

RODNEY C. LOWERY §
604 Powell Avenue §
Albertville, AL 35950, §

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

vs. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

DOCKET NO. P. 94-104

FINAL ORDER

The Revenue Department assessed a 100% penalty against Rodney C. Lowery ("Taxpayer"), as a person responsible for paying the trust fund taxes of Horseman's Paradise, Inc. The assessment involves State sales tax for January 1990 and May 1990 through September 1991, and withholding tax for December 1990 and January through September 1991. The Taxpayer appealed to the Administrative Law Division and a hearing was conducted in Birmingham on October 26, 1994. Roy F. King, Jr. represented the Taxpayer. Assistant counsel Mark Griffin represented the Department.

The issue in this case is whether the Taxpayer is personally liable for the unpaid sales and withholding taxes of Horseman's Paradise, Inc. pursuant to Alabama's 100% penalty statutes, Code of Ala. 1975, §§40-29-72 and 40-29-73.

An individual is personally liable for a corporation's unpaid trust fund taxes if (1) the person was "responsible" for payment of the taxes, and (2) the person "willfully" failed to pay the taxes. See generally, Morgan v. U.S., 937 F.2d 281 (5th Cir. 1991); Stallard v. U.S., 12 F.3rd 489 (5th Cir. 1994).

The Taxpayer concedes that he was responsible for paying the trust fund taxes in question. The issue thus is whether the Taxpayer "willfully" failed to pay those taxes. The Taxpayer willfully failed to pay if (1) he had actual knowledge that the taxes were not paid, or (2) he showed a reckless disregard for an obvious and known risk that the taxes had not been paid. Teel v. U.S., 529 F.2d 903 (9th Cir. 1976); Calderon v. U.S., 799 F.2d 254 (6th Cir. 1986); Mazo v. U.S., 591 F.2d 1151 (5th Cir. 1979); Malloy v. U.S., 17 F.3rd 329 (11th Cir. 1994).

The relevant facts are set out below.

Horseman's Paradise, Inc. was incorporated in 1987. The Taxpayer was 100% shareholder and president of the corporation. The corporation operated three separate businesses located adjacent to each other in Birmingham, a carpet outlet, a western wear and horse equipment business, and a car dealership ("Van World").

The Taxpayer lived in Albertville, Alabama and spent most of his time operating an unrelated business in Albertville. Consequently, he hired Ryan Holsenback as manager to run the Birmingham businesses. He subsequently hired Lloyd Deck as co-manager in 1987 to run Van World. Deck hired Patricia Wright in 1988 to keep the books, do title work and help out generally in the Van World office.

Patricia Wright testified that when she started working for Van World in 1988, all three businesses were reporting State sales

tax on a single return. According to Wright, Holsenback instructed her to fill out the motor vehicle portion of the State return and give it to him along with a check for the tax due. She assumed that Holsenback then completed the return and paid the total tax due to the Revenue Department.

Holsenback left the business in early 1989. It is unclear who actually reported and paid the State sales tax after Holsenback left. Wright testified that nobody told her what to do after Holsenback left, and that she believed the State taxes were being paid by the Taxpayer's accountant in Albertville. However, as discussed below, there is no evidence that the Taxpayer's accountant in Albertville was involved with the corporation's sales tax liability until after both Wright and Deck left the business in late 1991.

Wright concedes that she continued to report and pay the local sales taxes and also the State withholding tax for the corporation after Holsenback left. There is also evidence that Wright also continued to be involved in paying the State sales taxes for the corporation. (Taxpayer Exhibit 1, a letter from Wright to the "Sales Tax Dept." dated May 10, 1989 indicating she was directly involved in reporting and paying the corporation's sales tax at that time and expected to be involved in the future. See also, Taxpayer Exhibit 3, a State sales tax return signed by Wright).

In any case, the corporation's State sales and withholding tax

liabilities were paid through December 1989. The corporation failed to pay its January 1990 State sales tax, although the tax was paid for February through April 1990. No State returns were filed and no tax was paid from May 1990 through September 1991. Withholding tax also was not reported or paid for the last quarter of 1990 and the first three quarters of 1991.

Doug Williams, a Revenue Department agent, testified that he personally called on the Taxpayer in Albertville on March 22, 1990 concerning delinquent tax owed by the corporation. The Taxpayer told Williams that he would handle the problem. According to Williams, that March 22 meeting was the only time he met with the Taxpayer concerning the Horseman's Paradise taxes. The Taxpayer testified that while he doesn't remember the March 22 visit, Williams did call on him on at least two prior occasions concerning tax problems at Horseman's Paradise. The Taxpayer claims that he handled the problem as soon as he was notified that tax was due.

The Taxpayer testified that he believed Wright was paying all sales and withholding tax to the State during the period in issue.

He also thought that the corporation was making a small profit based on his periodic review of the corporation's financial statements. The Taxpayer claims that he first learned that a problem existed when he received a call from a clerical employee at Van World in August or September 1991. The employee called the

Taxpayer because the corporation was not paying its bills, and she thought that the Taxpayer as owner should know.

The Taxpayer investigated and learned that the corporation was having severe financial problems. The Taxpayer confronted and subsequently fired Deck in September 1991 after Deck failed to directly answer his questions. Wright had left the business earlier in 1991.

The Taxpayer assumed control at that time, but was unable to straighten out the corporation's financial problems. The corporation subsequently filed for bankruptcy in May 1992. The Taxpayer claims that he received his first notice from the Revenue Department in June 1992 concerning the delinquent sales and withholding taxes in issue. He immediately contacted his accountant, and returns were filed for all delinquent periods. However, the corporation did not have sufficient funds at that time to pay any of the tax due.

The Taxpayer claims that he was not notified concerning the unpaid taxes until June 1992. Sheila M. Clarke, a Revenue Compliance Officer, testified that the Department's standard policy is to notify a taxpayer in person if they are delinquent in filing or paying sales tax. Each Revenue Department District Office has its own delinquent list which is used to identify delinquent accounts. However, for some reason, Horseman's Paradise was coded by the Birmingham District Office as an out-of-state business.

Consequently, the Birmingham Office was unaware that the corporation had failed to file or pay, and thus failed to personally call on the Taxpayer concerning the problem.

In addition, Clarke also testified that the Department keeps a taxpayer primary entity list on its central computer in Montgomery. A delinquent notice is automatically printed and mailed each month to any taxpayer that fails to timely file a return. The Taxpayer's home address listed on his sales tax license application was 604 Powell Street, Albertville, Alabama.

However, again for some unknown reason, the Taxpayer's address on the primary entity list was 604 Powell Street, P. O. Box 100874, Birmingham, Alabama 35210. The above post office box was the Birmingham mailing address of Horseman's Paradise, Inc. The Taxpayer testified that he never used the Birmingham post office box and was never informed by anyone with access to the box that delinquent notices had been received. Rather, he claims that he discovered the numerous delinquent notices sent by the Department only when he cleaned out the Van World office after the business went bankrupt in 1992.

The Taxpayer is liable for the taxes in issue if he either knew that the taxes had not been paid, or acted with reckless disregard for a known risk that the taxes were not being paid. "Reckless disregard includes failure to investigate or correct

mismanagement after being notified that (delinquent trust fund) taxes have not been paid". Morgan v. U.S., supra, at page 286, citing Mazo, supra, at page 1154-55. See, also Malloy v. U.S., supra, at page 332.

There is no evidence that the Taxpayer knew that the delinquent taxes in issue were not being paid. Nor does the evidence indicate that the Taxpayer should have reasonably suspected that the taxes were not being paid. The Taxpayer knew from past experience that the Department would call on him personally if the corporation was not paying its taxes. Consequently, because the Department failed to notify the Taxpayer either in writing or in person that the delinquent taxes in issue had not been paid, it was reasonable for the Taxpayer to assume that the taxes were being paid.

The Taxpayer visited the businesses in Birmingham approximately once or twice a month, but he was never informed of the delinquent taxes or of the business' poor financial condition by Wright, Deck or anyone else connected with the businesses. His impression that everything was running smoothly was re-enforced by the corporation's financial statements, which showed that the businesses were making a small profit. Not until a clerical employee at Van World called him in Albertville in September 1991 did the Taxpayer suspect any problem. He investigated immediately, discovered the poor financial condition of the corporation, and

thereafter fired Deck and began trying to straighten out the business himself. He also started filing all tax returns for the corporation at that time, still not knowing that returns had not been filed or tax paid for the prior period in issue.

The Taxpayer obviously trusted Deck and Wright to properly operate the businesses and pay all taxes due. In retrospect, he was perhaps negligent and should have been more attentive. However, negligence to properly oversee the operation of a business does not constitute "willfulness" for purposes of the 100% penalty. Dudley v. U.S., 428 F.2d 1196, at page 1200 (9th Cir. 1970).

The Taxpayer would be liable if the Department had at some point notified him either in person or by mail that the taxes in issue were not being paid. However, under the facts of the case, the Taxpayer did not know or have reason to suspect that the taxes were not being paid until June 1992, at which time there was no money available to pay the taxes. Consequently, the Taxpayer did not "willfully" fail to pay the taxes in question, and thus cannot be held personally liable for those taxes. The assessment in issue is dismissed.

The Final Order may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered on March 20, 1995.

BILL THOMPSON

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Chief Administrative Law Judge