

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petitions :
of :
HARRY FRUHMAN : DETERMINATION
AND : DTA NOS. 821339
AMAR JIT SINGH : AND 821340
for Redetermination of Deficiencies or Refund of Personal :
Income Tax under Article 22 of the Tax Law for the Period :
Ended March 31, 2005. :

Petitioners, Harry Fruhman and Amar Jit Singh, filed petitions for redetermination of deficiencies or for refund of personal income tax under Article 22 of the Tax Law for the period ended March 31, 2005.

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on October 25, 2007 at 10:30 A.M., with all briefs to be submitted by March 17, 2008, which date began the six-month period for the issuance of this determination. Petitioner appeared by Mark R. Blaustein, PC (Donald Schwartz, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Peter B. Ostwald, Esq., of counsel).

ISSUE

Whether petitioners were persons required to collect, truthfully account for and pay over withholding taxes with respect to The Brunswick Hospital Center, Inc., for the period ended March 31, 2005 and willfully failed to do so, thereby becoming liable for a penalty imposed pursuant to Tax Law § 685(g).

FINDINGS OF FACT

Petitioners submitted 27 proposed findings of fact pursuant to State Administrative Procedure Act § 307(1), all of which have been incorporated into the facts below.

1. The Brunswick Hospital Center, Inc. (the Hospital) was a New York corporation, licensed and supervised by the New York State Department of Health to operate the Hospital located at 366 Broadway, Amityville, New York.

2. The Hospital had been owned and operated by Dr. Benjamin Stein, his wife, Claire, and son, Douglas, for approximately 50 years, until they entered into a contract of sale with Mr. Fruhman and Dr. Singh (petitioners) on March 31, 2000, immediately transferring Hospital management responsibilities to petitioners consistent with New York State Department of Health regulations and providing for the actual sale and conveyance of the Steins' ownership interest at a later date. Petitioners had worked together previously and had both independently been involved in Hospital "turnarounds," i.e., helping struggling healthcare facilities become profitable and more efficient. The Hospital had been in dire financial straits and was in desperate need of new management that could deal with a changing health care environment.

3. Until September 2005, the Hospital operated four divisions:

- a) Brunswick Hall, a psychiatric treatment center with 124 beds;
- b) Brunswick Nursing Home, a skilled nursing facility with 194 beds;
- c) Brunswick Physical Medicine and Rehabilitation Hospital with 64 beds; and
- d) Brunswick Hospital Center, an acute care facility comprised of a general hospital with 192 beds and an emergency room (Acute Care Division).

4. On September 24, 2001, the Stein family had petitioners physically removed from the Hospital and resumed management of the Hospital, whereupon petitioners commenced an action

in the New York State Supreme Court, Suffolk County, before Judge Peter Fox Cohalan, to protect their rights under the contract of sale. Following hearings held on December 5 and 7, 2001,¹ Judge Cohalan entered an Order, dated December 17, 2001, pursuant to New York Civil Practice Law and Rules (CPLR) 6401 and the Business Corporation Law (BCL) § 1202 that provided, inter alia, the following:

ORDERED that the meeting of the shareholders of Brunswick Hospital conducted December 7, 2001 is nullified and vacated in all respects, and it is further

ORDERED that the meeting of the Board of Directors/Governors conducted on December 7, 2001 is likewise nullified and vacated in all respects, and it is further

ORDERED that J. Stewart McLaughlin is and be appointed receiver of Brunswick Hospital Center, Inc. forthwith, and it is further

ORDERED that the parties cooperate with said receiver in all respects.

Until the litigation ended at some time prior to March 15, 2005, petitioners each held 4.95% of the stock of the Hospital. Only after the litigation ended did petitioners receive their 50% ownership shares pursuant to the contract of sale.

5. On January 22, 2002, Judge Cohalan entered an Amended Order that provided, in part, as follows:

a. That J. Stewart McLaughlin be appointed Receiver of Brunswick Hospital Center, Inc. nunc pro tunc and that he submit a surety bond of \$100,000.00 for the faithful discharge of his duties and the duty of accounting for all moneys and property received by him as such receiver;

b. That the Receiver take possession of all of the property of Brunswick Hospital Center, Inc. and that the Receiver may incur expenses and make such disbursements as necessary;

¹The Steins attempted to hold a shareholder meeting and board of directors/governors meeting of the Hospital on December 7, 2001 to elect a new director, thereby allowing them to redefine a quorum and give themselves a majority block and unfettered control of the corporation.

c. That the Receiver proceed forthwith to collect and receive the debts and property of the Brunswick Hospital Center, Inc., preserve same and operate the Brunswick Hospital Center, Inc.

d. That the Receiver take control of the property of Brunswick Hospital Center, Inc. to administer the operation of the Hospital and to take whatever appropriate actions he deems necessary to insure the survival and operation of the Brunswick Hospital Center, Inc. and to conduct the said duties as set forth in Annex A to the Amended Order;

e. That any and all persons now or at any time in the possession of the Hospital's property, upon demand of the Receiver, surrender the same to him; and

f. That the parties to the litigation, their agents, servants, and employees be and are hereby directed to cooperate with the Receiver and are hereby enjoined from interfering with the possession of the Receiver in regard to the property, and in all other respects concerning the lawful discharge of the Receivers' duties.

6. In "Annex A" to the Amended Order, dated January 22, 2002, Judge Cohalan set forth the Receiver's duties as follows:

To do all things normally done by a Chief Executive Officer of a health care institution such as Brunswick Hospital and to include:

a. Provide high quality care to patients at the lowest cost consistent with good standards of health care.

b. To take necessary steps to comply with all laws applicable to the Brunswick Hospital.

c. To control all revenues and to pay all debts as allowable by revenues received.

d. To enter into necessary contracts to accomplish the above with a term not to exceed one year.

e. To hire and fire counsel as may be necessary to protect the legal interests of the Brunswick Hospital.

f. To credential physicians and other health care providers following the credential procedures as set forth in the by-laws, rules and regulations of the Brunswick Hospital.

g. To arrange for financing and borrowings of money, capital improvements and expenditures.

h. To make periodic rounds of the Hospital and its grounds.

i. To attend meetings of the Medical Executive Committee and report on timely issues thereat.

j. To assist, as necessary, in meeting the health care needs of the community and to promote the general health of the community.

k. To hire and fire employees as necessary for the operation of Brunswick Hospital and to enter into employment contracts with a term not to exceed one year.

l. To make all decisions normally made by the Governing Board within the confines of these delineated duties.

7. J. Stewart McLaughlin served as operating receiver of Brunswick Hospital Center, Inc., from December 7, 2001 until he was discharged by Judge Cohalan on March 15, 2005 (the period of the receivership). Mr. McLaughlin previously served as chairman of the board of Southside Hospital in Bayshore, New York, and was a member of the board at North Shore Hospital as well. The Hospital's financial situation remained critical and it suffered severe cash flow issues.

8. During his period of service, J. Stewart McLaughlin was the only individual with check signing authority for the Hospital.

9. Between December 7, 2001 and March 15, 2005, the Hospital's governing board was precluded from functioning, as Judge Cohalan's Amended Order of January 22, 2002 clearly authorized the receiver to make all decisions normally made by the board.

10. While J. Stewart McLaughlin served as receiver, he maintained an office at the Hospital and was on the premises at least four out of every five days. He employed petitioners to assist him in the administration of the Hospital and agreed that they be reasonably compensated commensurate with their experience and competence. Petitioners' New York State personal

income tax returns for the year 2005 indicated that each received a substantial part of his income from the Hospital for that year.

11. Both Dr. Singh and Mr. Fruhman were in daily contact with the receiver, Dr. Singh advising on the medical needs of the Hospital and Mr. Fruhman providing information on the financial condition of the Hospital. Petitioners had the authority and responsibility, as assigned by Mr. McLaughlin, to review the day-to-day financial operations of the Hospital and were not prevented from doing so during the period in issue.

12. During the period of the receivership, Mr. McLaughlin exercised the authority granted to him by Judge Cohalan “to control all revenues and to pay all debts as allowable by revenues received.” In furtherance of his authority, Mr. McLaughlin was the sole signatory on all checks issued during his receivership and was the final arbiter of which creditors were to be paid first, if at all. He alone had the authority to hire and fire employees.

13. Additionally, the receiver, in exercising his authority, sought to improve revenues, reduce expenses, and maintain quality patient care. His fiduciary responsibilities included:

- a. engaging in extensive negotiations with Medicare officials concerning reimbursement issues;
- b. reducing staff and engaging in collective bargaining negotiations with the unions;
- c. eliminating salaries to the Stein family;
- d. requesting, in October 2004, that the New York State Department of Health approve the closing of the unprofitable Acute Care Division of the Hospital.

14. During the period of the receivership, Mr. McLaughlin endeavored to reduce the outstanding indebtedness to the taxing authorities and signed a check, dated February 16, 2005, during the quarter in issue herein, to the New York State Department of Taxation and Finance in

the sum of \$40,742.58 to be applied against outstanding assessments. However, due to the Hospital's dire financial situation, it did not maintain a tax accrual account for payroll taxes.

15. Brunswick Hospital Center, Inc., timely filed a New York State quarterly withholding tax return, Form NYS-45, for the quarter ending March 31, 2005 (period in issue), which reflected a withholding tax liability of \$420,929.66, payments of \$204,059.57 and a balance due of \$216,870.09. The return was signed by petitioner Harry Fruhman as "CFO," and was dated April 28, 2005.

16. Subsequent to the discharge of the receiver on March 15, 2005, the Hospital timely remitted \$31,327.52 and \$33,508.43 with the respective forms NYS-1 in full payment of the withholding taxes due for the two remaining paydays in the period in issue: March 18, 2005 and March 25, 2005.

17. The entire balance due and owing of \$216,870.09 for the period in issue was attributable to the paydays occurring prior to March 15, 2005, during the tenure of the receiver.

18. Notices of deficiency were issued to Harry Fruhman and Dr. Amar Jit Singh, both dated September 22, 2005, and each asserting an identical penalty under Tax Law § 685(g) for the quarter ended March 31, 2005 in the amount of \$216,870.09, for withholding taxes due from Brunswick Hospital Center, Inc.

19. During the period April 1, 2005 through December 31, 2005, under the leadership of Dr. Singh and Mr. Fruhman, the Hospital made regular weekly withholding tax payments and fully paid the withholding tax liabilities for the second, third and fourth quarters of 2005, despite filing a petition under Chapter XI of the Bankruptcy Act on October 15, 2005.

20. During the period between March 15, 2005 and October 15, 2005, under the leadership of Dr. Singh and Mr. Fruhman, the Hospital made four payments to satisfy New York State tax obligations which had been incurred during the period of the receivership:

<i>Date of Payment</i>	<i>Amount</i>
March 15, 2005	\$1,500.00
September 15, 2005	\$9,094.00
May 26, 2005	\$150,000.00
June 3, 2005	\$146,884.15

21. The receiver's request for permission to close the Acute Care Division was not approved by the New York State Department of Health until September 5, 2005.

22. The New York State Commission on Health Care Facilities in the 21st Century, also known as the Berger Commission, was established in 2005 by former Governor Pataki and the New York State Legislature. The Commission issued its final report on November 28, 2006, recommending the closing of 9 Hospitals and the reconfiguring of 48 Hospitals state-wide.

23. In a press release, dated May 7, 2007, the New York State Health Commissioner, Richard F. Daines, M.D., approved a plan to close Brunswick Nursing Home and stated:

I congratulate Brunswick Hospital Center on taking the first major step to restructure and improve long-term care services in Suffolk County.

24. In recognition of the financial crisis confronted by Hospitals in New York State and the economic impact of the Berger Commission's recommendations, New York State offered financial assistance to affected Hospitals up to \$550 million to support the implementation of the Berger Commission recommendations.

25. In letters of September 25, 2007 and October 9, 2007, petitioners' representative asked the Division's representative, Peter B Ostwald, Esq., to exercise the discretion granted to the tax

commissioner in Tax Law § 685(g) and waive the penalty asserted. There was neither a response to said letters nor an exercise of the discretion provided for in the statute.

CONCLUSIONS OF LAW

A. Tax Law § 685(g) provides:

Willful failure to collect or pay over tax.--Any person required to collect, truthfully account for, and pay over the tax imposed by this article who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. . . . the tax commission shall have the power, in its discretion, to waive, reduce or compromise any penalty under this subsection.

Tax Law § 685(n) defines "persons" subject to the section 685(g) penalty as follows:

[T]he term person includes an individual, corporation or partnership or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, . . . who as such officer, employee, manager or member is under a duty to perform the act in respect of which the violation occurs.

B. Whether someone is a "person" under a duty to collect and pay over withholding taxes is similar in scope and analysis to the question of whether one is a responsible individual for sales and use tax purposes (*see, Matter of Picciurro*, Tax Appeals Tribunal, August 11, 1994; *Matter of Chin*, Tax Appeals Tribunal, December 20, 1990). Factors which should be considered include whether the particular individual signed tax returns, derived a substantial part of his income from the corporation, or had the right to hire and fire employees (*Matter of Malkin v. Tully*, 65 AD2d 228, 412 NYS2d 186 [1978]; *see, Matter of MacLean v. State Tax Commn.*, 69 AD2d 951, 415 NYS2d 492, 494 [1978], *affd* 49 NY2d 920, 428 NYS2d 675 [1978]). Other pertinent areas of inquiry include the person's official duties, the amount of corporation stock owned, and the authority to pay corporate obligations (*Matter of Amengual v. State Tax Commn.*, 95 AD2d 949,

464 NYS2d 272, 273 [1983]; *see, Matter of McHugh v. State Tax Commn.*, 70 AD2d 987, 417 NYS2d 799, 801 [1979]).

C. The determination of whether an individual is a person under a duty to act for a business operation is based upon an examination of the particular facts of the case. In *Matter of Moschetto* (Tax Appeals Tribunal, March 17, 1994), the Tribunal reaffirmed the standard articulated in *Matter of Constantino* (Tax Appeals Tribunal, September 27, 1990):

[t]he 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 interests in the corporation.

D. In this matter, during the period in issue, the quarter ended March 31, 2005, all but the last two weeks occurred during the period of receivership. As noted above, the Hospital timely remitted the withholding taxes due for those paydays, March 18 and March 25, 2005, with forms NYS-1 and Hospital checks signed by petitioner Harry Fruhman. However, during the period December 7, 2001 through March 15, 2005, the record reveals that the Hospital was operated by the receiver, J. Stewart McLaughlin, pursuant to a court order which conferred specific authority on him to do so. Mr. McLaughlin was the sole signatory on all checks during this entire period of time and was endowed with the authority to control all revenues and to pay all debts as allowable by revenues received. He was vested with the authority to hire and fire employees; to arrange for financing, capital improvements and expenditures; and to make all decisions normally made by the governing board of the Hospital.

Prior to the receiver's appointment, petitioners would have conformed to the definition in Tax Law § 685(n) of persons required to collect, truthfully account for, and pay over the withholding taxes imposed by Article 22 by virtue of their stock ownership, derivation of substantial income from the Hospital, their authority to hire and fire employees, access to the books and records of the Hospital, responsibility for preparing and filing the tax returns and management of all day-to-day Hospital operations. However, following the appointment of the receiver it was clear that their ability to discharge any of their duties was placed at the discretion of the receiver by the very specific terms of the Supreme Court Order of January 22, 2002.

It is evident from the list of duties attached to the January 22, 2002 Order that the receiver was appointed to act in the place and stead of the Hospital's administrators and board of directors, the status of which was inconclusive pending the outcome of the litigation between petitioners and the Stein family. The receiver possessed all necessary power and authority to run the corporation in the absence of an administration and did so upon appointment. He maintained an office at the Hospital and was present at least four out of five days a week.

He employed petitioners to assist him in the administration of the Hospital, using Dr. Singh as a medical advisor and Mr. Fruhman as a financial advisor. Petitioners were directed by Mr. McLaughlin to review the day-to-day operations of the Hospital from both a medical and financial standpoint and report back to him. Once all outstanding bills and accounts were brought to his attention and the medical propriety and necessity explained, Mr. McLaughlin made the final decision with regard to which creditors would be paid and in what order of priority, if at all. Further, during the period of receivership, only Mr. McLaughlin had the ability to issue checks. Although petitioners had free access to all financial information concerning the Hospital, they were powerless to exercise any independent authority or

discretion over the Hospital's property or funds and were bound to act in accordance with Mr. McLaughlin's directions as provided for in the Supreme Court Order.

In discharging his duties, Mr. McLaughlin, who had experience in the healthcare industry, embraced his total executive control, engaging in all facets of administration including engaging in collective bargaining with unions and Medicare, reducing staff, eliminating unnecessary salaries, seeking to close the unprofitable acute care division of the Hospital and endeavoring to reduce the outstanding indebtedness for taxes.

E. In defining a responsible person, Tax Law § 685(n) requires that it be discerned if petitioners were "under a duty to perform the act in respect of which the violation occurred." The undisputed facts demonstrate that during the period of the receivership they were powerless to direct the payment of withholding taxes, disburse the funds of the Hospital or in any way exercise control over the Hospital's property. That authority was vested solely and unequivocally in the receiver by court order. (*Cf. Matter of Byram*, Tax Appeals Tribunal, August 11, 1994 [where the Tribunal rejected for lack of evidence petitioner's argument that the Trustee in bankruptcy and the New York State Department of Health had directed him to keep the Hospital running, which directive entailed not paying withholding taxes].)

The mere fact that petitioners were consultants to Mr. McLaughlin, drew salaries, and each owned a 4.95% interest during the period of receivership does not, in and of itself, establish liability as persons required to collect, truthfully account for, and pay over the withholding tax for the period in issue. It is equally of no moment that Mr. Fruhman signed the quarterly combined return for the quarter ended March 31, 2005, which he did on April 28, 2005, weeks after petitioners had regained control of the Hospital. The critical fact is that up until March 15, 2005, petitioners had neither the authority nor capacity to decide which

creditors would be paid or the ability to transfer funds, had they identified a creditor they wished to pay. As Mr. Fruhman credibly testified, the receiver was aware of all the outstanding liabilities, including taxes, and decided which were paid. The only conclusion that can be drawn from these undisputed facts is that petitioners did not have, nor could they have exerted, sufficient authority and control over the business of Brunswick Hospital Center, Inc., to be considered persons under a duty to collect and remit the unpaid taxes in issue, all of which became due and payable during the period of receivership.

F. Even if petitioners had been found to be persons required to collect, truthfully account for, and pay over the withholding tax, their conduct was not willful. The Court of Appeals held in *Matter of Levin v. Gallman* (42 NY2d 32), the test is "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 non-payment is required" (*Matter of Levin v. Gallman*, at 34). Further, the fact that section 685(g) imposes a penalty and is violated only by a willful failure is strong evidence that it was not intended to be imposed without personal fault. (*Matter of Gallo*, Tax Appeals Tribunal, September 9, 1988.) Petitioners' lack of authority to act on financial matters, imposed by a court order, precludes a finding of "willfulness" or personal fault.

In fact, the circumstances of this matter are more compelling than the line of cases descending from *Matter of Constantino*, which concern officers and employees who were denied meaningful access to books and records of their business enterprise. Here, by court order, petitioners were effectively removed from their executive positions and replaced by a receiver who was cloaked with complete authority to run the Hospital as he deemed appropriate

to insure its survival and continued operation. They were specifically ordered by the Supreme Court to cooperate with the receiver and enjoined from interfering with the receiver's discharge of his duties, as more fully set forth in Finding of Fact 6. Under these unique circumstances, petitioners did not and could not have acted willfully.

As noted by petitioners, after they took control of the Hospital upon the discharge of the receiver on March 15, 2005, they began making regular weekly withholding deposits with the Department of Taxation and Finance on March 18, 2005, and remained current until at least the date of the hearing. In addition, petitioners have made additional payments to the Department for tax delinquencies incurred during the period of receivership, despite the difficulty in doing so. These actions serve to support petitioners' argument that they were always committed to paying the withholding taxes due in a timely fashion, and that those taxes which were not paid arose during the period of receivership when they were unable and without authority to direct payment of same.

G. The Division argued that the strongest possible negative inference be taken from Dr. Singh's failure to appear and testify at the hearing. (*Matter of Drebin*, Tax Appeals Tribunal, March 27, 1997.) However, it was agreed to hear these matters together and specifically stated by the Administrative Law Judge on the record that any document entered into evidence was applicable to either petitioner as relevant to him. In addition, the circumstances surrounding the history and operations of the Hospital, credibly described by Mr. Fruhman in his sworn testimony, were equally relevant to Dr. Singh and, to the extent probative of his liability, were material in reaching the conclusions set forth above.

H. Petitioners raised the alternative basis for relief that, even if found liable for the penalty imposed under Tax Law § 685(g), the commissioner abused his discretion in not

waiving, reducing or compromising the penalty. However, since it has been concluded that, in consideration of all the circumstances, petitioners were not persons required to collect, truthfully account for, and pay over the withholding tax due from the Hospital for the period in issue, the argument is deemed moot.

I. The petitions of Harry Fruhman and Dr. Amar Jit Singh are granted and the notices of deficiency, dated September 22, 2005, are canceled.

DATED: Troy, New York
September 11, 2008

/s/ Joseph W. Pinto, Jr.
ADMINISTRATIVE LAW JUDGE