STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition :

of :

SALVATORE J. LIGA :

for Redetermination of Deficiencies or for Refund of New York State and New York City Personal Income Taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the Period October 1, 2000 through June 30, 2002. :

DETERMINATION
DTA NO. 821335

Petitioner, Salvatore J. Liga, filed a petition for revision of deficiencies or for refund of New York State and New York City personal income taxes under Article 22 of the Tax Law and the Administrative Code of the City of New York for the period October 1, 2000 through June 30, 2002.

A hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on May 16, 2007 at 10:30 A.M., with all briefs to be submitted by November 26, 2007, which date began the six-month period for the issuance of this determination. Petitioner appeared by Edmund J. Mendrala, Esq. The Division of Taxation appeared by Daniel Smirlock, Esq. (Kevin R. Law, Esq., of counsel).

ISSUE

Whether petitioner was a person required to collect, truthfully account for and pay over withholding tax with respect to New York Baking Co., Inc., who willfully failed to do so and is

therefore liable for penalties equal to the amount of unpaid withholding taxes due from such corporation pursuant to Tax Law § 685(g) and (n).

FINDINGS OF FACT

1. New York Baking Co., Inc. (NY Baking) manufactured and distributed bread and bread products such as rolls in the New York City area. It was a successor to Fink Baking Company, which was the principal bread manufacturer and distributor in the New York City area. The company withheld taxes and issued wage and tax statements to its employees. However, it did not file withholding tax returns after January 2001.

2. At the start of the audit, the Division of Taxation's (Division) auditor ascertained that New York Baking had filed for bankruptcy and was no longer in existence. The auditor examined the corporation's registration and found that petitioner was the president and chief executive officer of NY Baking. He also determined that petitioner signed both the corporate resolution which authorized the corporation's bankruptcy filing and the bankruptcy petition. The bankruptcy petition listed petitioner as owning 90.5 percent of the corporation's stock. The Division's auditor also spoke to two witnesses who confirmed that petitioner was the president, chief executive officer and an owner of the company.

3. The Division's auditor requested records from petitioner. NY Baking's payroll records were not provided to the Division. Therefore, in order to determine the amount of New York State and New York City tax due the Division utilized a claim which the Internal Revenue Service filed in the corporation's bankruptcy proceeding to arrive at the New York State and New York City income taxes due.

4. The total field time charged to this case was 7.5 hours. There was also an additional two hours of audit time charged for a telephone conference and for an in-office meeting.

5. On the basis of the forgoing, the Division issued five notices of deficiency, dated March 7, 2005, to petitioner, Salvatore J. Liga, which asserted that a penalty was due pursuant to Tax Law § 685(g) because petitioner was a responsible officer or person of NY Baking. The notices asserted that penalties were due as follows:

Assessment Number	Tax	Tax Period Ended	Penalty
L-025119164-2	NYC Administrative Code	12/31/00	$ 180,075.00
L-025119165	Article 22	12/31/01	$1,359,324.00
L-025119166-9	NYC Administrative Code	12/31/01	$ 679,668.00
L-025119167-8	Article 22	06/30/02	$ 589,272.00
L-025119168-7	NYC Administrative Code	06/30/02	$ 294,636.00

6. Petitioner is an attorney licensed in New York, Connecticut and certain Federal courts. In the spring of 2000, he became involved in debtor-in-possession financing, which involved lending money to bankrupt companies. In the course of this employment, petitioner encountered NY Baking.

7. Petitioner became interested in NY Baking because his family had been involved in the bakery business. The Fink Baking Company, which was the original name of the bakery, was the largest privately owned bakery in the northeastern United States. Petitioner regarded the Fink Baking Company as having been at the pinnacle of the baking business. However, it fell on hard times for a variety of reasons.

8. In September 2000, petitioner entered into an agreement with the Fink family for a "prepackaged bankruptcy." Under this arrangement, the Fink family agreed to go bankrupt and

simultaneously sign a contract with petitioner giving him the right to manage the bakery for three months. During this time, petitioner was required to post $2,000,000.00 with the U.S. Trustee's Office. At the end of the three months, petitioner could either purchase the business or walk away. Alternatively, the Fink family and the courts could decide that petitioner was unable to properly run the business, in which event petitioner would be compensated for the three months he managed the company.

9. When petitioner took over the company in September 2000, it was losing money at the rate of $200,000.00 a week. In the course of three months, petitioner was able to turn the company around to the extent that it was making a profit of $100,000.00 a week. The company paid all of its bills COD and all of its taxes through Fink Baking Company's tax identification number.

10. On December 7, 2000 petitioner purchased the business with his cousin, Placido Puccio, and Edward Flynn. Under the original plan, petitioner would own 60 percent, his cousin would own 30 percent and Edward Flynn would own 10 percent. However, in fact, petitioner initially acquired 88 percent. The shares were not actually distributed. They were all held in-house and a stock ledger was maintained.

11. At the time petitioner was negotiating to buy NY Baking, he was also negotiating with a factor known as Platinum Funding Corp. (Platinum) to collect the accounts receivable.

12. The total purchase price of NY Baking was $7,335,000.00. Platinum provided a little more than half of the proceeds in order to buy the company. Petitioner received contract credits as a debtor in possession for more than $1,000,000.00. This was the amount of the profit that the company made during the time he managed it in bankruptcy. Ultimately, petitioner did not invest

anything in the purchase. However, he spent approximately $50,000.00 of his own funds on legal fees.

13. As a factor, Platinum offered a service of collecting the accounts receivable. Under the agreement with NY Baking, Platinum advanced a certain percentage of the face value of the invoices presented. The customer receiving the bread or bread product was directed to pay all monies on the invoice to Platinum. Platinum also received a discount fee for prompt payment.

14. A factor was used because NY Baking did not qualify for conventional bank financing. Also, NY Baking did not have an operating history even though Fink Bakery was more than 100 years old.

15. Petitioner felt that he did a good job running the company. Efficiency increased 85 percent and collections were 99.6 percent of the amounts billed. The amount of bread that became damaged was below 1½ percent. The physical plant was clean and operating.

16. In the beginning, petitioner had a good relationship with Platinum. When petitioner entered into the factoring agreement, NY Baking was earning a profit each week. The factoring agreement allotted NY Baking a 75 percent advance on the invoices. This left NY Baking with a positive cash flow of $65,000.00 a week. Petitioner's position was that NY Baking was building a two-year track record so it could get a conventional bank loan.

17. Once the business arrangement with Platinum was consummated, NY Baking and Platinum executed a purchase and sale agreement on a daily basis for the accounts receivable. The forms sent to Platinum were signed in advance by petitioner and by petitioner's lawyer.

18. NY Baking had a process whereby the heads of different departments such as engineering, sanitation, packaging and sales, would set forth what they needed. This process was necessary to keep the factory operating because NY Baking was constantly receiving paper

products, gasoline and flour. NY Baking used the gasoline to make its own electricity. NY Baking employees, James Fink, Ted Flynn and the chief financial officer, Skip Sean, held a meeting to prioritize all of the bills. Messrs. Flynn and Sean would then tell petitioner what they needed to keep the factory running. Petitioner reviewed the recommendation of these employees and then discussed the matter with Eyal Levy, a representative of Platinum. Platinum then decided which bills would be paid.

19. NY Baking used the branch of Fleet Bank in Newport, Rhode Island, for its banking because Mr. Sean had a relationship with the people who worked in that branch. NY Baking did not use checks. Everything was paid by wire, and the only person who was authorized to use a wire, which is a separate authorization, was Skip Sean. Mr. Sean was the chief financial officer of NY Baking and was the sole signatory on the checking account.

20. NY Baking paid a payroll company approximately $2,500.00 a week to print payroll checks and file returns. The payroll records were prepared by the payroll company using compact discs as backup.

21. Prior to February 2001, petitioner collected a number of old accounts receivable and, as a result, collections exceeded sales and petitioner was able to pay the bills. However, beginning in February 2001, deposits started becoming unavailable and the cash flow of the business diminished considerably.

22. Petitioner did not notice the impact that Platinum was having on the business for the first few months of the business relationship because collections exceeded sales. After the first few months, petitioner noticed that there was an 11 percent reduction in receipts which differed significantly from the 3 percent that was projected and which would have left NY Baking profitable. Since NY Baking had a profit margin of approximately 10 percent, the 11 percent

reduction in receipts placed the company in a negative cash flow position. Once Platinum entered the business, NY Baking's collections were suddenly less than its sales. Petitioner discussed the situation with Platinum and its response was "tough." Petitioner was told that there was a two-year contract and that he would have to ride it out.

23. Each day, from about 2:00 P.M. until 4:30 P.M., petitioner's time was spent with representatives of Platinum arguing about money. It was petitioner's understanding that Platinum was advancing 75 percent of each invoice. As this was occurring, NY Baking would have tractor-trailers of flour and oil being delivered and people working. If the business went one day without funding, then it would close down because it did not have credit. Everything had to be wired and paid for prior to accepting delivery.

24. Platinum would not wire the money until approximately 4:30 P.M., which gave NY Baking only a half hour to accept the money and pay creditors.

25. Platinum provided the funds to pay just enough of the bills to keep the company operating. Platinum was aware that payroll taxes were not being paid from the very beginning. Starting the second or third week in February 2001, petitioner complained about this to Platinum. Petitioner asked for money to pay the payroll taxes and on some occasions sent letters. However, Platinum decided the purpose of the funds it was going to provide. Petitioner and his associates became upset because the tax bill was increasing.

26. Employees were paid on Fridays and, pursuant to their contract, had to be paid in cash. Platinum would not send the wire for funds to NY Baking but would send it directly to a check cashing company which, in turn, would send a truck to the site of the factory. After parking, two armed individuals would exit the truck. Employees would form a line to be paid and wait until it was confirmed that the check cashing company received its wire. Only the net payroll was sent

by wire. It was petitioner's belief that Platinum intentionally created stress by waiting until the last minute to send the money.

27. On one occasion, Platinum did not send the money and there was a riot. The employees started telling customers of NY Baking that NY Baking could not meet its payroll and customers started splitting a portion of their order with other bakeries. As a result, NY Baking lost 15 percent of its business. NY Baking lost another 10 to 15 percent of its business as a result of the catastrophic events which occurred on September 11, 2001, because NY Baking had customers in the area surrounding the World Trade Center.

28. Platinum hurt NY Baking's business in other ways. There were instances where NY Baking would give a customer 60 days to make a payment and Platinum would pressure the customer to make a payment after 30 days. In addition, petitioner believes that Platinum created fictitious invoices and then charged NY Baking a fee based upon the fictitious invoices.

29. Petitioner had meetings with representatives of Platinum which became heated because petitioner felt that Platinum had breached the factoring and sale agreements.

30. Petitioner believes that he was barred from bringing a lawsuit against Platinum because NY Baking filed for bankruptcy and it was no longer his company.

31. A second problem that Platinum encountered arose from an established practice of the delivery drivers to cash their own paychecks, make loans and cash paychecks of other employees. This was a difficult practice to monitor. Further, even though NY Baking had a gas station for its trucks, the drivers would purchase gas at independent stations. When some drivers needed money, they would replace the cash with their IOU's. Because of these practices, the office only received $35,000.00 to $50,000.00 a week out of collections of approximately $250,000.00 a week. The balance of the cash was spent on IOU's, cashing paychecks, cash receipts and toll

receipts even though petitioner had E-Z pass on all of its trucks. Over time, cash flows became even more strained. Petitioner objected to the drivers' practices, but his law firm told him that these were "past practices" and that he had to accept them.

32. The presidents of the unions demanded that union obligations be paid in cash. If petitioner did not agree with the unions, they would issue a 48-hour notice which was a prelude to a strike. Also, in order to put pressure on NY Baking, the unions would contact the New York City Schools on Friday at 4:30 P.M. and say that they would not have bread on Monday morning.

33. Petitioner could not lay off union people or get mandatory overtime. For practical purposes, labor was a fixed cost.

34. With the help of Mr. Sean, petitioner was able to secure replacement financing through a company called Bridgeport Capital Services (Bridgeport). Bridgeport invested $1,894,949.67 in order to satisfy the debt to Platinum. Thereafter, Platinum called NY Baking's customers and harassed them. Ultimately, Bridgeport sued Platinum because Platinum continued to collect accounts receivable that belonged to Bridgeport. Between the time the lawsuit started and the time it was fully resolved, NY Baking filed for bankruptcy. Bridgeport ended up losing approximately $2,000,000.00 because of a dilution of the accounts receivable.

35. Petitioner was only paid during the first six months of NY Baking's existence. He was also reimbursed for some business lunches.

SUMMARY OF THE PARTIES' POSITIONS

36. Petitioner submits that he had no effective control over the cash because the drivers delivered only a small amount to the company and other officers or employees disbursed the balance. Petitioner felt that he could have accused Platinum of converting funds, but if he had done so, Platinum would have stopped the funding and shut down the business. According to

petitioner, after the relationship with Platinum started, he did not have any control over the finances of his own business.

37. In his brief, petitioner's representative submits that petitioner's status as president of NY Baking is not sufficient to conclude that he was a responsible person. Petitioner's representative further contends that the Division did not use a reasonable method to determine the amount of the corporation's liability in the absence of adequate books and records. According to petitioner, there was no audit determination but a mere conclusion of liability based upon his status as president. Further, according to petitioner, the finding of liability was premised upon self-serving statements of two officers. Petitioner strenuously objects to the auditor's expedient closing of the case.

38. In response, the Division argues that at all relevant times petitioner was a responsible person within the meaning of Tax Law § 685(n), that petitioner's conduct was willful within the meaning of Tax Law § 685(g) and that petitioner has not met his burden of proving that the deficiencies were irrational or erroneous.

CONCLUSIONS OF LAW

A. Tax Law § 685(g) imposes upon any person required to collect, truthfully account for and pay over withholding taxes who willfully fails to collect and pay over such taxes, "a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over." Tax Law § 685(n) defines "person," for purposes of Tax Law § 685(g), to include, among others, corporate officers and employees who are under a duty "to perform the act in respect of which the violation occurs."

B. The holding of corporate office does not automatically impose tax liability upon an office holder (***Matter of Chevlowe v. Koerner***, 95 Misc 2d 388, 407 NYS2d 427 [1978]).

Rather, the resolution of whether a person is responsible for collecting and remitting sales tax for a corporation so that the person would have personal liability for the taxes not collected or paid depends on the facts of each case (***Matter of Cohen v. State Tax Commn.***, 128 AD2d 1022, 513 NYS2d 564 [1987]). In ***Matter of Constantino*** (Tax Appeals Tribunal, September 27, 1990), the Tax Appeals Tribunal stated :

> The question to be resolved in any particular case is whether the individual had or could have had sufficient authority and control over the affairs of the corporation to be considered a responsible officer or employee. The case law and the decisions of this Tribunal have identified a variety of factors as indicia of responsibility: the individual's status as an officer, director, or shareholder; authorization to write checks on behalf of the corporation; the individual's knowledge of and control over the financial affairs of the corporation; authorization to hire and fire employees; whether the individual signed tax returns for the corporation; the individual's economic interest in the corporation [citations omitted].

C. Initially, petitioner challenges the assessments on the basis that the Division did not conduct an audit. This argument is clearly without merit.

The record shows that the Division requested records from petitioner and from the corporation. There was no response to these requests. Thereafter, in an attempt to obtain the records, the auditor visited the office of the bankruptcy trustee. The auditor ascertained that the payroll records were not available. However, he was able to examine a claim by the Internal Revenue Service against NY Baking for unpaid payroll taxes. On the basis of the claims by the Internal Revenue Service the auditor calculated the amount of New York State and New York City taxes due.

D. Tax Law § 681(a) provides that if a taxpayer fails to file a return, the Division is authorized to estimate the tax due from the information in its possession. Since, withholding tax returns were not filed and payroll records were not available, it was reasonable and appropriate

for the Division to calculate the amount of tax due from the claims by the Internal Revenue Service. Since there is no evidence to show an error in the notices of deficiency, petitioner has not overcome the presumption of correctness (***Matter of Tavolacci v. State Tax Commn.*** 77 AD2d 759, 431 NYS2d 174 [1980]).

E. The next question presented is whether petitioner had or could have had sufficient control over the affairs of the corporation to be considered a person under a duty to collect and remit the withholding taxes (***Matter of Constantino***; ***Matter of Chin***, Tax Appeals Tribunal, December 20, 1990). The record shows that petitioner was the president of NY Baking, owned a controlling portion of the outstanding stock and had knowledge of the financial affairs of the corporation. Once subordinates prioritized the bills, petitioner reviewed the recommendations. Obviously, there would have been no point in the last step if he did not have input on what would be paid. Therefore, it is concluded that petitioner was a person within the meaning of Tax Law § 685(n) who was under a duty to collect and remit withholding taxes (***Matter of Amengual v. State Tax Commn.***, 95 AD2d 949, 950, 646 NYS2d 272, 273 [1983]).

F. Merely because a person is under a duty, it does not automatically follow that the failure to withhold and pay over income tax was "willful" within the meaning of Tax Law § 685(g). In ***Matter of Levin v. Gallman*** (42 NY2d 32, 396 NYS2d 623, 624-625 [1977]) the Court of Appeals explained that the test for willfulness was:

> whether the act, default, or conduct is consciously and voluntarily done with knowledge that as a result, trust funds belonging to the Government will not be paid over but will be used for other purposes. . . . No showing of intent to deprive the Government of its money is necessary but only something more than accidental nonpayment is required. (***See also Matter of Lyon***, Tax Appeals Tribunal, June 3, 1988.)

In this regard, it has been held that corporate officials cannot absolve themselves of responsibility by recklessly disregarding their duty to see that taxes are paid (***Matter of Capoccia v. State Tax Commn.***, 105 AD2d 528, 529 [1984]; ***Matter of Lyon***, Tax Appeals Tribunal, June 3, 1988; ***Matter of Gallo***, Tax Appeals Tribunal, September 9, 1988).

G. Petitioner submits that he lost control of his company as a result of the actions of Platinum and the labor unions. This argument also lacks merit. With respect to Platinum, petitioner has not directed attention to any provision in the agreement which gave Platinum any control over the finances of NY Baking. Moreover, even if such a provision existed, it was petitioner who allowed such an arrangement to occur and persist (***Bradshaw v. United States***, 83 F3d 1175 [1995], ***cert denied*** 519 US 928 [1996]). The effect of this arrangement was to prefer certain creditors over the obligation to collect and remit withholding taxes. Similarly, by acquiescing in the union's practice of not remitting its collections, petitioner wrongly preferred this creditor to NY Baking's withholding tax obligations. In each instance, actions were taken with knowledge that as a result withholding taxes would not be remitted. Such conduct was willful within the meaning of ***Levin*** (at ***supra*** 624-625). In sum, petitioner has failed to sustain his burden of proof (***see*** Tax Law § 689[e]; 20 NYCRR 3000.15[d][5]) to show that he was not such an officer for withholding tax purposes who willfully failed to collect and to pay over such taxes.

H. The petition of Salvatore J. Liga is denied and the notices of deficiency are sustained.

DATED:Troy, New York
May 27, 2008

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE