

STATE OF NEW YORK
TAX APPEALS TRIBUNAL

In the Matter of the Petition	:	
of	:	
HARVEY RUSSACK, OFFICER OF	:	DECISION
NOHOS UNIQUE CLOTHING WAREHOUSE, INC.	:	DTA No. 811409
	:	
for Revision of a Determination or for Refund of Sales and	:	
Use Taxes under Articles 28 and 29 of the Tax Law for the	:	
Period December 1, 1986 through February 28, 1991.	:	

The Division of Taxation and petitioner, Harvey Russack, officer of Nohos Unique Clothing Warehouse, Inc., 58 Pond View Lane, Chappaqua, New York 11051, each filed an exception to the determination of the Administrative Law Judge issued on April 13, 1995. Petitioner appeared by Beldock, Levine & Hoffman (Myron Beldock, Esq., of counsel). The Division of Taxation appeared by Steven U. Teitelbaum, Esq. (John Matthews, Esq., of counsel).

The Division of Taxation and petitioner each filed a brief in support of their exceptions, in opposition to the other party's exception and in reply to the other party's opposition. Petitioner's reply brief was received on August 28, 1995, which date began the six-month period for the issuance of this decision. Petitioner's request for oral argument was denied.

The Tax Appeals Tribunal renders the following decision per curiam.

ISSUE

Whether petitioner, the controlling stockholder and vice president of Nohos Unique Clothing Warehouse, Inc., is personally liable under Tax Law § 1133 for the sales and use taxes of the corporation when the financial officers of the corporation deliberately withheld from him any information as to taxes due.

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge except for finding of fact "9(b)" which has been modified. The Administrative Law Judge's findings of fact and the modified finding of fact are set forth below.

Petitioner, Harvey Russack, in 1973 became involved with Fresh Water, Inc., a family business and the predecessor of Nohos Unique Clothing Warehouse, Inc. ("Unique"). Fresh Water, Inc., operated a clothing and military surplus store on lower Broadway in New York City near New York University. In 1975, Unique was formed with petitioner retaining 100% ownership. Around 1978, a family tragedy caused petitioner to want to leave the business. He ultimately did not leave, but did look for someone to handle the day-to-day operations of the business.

In 1980, Richard Wolland, who had had extensive experience at E. J. Korvette, joined the business and was manager of the store from that time. It was understood he would greatly expand the business.

In 1982, Unique hired David Berdon & Co. ("Berdon") as its certified public accountant. This was at the suggestion of Mr. Wolland and after interviews with petitioner.

In 1985, the business was separated into Nohos Unique Clothing Warehouse Realty, Inc. ("Realty"), of which petitioner retained complete ownership, and Unique, owned by Realty to the extent of 82.5% and by Mr. Wolland (17.5%). Mr. Wolland became president of Unique with petitioner as both chairman and vice president.

In 1989, Unique acquired and moved into a new and much larger building at 726 Broadway, other stores were acquired and an office was rented at 704 Broadway.

In 1985, Unique's receipts had been less than it had projected and it failed to pay some sales taxes. It entered into a deferred payment agreement with the Division of Taxation ("Division"). Petitioner had expressed some concern with this. (This matter is not, however, in issue in this case.)

Petitioner admits that he had ultimate legal control of Unique through his stock ownership and as chairman of the board of directors.

Petitioner had made many loans to the business and had guaranteed other loans to the business. Petitioner drew a salary from Unique. He regarded this as partly for his work with Realty.

Petitioner had desk space at Unique's offices at 704 Broadway. His personal interest in the business involved style and design. He had other interests, aside from Unique, in the clothing business. He very seldom came to the office.

The organizational chart of Unique during this time showed everyone reporting to Mr. Wolland and no one to petitioner. Petitioner was shown on the chart with a horizontal line over to Mr. Wolland.

In April 1988, Unique hired Melson Muneses as its comptroller. For this job he had been interviewed by Berdon and petitioner. He reported to Mr. Wolland.

The responsibility for conducting and controlling Unique's daily financial activities, maintaining general ledgers and payroll records, making payments of Federal and State taxes, and preparing tax returns and financial statements was that of Unique's controller, Melson Muneses, and the independent certified public accountant, Berdon.

Although petitioner had check-signing power, he in fact rarely exercised it and then, generally, only when other signatories were unavailable. The vast majority of corporate checks were signed by Mr. Wolland or by a signature stamping machine under the control of Mr. Muneses.

Petitioner did not sign Federal or State tax returns or checks for Federal or State tax payments. His machine signature did appear on some sales tax checks. That machine, however, was under the control of Mr. Muneses. Petitioner did not have, during the relevant periods, the responsibility, under Unique's management structure, to direct that a payment be made to a taxing authority rather than to some other corporate creditor.

Petitioner kept up with the reports and statements of both the certified public accountants and Unique's own accountants. However, although petitioner, from his own testimony, had contracted with the certified public accountant, Berdon, for full audits including the policing of tax payments, Berdon's report states that it is merely a compilation of information received from management.

Both the outside accountants' reports and the corporation's own statements regularly showed little or no current sales tax liability (and further they showed reduced sales tax liabilities for the pre-1986 deferred payment agreement).

Petitioner regularly attempted to obtain information and records concerning financial affairs and regularly attempted to ascertain whether, and be assured that, Unique's tax obligations were current.

Throughout the relevant period, petitioner regularly sought and received assurances from Mr. Wolland and Mr. Muneses that Unique's financial obligations, including its tax payments, were current. In particular, when petitioner did visit Unique's office, he regularly inquired of Mr. Muneses as to whether Unique was meeting both its current sales tax payments, and its obligations to make regular payments under the deferred payment agreement to retire an arrears balance arising from the earlier sales tax problem.

We modify the Administrative Law Judge's finding of fact "9(b)" to read as follows:

Mr. Muneses admitted at the hearing that he always responded to petitioner's questions by saying that everything was in order, even on occasions when he knew that not to be the case and, in addition, that on Mr. Wolland's instructions, he withheld from Mr. Russack financial information concerning Unique's disbursements that the latter had requested. In addition, Mr. Muneses deliberately made incorrect entries in the corporation's financial journals for the purpose of hiding the sales

tax liability of the corporation. Mr. Muneses began making these incorrect entries in June of 1990.¹

In making those findings, I have relied on testimony of petitioner himself, Mr. Muneses and also Mr. Wolland, the office manager, all of whom I find entirely credible.

In early 1991, Unique filed under Chapter 11 of the Bankruptcy Act.

The period of limitation for assessment against Unique was extended by consents signed by its president, Richard Wolland. The first consent was signed on June 15, 1990 for the period December 1, 1986 through August 31, 1987 and extended the limitation period to December 20, 1990. The second consent was signed on November 12, 1990 for the period December 1, 1986 through February 29, 1988 and extended the limitation period to June 20, 1991. The third consent was signed on May 30, 1991 for the period December 1, 1986 through August 31, 1988 and extended the limitation period to December 20, 1991.

Two notices of determination were issued to petitioner on April 19, 1991. One was for the quarter ending May 31, 1990 in the amount of \$41,025.16 plus penalty and interest and the other for the quarter ending August 31, 1990 in the amount of \$139,637.52 plus penalty and interest. Both of these were for taxes shown on returns filed by Unique which were not paid in full.

A further notice of determination was issued against petitioner on August 23, 1991 for the period December 1, 1986 through May 31, 1990 in the amount of \$110,951.88 plus interest. This was based on a finding of taxes not reported on any return.

OPINION

The Administrative Law Judge found in favor of petitioner on the issues of whether petitioner was personally liable under section 1133(a) of the Tax Law for the sales and use taxes of Unique and on the issue of whether consents executed on behalf of the corporation to extend

¹We modified the Administrative Law Judge's finding of fact "9(b)" by adding the last two sentences to reflect more details of the record.

the period of limitations for assessing taxes were effective to extend the period for assessing taxes against petitioner. The Division took exception to these rulings.

The Administrative Law Judge ruled in favor of the Division on the issue of whether petitioner as an officer of the corporation could be liable for penalty and interest due on the taxes not paid by the corporation and on the issue of whether petitioner proved that Unique had reasonable cause for its failure to pay taxes. Petitioner took exception to these rulings.

We will first address whether the Administrative Law Judge correctly held that petitioner was not personally liable for the sales and use taxes of the corporation.

The Administrative Law Judge relied on Vogel v. New York State Department of Taxation & Fin. (98 Misc 2d 222, 413 NYS2d 862, 866) for the principle that a corporate officer is not an insurer for the corporation and is required to perform his duties only with the ordinary care a normal prudent person would use under similar circumstances. The Administrative Law Judge found that petitioner was not a responsible officer of Unique on the basis that "it is completely clear that petitioner was kept in the dark by the deliberate actions of Mr. Wolland, the president, and Mr. Muneses, the treasurer. The rule against absolute liability would be undercut by the Division's arguments that all delegation of duties to Mr. Wolland or Mr. Muneses was improper" (Determination, conclusion of law "A").

On exception, the Division has not requested any modifications to the facts as found by the Administrative Law Judge, but on the facts found by the Administrative Law Judge the Division argues that petitioner was a responsible officer of Unique. The facts relied on by the Division include that petitioner controlled 82.5% of the stock of Unique, was chairman of the board of directors and vice president of Unique, received income from Unique, made loans to the corporation, and that some of the checks remitting sales tax from the corporation bore petitioner's machine signature. The Division argues that petitioner's authority was nondelegable and that petitioner was not precluded from exercising his authority. Finally, the Division argues that the

Administrative Law Judge's basis for finding that petitioner was not a responsible officer -- that he was deceived by Mr. Muneses and Mr. Wolland -- is unsupported by Tribunal precedents.

We affirm the determination of the Administrative Law Judge.

It is well established that the holding of corporate office does not in and of itself impose liability on the office holder for the sales taxes of the corporation (Matter of Blodnick v. New York State Tax Commn., 124 AD2d 437, 507 NYS2d 536, citing Chevlowe v. Koerner, 95 Misc 2d 388, 407 NYS2d 427). We have concluded in several cases that an officer that had apparent authority within a corporation was not a responsible officer because an examination of the circumstances within the corporation revealed that the officer was actually precluded from exercising his authority (see, Matter of DeFeo, Tax Appeals Tribunal, March 9, 1995; Matter of Taylor, Tax Appeals Tribunal, October 24, 1991; Matter of Constantino, Tax Appeals Tribunal, September 27, 1990). In the instant case, we conclude that the deliberate deception by Mr. Muneses and Mr. Wolland effectively precluded petitioner from exercising his authority within the corporation and for this reason petitioner cannot be held to be a responsible officer of the corporation.

Petitioner's situation is very different from those cases where the officer simply chose not to pay attention to whether the sales tax obligations of the corporation were being met (see, e.g., Matter of Martin v. Commissioner of Taxation & Fin., 162 AD2d 890, 558 NYS2d 239; Matter of Cohen v. State Tax Commn., 128 AD2d 1022, 513 NYS2d 564; Matter of Blodnick v. State Tax Commn., supra; Matter of Klein, Tax Appeals Tribunal, January 25, 1996, Matter of Napoli, Tax Appeals Tribunal, July 13, 1995). In the instant case, the Administrative Law Judge found that petitioner was concerned with whether the corporation met its sales tax obligations and that petitioner regularly inquired of Mr. Wolland and Mr. Muneses whether the taxes were being paid. In response to these regular inquiries, Mr. Muneses admitted that he lied to petitioner, that he withheld financial records from petitioner and that he intentionally made incorrect entries in the corporation's financial journals for the purpose of hiding the sales tax liability of the

corporation. Thus, petitioner exercised regular supervision over the financial affairs of the corporation but was unable to determine that taxes were not being paid because of the intentional deception of Mr. Muneses. To hold petitioner liable in these circumstances would mean that an officer would be required to perform all tasks within a corporation to avoid potential liability for sales taxes. We do not think that the Legislature intended to impose such an absolute liability on officers, or as the Vogel court stated, to make the officer an insurer of the corporation.

The Division argues that we have addressed a factual situation very similar to the present in Matter of Binder (Tax Appeals Tribunal, August 19, 1993) where we found the officer liable. We do not agree that the two cases are similar.

In Binder, the Administrative Law Judge did not find as a fact that the petitioner regularly inquired about the sales tax obligations of the company and that the petitioner was regularly deceived on this topic.² Instead, the only fact found by the Administrative Law Judge with respect to this topic was that the "[p]etitioner testified that he was told by Mr. Wachs and by Donald Talbot, a certified public accountant who prepared financial statements for the public offering, that Musikahn had no outstanding tax liabilities at the time of the public offering" (Matter of Binder, supra). At the very most this fact indicates that, if the testimony was believable (and the Administrative Law Judge did not say it was), the petitioner in Binder made a single inquiry about the sales tax liability which is obviously different from the regular supervision exercised by petitioner in this case.

In its reply brief, the Division argues that the actions of Mr. Wolland and Mr. Muneses are not causally connected to petitioner's failure to pay the sales tax at issue. The Division asserts that this is especially true for the assessment covering the period December 1, 1986 through May 31, 1990 because this assessment was based on the corporation's failure to properly

²The petitioner in Binder asserted that he "prudently and responsibly relied on the assurances of others that taxes were paid"; however, contrary to the Division's brief in the instant matter, neither the Administrative Law Judge nor the Tribunal found such a fact in Binder.

document claimed nontaxable sales and the record does not indicate that Mr. Wolland or Mr. Muneses took any action to conceal this problem.

As petitioner correctly notes, the only evidence about the audit of Unique, which resulted in the assessment for the period December 1, 1986 through May 31, 1990, is in the Audit Report (Exhibit "H") which states that disallowed nontaxable sales accounted for only \$18,139.19 of the \$199,289.73 deficiency, while \$171,126.62 arose from additional gross sales determined by the auditor. Therefore, we see no basis to the Division's claim that the assessment was based on disallowed nontaxable sales.

With respect to the other two assessments, the Division argues that petitioner has not shown that the actions of Mr. Muneses and Mr. Wolland "were causally related in time to the failure to timely pay the tax reported" for the quarters ending May 31 and August 31, 1990 (Division's reply brief, p. 2). The testimony of Mr. Muneses, which is reflected in the findings of facts, was that he never gave petitioner an accurate report which would have indicated the bad financial situation of the corporation. In addition, Mr. Muneses began making incorrect journal entries in June of 1990. Thus, there is a temporal connection between the deceptions of Mr. Muneses and the corporation's failure to pay.

Because our decision in favor of petitioner means that there will be no further review of our decision (Tax Law § 2016), we will not address the remaining issues.

Accordingly it is ORDERED, ADJUDGED and DECREED that:

1. The exception of the Division of Taxation is denied;
2. The exception of Harvey Russack, Officer of Nohos Unique Clothing Warehouse, Inc. is denied;
3. The determination of the Administrative Law Judge is affirmed;
4. The petition of Harvey Russack, Officer of Nohos Unique Clothing Warehouse, Inc., is granted; and

5. The notices of determination dated April 19, 1991 and August 23, 1991 are cancelled.

DATED: Troy, New York
February 8, 1996

/s/John P. Dugan
John P. Dugan
President

/s/Francis R. Koenig
Francis R. Koenig
Commissioner

/s/Donald C. DeWitt
Donald C. DeWitt
Commissioner