**JURISDICTION:** **OKLAHOMA TAX COMMISSION - DECISION**
**CITE:** **99-03-23-005 / NOT PRECEDENTIAL**
**ID:** **P9600214 / P9600216**
**DATE:** **03-23-99**
**DISPOSITION:** **DENIED**
**TAX TYPE:** **WITHHOLDING**
**APPEAL:** **NO APPEAL TAKEN**

## FINDINGS OF FACT AND CONCLUSIONS OF LAW

Upon review of the file and records, including the record of the hearing and the exhibits received into evidence, the undersigned finds:

1. Protestants were the founders and incorporators of THE CORPORATION (hereinafter "Corporation"). At all times relevant, Protestants were authorized signatories on the operating account of the Corporation.

2. Protestants admit they were officers and directors of the Corporation during the audit period.

3. The Corporation was acquired by ANONYMOUS, INC., formerly known as XXX Corp., in June 1994, at which point the Corporation became a wholly owned subsidiary of ANONYMOUS, INC.

4. Protestants also admit that they were directors and shareholders of ANONYMOUS, INC during the audit period and were officers of ANONYMOUS, INC from and during the period of June 12, 1995 through the bankruptcy settlement of ANONYMOUS, INC and the Corporation in November, 1995.

5. The Corporation during the period in question was a developmental stage company with no source of revenue. The Corporation relied solely on ANONYMOUS, INC and the profits from another wholly owned subsidiary of ANONYMOUS, INC., ABC, INC., for cash infusion to run its operations.

6. According to Protestants, they were required to provide the principals of ANONYMOUS, INC ("A", "B", and "C") with a bi-weekly cash requirement report in order to secure funding for their creditors, including withholding taxes. The cash requirement reports were prioritized into three categories with priority one including those creditors which had to be paid in the judgement of Protestants. The principals of ANONYMOUS, INC would review the reports and decide how much money would be forwarded to the operating account of the Corporation.

7. According to Protestants, the principals of ANONYMOUS, INC., without their knowledge, misdirected the funds of ANONYMOUS, INC. and sequestered the funds of ANONYMOUS, INC. in the other wholly owned subsidiary. The principals also cut off the cash flow to the Corporation and began either directing which creditors would be paid or paying the creditors directly.

8. Protestants attempted to remove the principals of ANONYMOUS, INC. during a June, 1995, board of directors meeting of ANONYMOUS, INC. Protestants also attempted to change the bank signature card for the account of ABC, INC. during this meeting. Protestants' attempt to secure the account of ABC, INC. was not honored by the bank. According to Protestants, they had no authority over the account of ABC, INC. and could not execute checks on the account.

9. Protestants admit that they liquidated their personal savings to pay the salaries and benefits of certain key employees of the Corporation.

10. The amount in controversy is $5,706.62, inclusive of withholding tax in the amount of $3,694.20, penalty in the amount of $1,306.77 and interest accrued through August 30, 1996, in the amount of $705.65.

## ISSUES AND CONTENTIONS

The issue presented for decision is whether Protestants sustained their burden of proving that they were not "employers" of the Corporation during the period in question.

Protestants agree the taxes are due and owing, but contend that the responsible parties are the principals of ANONYMOUS, INC. who controlled the finances of the Corporation. In support of this contention, Protestants argue that the principals of ANONYMOUS, INC. controlled the funding for the Corporation, misdirected and sequestered the funds of the Corporation and cut off the funding for the Corporation. Protestants further argue that the principals of ANONYMOUS, INC. were aware of the funding needs of the Corporation and the delinquent payroll taxes.

The Division contends that Protestants failed to sustain their burden of proving that they were not the "employers" of the Corporation during the period in question. In support of this contention, the Division argues that all of the factors considered in determining personal liability are applicable with regard to Protestants' role with the Corporation.

## APPLICABLE LAW

Personal and individual liability for withholding taxes is found at Section 2385.3(d), wherein it 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....

In furtherance of this 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 . . . withheld income taxes . . . 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 . . . withheld income 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.[1]

The courts have developed a two prong test for imposition of the penalty under the Internal Revenue Code. ***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 determination of liability under Section 253 is limited to the standards for determining who is a "responsible person". Oklahoma Tax Commission Order No. 96-12-17-037 (Prec.).

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[1]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 courts have also developed standards to be utilized in determining whether each prong of the test has been satisfied. The factors considered by the courts under the first prong 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).

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 person 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.

A proposed assessment is presumed correct and the taxpayer bears the burden of showing that it is incorrect, and in what respect. Rule 710:1-5-47 of the *Oklahoma Administrative Code*. See, ***Enterprise Management Consultants, Inc. v. State ex rel. Oklahoma Tax Commission***, 768 P.2d 359 (Okl. 1988). The standard burden of proof in administrative proceedings is "preponderance of evidence." Black's Law Dictionary, 1064 (5th ed. 1979). See, *Oklahoma Tax Commission Order No.* 91-10-17-061. "Preponderance of evidence" means "[E]vidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows that the fact sought to be proved is more probable than not." Id. It is also defined to mean "evidence which is more credible and convincing to the mind ... [T]hat which best accords with reason and probability." Id.

## 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. An officer or employee who is an "employer" of a corporation may be personally liable for the withholding taxes of the corporation. 68 O.S. 1991, § 2385.3(d).

3. Whether 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. Evidence pertaining to a lockbox arrangement is irrelevant and does not negate 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).

5. Here, the evidence proves that Protestants were "employers" and "responsible persons" for the withholding taxes of the Corporation during the period in question. Accordingly, the protest of Protestants to the assessment of withholding tax, penalty and interest against them personally should be denied.

## DISPOSITION

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

**OKLAHOMA TAX COMMISSION**

**CAVEAT:** This decision was **NOT** deemed precedential by the Commission. This means that the legal conclusions are not generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.