STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
JAMES W. HENRIE	:	
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 2008 through November 30, 2008.	:	DETERMINATION DTA NOS. 825871 AND 825872
In the Matter of the Petition	:	
of	:	
MICHAEL M. MCBRIDE	:	
for Revision of Determinations or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 2008 through November 30, 2008.	:	

Petitioner James W. Henrie filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 2008 through November 30, 2008.

Petitioner Michael M. McBride filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 2008 through November 30, 2008.

A hearing was held before Arthur S. Bray, Administrative Law Judge, in New York, New York, on June 30, 2015 with all briefs to be submitted by January 25, 2016, which date

commenced the six-month period for the issuance of this determination. Petitioners appeared by Ballon Stoll Bader & Nadler, P.C. (Avraham Cutler, Esq., and Courtney DeBlis, Esq., of counsel). The Division of Taxation appeared by Amanda Hiller, Esq. (Michael J. Hall).

ISSUES

I. Whether petitioners are personally liable for the sales and use taxes due from NS Partners, LLC as persons required to collect and pay such taxes under Tax Law §§ 1131(1) and 1133(a) and, if so,

II. Whether petitioners are entitled to relief under the tax policy set forth in TSB-M-11(17)S.

III. Whether petitioners have established any facts or circumstances warranting the reduction or abatement of the penalties.

FINDINGS OF FACT

1. Namwest, LLC (Namwest) was a firm that invested in commercial real estate, including hotels, in the United States. In or about February 2005, Namwest purchased a hotel, known as Holiday Inn Select, from Servico New York, Inc. Namwest, LLC was the 100 percent owner of Namwest of Niagara, LLC which owned 99 percent of NS Partners, LLC. The remaining 1% was owned by Namwest Niagara MM, Inc. Petitioner Michael McBride executed the purchase agreement on behalf of the purchaser as a member of Namwest.

2. On April 6, 2005, NS Partners was organized in New York State as a limited liability company. Petitioners were members of NS Partners.

3. NS Partners was created by Namwest with the intention of transforming the Holiday Inn Select located in Niagara Falls, New York, into an upscale Crowne Plaza Hotel.

4. On or about July 11, 2005, NS Partners entered into a management agreement with Sentry Hospitality of Western New York (Sentry). Michael McBride signed the agreement on behalf of NS Partners in his capacity as president of Namwest Niagara MM, Inc. Under the management agreement, Sentry had the right to hire, fire and supervise hotel employees. NS Partners was accorded the right to review the hotel's books and records.

5. On May 23, 2005, Michael McBride filed a New York State Application for Registration as a Sales Tax Vendor on behalf of NS Partners. Mr. McBride was listed as manager on the form. At or about the same time, NS Partners filed an Application for Alcoholic Beverage Control Retail License with the State of New York Liquor Authority. James W. Henrie and Michael McBride were each listed as having a 16.6 percent share of ownership of NS Partners. Their signatures appear on the application and on an attachment to the application.

6. Kathy Miller, also known as Kathleen Miller, signed sales tax returns during and after the period at issue as an agent of NS Partners.

7. In early 2007, NS Partners was approved for a grant in the amount of $5,500,000.00[1] from the Empire State Economic Development Fund. The terms of the grant required NS Partners to meet certain employment goals that were subsequently satisfied. In addition, NS Partners received exemptions from sales tax.

8. In December 2006, NS Partners engaged in negotiations with Gramercy Capital Corp. (Gramercy) to refinance its loan in the amount of $30,045,000.00. The terms of the loan were summarized in a letter dated December 12, 2006 from Gramercy to Mr. Henrie as principal of

[1] There is a conflict in the record regarding the amount of the grant. The total amount of the grant may have been as much as $6,000,000.00.

Namwest. At the conclusion of the letter, Mr. Henrie signed the letter, as a principal of the borrower, in order to indicate his agreement to the terms of the loan.

9. In March 2007, NS Partners refinanced its loan with Gramercy. Namwest Niagara MM, Inc. by Michael McBride, as president, executed the document on behalf of NS Partners. The loan agreement provided for a first priority for the perfected mortgage encumbering the property, and a first priority perfected security interest in all monies deposited into the clearing account and deposit account, including all subaccounts, escrow accounts and reserve accounts. According to the loan agreement, Gramercy had the right to act as a servicer, at the borrower's expense, and to act as its agent in connection with the loan. The loan was a full recourse loan to the principals, James Henrie and Michael McBride, who were also guarantors of the loan. Deposits into the clearing account were to be free of all taxes, and, if taxes were deducted from the monies, the borrower was directed to make up these amounts. The management agreement was collaterally assigned to Gramercy as security for the loan and subordinated to the loan.

10. NS Partners used $3 million of the grant from the Empire State Economic Development Fund to Gramercy to pay down the Gramercy loan. The balance of the loan was distributed to SWB Enterprises, LLC (SWB). During the period in issue, SWB owned 100 percent of Namwest.

11. The ownership of NS Partners changed over time. At one juncture Ezri Namvar owned 50 percent of the firm and the remaining three partners, including the petitioners herein, owned equal one-third interests in the remaining 50 percent of the enterprise. Mr. Namvar later withdrew from the firm and, during the period in issue, James Henrie and Michael McBride each possessed 33.3333 percent ownership interests.

12. NS Partners fell into arrears in school taxes and property taxes for the years 2007 and 2008. A subsequent owner of the property, GKK Hotel Niagara Owner LLC, paid at least a potion of the outstanding tax liability.

13. In March 2008, NS Partners was declared to be in default of the mortgage because it had failed to remain current in satisfying its sales and real property tax obligations. Green Loan Services, LLC (Green Loan Services), a Gramercy affiliate that serviced the loan, advised NS Partners that the failure to pay the taxes was a default and that the failure to cure would constitute an "Event of Default."

14. As a result of the default in taxes and an increase in the expenses exceeding the amount permitted in the loan agreement, Green Loan Services sent a notice of default in March 2008 to NS Partners. Thereafter, Gramercy stopped releasing funds from the lockbox to the operating account and, together with Sentry, assumed complete control over the operations and operating revenue of the hotel. Sentry would determine who would be paid and that decision would be conveyed to NS Partners, Phoenix and Gramercy. The people who collected, counted and delivered the money to the bank were all Sentry employees. Gramercy would release money into a bank account that only Sentry had access to and then Sentry would write the checks. NS Partners reminded Gramercy of its obligation to pay the taxes but Gramercy chose not to release the funds.

15. NS Partners became delinquent in satisfying its sales tax obligations prior to the period in issue. For the tax period ended May 31, 2008, NS Partners reported that tax was due in the amount of $189,883.04. However, payment was not remitted with the return. For the tax period ended August 31, 2008, the sales and use tax return was due on September 22, 2008. However, it was not received until September 29, 2008. The return reported that tax was due in the amount

of $351,766.55. However, it was filed without remittance. For the tax period ended November 30, 2008, the return was due on December 22, 2008. However, it was not received until December 29, 2008. The return reported that tax was due in the amount of $186,477.51. There was a timely payment of $70,758.97 and a late payment of $37,911.11. The checks for each of the latter two payments were signed by Kathy Miller.

16. Mr. Henrie filed a New York State personal income tax return for the year 2006 wherein he claimed Empire Zone Wage credits (EZE) and Qualified Empire Zone Enterprise (QEZE) credits based upon his status as a member of NS Partners.[2]

17. The Division of Taxation (Division) conducted an audit of Mr. Henrie's tax return for 2006. Initially, the Division denied the credits. Mr. Henrie appealed the denial of the credits and, based upon documentation provided by Mr. Henrie, the Division concluded that the employees of Sentry should be considered the employees of NS Partners for purposes of the credits. As a result, the credits were allowed.

18. Mr. Henrie and Mr. McBride filed New York State personal income tax returns for the years 2008 and 2009 wherein they claimed EZE and QEZE credits based upon their status as members of NS Partners. The application of the credits would have resulted in the payment of refunds. In the course of reviewing petitioners' claimed enterprise zone tax credits for 2008, petitioners provided information showing that the 2008 ownership interests of Michael McBride, James Henrie and David Cutler in NS Partners were each 33 and 1/3 percent.

19. On March 24, 2009, Supreme Court Justice Richard C. Kloch, Sr., issued an ex-parte order appointing Michael J. Norris a receiver of the rents and profits of NS Partners. The

---

[2] Since NS Partners was a partnership LLC, the QEZE and EZ credits are claimed on the personal income tax returns of the partners.

receiver was ordered to pay only the current taxes and not the taxes due from the time of the hotel's seizure by Gramercy. On September 8, 2009, Mr. Norris's application for a new liquor license as a receiver of NS Partners was granted.

20. The Division issued a series of notices of determination to Michael McBride and James Henrie, which assessed sales and use taxes as follows:

Date of Notice	Period Ended	Tax	Interest	Penalty	Balance Due
05/26/09	05/31/08	$189,883.04	$28,416.29	$41,297.57	$259,596.90
05/26/09	08/31/08	$351,766.55	$39,316.74	$66,540.76	$457,624.05
07/27/09	11/30/08	$77,807.43	$9,014.20	$18,574.48	$105,396.11

21. On November 15, 2011, the Division issued an Account Adjustment Notice - Personal Income Tax to Michael McBride and his spouse stating that, for the year 2008, all or part of his refund was applied to New York State tax debts. As a result, the total payments and refundable credits of $767,096.00 were reduced to $15,982.81. On November 22, 2011, the Division issued an additional account adjustment notice to Michael McBride and his spouse concerning 2009 similarly stating that the Division adjusted their New York State and New York City refundable credits. Consequently, the refund amount was adjusted to $325,209.00 plus interest for a balance payable of $327,945.40. The refund offset of $367,565.19 occurred because the Division applied the refund to the liabilities asserted in the notices of determination that had been issued to him (***see*** Finding of Fact 20).

22. On November 15, 2011, the Division issued an Account Adjustment Notice - Personal Income Tax to James Henrie and his spouse for the year 2008 that bore the same message as that sent to Mr. McBride. Therefore, his refund was similarly reduced to $15,982.81. On November

22, 2011, the Division issued an additional account adjustment notice pertaining to 2009 to James Henrie and his spouse similarly stating that the Division adjusted their New York State and New York City refundable credits. Consequently, the refund amount was adjusted to $325,209.00. The refund offset of $367,565.19 occurred because the Division applied the refund to the liabilities asserted in the notices of determination that had been issued to him (***see*** Finding of Fact 20). On December 3, 2011, $38,880.90 was refunded to Mr. Henrie.

23. Mr. McBride and Mr. Henrie filed refund claims in the amount of $367,565.19 each for the monies applied to their liabilities. On May 23, 2012, the Division sent letters to Mr. McBride and Mr. Henrie stating that their claims for refunds of sales and use taxes were denied because as members of a limited liability company they are liable per se as persons required to collect tax pursuant to Tax Law § 1131(1).

SUMMARY OF THE PARTIES' POSITIONS

24. Petitioners argue that they should not be held liable for the failure to collect and remit sales tax since they were precluded from exercising any involvement in the hotel once Gramercy seized control in March 2008. Petitioners further maintain that they are not liable as minority owners in NS Partners because NS Partners itself was not liable since it was "cut out of the financial decisions of the Hotel once Gramercy seized the Hotel." (Petitioners' brief, p.9.) Petitioners posit that the penalties should be cancelled because there was an absence of a willful failure to pay the sales tax. Lastly, petitioners argue that they are entitled to relief pursuant to TSB-M-11(17)S and that they should not be responsible for more than the amount reflecting their ownership interest which, according to petitioners, is 16.5 percent of $528,716.79 or $87,238.27 each.

25. At the hearing, petitioners presented the testimony of Mr. Douglas Williams who stated, among other things, that Kathy Miller was an accounts manager of Sentry, and NS Partners did not authorize her to sign tax returns. He also stated that the sales tax arrearage did not arise until after Gramercy took over the hotel and that each petitioner had a 16.6 percent interest in NS Partners. Petitioners did not appear at the hearing and offered affidavits rather than testimony on their own behalf.

26. The Division contends that during the period in issue petitioners were members of a limited liability company and were therefore subject to per se liability for the taxes due from NS Partners; that both petitioners participated in the management of the firm; that petitioners bear the burden of showing that they are not responsible persons; that petitioners have not demonstrated that they are eligible for relief under TSB-M-11(17)S; that the denial of the refunds does not violate their due process rights; and, that petitioners are personally liable for the penalties and interest assessed against NS Partners.

27. In their reply brief, petitioners reiterate their argument that NS Partners did not collect sales tax because the hotel had been seized and, therefore, petitioners cannot have any derivative liability. Petitioners further submit that they never claimed that they were essential participants in the management of NS Partners and the evidence is undisputed that they were not involved in running the hotel after the seizure. With regard to the decision not to offer the testimony of Mr. Henrie or Mr. McBride, petitioners contend that Mr. Williams offered the best testimony in this case and that both Mr. McBride and Mr. Henrie live across the country whereas Mr. Williams resides in New York State. In addition, the affidavits of Mr. McBride and Mr. Henrie, which were provided in lieu of their testimony, were prepared for a previous case and not for the present litigation. Petitioners further maintain that TSB-M-11(7)S must be applied consistently and that,

if this memorandum were followed petitioners would only be liable for the 16% interests that they had at the time the liability arose. In this regard, petitioners submit that the Division's citation to the ownership percentages at a subsequent period of time overlooks Mr. Williams's testimony that the percentages of ownership changed after the tax liability arose in this case and before petitioners applied for tax credits. Lastly, petitioners contend that they should not be held responsible for penalties and interest

CONCLUSIONS OF LAW

A. Tax Law § 1133(a) provides that "every person required to collect any tax imposed by [Article 28] shall be personally liable for the tax imposed, collected or required to be collected under this article."

B. Tax Law § 1131(1) defines "person required to collect any tax imposed by this article" to include:

> "any officer, director or employee of a corporation or of a dissolved corporation, any employee of a partnership, any employee or manager of a limited liability company, or any employee of an individual proprietorship who as such officer, director, employee or manager is under a duty to act for such corporation, partnership, limited liability company or individual proprietorship in complying with any requirement of this article; *and any member of a partnership or limited liability company* (emphasis added)."

C. The Tax Appeals Tribunal has consistently interpreted the foregoing language as imposing strict liability upon members of a limited liability company for the failure to collect and remit sales tax (***Matter of Boissiere and Krystal***, Tax Appeals Tribunal, July 28, 2015; ***Matter of Franklin***, Tax Appeals Tribunal, June 12, 2014; ***Matter of Santo***, Tax Appeals Tribunal, December 23, 2009). Accordingly, as members of a limited liability company, petitioners were personally liable for the sales taxes due from NS Partners pursuant to Tax Law § 1133(a).

D. Petitioners contend that the foregoing analysis does not apply to them because Gramercy allegedly seized the hotel and, as a result, neither the limited liability company nor its members, may be held liable for the sales taxes due from the hotel. In contrast, the Division contends that the hotel was not seized. Rather, NS Partners voluntarily yielded control to Gramercy. The difference in the interpretation of the facts is determinative of the outcome. Generally, where the lack of control over the financial affairs of a firm arises from a choice not to exercise that authority, liability for sales and use taxes is imposed (***Matter of Blodnick***, 124 AD2d 437 [1986], ***appeal dismissed*** 69 NY2d 822 (1987); ***Matter of LaPenna***, Tax Appeals Tribunal, March 14, 1991; ***Matter of Baumvoll***, Tax Appeals Tribunal, November 22, 1989). However, where a person is precluded from acting on behalf of the business through no fault of his own, the obligations of a responsible person have not been imposed (***see e.g. Chevlowe v. Koerner***, 95 Misc2d 388 [1978]; ***Matter of Constantino***, Tax Appeals Tribunal, September 27, 1990; ***Matter of Stern***, Tax Appeals Tribunal, September 1, 1988). Unquestionably, there is support in the record for petitioners' contention that petitioners lacked control over the financial affairs of the hotel once Gramercy had taken over. However, the question presented is whether this situation arose because of decisions made by petitioners (***see Matter of Kieran***, Tax Appeals Tribunal, November 13, 2014).

E. It is clear from the documents that prior to the assumption of control by Gramercy, petitioners were directly involved in the management and financial affairs of NS Partners. In 2005, Michael McBride signed a management agreement, on behalf of NS Partners, giving Sentry the authority to manage the hotel. Among other things, the management agreement delegated to Sentry the right to hire and fire employees. Significantly, NS Partners retained the right to review the hotel's books and records. At or about the same time, NS Partners filed an

Application for Alcoholic Beverage Control Retail License on behalf of NS Partners. Mr. Henrie and Mr. McBride were each listed on the Application as owning 16.6 percent of the firm.[3] Mr. McBride signed the form on behalf of NS Partners and Mr. Henrie's signature appears on an attachment. On March 7, 2007, NS Partners refinanced its loan with funding provided by Gramercy. Namwest Niagara MM, Inc., by Michael McBride, as president, executed the document on behalf of NS Partners.

F. It is petitioners' position that since Gramercy controlled the hotel's revenues, they did not willfully fail to pay and therefore they are not liable for the unpaid taxes. The position taken by petitioners is in direct conflict with the principle underlying the Tribunal's holding in ***Matter of Button*** (Tax Appeals Tribunal, January 28, 2002). As in ***Button***, NS Partners voluntarily entered into an arrangement that ultimately led to NS Partners' inability to pay sales tax. In this case, as in ***Button***, there was an act that permitted a creditor to exercise rights that directly resulted in the nonpayment of taxes. In each situation, the inability to act was the responsible officer's own creation and was foreseeable in the event of financial difficulties. Accordingly, the arrangement with Gramercy may be viewed as a dereliction of a duty to "properly safeguard the interests of the State with regard to such taxes" (20 NYCRR 532.2[c][3]); ***Matter of Button***). Since the inability of NS Partners to determine the disposition of funds after Gramercy assumed control was a situation of NS Partners' own making, it may not be relied upon to absolve NS Partners of responsibility. It follows that petitioners' argument that they may not be held responsible since NS Partners could not collect and remit sales tax is without merit. Similarly, the Gramercy takeover does not absolve petitioners from liability.

---

[3] Ezri Namvar was listed as owning 50 percent of the firm.

G. Petitioners contend that they should not be liable for penalty and interest because after the alleged seizure by Gramercy, they did not have the ability or responsibility to pay the tax. In this regard, petitioners note the testimony in the record by Mr. Williams, on behalf of petitioners, that he tried to convince Gramercy to pay the tax.

H. The foregoing argument is also rejected. As set forth above, the inability to act was petitioners' own creation and was foreseeable in the event of financial difficulties. Accordingly, the failure to pay the taxes due is properly viewed as a dereliction of duty. It follows that petitioners have not established that the failure to pay was due to reasonable cause and not willful neglect (Tax Law § 1145(a)(1)(iii); ***see Matter of F & W Oldsmobile v. Tax Commn.***, 106 AD2d 792 [1984]).

I. Petitioners contend that they are entitled to relief under TSB-M-11(17)S. In this memorandum, the Division adopted a policy to alleviate some of the harsh consequences of being found to be a responsible officer pursuant to sections 1131(1) and 1133 of the Tax Law. Specifically, the memorandum provided:

> "In the case of a partnership or LLC, section 1131(1) of the Tax Law provides that each partner or member is a responsible person regardless of whether the partner or member is under a duty to act on behalf of the partnership or company. This means that these persons can be held responsible for 100% of the sales and use tax liability of a business. The department recognizes that this provision can result in harsh consequences for certain partners and members who have *no involvement in or control of the business's affairs*. Accordingly, the department has developed the following new policy that provides some relief from this *per se* personal liability for certain limited partners and members (emphasis added)."

J. It is clear from the policy statement that the Division properly declined to apply TSB-M-11(17)S. On its face, the policy in question does not apply to a member who has substantial involvement in the financial affairs and management of the business. Here, petitioners exercised

substantial authority over the business and financial affairs of NS Partners until there was an event of default, which led to Gramercy's utilization of the lockbox.

K. It is noted that petitioners' reliance upon ***Matter of Boissiere and Krystal*** to support their position is misplaced. In ***Boissiere and Krystal*** the petitioners were given the benefit of TSB-M-11(17)S. However, unlike the current matter, neither petitioner in ***Boissiere and Krystal*** exercised managerial or financial authority over the business. Further, since the policy does not apply to this situation, petitioners have not shown that they are being treated differently than other taxpayers who are similarly situated. Therefore, a constitutional infirmity is not presented.

L. The petitions of James W. Henrie and Michael M. McBride are denied, the notices of determination dated May 26, 2009 and July 27, 2009 are sustained together with such penalties and interest as may be lawfully due and the claims for refund are denied.

DATED: Albany, New York
July 14, 2016

/s/ Arthur S. Bray
ADMINISTRATIVE LAW JUDGE