

Cite as Det. No. 95-101, 15 WTD 136 (1996).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
for Correction of Assessment of)	
)	No. 95-101
)	
. . .)	Registration No. . . .
)	YR. . ./Audit No. . . .
)	

- [1] RULE 217; RCW 82.32.145: RETAIL SALES TAX -- INDIVIDUAL CORPORATE LIABILITY. In order for an individual to be liable for a corporation's failure to remit collected retail sales tax: 1) the retail sales tax must be a corporate liability; 2) the corporation must have been terminated, dissolved, or abandoned; 3) the taxpayer must have wilfully failed to pay or to cause to be paid such retail sales tax; 4) the taxpayer must have supervision or control over the trust funds or be responsible for reporting and remitting the tax; and 5) there must be no reasonable means to collect the tax from the corporation.
- [2] RULE 217; RCW 82.32.145: RETAIL SALES TAX -- INDIVIDUAL CORPORATE LIABILITY -- PROPRIETARY INTEREST. There is no requirement that an individual have a proprietary interest in the business before that individual can be found to be liable for the failure to remit collected retail sales tax.
- [3] RULE 217; RCW 82.32.145: RETAIL SALES TAX -- INDIVIDUAL CORPORATE LIABILITY -- DELEGATION OF AUTHORITY -- CONTROL AND SUPERVISION. A taxpayer who has check signing authority and who has the discretion and responsibility to collect and remit trust funds to the Department is a responsible party under the statute.
- [4] RULE 217; RCW 82.32.145: RETAIL SALES TAX -- INDIVIDUAL CORPORATE LIABILITY -- DISCRETION AND AUTHORITY OF NON-OFFICER EMPLOYEE. A non-officer

employee, who is instructed by the sole owner and officer of a corporation not to pay trust funds to the state, does not have the "authority and discretion" to be a responsible party, even though the employee continues to sign checks for the benefit of trade creditors.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

Former employee of a business protests the assessment of individual corporate liability for the dissolved corporation's failure to remit collected retail sales tax.¹

FACTS:

Mahan, A.L.J. -- In late 1992, an automobile dealership was incorporated and, shortly thereafter, started business. The company had a sole shareholder and corporate officer. He hired two individuals as co-managers. They were responsible, to one degree or another, for the day-to-day operations of the business. These two individuals had previously worked together at another dealership. One of these individuals is the taxpayer in this appeal. Another individual who had previously worked with the co-managers was also hired to provide bookkeeping services for the new dealership. This individual later married the taxpayer.

According to the records, the monthly state tax returns were prepared and signed by the bookkeeper. The records also show that the owner and the two co-managers had check writing authority for the business. A review of a sampling of the checks written on the business account shows that, with the exception of several checks signed only by the other co-manager, all checks were signed by the two co-managers. This included the checks used to remit the collected retail sales tax to the state.

The company was undercapitalized. After operating for three months, the company ran short of funds. The state tax returns for March, April, and May of 1993 were prepared but never filed. The collected retail sales tax for that period was never remitted to the state.

¹Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

In or about June of 1993, the corporation began doing business under new management and under a new name. It also moved the company's inventory to a new location. On June 8, 1993, the corporation was administratively dissolved by the Secretary of State for the failure to file an initial report. Shortly thereafter, the owner formed a new corporation and continued in business.

A Revenue Officer with the Department of Revenue (Department) investigated the operation and dissolution of the corporation. His report states that he talked with the new managers, who had previously worked as sales employees for the corporation. They reported that taxpayer and the other co-manager were previously responsible for the collection and payment of retail sales tax, and the owner was not involved in the day-to-day management of the company. The Revenue Officer's report also states that he discussed the matter with the owner, who claimed to have only been a financial backer, and he was not involved in the decisions as to which bills to pay.

The Department asserted successorship liability against the owner's new corporation and individual corporate liability against the two alleged co-managers. Individual corporate liability was not assessed against the owner.

The taxpayer acknowledges having co-management and check signing authority. However, he contends that it was acknowledged when the business started that the initial capitalization would be inadequate, and that the owner would contribute additional capital when needed. He testified that, when the company became short on operating funds, the owner assured him that he would provide funds to pay the tax obligations. He further testified that the owner applied for a bank loan, but decided not to take out the loan because the bank required a personal guarantee.²

The taxpayer further contends that the owner was involved in all major decisions concerning the company. In support of this contention, the taxpayer testified that neither he nor the other co-manager had any previous experience running a business. From this fact, the taxpayer asserts that it would have been unreasonable for the owner, an experienced business owner, to not have been involved in major financial and operational decisions. In support, the bookkeeper testified that the owner came by

²The taxpayer does not have access to corporate records and, accordingly, cannot support this testimony by a copy of a loan application.

several times a week to review the records and to meet with the taxpayer.³

The taxpayer further testified that, when the company was unable to pay all of its creditors, he met with the owner, who instructed him to pay only the creditors necessary to continue operations and to not pay the state tax bill. According to the taxpayer, he did as he was instructed.

Based on these factual assertions, the taxpayer contends that, for the period where taxes were not paid, he was no longer a party responsible for paying the taxes, and any failure on his part was not wilful. The taxpayer further contends that this state's individual corporate liability statute was not intended to reach an employee who does not have a proprietary interest in the business.

ISSUES:

1. Whether only individuals with a proprietary interest in the business are subject to individual corporate liability.
2. Whether a manager who is generally responsible for paying creditors and who has check signing authority is a responsible party.
3. Whether a managing employee who was allegedly instructed by the owner not to pay taxes continued to be a responsible party.
4. Whether a manager acts wilfully when he knows that trust funds have not been paid but, instead, issues checks to other creditors.

DISCUSSION:

In general, a corporate employee is not liable for a corporate debt. An exception to this general rule is created by RCW 82.32.145, which imposes personal liability on certain

³Although not argued by the taxpayer, we note that the owner in very short order hired new managers, moved the business, and began operating under a new name. None of the income earned after the move was voluntarily used to pay the past due tax obligation. Such actions indicate more involvement in the business than the owner alleged and give rise to an inference that the owner was attempting to avoid creditors, including the state.

individuals when retail sales tax has been collected but not remitted by the corporate taxpayer.

[1] In order for an individual to be personally liable for collected and unremitted retail sales tax: 1) the retail sales tax must be a corporate liability; 2) the corporation must have been terminated, dissolved, or abandoned; 3) the taxpayer must have wilfully failed to pay or to cause to be paid such retail sales tax; 4) the taxpayer must have supervision or control over the trust funds or be responsible for reporting and remitting the tax; and 5) there must be no reasonable means to collect the tax from the corporation. RCW 82.32.145; WAC 458-20-217(6) (Rule 217). A taxpayer may avoid liability if he or she can show that the failure to pay or to cause to be paid such taxes resulted from circumstances beyond the taxpayer's control. Id.

Here, it is undisputed that the tax was the liability of a corporation, which had been dissolved or abandoned, and there is no reasonable means to collect it from any corporate entity except a successor corporation. We are concerned with only the third and fourth elements and the overall issue of whether the reach of the statute is limited to those individuals with a proprietary interest in the business. Each issue will be discussed below.

1. Proprietary Requirement.

[2] The taxpayer contends that the statute is ambiguous with respect to the types of individuals who may be held liable for corporate obligations and, therefore, resort to legislative history is appropriate. Based on the legislative history, the taxpayer argues that only officers or other individuals with a proprietary interest can be held liable. To support his proprietary requirement argument, the taxpayer relies on a statement in The Final Legislative Report for the Fiftieth Washington State Legislature 1987 Regular and Special Sessions, which contains the following bill summary for Substitute House Bill 198:

Procedures for collecting unremitted sales taxes owing from businesses are altered. In the event of a termination of a business, any officer or individual having a proprietary interest in the corporation will be personally liable for state and local sales tax funds that have not been remitted to the state within ten days of the business termination date.

Even if we assume, arguendo, that the statute is ambiguous, we cannot find for the taxpayer on this argument. While we would agree that officers and individuals with a proprietary interest would be the ones most commonly subject to liability, we cannot

construe the legislative history as supportive of the conclusion that liability should be restricted to such individuals. To the contrary, the legislative history amply supports a broader application. House Bill 198 originally contained language limiting the application to officers or individuals having a proprietary interest. Substitute House Bill 198 deleted the proprietary limitation in favor of broader liability being imposed, that is, on "any officer or other person."

The legislative history also provides that the statute "would give the state of Washington equal authority with the IRS in regard to personal liability for corporate trust fund taxes." As discussed infra, the IRS's authority is not limited to individuals with a proprietary interest. Further, the rule and the cases issued since the enactment support the imposition of liability on individuals who do not have a proprietary interest in the business. See Rule 217; Det. No. 93-114, 13 WTD 249 (1993). For these reasons, we find that there is no proprietary limitation on the "other persons" who may be liable under the statute.

2. Responsible Party Requirement.

[3] With respect to responsibility for unremitted sales tax, RCW 82.32.145 identifies two types of individuals who may be held liable. A party may be liable as a result of control or supervision over collected funds or as a result of having responsibility for the filing of returns or payment of the trust funds, to wit:

(1) Upon termination, dissolution, or abandonment of a corporate business, any officer or other person having control or supervision of retail sales tax funds collected and held in trust under RCW 82.08.050, or who is charged with the responsibility for the filing of returns or the payment of retail sales tax funds collected and held in trust under RCW 82.08.050, shall be personally liable for any unpaid taxes and interest and penalties on those taxes, if such officer or other person wilfully fails to pay or to cause to be paid any taxes due from the corporation pursuant to chapter 82.08 RCW. For the purposes of this section, any retail sales taxes that have been paid but not collected shall be deductible from the retail sales taxes collected but not paid.

(Emphasis added.)

The administrative rule adopted in accordance with RCW 82.32.145, Rule 217, identifies the control or supervision required for liability as follows:

(i) "Control or supervision of the collection of retail sales tax" shall mean the person who has the power and responsibility under corporate bylaws, job description or other proper delegation of authority (as established by written documentation or through a course of conduct) to collect, account and deposit the corporate revenue and to make payment of the retail sales tax to the department of revenue. The term means significant rather than exclusive control or supervision. Thus, the term shall not mean the sales clerk who actually collects the funds from the customer or the person whose only responsibility is to take control of the funds and deposit the same into the bank, but it shall include the treasurer of the corporation if it is that person's responsibility to assure that the revenue is collected from the cash registers, tills or similar collection devices and that the amounts are deposited into the corporate account. It may also include the bookkeeper if the bookkeeper has the responsibility to collect, account and deposit the corporate revenue. In both examples, it is the treasurer or bookkeeper who have the significant control or supervision.

(Emphasis added.)

Although there was no formal delegation of authority through bylaws or an employment contract, the course of conduct of the business clearly shows that the taxpayer, at least initially, had the authority to collect the retail sales tax and to pay the collected funds to the state. The taxpayer had both day-to-day management authority, which extended to the collection of retail sales tax, and the authority to sign checks for the payment of the sales tax. The ability to sign checks is a significant factor, because it generally comes with the ability to choose which creditors will be paid.

The taxpayer, at least initially, was also a responsible party because of his authority and discretion to determine which corporate debts should be paid. Rule 217 identifies when an individual is responsible for the payment of collected retail sales tax, as follows:

(ii) "Responsibility for the filing of returns or the payment of the retail sales tax collected and held in trust" shall mean the person who has the authority and discretion to file state excise tax returns and to determine which corporate debts should be paid. The person who signs the state excise tax returns or signs checks on behalf of or for the corporation may be a responsible party if that person also has the authority and discretion to determine which corporate debts should be paid. If the corporate account requires the signature of more than one person, then all

such signatories may be a responsible party for trust fund accountability purposes. A member of the board of directors, a shareholder or an officer may also become a responsible party if the director, shareholder or officer actually approves the payment of corporate debts whereby the result of such approval is to pay the trust funds to someone other than the department of revenue.

(Emphasis added.)

Under the statutory scheme, there is no question that a taxpayer who has the authority and the discretion to disburse funds for the benefit of creditors and who has check signing authority is a responsible party. A corporate officer who has primary or secondary authority to file tax returns or to remit collected retail sales tax has been found to be a responsible party. See Det. No. 90-319, 10 WTD 319 (1990). A non-officer employee may also be a responsible party. See Det. No. 93-114, 13 WTD 249 (1993). In this case, the record is clear that the taxpayer had check signing authority and, at least initially, had the authority and discretion to determine which corporate debts should be paid. Whether an otherwise responsible party is relieved of liability when a superior instructs the employee not to pay the tax is discussed below.

3. Effect of an Employee Being Instructed Not to Pay the Tax.

An individual is liable for unremitted trust funds only for the period of time when he or she is a responsible party. In this regard, RCW 82.32.145(2) provides:

The officer or other person shall be liable only for taxes collected which became due during the period he or she had the control, supervision, responsibility, or duty to act for the corporation described in subsection (1) of this section, plus interest and penalties on those taxes.

Accordingly, if the taxpayer did not have the requisite control, supervision, responsibility, or duty during the period when the trust funds were not remitted to the state, he would not be individually liable for payment of those funds.

[4] We have not previously addressed whether an employee, who is allegedly instructed by a superior to withhold payment of the trust funds to the state, is a responsible party. The federal courts have considered this issue in the context of a similarly worded provision under Section 6672 of the Internal Revenue Code,

26 U.S.C. § 6672. The case law construing Section 6672 can provide guidance in the application of RCW 82.32.145.⁴

In general, the federal appellate courts have concluded that an otherwise responsible party remains liable even though instructed by a superior to not pay trust funds to the government. See, e.g., Brounstein v. United States, 979 F.2d 952 (3rd Cir. 1992); Gephart v. United States, 818 F.2d 469 (6th Cir. 1987); Roth v. United States, 779 F.2d 1567 (11th Cir. 1986); Howard v. United States, 711 F.2d 729 (5th Cir. 1983).

With the exception of Gephart, each of these cases, however, involved an individual who was both a corporate officer and an employee. In these cases, the courts reasoned that an otherwise responsible officer cannot abdicate the responsibility to pay the trust funds to the government despite instructions from a superior officer. In Gephart, the court also concluded that a non-officer employee remained a responsible party. In so concluding, the court specifically found that the employee continued to have the authority to initially determine which creditors would be paid. In this manner, the court distinguished two other cases, Geiger v. United States, 583 F. Supp. 1166 (D. Arizona 1984) and Cellura v. United States, 245 F. Supp. 379 (N.D. Ohio 1965), where non-officer employees were found not to be responsible parties after being instructed by their superiors to withhold payment of trust funds to the government.

The present case most closely resembles Cellura. In that case, the manager of a restaurant, who had check signing authority, was instructed by the owner to pay only trade creditors and not the Internal Revenue Service (IRS). The court concluded that the owner was the only one who had the authority to prefer other creditors to the IRS. Under such circumstances, the court held the employee was not a liable party.

Given the express requirement of Rule 217 that an individual have either a proper "delegation" of authority or the "authority and discretion" to determine which corporate debts should be paid, we are inclined to follow the holding in Cellura. In the present case, the taxpayer was an employee employed at the will of the

⁴Because the federal and state trust fund statutes are intended to reach similar results, the Department may refer to cases under the federal statute for guidance in determining whether the taxpayer was a responsible party. See Sauve v. K.C., Inc., 19 Wn. App. 659, 665, 577 P.2d 599 (1978), aff'd, 91 Wn.2d 698, 591 P.2d 1207 (1979).

corporation's owner. Initially, he signed checks and made day-to-day management decisions as to which creditors to pay. Until the period in question, he enjoyed the status of a responsible party. However, when he was instructed by the owner, who was in sole control of the company, not to pay funds to the state, he no longer had the same authority and discretion. At that time, he lost his status as a responsible party. Accordingly, while the taxpayer continued to have the authority to sign checks, we find that the discretion to determine whether to pay the trust funds to the state was lacking for the period in question.⁵

DECISION AND DISPOSITION:

The taxpayer's petition is granted. This matter will be remanded to the Taxpayer Account Administration Division for cancellation of the Individual Corporate Liability assessment as against this taxpayer.⁶

DATED this 25th day of May, 1995.

⁵Because of this conclusion, we do not need to reach the taxpayer's wilfulness argument.

⁶This decision did not address the corporate officer.