JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2002-12-20-003 / NOT PRECEDENTIAL**
ID: **P000136A**
DATE: **12-20-02**
DISPOSITION: **SUSTAINED**
TAX TYPE: **SALES**
APPEAL: **NO APPEAL TAKEN**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. THE CORP was formed as an Oklahoma corporation in 1986 or 1987 by MR. X and MR. Y.

2. THE CORP'S corporate headquarters and manufacturing plant were located in LITTLETOWN, Oklahoma.

3. THE CORP manufactured upholstered goods - chairs and living room furniture.

4. At the time THE CORP was formed ABC, an Arkansas corporation, was in business.

5. ABC'S corporate headquarters were located in ANYTOWN, Oklahoma until sometime in 1998 when it was moved to LITTLETOWN, Oklahoma.

6. ANYTOWN, Oklahoma is located approximately fifteen (15) to twenty (20) minutes west of LITTLETOWN, Oklahoma.

7. When ABC moved to LITTLETOWN, Oklahoma, THE CORP and ABC were located in the same industrial park, but maintained separate buildings.

8. ABC sells furniture at retail and has approximately twenty (20) stores in four (4) states, none of which are in Oklahoma.

9. THE CORP was ABC's main supplier of upholstery products.

10. THE CORP sold approximately ninety percent (90%) of its manufactured goods to ABC and ABC dedicated approximately fifty percent (50%) of its floor space to THE CORP'S product.

11. In 1988, the owner of ABC, MR. Z acquired an interest in THE CORP.

12. According to MR. X, MR. Z held the office of Secretary for THE CORP, but let MR. X and MR. Y run things.

13. MR. Z assisted MR. X and MR. Y in the selection of fabric and frames.

14. By 1993, MR. X and MR. Z each owned fifty percent (50%) of THE CORP.

15. MR. W was hired by ABC as its chief financial officer in May, 1993.

16. As part of his duty as CFO of ABC, MR. W prepared ABC's tax returns - income, franchise and ad valorem, handled all tax matters and accounting, and acted in a quasi-legal capacity when required, including the recording of any minutes of officer, director or shareholder meetings or the preparation of corporate resolutions.

17. MR. W's first involvement with THE CORP was in the fall of 1993.

18. MR. W testified that he recorded the minutes of a corporate meeting of THE CORP in November, 1993.

19. During this meeting, MR. X'S ownership interest in THE CORP was reduced to ten percent (10%), however he remained President of THE CORP. MR. Z's ownership interest was reduced to thirty percent (30%) and he was removed as an officer of THE CORP. MR. M was granted a sixty percent (60%) interest in THE CORP and was named chief executive officer/treasurer of THE CORP. Also during this meeting, MR. M, MR. N and MR. O were named directors of THE CORP and MR. N was named vice-president/secretary of THE CORP.

20. According to MR. M, he was approached by MR. Z in late 1993 or early 1994 regarding THE CORP and how to get THE CORP'S labor in line and sales going. MR. M testified that coinciding with this time period he had formed BUSINESS C, a mattress manufacturing business, and agreed to MR. Z's proposal since BUSINESS C was not yet up and running. He stated that he was actively involved in the daily affairs of THE CORP up and to May or June, 1994. He further testified that he relinquished his interest in THE CORP in 1997 because his time and energy was devoted to BUSINESS C, rather than THE CORP. He further stated that during the audit period, he had some supervisory capacity over THE CORP, he was an officer of THE CORP and he had check signing authority on THE CORP's operating account. He further stated that after relinquishing his ownership interest in THE CORP, he was a business consultant to THE CORP on product and may have called on retail stores trying to sell THE CORP's products.

21. According to MR. W, the officers of THE CORP from November, 1993 to January, 1999, were MR. X, MR. M and MR. N. He testified that no corporate meetings were held, minutes maintained, nor resolutions prepared during this period. He stated that after MR. M was bought out in December, 1996, the only officer present at THE CORP prior to January, 1999, was MR. X. He further stated that the only signatory of checks for THE CORP prior to January, 1999, was MR. X.

22. In a letter dated May 20, 1996, from MR. Z to MR. M and MR. N, Mr. Z writes:

> Over the past several months it has become apparent that THE CORP is more dependent on ABC for its survival than it was two years ago. Hindsight is always 20/20 and we realize that in our original agreement, copy attached, you may have been spread too thin. It may have been too much to ask that you not only start BUSINESS C from scratch but be able to devote the time necessary to overhaul THE CORP and bring in an additional $500,000 in outside sales per year. At this time it looks like ABC needs to be more involved in THE CORP. It appears that both THE CORP and BUSINESS C would be better served if we were to rethink the original agreement. One simple solution would be for you to sell your interest in THE CORP back to me. I want both of you to give this some serious thought and get back to me. Although there have been some positive aspects to your involvement with THE CORP, it may be better for all concerned to have you totally involved in BUSINESS C. If you were to sell, this would eliminate future taxes, due to THE CORP's income, or any obligation for both of you to provide outside sales, liability assumption, or management help.

23. MR. W testified that he only prepared the federal and state corporate income tax returns for THE CORP and THE CORP's monthly financial statements which he delivered to THE CORP and its owners. He stated that he did not prepare THE CORP's franchise tax returns and did not review any of THE CORP's other tax documents. During rebuttal, MR. W admitted to reviewing the balance sheet on one of THE CORP's franchise tax returns. He stated that he reviewed it because MR. X and his secretary/bookkeeper could not get it to balance. He further stated that he did not prepare any documents showing that MR. P or MR. O were officers of THE CORP and was unaware of any documents to that effect.

24. MR. X initially testified that he did not know who prepared the 1999 franchise tax return of THE CORP. On cross-examination, however, he stated that his bookkeeper prepared the franchise tax returns. He further testified that the returns would be sent to MR. W for review and MR. W would send them to him for signature.

25. In preparing the monthly financial statements for THE CORP, MR. W testified that MR. X or his secretary/bookkeeper would provide him with sales summaries, a general ledger of expenses and checks written and the monthly inventories. From this information, he did journal entries to book the sales and expenses and the changes in inventory. He stated that he initiated changes in some of THE CORP's forms and how they prepared them and what they did to close out a particular period.

26. MR. X testified that MR. W would review a monthly statement THE CORP produced from a computer program that he, MR. W had implemented to do the background for the financials. He stated that MR. W would make changes to the financials at the end of the month and send the statement to him and the other officers of THE CORP.

27. MR. W testified that because the bookkeeping was done in house at THE CORP and he only received in summary form THE CORP's total sales for the month, not individual sales or who the product was sold to, he was not aware of THE CORP's sales of product to end users.

28. MR. X testified that he collected sales tax on the sales of product to non-resellers. He also testified that MR. W, MR. P and MR. O knew THE CORP did not have a sales tax permit.

29. THE auditor for the Division, testified that most of the sales to end users were to hotels and motels. She stated that sales tax was not charged or collected on these sales.

30. On December 18, 1998, MR. X was relieved of his duties with THE CORP by MR. P and MR. O, which according to MR. W was done as owners of THE CORP. MR. W testified that MR. X was relieved of his duties because ABC had received notification that someone within THE CORP was stealing the product and selling it to one of ABC's competitors.

31. After MR. X was fired no one at THE CORP was authorized to sign checks. At this point, MR. W contacted the bank and according to MR. W, an officer of the bank came to ABC with a form corporate officers change resolution and a signature authorization. MR. P and MR. O appointed themselves officers of THE CORP and signed the signature authorization.

32. MR. X testified that MR. P and MR. O were officers of THE CORP during the audit period. He stated that in late 1996 or early 1997, MR. Z, MR. P, MR. O and he were taking MR. Z to the airport in MR. O's suburban. During this trip, according to MR. X, MR. Z announced that he, MR. X, had two new partners, that each of them owned forty-five percent (45%) of THE CORP, that he still had ten percent (10%) and that although no votes were taken, MR. X remained as President of THE CORP, MR. O was given the title of vice-president of THE CORP and MR. P was given the title of secretary of THE CORP.

33. The 1997 federal income tax return of THE CORP, form 1120S, which was prepared by MR. W, indicates on the attached Schedule K-1s that MR. Z, MR. O and MR. P each owned thirty percent (30%) of THE CORP and MR. X owned ten percent (10%). The schedules reflect full year ownership. No partial year ownership is reported.

34. The 1997 franchise tax return of THE CORP indicates on schedule A thereto that the officers of THE CORP as of June 30, 1996, were MR. X, President; MR. N, Secretary; and MR. M, Treasurer.

35. The 1998 franchise tax return of THE CORP indicates on schedule A thereto that the officers of THE CORP as of June 30, 1997, were MR. X, President/Treasurer; MR. 0, Vice-President; and MR. P, Secretary.

36. The 1999 franchise tax return of THE CORP indicates on schedule A thereto that the officers of THE CORP as of June 30, 1998, were MR. X, President; MR. O, Vice-President; and MR. P, Secretary/Treasurer.

37. In regard to the 1998 franchise tax return, MR. W testified that there was no reason to elect MR. P or MR. O as officers of THE CORP in 1997 or 1998.

38. MR. O testified that he works at ABC and has been an officer of ABC since 1993 or 1994.

39. MR. P testified that he is the case goods buyer for ABC and has been vice-president of ABC since 1989 or 1990.

40. Both MR. O and MR. P testified that they never assumed an officer position with THE CORP prior to January, 1999. They further testified that they never directed the activities of THE CORP, that they never had anything to do with the sales of THE CORP products and that they never told MR. X how to do his job. They stated that they never borrowed funds from, loaned funds to or invested funds in THE CORP. They also stated that prior to January, 1999, they never signed any checks for THE CORP, they never attended any officer or shareholder meetings of THE CORP, never received a dividend from THE CORP and with the exception of MR. X, never hired nor fired any employees of THE CORP. They further stated that they were not aware the franchise tax returns of THE CORP bore their names and did not give anyone permission to put their names on the franchise tax returns. They further estimated that they went to THE CORP's building on average once every three (3) or four (4) months.

41. MR. X testified that during the audit period he was in charge of production and made the daily business decision for THE CORP. He stated that the duties of the other officers with respect to THE CORP was to assist in the selection of fabric and frames, assist with THE CORP's accounting and assist in the pricing and selling of THE CORP's products. He further stated that with respect to the pricing of product, ABC kept the margins low and more or less dictated to him what the prices could be. He also stated that he would put a cost sheet together on a product, present his estimate to MR. W, MR. P and MR. O and a decision would be made. He further testified that MR. W developed a method of analyzing what they should sell a product for and attempted to develop different methods of production to meet the profit margins.

42. MR. X testified that there were never any corporate meetings of THE CORP. He stated that he met with MR. P and/or MR. O at least every Monday when he went to pick up the check from THE CORP for the orders ABC placed with THE CORP. He also stated that he met with them whenever he had a problem that needed their attention. He further stated that he would often meet with MR. W either before or after meeting with MR. P and/or MR. O. He further testified that the checks of ABC would be signed by MR. P or MR. O and that at times the checks would include a loan amount - an amount above the invoice order amount of ABC - to cover outstanding checks of THE CORP.

43. MR. O admits that ABC loaned money to THE CORP.

44. MR. X testified that he discussed the purchases of major equipment with MR. P, MR. O and MR. W. He stated that examples of this were the purchase of three (3) sewing machines valued at $6,000.00 and whether to purchase or lease a delivery truck. He further stated that he did not meet with them to discuss the purchase of small maintenance type items.

45. MR. X testified that he hired and fired the production employees of THE CORP. He stated that MR. P and/or MR. O recommended sales people to him for hiring, however, they never recommended the hiring of anyone who he did not choose to hire. He further stated that MR. P and MR. O never hired nor fired any employees of THE CORP.

46. MR. X testified that neither MR. P nor MR. O had signature authority on the account of THE CORP during the audit period. In regard to that part of the audit period when he was the only person at THE CORP who had signature authority on the account of THE CORP, MR. X stated that he talked to MR. P, MR. O and MR. W about his concern should anything happen to him. He testified that MR. W advised him that if anything should happen they could go to the bank and have someone added to the signature card.

47. MR. X prepared the payroll checks, signed the checks and prepared the payroll taxes. MR. X testified that the day after he was fired, he went back to THE CORP and prepared the payroll checks for the employees.

48. MR. X admitted to selling THE CORP products "off the books." He testified that the money from these sales was put back into the business, however, he did not keep an accounting of this money. He further testified that he did not tell MR. W, MR. P or MR. O that he was selling product off the books, collecting sales taxes on these sales and not remitting the taxes to the Tax Commission. However, according to MR. X, they knew this was occurring.

49. MR. W testified that neither MR. P nor MR. O ever had any day to day hands on overseeing of work with regard to THE CORP and neither of them ever conducted themselves as officers of THE CORP.

50. On July 14, 1997, MR. P executed a warranty deed on behalf of THE CORP as secretary of THE CORP. The warranty deed was filed of record in the county clerk's office of Sequoyah County on July 28, 1997. The warranty deed transferred certain real property owned by THE CORP to MR. Z, MR. O, MR. P and MR. X.

51. MR. P testified that he did not recall the circumstances surrounding the deed, but believes that it was just handed to him and he signed it.

52. In regard to the Tax Commission forms "Taxpayer's List of Principal Officers, Partners or Members (LLC)", THE AUDITOR testified that she prepared the typewritten portions of the forms which were determined from the franchise tax returns. She further testified that the forms have not been altered in any manner since they were received.

53. MR. W testified that he filled out the forms - handwritten portions - prior to MR. P executing the forms. He stated that he advised the auditor from the very start of the audit that MR. P and MR. O were not officers of THE CORP until after December, 1998. He further testified that the dates of 6/30/97-2/28/99 appearing on the forms identifying MR. P and MR. O as officer refer only to the information on the franchise tax returns. He further stated that he doesn't challenge the accuracy of the information on the forms identifying MR. X, MR. N and MR. M as principal officers of THE CORP, but does challenge the accuracy of the information on the forms identifying MR. P and MR. O as principal officers of THE CORP during the period of 6/30/97 through 11/30/98.

54. A sales tax assessment was issued against MR X as an officer of THE CORP. MR. X did not protest the assessment.

55. On May 26, 2000, sales tax assessments were issued against MR. O, MR. P, MR. N and MR. M as officers of THE CORP. Each of these individuals timely protested these assessments.

56. The assessment issued to MR. O identifies him as Vice President of THE CORP for the period of June 30, 1997 through November 30, 1998. The total amount assessed was $9,999.10, consisting of sales tax in the amount of $6,866.08, interest accrued through June 30, 2000, in the amount of $2,446.38 and delinquency penalty in the amount of $686.64.

57. The assessment issued to MR. P identifies him as Secretary of THE CORP for the period of June 30, 1997 through November 30, 1998. The total amount assessed was $9,999.10, consisting of sales tax in the amount of $6,866.08, interest accrued through June 30, 2000, in the amount of $2,446.38 and delinquency penalty in the amount of $686.64.

58. The assessment issued to MR. M identifies him as Treasurer of THE CORP for the period of March 1, 1996 through December 31, 1996. The total amount assessed was $6,269.18, consisting of sales tax in the amount of $3,770.56, interest accrued through June 30, 2000, in the amount of $2,121.54 and delinquency penalty in the amount of $377.08.

59. The assessment issued to MR. N identifies him as Secretary of THE CORP for the period of March 1, 1996 through December 31, 1996. The total amount assessed was $6,269.18, consisting of sales tax in the amount of $3,770.56, interest accrued through June 30, 2000, in the amount of $2,121.54 and delinquency penalty in the amount of $377.08.

ISSUES

Several issues are presented for decision. The first issue is whether the evidence adduced proves Protestants were officers of THE CORP during any portion of the audit period. The second issue is whether the evidence adduced proves Protestants were "principal officers" of THE CORP during any portion of the audit period. The third issue is whether under extant Oklahoma jurisprudence, a principal officer's personal liability for the sales taxes of a corporation is dependant upon a finding of a "willful" failure to remit the taxes. The fourth issue is whether a principal officer should be absolved of personal liability for the sales taxes of a corporation when said taxes are attributable to sales made "off the books" of the corporation.

APPLICABLE LAW

The principal officers of a corporation are personally liable for the sales taxes required to be collected on any sales made by the corporation which are subject to sales tax under the Oklahoma Sales Tax Code[1]. 68 O.S. 1991, ‚ 1361(A). In furtherance of Section 1361(A), Section 253 of the Uniform Tax Procedure Code[2] provides:

> When the Oklahoma Tax Commission files a proposed assessment against corporations for unpaid sales taxes, 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 sales tax, 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.

A two prong test has been developed for determining liability for payment of federal withholding tax 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 68 O.S. 1991, ‚ 1350 et seq.

2 68 O.S. 1991, ‚ 201 et seq.

Standards have been developed and utilized to determine whether each prong of the test has been satisfied. The factors considered 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).

Imposition of personal liability on the "principal officers" of a corporation for the sales taxes of the corporation is determined on a case by case analysis of the particular facts and circumstances of each case. Not every officer of a corporation is a principal officer for purposes of imposition of personal liability. See, 68 O.S. 1991, ∋ 253.

The "responsible person" for purposes of determining liability for payment of federal withholding tax pursuant to the Internal Revenue Code is frequently defined as the person who has the final word as to what bills or creditors should or should not be paid and when, ***White v. U.S.***, 372 F.2d 513, 178 Ct. Cl. 765 (1967); the person who is so connected with the business as to be in the position to exercise full authority over the financial affairs, and therefore to be ultimately responsible for the decision as to the payment of the tax, ***Koegel v. U.S.***, 437 F.Supp. 176 (D.C. N.Y. 1977); and the person who has or shares the final word as to what bills should or should not be paid, ***Cellura v. U.S.***, 245 F.Supp. 379 (D.C. Ohio 1965).

The mere holding of office, by itself, does not render one a "responsible person". ***Bauer v. United States***, 543 F.2d 142, 149 (Ct.Cl. 1976). More than one individual may be found to be a "responsible person" for a particular tax period and liability may be imposed on both. ***Turner v. United States***, 423 F.2d 448, 449 (9th Cir. 1970). Responsibility is a matter of status, duty and authority, not knowledge. ***Mazo v. United States***, 591 F.2d 1151, 1156 (5th Cir. 1979). The control necessary to support liability under federal law is the ability to direct or control the payment of corporate funds. ***Wilson v. United States***, 250 F.2d 312, 316 (9th Cir. 1958).

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 of a corporation shall hold his or her office for such term as are prescribed by the bylaws or determined by the board of directors or other governing body and until his or her successor is elected and qualified or until his or her earlier resignation or removal. 18 O.S. 1991, ∋ 1028(B). Any officer may resign at any time upon written notice to the corporation. Id.

3. A "principal officer" of a corporation shall be personally liable for the sales taxes of the corporation. See, 68 O.S. 1991, ∋ 1361(A).

4. Not every officer of a corporation is a "principal officer" for purposes of imposing personal liability for the sales taxes of the corporation. See, 68 O.S. 1991, ∋ 253.

5. A "principal officer" is one who has or shares the final word as to what bills or creditors should or should not be paid and when, who is so connected with the business as to be in position to exercise authority over the financial affairs of the corporation or who has or shares the responsibility for the ultimate decision to forego the payment of the taxes in favor of another bill or creditor. See, ***Koegel***, supra and ***Wilson***, supra.

6. Under extant Oklahoma jurisprudence, personal liability may be imposed on a "principal officer" of a corporation without a finding of a willful failure to collect, or truthfully account for, or pay over the tax. Oklahoma Tax Commission Order No. 96-12-17-037 (Prec.).

7. Here, the evidence proves Protestants were officers of THE CORP during certain portions of the audit period. The evidence, however, fails to proved that they were "principal officers" of THE CORP. With respect to MR. N and MR. M, the record establishes that at least as early as January, 1997, they were no longer involved with the operations of THE CORP. With respect to MR. P and MR. O, the record establishes that they did not take an active role in the financial affairs of THE CORP. The record establishes that MR. X controlled the books, records and accounts of THE CORP, exercised full authority over the financial affairs of THE CORP and had the final word as to what bills or creditors would be paid and when.

7. Protestants' protests to the proposed sales tax assessments should be sustained.

DISPOSITION

Based on the above and foregoing findings of fact and conclusions of law, it is DETERMINED that the protest of Protestants be sustained.

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.