

STATE OF MINNESOTA
OFFICE OF ADMINISTRATIVE HEARINGS

FOR THE MINNESOTA DEPARTMENT OF REVENUE

In the Matter of the Denial of
a Tax Clearance Certificate to
Robert L. Koentopp, f/d/b/a
Third Street Place Ltd.,
1460 Danforth Street
St. Paul, Minnesota 55117,
Minnesota Identification
No. 3289382

FINDINGS OF FACT
CONCLUSIONS AND
RECOMMENDATION

The above-entitled matter came on for hearing before Howard L. Kaibel, Jr., Administrative Law Judge, on June 8, 1993, at the Office of Administrative Hearings in Minneapolis, Minnesota. The record closed on June 21, 1993, when the period expired for responding to the Department's June 14, 1993 post-hearing filings.

Patrick J. Finnegan, a staff attorney at the Minnesota Department of Revenue, Mail Station 2220, St. Paul, Minnesota 55146-2220, appeared on behalf of the Collection staff of the Department of Revenue (Department Staff). Robert L. Koentopp, 1460 Danforth Street, St. Paul, Minnesota 55117 (Respondent), appeared on his own behalf without benefit of counsel.

This Report is a recommendation, not a final decision. The Commissioner of the Minnesota Department of Revenue will make the final decision after a review of the record which may adopt, reject or modify the Findings of Fact, Conclusions, and Recommendations contained herein. Pursuant to Minn. Stat.

14.61, the final decision of the Commissioner shall not be made until this Report has been made available to the parties to the proceeding for at least ten days. An opportunity must be afforded to each party adversely affected by this Report to file exceptions and present argument to the Commissioner. Parties should contact Morris J. Anderson, Commissioner, Minnesota Department of Revenue, 10 River Park Plaza, St. Paul, Minnesota 55146, to ascertain the procedure for filing exceptions or presenting argument.

STATEMENT-OF ISSUES

1. Should an employee of a corporate sales tax permit holder, who has no ownership interest in the corporation and is neither a director nor an officer of that corporation, who had no responsibility for filing and paying

sales taxes, be treated as "owing" alleged corporate delinquencies in
applying
the license clearance provisions of Minn. Stat. 270.72?

2. Did the Department Staff have jurisdiction to notify the Commerce Commissioner to hold up Respondent's real estate license when he had entered into a payment agreement to assign 25 percent of all of his commissions to the Department in order to keep the license and had not breached that agreement?

3. Did the Legislature intend Minn. Stat. 270.72 to be applied to deny a respondent a license to practice his profession while he contests an alleged liability in good faith and is willing to enter into a reasonable payment agreement while the dispute is being resolved?

Based upon all of the proceedings herein, the Administrative Law Judge makes the following:

FINDINGS_OF_FACT

1. The sales tax permit involved in this case was issued by the Department Staff to Third Street Place Ltd., a corporation formed under the Minnesota Business Corporation Act in 1985. There is no evidence that Respondent ever had anything to do with applying for or securing that permit.

2. The Articles of Incorporation for Third Street Place were filed with the Secretary of State's office on January 29, 1985, listing William Koentopp, Respondent's brother, as the sole stockholder and sole director of the corporation.

3. Shortly after the corporation was formed, in early 1985, William Koentopp sold stock to five other investors, including Willard Bollenbach III who purchased one-third of the total shares. He also hired Mr. E. V. Franzmeier as the accountant for the corporation to handle its financial affairs.

4. In September of 1985, William Koentopp and Willard Bollenbach got into some kind of disagreement. Mr. Bollenbach took over the corporation as sole stockholder and "unhired" Mr. Franzmeier.

5. Appropriate forms were filed to confirm this transfer of ownership as of December 31, 1985, and the stock transfer was approved by the White Bear Lake City Council (which had issued a liquor license to William Koentopp as president of the corporation) in March of 1986.

6. Respondent continued to work for the corporate permit holder after the ownership transfer, because he needed the job. In 1987, the time period relevant to these proceedings, Respondent worked as a bartender for the corporation and held the title of "manager" of the bar.

7. Department Staff concedes that Respondent has never held any ownership interest of any kind in the corporation and there is no evidence that he was ever part of any profit sharing or other arrangement wherein his remuneration would be contingent upon the profitability of the venture.

8. Respondent was not responsible for preparing or filing or paying monthly sales tax returns. He did not supervise or control compliance with the sales tax laws in any fashion. Prior to the bankruptcy of the corporation, sales tax matters were dealt with solely by the accountant and corporate officers.

9. It is not alleged that Respondent knew in 1987, prior to the bankruptcy of the corporation, that monthly sales tax returns were not being filed or that they were not being paid in a timely fashion.

10. Respondent had no authority to act in any way during this period to favor other business creditors over the government in dispersing corporate funds. He could not pay bills out of daily receipts or otherwise exercise any such favoritism.

11. There is no evidence that Respondent ever held himself out to be a representative of the corporate permit holder to banks, creditors, Revenue officials or anyone else as having authority to act on its behalf.

12. There is no evidence that Respondent ever wrote any checks on the corporate bank account during the April 1987 through 1988 period relevant to these proceedings.

13. There is no evidence that Respondent had significant management authority to go with his title such as the power to: keep the books and prepare financial statements, make wholesale purchases of the goods sold at retail, control inventory, hire and fire employees, set or vary wages, hours or working conditions, prescribe or effectively control margins, prices or other sales practices, deal with liquor licensing and other governmental regulators, etc.

14. There is no evidence of any contracts of any kind having been executed by the Respondent on behalf of the corporate permit holder at any time.

15. There is no material evidence in the record to contradict Respondent's contention that he had no authority to withdraw funds from the corporate permit holder's bank accounts to pay sales taxes during the period in question. Department Staff previously subpoenaed the permit holder's bank records and most of them were evidently lost or destroyed. The only signature card they could produce was from an account which the bankruptcy filings indicated had been closed.

16. The corporate permit holder allegedly failed to file and/or pay sales taxes for the months of February 1987 through March of 1988, closing its bar business at some unspecified time during or after this period.

17. Mr. Bollenbach subsequently filed a petition in bankruptcy pursuant to Ch. 7 on behalf of the corporate permit holder.

18. Pursuant to those proceedings, Mr. Bollenbach instructed the Respondent on August 30, 1988, to sign and make copies of sales tax returns that he had already allegedly filed and to submit them to the bankruptcy court.

19. Respondent worked at another bar in 1989 and filed returns showing a 1989 personal income of \$6,870.00 in March of 1990.

20. On April 23, 1990, Department Staff applied Respondent's 1989 income tax refund to pay off the alleged February 1987 sales tax liability of the now bankrupt corporate permit holder.

21. On April 27, 1990, four days later, the Department Staff issued an order hypothesizing that Respondent was personally responsible for the alleged sales and withholding tax liability of the corporate permit holder. This order invited Respondent to submit documentation proving himself innocent of the alleged liability, such as corporate bylaws, minutes and bank records, within ten days. Respondent did not receive this notice until after the ten day protest period and subsequent to the sixty-day court review period provided in the notice.

22. When Respondent subsequently learned of the attempt to hold him responsible for the defunct corporation's alleged liability without consulting him, his objection led Department Staff to provide a gratuitous, non-binding informal review of his concerns, by a Department Staff employee who specialized in examining questions of personal liability. It was the opinion of that Department Staff employee that Mr. Bollenbach, the president of the bankrupt permit holder, and Respondent should be treated as jointly liable personally for all of the bankrupt corporation's tax debt.

23. In response to a threat from Department Staff to take away his real estate license, Respondent entered into a payment agreement on June 29, 1992 to allow Department Staff to deduct 25 percent of any real estate commissions over the next year with a balloon payment that would make the entire corporate liability, minus those deductions, due and payable on June 1, 1993.

24. Although that payment agreement contains a written admission of liability and a legal confession of judgment, the Department Staff officer signing the agreement does not dispute Respondent's assertion that she assured him that he could continue to dispute the alleged liability and that the agreement would not prejudice his rights in that regard.

25. On March 22, 1993, Department Staff issued a notice to the Department of Commerce directing that department to hold up renewal of Respondent's license, which was up for renewal on July 1, 1993.

26. There is no evidence in the record indicating that Respondent was in breach of this agreement in any way in March of 1993. There is no allegation that his employer reneged on its explicit promise to make and forward deductions or that Respondent had somehow intentionally failed to comply with his obligations.

27. Respondent thereafter duly requested this hearing on the question of

whether he should be allowed to renew his real estate license.

28. As of the date of the hearing, according to Department records, the bankrupt corporate permit holder owed sales taxes of \$8,314.31 and penalty and interest of \$7,050.82. In other words, the daily accruing and compounding penalty and interest on the Department computer will soon eclipse the amount of the original alleged liability.

29. There is no administrative or court action pending which contests the amount or validity of the tax liability in question, as opposed to this administrative proceeding contesting the licensure action.

30. The Respondent and Department Staff have entered into a payment agreement with regard to the alleged tax liability which has not been breached or repudiated by either party. It did not expire until June 29, 1993, after the close of the record.

Based upon the foregoing Findings of Fact, the Administrative Law Judge makes the following:

CONCLUSIONS

1. The Commissioner of Revenue and the Administrative Law Judge have jurisdiction in this case under Minn. Stat. 14.50 and 270.72.
2. The Notice of Hearing issued by the Department is in all respects proper with regard to form, content and execution and filing.
3. The Department Staff did not fulfill all relevant substantive and procedural requirements of law and rule, as discussed in the attached Memorandum.
4. There is a good faith dispute here as to whether Respondent owes any tax liability.
5. Respondent did not have control, supervision or responsibility for the preparation, filing and payment of sales taxes as is required to make him personally liable under Minn. Stat. 270.10, subd. 4, and 297A.01, subd. 2.

Based upon the foregoing Conclusions, the Administrative Law Judge makes the following:

RECOMMENDATION

IT IS HEREBY RECOMMENDED: that the Commissioner of Revenue refer this case to the Taxpayer Advocate and abate further accrual of penalties and interest pending the Advocate's review and action; and

IT IS FURTHER RECOMMENDED: that the Commissioner withdraw the March 22, 1993 notice to the Department of Commerce so that Respondent's license can be renewed and endeavor to extend the payment agreement with Respondent pending resolution of the dispute.

Dated this 114 day of July, 1993.

administrative Law Judge

HOWARD L. KAIBEL JR.

NOTICE

Pursuant to Minn. Stat. 14.62, subd. 1, the agency is required to serve its final decision upon each party and the Administrative Law Judge by first class mail.

Reported: Taped. Not transcribed. Tape nos. 19,396 and 19,399.

MEMORANDUM

Procedure

The notice to the Commissioner of Commerce was issued in this case prematurely. The definition of "tax delinquency" in the statute (Minn. Stat.

270.72, subd. 2) explicitly excludes amounts that are the subject of a payment agreement. At the time the notice was sent to the Department of Commerce, the amounts were the subject of an agreement and there was consequently no tax delinquency. The notice was accordingly improperly given. The best course of action at this point in time is to withdraw that notice so that the Commerce Commissioner can quickly renew Respondent's real estate license pending resolution of the underlying dispute.

The assignment of commissions expired one year after the date it was executed, and it consequently lapsed on June 29, 1993. Because the agreement has now technically lapsed, a new notice could be issued affecting future renewals. However, this will not resolve the fundamental dispute over whether Respondent should be personally liable for his employer's alleged tax arrearages. Perhaps the Taxpayer Advocate can assist in this process or perhaps the ultimate issue could be resolved in an action to enforce the confession of judgment in the permit agreement. Perhaps Respondent will enter into a renewed payment agreement placing his real estate commission deductions in escrow pending resolution of the dispute over personal liability, so that all licensure questions could be put aside. In any case, regardless of procedure, there is a serious underlying question here of personal liability which must be resolved before the Department Staff's proposed action can be affirmed to deprive Respondent of his right to practice his profession.

Personal Liability

Department Staff counsel argues, perhaps correctly, that the ultimate issue of personal liability has already been resolved. He asserts that the Respondent's failure to appeal the earlier order assessing personal liability makes him liable as a matter of law for the alleged sales tax and withholding tax arrearages of his bankrupt former corporate employer.

This Report should not be misinterpreted as necessarily disagreeing with the staff counsel's conclusions. The withholding tax question was certainly never an issue in this proceeding and it was not litigated. It is clear from the case law on this subject that someone could be liable for withholding taxes of a defunct corporation and not be liable for its sales taxes. Perhaps Respondent personally handled withholding deductions from employees' paychecks, deposited those funds in an account that he controlled or

supervised and had the responsibility for preparing, filing and paying withholding tax returns. The evidence with regard to those matters was never considered in this proceeding because the Notice of Hearing was limited to sales tax matters. The attached Report should not be misconstrued by either of the parties as being a final determination of Respondent's liability for his former employer's withholding taxes or sales taxes. This Report is solely limited to the question of whether it is appropriate to use the licensing sanctions as an enforcement tool to collect the former employer's alleged liability.

However, Department Staff counsel agreed that Respondent's personal liability is a question that must be examined in deciding whether the somewhat extraordinary licensure sanction should be applied to collect monies he allegedly "owes" under the statute. It is clear from the definition section of that statute that the law is to be applied only after good faith disputes have been administratively and judicially finally resolved. This is the first opportunity Respondent has had to present his defense in an independent administrative or judicial forum. His appeal cannot be summarily dismissed based on his failure to respond to a notice he never received three years ago.

The statutory framework for assessing personal liability for corporate taxes is relatively straightforward. Minn. Stat. 270.101, dealing with personal liability is effective for taxes becoming due on or after August 1, 1990. The order assessing personal liability in this case is dated April 27, 1990. Therefore, the statute applicable herein is Minn. Stat. 270.10, subd. 4. That section allowed assessment of corporate liability against any officer, director or employee of a corporation..... who as an . . . employee..... falls within the personal liability provisions of section . . . 297A . . ." Minn. Stat. 297A.01, subd. 2, extends such liability to any "person" who has "the control, supervision or responsibility of filing returns and making payment of the amount of tax imposed by this chapter." In short, the statute imposes personal liability for corporate taxes on those who control, supervise and are responsible for the filing and payment of those

taxes.

The federal and other court decisions dealing with the subject attempt to identify who has authority to direct, control and supervise tax compliance. United States v. Davidson, 558 F. Supp. 1048 (W.D. Mich. 1983) at 1052, a leading federal decision reviewing this question, lists five factors that are generally looked to by courts in identifying responsible persons for purposes of assessing liability:

- (1) Identity of officers, directors and stockholders of the corporation and their duties;
- (2) Ability to sign corporate checks;
- (3) Hiring and firing of employees;
- (4) Control over corporate financial affairs; and
- (5) "Entrepreneurial" stake in corporate affairs.

Applying these standards to this Respondent, he would certainly appear to have a good defense against liability. He was not an officer or even a stockholder in the corporation and was not specifically delegated any of their sales tax duties. It does not appear that he was able to sign checks, keep the books or exert any other effective control over corporate financial affairs. He had no ownership or "entrepreneurial" interest of any kind in the corporation.

The most recent Minnesota case dealing with this subject uncovered in limited research is *Hunt v. Commissioner*, Docket No. 6003, filed April 29, 1993. That case involved a partnership, as opposed to a corporation, where Mr. Hunt was one of two sole partners. That case turns on the same kind of factors and contrasts markedly with this one. Mr. Hunt was an owner and full partner in the business who was one of only two authorized signors on the bank account. He and the other partner were the only employees operating the business, handling everything from inventory to cleaning. He signed at least 140 checks drawn on the partnership account, including payroll checks and exercised direct control over all financial affairs. The tax court in that case affirmed an order of the Commissioner of Revenue, making Mr. Hunt personally liable for unpaid sales and withholding taxes.

That decision also cites *Benoit v. Commissioner*, 453 N.W.2d 336 (Minn. 1990) where the Minnesota Supreme Court reversed a judgment of the tax court and held a taxpayer personally liable for corporate taxes. That case appears to be the first and only Minnesota court case that has addressed the potential liability of corporate officers under our withholding and sales tax statutes. The decision again involved a taxpayer whose role contrasts markedly with that of the Respondent here. Benoit was the sole shareholder, sole director and chief executive officer of the corporate taxpayer. He was the only signatory other than the bookkeeper on the corporate checking account, hired and fired employees and controlled the amount of wages they were paid. He issued all paychecks and prepared and signed all sales tax returns. He executed all contracts on behalf of the corporation and ultimately filed the bankruptcy petition on behalf of the corporation, holding himself out to the court and creditors as the person in control of the corporation.

All of the other cases in other jurisdictions reviewed apply basically the same reasoning. Control and/or influence over the "disbursement of funds and priority of payments to creditors" has also been identified in one decision as a particularly important element. *Taubman v. United States*, 499 F. Supp. 1133 (E.D. Mich. 1978). Michigan courts apply a somewhat different statute in arriving at basically similar results. *Livingstone v. Department of Treasury*, 456 N.W.2d 684 (1990).

No case has been cited in this jurisdiction or elsewhere, or uncovered in cursory research holding a non-stockholding employee of a corporation personally liable for its sales taxes. Indeed, even in the cases of unincorporated partnerships and other businesses, there do not appear to be any recorded instances of employees without sales tax duties being held personally liable for sales taxes.

Licensure-Statute

The provisions of Minn. Stat. 270.72, allowing revocation of occupational licenses are a blunt instrument which can yield severe and counterproductive consequences, even when wielded with the skill of a surgeon. The Legislature obviously intended them to be used sparingly to force cooperation from unusually recalcitrant or repeatedly delinquent taxpayers. (Welch, OAH Docket No. 5-2700-4833-2, issued October 31 , 1 990) .

It is clear that the legislators did not intend this statute to be applied in this situation. The law is explicitly limited in the definition section to cases where all administrative and judicial appeals have been exhausted - as opposed to a good faith dispute over whether the taxpayer should be assessed. It is also specifically limited to cases where such taxpayers stubbornly refuse to enter into any reasonable payment agreement not a situation where the citizen has, albeit under protest, signed over 25 percent of his pretax license income for mandatory deduction and complied vigorously with his promises, despite his misgivings.

There is a good faith dispute here over who should be forced to pay this six year-old alleged liability. Legislators doubtless never intended to deprive this citizen of his livelihood while he defends himself against the allegations.

HLK