to Section 6672, Sections 1361(A) and 2385.3(d) do not contain the words "willful" or "willfully." Section 1361(A) imposes personal liability on "[E]very person required to collect any tax imposed by this article, and in the case of a corporation, each principal officer thereof". Section 2385.3(d) imposes personal liability on "[E]very employer who fails to withhold or pay to the Tax Commission any sums herein required to be withheld or paid". Since Sections 1361(A) and 2385.3(d) do not contain a "willfulness" component, the determination of liability under Section 253 is limited to the standards for determining who is a "responsible person". Otherwise, the provisions of the statutes which impose liability and the provisions of the statute which provide the standard for determining liability would be in conflict which, under Oklahoma law, is to be avoided. See, ***Macy v. Freeman***, 814 P.2d 147 (Okl. 1991) and ***Roach v. Atlas Life Ins. Co.***, 769 P.2d 158 (Okl. 1989).

Responsible persons cannot delegate away their statutory responsibility of truthfully reporting and remitting taxes by agreeing to lockbox arrangements. See, ***Lee v. United States***, 951 F.Supp. 79 (W.D.Pa. 1997), citing ***Kalb v. United States***, 505 F.2d 506 (2nd Cir. 1974). In ***Kalb***, the Court rejected plaintiffs' assertion that the financing arrangement whereby the delinquent company's bank controlled its finances and prevented them from paying the withholding taxes despite the company's insistence thereof, relieved the plaintiffs' statutory responsibility. The ***Kalb*** Court reasoned:

> To permit corporate officers to escape liability . . . by entering into agreements which prefer other creditors to the government would defeat the entire purpose of the statute. . . . [W]ithholding taxes are held in trust. We cannot imagine that in any context a trustee could avoid his obligations by entering into an agreement by which funds entrusted to him are used to pay his other obligations. ***Id***. at 510.

In ***Lee***, the Court held that any evidence pertaining to a lockbox arrangement between a lender and a company whereby the lender refused to approve the payment of taxes, was irrelevant and did not negate the plaintiffs' status as a responsible persons under the applicable statute. See, ***Mortenson v. United States***, 910 F.Supp. 1325 (N.D.Ill. 1995). The Court in ***Lee*** reasoned that "to hold otherwise would force the government into becoming an unwilling partner in an enterprise of questionable finances at the whim of the taxpayers." Id. at 82.

Protestant argues that equitable considerations dictate absolution of any personal liability. The undersigned, however, finds that equity favors the state in this matter. The state is statutorily restricted as to whom or from whom it can seek restitution. See, 68 O.S. 1991, §§ 1361(A) and 2385.3(d). Further, the state was not a party to the Lockbox Arrangement and cannot sue thereunder. As stated in ***Collins v. United States***, 848 F.2d 740, 741-742 (6th Cir. 1988), "the government cannot be made an unwilling partner in a floundering business." Finally, Protestant received the benefit of these funds in that they were used to reduce his note payable to MAJOR SUPPLIER OF INVENTORY AND PRINCIPAL CREDITOR.

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Tax Commission. 68 O.S. 1991, § 207.

2. A "principal officer" or an officer or employee who is an "employer" of a corporation may be personally liable for the sales and withholding taxes of the corporation. 68 O.S. 1991, §§ 1361(A) and 2385.3(d).

3. Whether a "principal officer" or an "employer" is personally liable for the taxes of the corporation is determined in accordance with the standards for determining liability for payment of federal withholding tax pursuant to the Internal Revenue Code. 68 O.S. 1991, § 253.

4. Sections 1361(A) and 2385.3(d) do not contain a "willfulness" component and therefore, the determination of liability under Section 253 is limited to the standards for determining who is a "responsible person".

5. Evidence pertaining to a lockbox arrangement is irrelevant and does not negate a principal officer's or an employer's status as a responsible person. See, ***Lee v. United States***, 951 F.Supp. 79 (W.D.Pa. 1997) and ***Kalb v. United States***, 505 F.2d 506 (2nd Cir. 1974)

6. Here, the evidence proves that Protestant was a "principal officer" and an "employer" of the Corporation. Further, the evidence proves that Protestant was a "responsible person" for the sales and withholding taxes of the Corporation. Accordingly, Protestant's protest to the proposed sales and withholding tax assessments should be denied.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is DETERMINED that the protest be denied. It is further DETERMINED that the amounts in controversy, plus any additional accrued and accruing interest, be fixed as the deficiencies due and owing.

OKLAHOMA TAX COMMISSION