

STATE OF NEW YORK

TAX APPEALS TRIBUNAL

In the Matter of the Petition :

of :

HARSHAD SHAH :

for Redetermination of a Deficiency or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the New York City Administrative Code for the Period July 1, 1992 through December 31, 1992. :

DECISION
DTA NO. 814588
and 814589

In the Matter of the Petition :

of :

HARSHAD SHAH :

for Revision of a Determination or for Refund of Sales and Use Taxes Under Articles 28 and 29 of the Tax Law for the Periods June 1, 1991 through August 31, 1991 and March 1, 1992 through May 31, 1993. :

Petitioner Harshad Shah, 731 West Street, Harrison, New York 10528-1708, filed an exception to the determination of the Administrative Law Judge issued on December 11, 1997.

Petitioner appeared by Robinson, Brog, Leinwand, Greene, Genovese and Gluck, P.C.

(A. Mitchell Greene, Esq., of counsel). The Division of Taxation appeared by Steven U.

Teitelbaum, Esq. (Brian J. McCann, Esq., of counsel).

Petitioner filed a brief in support of his exception and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument, at petitioner's request, was heard on September 24, 1998 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

ISSUES

I. Whether petitioner was a person required to collect, truthfully account for and pay over withholding tax with respect to 211 East 59th Street Restaurant Corp., 1655 Broadway Restaurant Corp. or One Station Square Restaurant Corp., who willfully failed to do so thus becoming liable for a penalty equal to such unpaid tax under section 685(g) of the Tax Law.

II. Whether petitioner had sufficient involvement in and control over the activities of any or all of the above-named corporate entities so as to be considered a person responsible to collect and remit sales tax on behalf of such corporations pursuant to Tax Law §§ 1131(1) and 1133(a).

FINDINGS OF FACT

We find the facts as determined by the Administrative Law Judge. References in the determination to petitioner Kewal K. Chopra have been amended to indicate that Mr. Chopra is not a party to this exception. These facts, as amended, are set forth below.

At issue in this proceeding are two notices of deficiency and twelve notices of determination issued by the Division of Taxation ("Division") against petitioner Harshad Shah. These notices reflect liabilities allegedly owed by petitioner based on his failure to collect and remit taxes on behalf of three corporate entities known, respectively, as 211 East 59th Street Restaurant Corp. ("211"), 1655 Broadway Restaurant Corp. ("1655") and One Station Square Restaurant Corp. ("OSS"). Information relative to the notices at issue is as follows:

Notices issued against petitioner Harshad Shah:

<u>DATE</u>	<u>NOTICE NUMBER</u>	<u>TYPE OF TAX</u>	<u>PERIOD</u>	<u>AMOUNT¹</u>
12/10/93	L008311857	Sales and Use	02/28/93	\$13,200.00
12/10/93	L008311858	Sales and Use	11/30/92	\$11,844.52
12/10/93	L008311859	Sales and Use	08/31/92	\$19,771.04
12/10/93	L008311860	Sales and Use	05/31/92	\$ 6,405.80
01/13/94	L008371537	Sales and Use	11/30/92	\$76,477.34
01/13/94	L008371538	Sales and Use	05/31/92	\$50,737.17
01/13/94	L008371539	Sales and Use	08/31/92	\$75,767.18
09/12/94	L009491411	Sales and Use	05/31/93	\$ 300.00
09/12/94	L009491412	Sales and Use	02/28/93	\$14,500.00
09/12/94	L009491413	Sales and Use	11/30/92	\$13,090.03
09/12/94	L009491414	Sales and Use	08/31/92	\$18,488.58
09/12/94	L009491415	Sales and Use	08/31/91	\$ 0.00
01/13/94	L008371696	Withholding	12/31/92	\$14,528.26
09/12/94	L009491218	Withholding	12/31/92	\$ 5,558.50

At the commencement of proceedings, the parties agreed that the dollar amounts listed on the notices are not in question, and that the only issue is whether petitioner should properly be held liable for the payment thereof.

Petitioner Harshad Shah has a background in the banking industry, having worked for Manufacturer's Hanover Trust in New York City from 1970 through 1981. Thereafter, he became involved in operating his own real estate business. Prior to 1990, Mr. Shah had not owned any restaurants or been involved in the restaurant industry.

¹ The dollar amounts listed represent the amounts of tax due, exclusive of penalty and interest thereon, and inclusive of payments or credits against such amounts of tax. In each instance where payments or credits apply, the same are reflected on the individual notices. In the instance where the amount of tax shown is zero, the item at issue is penalty only. The two notices pertaining to withholding tax reflect the amount of withholding tax unpaid and asserted against petitioner as a penalty. Finally, the first four notices listed against petitioner Shah pertain to OSS, the next three pertain to 1655, the next five pertain to 211, the next one pertains to 1655 and the next one pertains to 211.

As of approximately 1986, Bombay Palace Restaurant Corp. ("Bombay") was the owner of 10 to 15 restaurants. Thereafter, in 1987, Bombay acquired 50 to 60 additional restaurants from a publicly traded company. On or about September 21, 1989, Bombay filed for bankruptcy protection under Chapter 11 of the United States Code ("the Bankruptcy Code"). According to testimony, Bombay sought bankruptcy protection because of an inability to pay its creditors brought on by financial deterioration following its acquisition of the additional restaurants.

In or about August 1990, petitioner Harshad Shah entered into negotiations with Bombay, primarily through its sole shareholder, one Sant S. Chatwal, for the purchase of seven of Bombay's restaurants including the three entities in question here. After review of the financial information for the seven restaurants, Mr. Shah believed the same to be viable profitable entities. The negotiations culminated in or about September 1990 with Mr. Shah's agreement to purchase the seven restaurants. The three corporate entities at issue herein, 211, 1655 and OSS, were all formed in or about October 1990, and Mr. Shah was the sole shareholder and officeholder of all three entities.

As part of the negotiations for the purchase of the restaurants, it was agreed that the restaurants would be managed by Bombay pursuant to a management agreement.² Although the management agreements were referred to by the parties and spoken of in testimony (apparently separate but nearly identical agreements were made for the various Bombay subsidiary management companies), none of the agreements was offered in evidence. On or about November 8, 1991, the stock of the three entities (211, 1655 and OSS) was transferred to a

²It appears that the separate corporate entities which had previously owned the restaurants, and which were each subsidiaries of Bombay, were engaged to manage the separate restaurants after their acquisition by Mr. Shah.

corporation known as Ultimate Food Services of NY, Inc. ("Ultimate"). Mr. Shah was, and is, the sole shareholder of Ultimate.

Bombay emerged from bankruptcy in the summer of 1991. As part of Bombay's plan of reorganization, the monies realized from the sale of the seven restaurants to Mr. Shah were used to help fund the reorganization. Mr. Shah purchased the restaurants by his assumption of the restaurants' debt, by an infusion of approximately \$500,000.00 of his own money, and by a loan personally guaranteed by Mr. Shah and his wife in the amount of \$6,750,000.00. The loan was to be repaid out of the ongoing operation of the restaurants.

At the outset, Mr. Shah arranged for a person on his staff to regularly review the books of the newly-acquired restaurants to verify receipts and expenses. He viewed this person as an "overseer" or "owner's representative" to assure compliance with the terms of the management agreements vis-a-vis timely payments of rents, taxes, etc., and to review restaurant sales and operating cost data. Mr. Shah also retained accountants to prepare quarterly unaudited financial reports and yearly audited statements as required by the bank which had financed the purchase of the restaurants.

During the first few months following the acquisition, operations apparently went well and Mr. Shah received some distributions from the restaurants. However, Mr. Shah explained that he began to be "shut out" from obtaining financial information concerning the restaurants shortly thereafter. For example, the audited financial statements required for the period ended December 31, 1991 were not forwarded to the lending bank and the bank, in turn, contacted Mr. Shah. Mr. Shah contacted Mr. Chatwal who reassured Mr. Shah that everything was in order. Mr. Shah began to realize that Mr. Chatwal was intentionally withholding financial information

about the restaurants in or about January 1992. Mr. Shah described this situation as a "series of roadblocks", such as information not being made available to the individual designated by Mr. Shah to review the operations of the restaurants, and appointments with Mr. Shah's accountants being rescheduled by Mr. Chatwal to later dates. Mr. Shah realized that Bombay was not in compliance with the management agreements when the lending bank contacted Mr. Shah to advise that the loan was not being paid in accordance with the payment schedule (i.e., partial, as opposed to full, payments were being made). By March 1992, Mr. Shah discontinued the services of the person he had designated to review the restaurants' financial operations, because no information was being provided from the Bombay management companies to be reviewed. From this point forward, Mr. Shah talked directly to Mr. Chatwal on a weekly or biweekly basis concerning the lack of information, nonpayment of the bank loan and "all other matters."

Mr. Shah hired attorneys near the end of 1992 to represent him with respect to the problems at the restaurants. Thereafter, in March 1993, Mr. Shah terminated the management agreements with the Bombay corporations, and commenced operating the restaurants on his own. Mr. Shah considered suing the Bombay management companies, but they filed for bankruptcy and he did not further pursue the matter. Mr. Shah does not dispute that after his takeover of the management of the restaurants, he was properly responsible for the tax filing and payment obligations of the restaurants. He alleges that from the time of his direct involvement, all of such obligations were carried out on a timely basis. He further alleges that he was unaware of the unpaid taxes at issue here until April of 1993 when Mr. Chopra presented him with a list of such outstanding taxes.

Prior to his termination of the management agreements, Mr. Shah did not execute documents or sign checks or tax returns (except for one request for a filing extension) on behalf of the restaurant corporations. He did not gain access to the books and records of the businesses and, allegedly due to the management agreements, did not hire or fire any employees, or become involved in the daily operations of the restaurants. He noted that on occasion he attempted to ask questions of the restaurant managers or employees, but found them to be loyal to Mr. Chatwal as their long-time employer and not forthcoming with information concerning the restaurants.

Kewal K. Chopra first met Sant Chatwal in or about 1967. He started working for Mr. Chatwal in one of Mr. Chatwal's hotels in 1981. In March 1986, Mr. Chopra became a vice-president of Bombay. At this time, Bombay owned 10 to 15 restaurants, and Mr. Chopra assisted Mr. Chatwal in the operation of the restaurants. Mr. Chopra described his duties as overseeing the operation of the restaurants, including assuring that food and labor costs were "in order" and that the restaurants opened and closed on time. His office was located away from the restaurants and at the same location as Mr. Chatwal's office. In 1988, prior to Bombay's filing for bankruptcy protection, Mr. Chopra resigned his office as vice-president and became a consultant to Bombay. He remained in this role, consulting only with Bombay, until June 1991 when he resumed the office of vice-president of Bombay. He was involved in the preparation of some of the documents pertaining to the bankruptcy filing. His resumption of the office of vice-president coincides with the time of Bombay's emergence from bankruptcy. Mr. Chopra remained as vice-president of Bombay until March 1993, at which time he left employment with Bombay and became an employee and assumed the title of president of Mr. Shah's company Ultimate. This

change of employment coincides with the time of the termination of the management agreements and the takeover of operations by Mr. Shah.

Mr. Chopra signed tax returns, including sales tax returns, on behalf of the subject restaurant corporations. As vice-president of the management corporations, he also signed checks drawn on the bank accounts of the restaurants. According to Mr. Chopra, and according to an April 19, 1995 letter from Mr. Chatwal, all of these actions were undertaken at the direction of Mr. Chatwal. Mr. Chopra alleged and the Chatwal letter states, that Mr. Chopra had no authority to bind Bombay in any transaction without Mr. Chatwal's authorization. Furthermore, Mr. Chopra stated that he did not sign checks without Mr. Chatwal's approval. In this regard, the bookkeeping staff of the Chatwal organization would prepare a list of payables, present it to Mr. Chatwal for approval and, upon approval, would prepare checks to pay the approved bills. The checks were in turn forwarded to Mr. Chopra for signature. Mr. Chopra described himself as essentially a bookkeeper for the Chatwal companies without any authority or discretion over the payment of bills. He explained that he was not consulted by Mr. Chatwal with respect to the financial aspects of the businesses, and noted that Mr. Chatwal ran the cash management aspects of the businesses. Mr. Chopra did not hire or fire employees of the restaurants and claimed that he had no authority to do so. Mr. Chopra had no stock or other ownership interest in Bombay or in any of the restaurant (or management) corporations. He was paid a salary which was less than that paid to some of the restaurant managers. Mr. Chopra did not meet with banks with regard to negotiating loans for Bombay or its subsidiaries, and he did not lend any money to Bombay or its

subsidiaries.³ The negotiations for the sale of the restaurants to Mr. Shah were conducted between Mr. Shah and Mr. Chatwal, and Mr. Chopra was not a party to or present at such negotiations.

Soon after the sale of the restaurants to Mr. Shah, Mr. Chopra was instructed by Mr. Chatwal not to disclose information from the books and records of the restaurants to Mr. Shah. Mr. Chopra stated he did not know the reason for this directive, and explained that in carrying out this order to purposely withhold information he was simply following the instructions of his employer Mr. Chatwal. Mr. Chopra did not make this order not to disclose known to Mr. Shah until after the termination of the management agreements.

THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE

The Administrative Law Judge reviewed relevant statutory provisions and case law concerning the criteria for determining whether an individual is a person liable for unpaid sales and use taxes or for penalties equal to unpaid withholding taxes. The Administrative Law Judge noted that the factors to be considered in making such an inquiry include the person's official duties, the amount of corporation stock owned, the person's authority to pay corporate obligations and whether the particular individual signed or had the power to sign tax returns, derived a substantial part of his income from the corporation or had the right to hire and fire employees.

³Mr. Chopra noted that the IRS released him from liability under certain liens it held against him for unpaid Federal withholding tax with regard to Bombay and its subsidiaries. However, documents in the record show that such release pertained to liens running through the period ended September 30, 1989, which is prior to the periods at issue here. The record does not disclose whether the IRS asserted liability against Mr. Chopra for the periods at issue here or, if so, the disposition of such asserted liability.

The Administrative Law Judge noted that the issue to be resolved is whether petitioner had, or could have had, sufficient authority and control over the affairs of the corporations to be considered a person under a duty to collect and remit the unpaid taxes in question. For withholding tax, it must further be determined whether such a person's failure to withhold and pay over such taxes was willful.

The Administrative Law Judge concluded that while petitioner asserted that he was merely an investor without the authority to carry out the tax payment obligations of the businesses at issue, the record supports the conclusion that he was a person who had, or could have had, the ability to control the affairs of the corporations. In this regard, petitioner was the sole stockholder, director and officer of the restaurant corporations. It was petitioner who applied for and received liquor licenses and certificates of authority vis-a-vis sales tax on behalf of the three entities. It was petitioner who transferred the stock of these entities to another entity of which he was the sole shareholder during the periods at issue. Petitioner had a substantial investment in the restaurants. Whatever restrictions may have been placed on petitioner by the management agreements are unknown since these agreements were not offered in evidence and are not a part of the record.

As a result, the Administrative Law Judge concluded that petitioner was liable for the taxes and penalties asserted due.

ARGUMENTS ON EXCEPTION

On exception, petitioner argues that he was not a person responsible for the collection and payment of sales taxes or withholding taxes. Specifically, he argues that at the time he purchased the three restaurants in issue in 1991 from Bombay, the Bankruptcy Court entered an order

approving the sale to petitioner which order included a provision that required Bombay to continue their management of the restaurants. Further, petitioner argues that he was denied access to financial information concerning the three restaurants and that Bombay employees were specifically instructed to withhold such information from petitioner. Petitioner argues that he was only able to terminate the management agreements with Bombay after he retained counsel for this purpose.

Petitioner argues that he is not a responsible officer because he had no authority over the affairs of the restaurants. He was merely a corporate officer and shareholder. Although he was an officer, he had no responsibility in running the restaurants. He never had control or authority over their operations. Thus, he could not have been found to have delegated this authority away. He was simply an investor.

Petitioner argues he is situated similarly to the taxpayer in *Matter of Russack* (Tax Appeals Tribunal, February 8, 1996). There, the taxpayer was found not to have been liable for the payment of sales and use tax even though he was the controlling stockholder and corporate vice-president. In *Russack*, financial information was deliberately withheld from the taxpayer and he was misled concerning corporate compliance with tax obligations. Petitioner argues that he had no actual authority over the running of the restaurants and, without such authority, he had no ability to control their affairs. Thus, he was prevented from exercising any authority until after the management agreements were terminated.

Petitioner argues that his mere status as a shareholder, officer and director does not give rise to a determination that he is responsible for tax payment. The applicable test of responsibility is to determine who was in charge of the day-to-day management of the restaurant.

Even if petitioner possessed the ultimate authority over a corporation as a shareholder, petitioner argues that this is not sufficient to impose liability if he did not actually exercise control over the management of the business. Relying on Federal case law concerning 26 USC 6671 (similar to Tax Law § 685[g]), petitioner argues that authority and duty are not synonymous.

The Division, in opposition, argues that the determination of the Administrative Law Judge was correct. The Division argues that a corporate officer may not avoid liability as a responsible person under Tax Law § 1131(1) by delegating his responsibilities nor can he disregard his duties under the Tax Law by leaving them for someone else to discharge. Petitioner was the sole officer, director and shareholder of the three corporations at issue from the time they were formed until their stock was transferred to Ultimate, a corporation wholly owned by petitioner. Thus, petitioner has remained the sole beneficial shareholder and owner of the restaurants. The Division argues that petitioner's voluntary agreement to allow a management company to run each of these restaurants does not allow petitioner to avoid his responsibility under the Tax Law. Despite petitioner's arguments that the management agreements were a precondition to purchasing the businesses at issue from Bombay, petitioner voluntarily acceded to these alleged conditions. He was not compelled to make the purchases. Thus, the Division maintains that there is simply no basis for the argument of petitioner that he never had the authority to affect the payment of taxes or to delegate his authority.

The Division further argues that since the management agreements seemingly relied on by petitioner were never introduced into evidence, an unfavorable inference should arise from petitioner's failure to produce these documents. Even if petitioner never signed checks, tax

returns or maintained books and records of the corporations, it is not known, due to the absence of the management agreements, whether or not he had the authority to do so.

The Division argues that other indicia of petitioner's authority appear in the record indicating that petitioner was a person responsible for collecting and remitting sales and use tax and withholding tax. Petitioner received distributions from the restaurants, petitioner met with the manager of the restaurants and petitioner applied for liquor licenses for these corporations. The Division points out that petitioner was aware that creditors were not being paid in full in early 1992. Thus, he should have been put on notice that the potential for other defaults in obligation payments existed. However, he failed to exercise reasonable oversight and control. Nor is there evidence that he was precluded from doing so.

The Division argues that *Matter of Russack (supra)* is clearly distinguishable from the present case because in *Russack*, the taxpayer was not aware of the nonpayment of debts while petitioner here was clearly aware in early 1992. Further, the taxpayer in *Russack* specifically inquired whether or not sales taxes were being paid and was lied to, while here, there is no evidence that a specific inquiry as to tax payments was ever made by petitioner.

The Division argues that as to withholding tax, there has been no showing by petitioner that his failure to pay was not willful. The willfulness requirement can be met in the absence of actual knowledge of the failure to remit taxes. A reckless disregard of the corporate responsibility to see that taxes are paid is sufficient. The Division argues that petitioner's only support for his arguments is his own self-serving testimony and that of Kewal Chopra without documentary support.

OPINION

The essence of petitioner's position is that although he was the sole shareholder, officer and director of the three restaurant corporations and of Ultimate, he did not actually have a duty to collect and pay over sales and withholding taxes because he had contracted away the authority and any duty he may have had to do so in the management agreements. Petitioner is correct that his status as a shareholder, officer and director does not, per se, impose liability for the payment of taxes on him. However, petitioner bears the burden of proof to overcome the assessments. Here, petitioner has failed to meet that burden. Specifically, he has not introduced into the record sufficient evidence to demonstrate how his authority to control the corporations of which he was the sole shareholder and officer was restricted by the management agreements upon which he relies. While the Administrative Law Judge was justified in concluding in his determination that management agreements existed, their terms cannot likewise be inferred. Without any evidence of the terms of those agreements or of how they actually impacted the authority of petitioner to control the affairs of or actively participate in the businesses he owned, there is no basis on which to conclude that petitioner did not have sufficient authority and control over the affairs of the corporations to be considered a person under a duty to collect and remit the unpaid taxes in question.

The Administrative Law Judge recites numerous facts in the record which belie petitioner's claim. Perhaps most significant is that petitioner unilaterally terminated the management agreements with the Bombay corporations in March 1993 and, thereafter, operated the restaurants on his own. The record does not indicate that petitioner could not have taken such action in early 1992 had he deemed it prudent to do so.

Nor do we find petitioner's situation similar to that of the taxpayer in *Matter of Russack* (*supra*). In that case, we found that the taxpayer was precluded from exercising his corporate authority as distinguished from a corporate officer who "simply chose not to pay attention to whether the sales tax obligations of the corporation were being met". In *Russack*,

petitioner was concerned with whether the corporation met its sales tax obligations and . . . petitioner regularly inquired . . . 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 (*Matter of Russack, supra*).

In the present case, the Administrative Law Judge found that petitioner began to realize that Mr. Chatwal was intentionally withholding financial information about the restaurants in or about January 1992. However, unlike the taxpayer in *Russack*, there is no evidence that petitioner exercised "regular supervision over the financial affairs of the corporation" or ever inquired as to whether or not tax payments were being made.

The Administrative Law Judge, in his determination, correctly and fully analyzed the relevant statutes and case law applicable to determining liability for the taxes at issue and applied them to the facts adduced in this case. Therefore, we affirm that determination for the reasons set forth therein.

Accordingly, it is ORDERED, ADJUDGED and DECREED that:

1. The exception of Harshad Shah is denied;
2. The determination of the Administrative Law Judge is sustained;

3. The petition of Harshad Shah is denied; and

4. The notices of deficiency dated January 13, 1994 and September 12, 1994, respectively, and the notices of determination dated December 10, 1993, January 13, 1994 and September 12, 1994, respectively, issued against Harshad Shah are sustained.

DATED: Troy, New York
February 25, 1999

/s/Donald C. DeWitt

Donald C. DeWitt
President

/s/Carroll R. Jenkins

Carroll R. Jenkins
Commissioner

/s/Joseph W. Pinto, Jr.

Joseph W. Pinto, Jr.
Commissioner