

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
<b>JOSEPH P. SANTO</b>	:	DETERMINATION
	:	DTA NO. 821797
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 March 1, 2005 through November 30,	:	
2005.	:	

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Petitioner, Joseph P. Santo, filed a petition 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 March 1, 2005 through November 30, 2005.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on June 12, 2008 at 10:30 A.M., with all briefs to be submitted by September 15, 2008, which date began the six-month period for the issuance of this determination. Petitioner appeared pro se. The Division of Taxation appeared by Daniel Smirlock, Esq. (Osborne K. Jack, Esq., of counsel).

On March 12, 2009, the Administrative Law Judge issued a determination holding that petitioner was not personally liable for the sales and use taxes due on behalf of New Road One, LLC, as a person required to collect and pay such taxes under Tax Law §1131(1) and §1133(a). In view of his conclusion, the Administrative Law Judge did not address the issue of whether penalties assessed against petitioner should be abated.

The Division of Taxation filed an exception to the determination of the Administrative Law Judge. On December 23, 2009, the Tax Appeals Tribunal issued a decision reversing the Administrative Law Judge and holding that petitioner was personally liable for the sales and use taxes due on behalf of the limited liability company since Tax Law § 1131(1) imposes strict liability upon members of a partnership or limited liability company. The Tribunal remanded the matter to the Administrative Law Judge for a determination on the issue of penalties based on the existing record.

### ***ISSUE***

Whether penalties assessed against petitioner by virtue of his being personally liable for the sales and use taxes due on behalf of New Road One, LLC, should be abated.

### ***FINDINGS OF FACT***

1. On April 2, 2004, petitioner and Joseph M. Scotti and Thomas Smario entered into an Operating Agreement (the Agreement) for the formation of a limited liability company known as New Road One, LLC (the LLC), the purposes of which were to own and operate a Red Robin Restaurant. The restaurant operated under the trade name Red Robin Gourmet Burgers & Spirits and the address of the restaurant was 14 Crystal Run Crossing, Middletown, New York 10941.

2. The Agreement provided that Messrs. Scotti and Smario and petitioner were to be the “Managing Members” but stated more particularly that Joseph M. Scotti “is the Financial and Administrative Managing Member in charge of all the financial operations of the company, as well as the administrative matters;” that Thomas Smario “is the Managing Member designated as the construction manager, who will oversee the building and the improvements and general repairs and maintenance of the operation;” and that petitioner “is the Managing Member in charge of the daily operations of the company, which include the operation of the actual

restaurant which includes directing, managing the staff available for food and beverage, consultants, systems, cleaning and maintenance.”

3. Pursuant to the Agreement, each managing member was to contribute \$1,000.00 to the capital of the LLC and each managing member was to own a 33 1/3% interest. However, a Summary of Receipts as of November 1, 2004 indicated that Joseph M. Scotti had contributed \$184,300.00, Thomas Smario had contributed \$62,000.00 and petitioner had contributed nothing to the LLC.

Mr. Scotti indicated to the other managing members that he had adequate funds to begin construction of the restaurant, which ended up costing nearly \$4,000,000.00, but that proved not to be the case. Therefore, other investors had to be found. The November 1, 2004 Summary of Receipts indicated that a number of other persons had become investors in the LLC. As a result thereof, as of November 1, 2004, the interest of petitioner and the other principals (Joseph M. Scotti and Thomas Smario) had been reduced to 24.17% each.

4. The Agreement provided that the financial managing member (Mr. Scotti) would, among other things, “prepare or cause to be prepared all Federal, State and local income tax and information returns for the Limited Liability Company, and shall cause such tax and information returns to be filed timely with the appropriate governmental authorities.”

5. The Agreement stated that all books and records and tax and information returns were to be maintained at the principal place of business of the LLC, which was 322 President Street, Brooklyn, New York, the home address of Joseph M. Scotti.

6. Petitioner joined with Messrs. Scotti and Smario on the condition that he would not be involved in raising funds and that he would not be responsible for financial duties on behalf of the LLC. While petitioner did not initially make any monetary investment in the LLC, he later

loaned the LLC the sum of \$15,000.00 (which was the extent of his savings) to cover payroll. This loan was to be repaid within two weeks after its advance; however, it was never repaid.

In addition to petitioner's savings, his family and friends invested more than \$900,000.00, which was lost in the LLC venture.

7. Because of his previous experience in the restaurant business, petitioner's function was to oversee the restaurant's managers who were to operate the restaurant in Middletown. Petitioner hired the managers who then hired the other employees. In his position as supervisor of the restaurant managers, petitioner visited the restaurant once or twice weekly.

The managers made direct deposits into the bank twice daily and all bank statements and information went to Mr. Scotti who had the LLC's checkbooks in his possession.

8. The restaurant opened in March 2005. However, the LLC had difficulty paying construction creditors, and investors were not getting the profit and loss reports as required by the Agreement. As a result, it became exceedingly difficult to raise money.

9. When the restaurant opened, petitioner, because of his previous experiences, reminded Mr. Scotti that it was imperative to timely file tax returns and pay the LLC's tax liabilities since the failure to do so would result in the imposition of interest and penalties. On several occasions, petitioner asked Mr. Scotti for copies of the sales tax returns, but he did not receive the copies as requested. In addition, petitioner asked for bank reconciliation statements because "I was getting a little nervous and we didn't get those for a long time and when we got them, they were not legible."

10. Petitioner had no role in the preparation of the LLC's sales tax returns. Each of the sales tax returns for the period at issue was signed by Joseph Scotti, Member.

For the sales tax quarter ended May 31, 2005, the LLC reported sales tax due in the amount of \$70,012.31, but paid only \$4,862.31, thereby leaving a balance due of \$65,150.00.

For the sales tax quarter ended August 31, 2005, the LLC reported sales tax due in the amount of \$65,111.00, but had total tax credits and advance payments totaling \$44,908.00, thereby leaving a balance due of \$20,203.00. Attached to the return were copies of eight checks, all of which were dated September 15, 2005, totaling \$20,053.00. These checks bore what appears to be the signature of Joseph Scotti, who signed the sales tax return.

For the sales tax quarter ended November 30, 2005, the LLC reported sales tax due of \$50,683.00, but had total tax credits and advance payments totaling \$33,872.00, thereby leaving a balance due of \$16,661.00. Attached to the return were copies of two checks, dated December 15, 2005, totaling \$5,661.00. The checks bore what appears to be the signature of Joseph Scotti, who signed the sales tax return.

11. On May 22, 2006, the Division issued three notices of determination to petitioner advising him that he was being assessed as an officer or responsible person of New Road One, LLC.<sup>1</sup> The notices assessed as follows:

Period Ended	Tax	Interest	Penalty	Payments/Credits	Total
05-31-05	65,150.00	8,546.76	13,281.50	17,500.00	69,478.26
08-31-05	65,111.00	7,228.63	12,394.11	0.00	84,733.74
11-30-05	26,150.00	1,747.41	4,072.50	0.00	31,969.91

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<sup>1</sup> Based upon the sales tax returns filed, the credits claimed and the copies of the checks attached to the returns, it is unclear how the amounts of tax assessed by the notices of determination were calculated.

12. Petitioner had check signing authority on behalf of the LLC; however, he signed only six to ten checks in total, drawn on one of the business's checking accounts, and signed these checks only when Mr. Scotti was on vacation.

13. In 2004, petitioner began undergoing radiation implantology for prostate cancer. On July 21, 2006, petitioner went into cardiac arrest and was taken to the hospital where he was resuscitated and implanted with a pacemaker. After approximately two weeks in the hospital, petitioner notified Messrs. Scotti and Smario that he could no longer tolerate the extreme stress of the business and he, therefore, separated himself from the operation.

14. In the fall of 2006, bankruptcy proceedings on behalf of the LLC were commenced and the restaurant closed.

15. As previously noted, the Tax Appeals Tribunal, in its decision rendered on December 23, 2009, held that pursuant to Tax Law § 1131(1) and *Matter of Bartolomei* (Tax Appeals Tribunal, April 3, 1997), "persons required to collect [sales] tax" includes "any member of a partnership or limited liability company," and since petitioner was a member of a limited liability company (New Road One, LLC), he is subject to per se liability for the taxes due therefrom. Since the determination issued by the Administrative Law Judge on March 12, 2009 held that petitioner was not personally liable for the sales and use taxes due on behalf of the limited liability company, the determination did not address the issue of whether penalties assessed against petitioner should be abated. Accordingly, that issue will be the sole issue considered herein.

### ***CONCLUSIONS OF LAW***

A. While the record in this matter does not disclose, with specificity, the penalties imposed by the Division, it shall be assumed that the penalties were asserted pursuant to Tax

Law § 1145(a)(1)(i) which provides that any person failing to timely file returns or pay any sales or use tax within the time required shall be subject to a penalty. As indicated in Finding of Fact 10, the LLC filed returns but did not pay the entire amounts of tax due.

Pursuant to Tax Law § 1145(a)(1)(iii), this penalty may be canceled if the Commissioner of Taxation and Finance determines that the failure to file or pay was “due to reasonable cause and not due to willful neglect.” The Commissioner of Taxation’s regulations provide that the penalty imposed under Tax Law § 1145(a)(1)(i) “*must be imposed* unless it is shown that such failure was due to reasonable cause and not due to willful neglect.” (20 NYCRR 2392.1[a][1]; emphasis added.) “By first requiring the imposition of penalties (rather than merely allowing them at the Commissioner’s discretion), the Legislature evidenced its intent that filing returns and paying tax according to a particular timetable be treated as a largely unavoidable obligation [*Matter of F&W Oldsmobile v. Tax Commn. of the State of New York* , 106 AD2d 792, 484 NYS2d 188]” (*Matter of MCI Telecommunications Corp.*, Tax Appeals Tribunal, January 16, 1992). The taxpayer faces the “onerous task” of establishing reasonable cause as well as the absence of willful neglect (*Matter of Philip Morris, Inc.*, Tax Appeals Tribunal, April 29, 1993).

B. In determining whether reasonable cause exists, the regulations provide a number of specific grounds and a general provision which states as follows:

Additional grounds. Any other ground for delinquency which would appear to a person of ordinary prudence and intelligence as a reasonable cause for delay and which clearly indicates an absence of willful neglect may be determined to be reasonable cause (20 NYCRR 2392.1[d][5]).

C. While the Tribunal, in its decision rendered on December 23, 2009, held that the fact that petitioner was a member of the limited liability company subjected him to per se liability for the sales and use taxes due from the LLC, the issue as to whether reasonable cause exists for

abatement of penalty must be determined upon the particular facts of the case since, as the regulations provide, reasonable cause may be found if the ground for failure to file a return or pay over tax due appears “to a person of ordinary prudence and intelligence as a reasonable cause for delay and which clearly indicates an absence of willful neglect” (20 NYCRR 2392.1[d][5]).

D. While the Tribunal held that the Administrative Law Judge’s reliance on *Matter of Constantino* (Tax Appeals Tribunal, September 27, 1990), in considering whether petitioner was a person required to collect sales tax, was misplaced because his membership in a limited liability company subjected him to per se liability, *Constantino* provides useful guidelines to determine whether petitioner acted reasonably. In *Constantino*, the Tribunal, in holding that an officer and shareholder of a corporation was not a person responsible for the collection and payment of tax pursuant to Tax Law §§ 1131 and 1133 stated:

petitioner’s role was essentially that of a minority investor and supervising employee who was precluded from taking action with regard to the financial and management activities of the corporation.

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The significance of petitioner’s officer and shareholder status in the determination of responsibility is offset by the circumstances relating to control of the corporation which are present here. Petitioner lacked the power to exercise the tax collection responsibilities on behalf of the corporation. The evidence does not support a conclusion that petitioner could have acted but chose not to.

E. As stated in the Administrative Law Judge’s determination issued March 12, 2009, petitioner’s credible testimony established that his role was similar to the petitioner in *Constantino*, i.e., he was a minority investor who was precluded from taking action with regard to the financial and management activities of the LLC. The Operating Agreement stated that Joseph M. Scotti was in charge of all of the financial operations and administrative matters



pertaining to the LLC. Petitioner's role was to manage the staff involved in the operation of the restaurant. The Operating Agreement further provided that the financial managing member (Mr. Scotti) would prepare or cause to be prepared all tax returns for the LLC and would cause the returns to be filed timely with the appropriate governmental authorities. All books and records, as well as tax and information returns, were to be maintained at the LLC's principal place of business which was designated in the Agreement as the home address of Mr. Scotti.

Petitioner was not involved in the day-to-day operation of the restaurant and visited it only once or twice weekly. The restaurant managers made all of the bank deposits and all bank statements and information went directly to Mr. Scotti, who maintained the LLC's checkbook.

Petitioner, because of his previous experience in the restaurant business, was aware of the necessity of timely filing tax returns and paying the restaurant's tax liabilities. He asked Mr. Scotti for copies of the LLC's sales tax returns on several occasions, but was not provided with the returns as requested. He also asked for the LLC's bank reconciliation statements, but was not supplied with the statements for long periods of time, and when such statements were provided to petitioner, they were not legible.

Petitioner did not prepare the sales tax returns for the LLC nor did he sign them. All of the sales tax returns as well as the checks issued in partial payment of the tax liability were signed by Mr. Scotti.

During the period in which the restaurant was in business, petitioner was often seriously ill. He began undergoing radiation treatments for prostate cancer in 2004 and on July 21, 2006, he went into cardiac arrest, was resuscitated and implanted with a pacemaker.

F. In summary, the facts and circumstances herein provide sufficient evidence by which it may be reasonably concluded that petitioner had reasonable cause for his failure to collect and

pay over sales and use taxes on behalf of the LLC and that there was a clear absence of willful neglect on his part. This was not a case where petitioner could have acted, but chose not to do so. He did not shirk his duties as a managing member or delegate his responsibilities to others. He attempted to ascertain whether the LLC was current in its tax filings and its remittances; however, the Financial and Administrative Managing Member, Joseph M. Scotti, thwarted such attempts. Accordingly, it must be found that since there existed reasonable cause for petitioner's failure to collect and pay over sales and use taxes on behalf of the LLC and that there was no willful neglect on his part, penalties imposed herein are canceled.

G. The petition of Joseph P. Santo is granted to the extent indicated in Conclusion of Law F; the Division of Taxation is hereby directed to modify the notices of determination issued May 22, 2006 accordingly; and except as so granted, the petition is in all other respects denied.

DATED: Troy, New York  
April 15, 2010

/s/ Brian L. Friedman  
ADMINISTRATIVE LAW JUDGE