

STATE OF MINNESOTA

TAX COURT

COUNTY OF RAMSEY

REGULAR DIVISION

Christopher R. Paddock,
Appellant,

**FINDINGS OF FACT,
CONCLUSIONS OF LAW, and
ORDER FOR JUDGMENT**

vs.

Docket 7856-R
No.

Commissioner of Revenue,
Appellee.

Dated: March 31, 2008

The Honorable Sheryl A. Ramstad, Judge of the Minnesota Tax Court, heard this matter, on January 9, 2008, at the Minnesota Judicial Center, St. Paul, Minnesota.

Bruce N. Crawford, Attorney at Law, represented the Appellant.

Rita Coyles deMeules, Assistant Attorney General, represented the Appellee.

The issue in this case is whether Appellant is personally liable for unpaid sales tax for March through August 2005 and October 2005.

Both parties submitted post-trial briefs. The matter was submitted to the Court for decision on February 7, 2008.

The Court, having heard and considered the evidence adduced at the hearing, and upon all of the files, records and proceedings herein, now makes the following:

FINDINGS OF FACT

1. Christopher R. Paddock ("Appellant") was President and director of Mojito, Inc. ("Mojito"), a St. Louis Park, Minnesota restaurant which ceased business activities on or about October 28, 2005.
2. During March through August 2005, and October 2005 ("the tax periods at issue"), as President of Mojito, Appellant was responsible for the general active management of the business of the corporation. Appellant was actively involved in employee matters. He also served as a member of Mojito's Board of Directors and was 1/3 owner.
3. Appellant was involved in the day-to-day operations of the business and was a signatory on the business bank accounts. He had access to Mojito's accounts through paper checks, through on-line electronic access, or through communication with the bank. During the tax periods at issue, he had control or supervision jointly with others over the finances of Mojito, including the payment of taxes.
4. Mojito began having problems with unpaid sales taxes sometime in 2004. Although Appellant was on personal leave from September, 2004 through February, 2005, his partners copied him on email messages so he continued to be informed of Mojito's sales tax liability during that time. From March through October of 2005, he was involved in Mojito's operations and kept up to date on its sales tax status. As early as March 2005, he was advised of the risk that Mojito would be posted by the State for unpaid taxes so it could no longer

purchase liquor. Again in April 2005, Appellant was notified that although Mojito's sales tax return had been filed, the amount owed (\$13,778) had not been paid. By June 2005, Appellant was working with and proposing compromises to Mojito's creditors and negotiating with the restaurant's landlord to assist Mojito in paying down its outstanding sales tax liability to the state.

5. Appellant continued hold himself out as and act as the President of Mojito until it closed in October 2005.
6. From March through August 2005 and October 2005, Mojito failed to pay sales tax to the State of Minnesota.
7. On November 22, 2005, and December 2, 2005, the Commissioner issued Orders assessing personal liability against Appellant for Mojito's unpaid sales tax for the tax periods March through August, 2005, and October, 2005. The amounts totaled \$91,670.29 for taxes, penalty and interest. Appellant administratively appealed these Orders.
8. The Commissioner denied the administrative appeal, issuing an Order dated March 7, 2006. On June 6, 2006, Appellant timely filed this appeal with the Minnesota Tax Court.

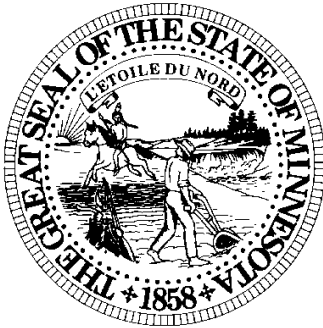
CONCLUSIONS OF LAW

1. Appellant Christopher R. Paddock was a responsible person for the filing and payment of sales tax due from Mojito, Inc.
2. The Order of the Commissioner of Revenue dated March 7, 2006, assessing personal liability against Appellant for unpaid

sales tax for the tax periods March through August 2005, and October 2005, plus penalties and interest, totaling \$91,670.29, is hereby affirmed in all respects.

IT IS SO ORDERED. THIS IS A FINAL ORDER. A STAY OF FIFTEEN DAYS IS HEREBY ORDERED.

BY THE COURT,



Sheryl A. Ramstad, Judge
MINNESOTA TAX COURT

DATED: March 31, 2008

Memorandum

Background

The issue in this case is whether Christopher R. Paddock (“Appellant”) is personally liable for sales tax payable by Mojito, Inc. (“Mojito”), a corporation in which he was an officer, shareholder, director, and check signatory.

The Commissioner of Revenue (“Commissioner”) assessed personal liability against Appellant for Mojito’s unpaid sales tax for the months of March, April, May, June, July, August, and October of 2005. Appellant administratively appealed the Orders dated November 22, 2005, and December 2, 2005, and on March 7, 2006, the Commissioner upheld the Orders of Assessment. Appellant filed a timely appeal with this Court on June 6, 2006.

Discussion

Appellant was president of Mojito, a St. Louis Park, Minnesota restaurant which ceased doing business in late October 2005. Appellant contends that he was unaware of Mojito's unpaid tax liability and did not have the ability to direct, control, or supervise the payment and/or filing of Mojito's sales taxes for the relevant periods.

Personal liability for sales tax is imposed upon a person who "has control of, supervision of, or responsibility for filing returns or reports, paying taxes, or collecting or withholding and remitting taxes and who fails to do so...." ¹ The term "person" includes "directors and officers of corporations...who, either individually or jointly with others, have the control, supervision or responsibility of filing returns and making payment o the amount of...tax imposed...." ²

Benoit Factors

The criteria for determining personal liability for sales tax involve control, supervision, and responsibility for making payments of the sales tax.³ The Minnesota Supreme Court in Benoit established a five-part functional test which focuses on those persons who have the power and responsibility to see that the taxes are paid.⁴ These five factors include:

- (1) identity and duties of officers, directors and stockholders,
- (2) check writing ability of the corporation,

¹ Minn. Stat. § 270C.56, subd. 1 (2006). This statute was previously codified at Minn. Stat. § 270.101, subd. 1 (2004). The recodification in Chapter 270C was effective August 1, 2005. See 2005 Minn. Laws 1396.

² Minn. Stat. § 270C.56, subd. 2 (2006), previously codified at Minn. Stat. § 297A.01, subd. 2 (2004).

³ Larson v. Commissioner of Revenue, 581 N.W.2d 25, 29 (Minn. 1990); Benoit v. Commissioner of Revenue, 453 N.W.2d 336, 344 (Minn. 1990); Carlson v. Commissioner of Revenue, 517 N.W.2d 48, 52 (Minn. 1995).

⁴ Benoit, 453 N.W.2d at 342 (citations omitted).

- (3) identity of individuals who hired and fired employees,
- (4) identity of individuals who were in control of the corporation's financial affairs, and
- (5) identity of those with an entrepreneurial stake in the corporation.⁵

Appellant raises two arguments with respect to the legal standards that control this Court's ultimate decision. First, Appellant suggests that the willfulness standard applied under federal law is relevant here based upon the Benoit court's citation to the federal district court's decision in Platt v. United States.⁶ It is evident from the opinion that the Benoit court cited to the Platt decision because "this court has never addressed the potential liability of corporate officers under the withholding and sales tax statutes."⁷ Since Benoit, however, the Minnesota Supreme Court has clarified that the federal willfulness standard does not apply to the imposition of personal liability for unpaid sales tax under Minnesota's statutory standards.⁸ Thus, there is no requirement under Minnesota law that a person must willfully fail to pay sales tax in order to be found liable for the nonpayment.

Second, Appellant contends that the reference to "significant control" in Krech v. Commissioner of Revenue⁹ imposes a limitation on the statutory standard of control, supervision of, or responsibility for filing or paying taxes. The

⁵ Id. at 344.

⁶ 519 F.Supp. 203 (N.D. Ill. 1981).

⁷ Benoit, supra at 341.

⁸ See Igel supra at 709-10 (rejecting taxpayer's argument to impose a federal "willfulness" standard on personal liability test).

⁹ 557 N.W.2d 335 (Minn. 1997).

Commissioner argues that the Court's reference to "significant control" in Krech was based upon facts in that case that are not present here. We agree.¹⁰

Thus, we turn to the Benoit factors, which continue to be informative even though the statute upon which that case relies has changed.¹¹ Both parties agree that these five factors are a useful gauge of a person's control, power, and responsibility. They do not depend upon an isolated view of titles or specific acts but, rather, address a broad view of the person's knowledge of and role in the financial matters of a company.

Identity and duties of officers, directors, and stockholders

Appellant admits he was a stockholder of Mojito. He also admits that he was President and director of Mojito until June 23, 2005, which is the date he testified his partners attempted to remove him from those positions.¹² The documents and evidence introduced at trial, however, contradict Appellant's claims. For example, there was no document supporting Appellant's testimony that he was removed from his positions as President and director of Mojito. Furthermore, Mojito's Chief Financial Officer James Behnke ("Mr. Behnke") testified that the only change taking place as far as Appellant's corporate roles was that he was asked to be less of the "front man" for Mojito since there had been some bad newspaper publicity concerning a lawsuit in which Appellant was

¹⁰ In Krech, the potentially liable officer met only one of the Benoit factors: his ability to sign checks on behalf of the company. The Court specifically found that Krech was not an officer, director, or shareholder, had ministerial authority only, had no entrepreneurial interest, and had no power to hire or fire employees. Thus, the Minnesota Supreme Court concluded "that check signing authority without further indicia of control is not enough to establish personal liability." Id. at 341.

¹¹ Larson, 581 N.W.2d at 29.

¹² Tr. at 31.

involved.¹³ Additionally, Mojito's Vice President of Operations Patrick Weber ("Mr. Weber") corroborated Mr. Behnke's testimony, indicating that he was concerned that Appellant not be the lead contact with prospective investors for Mojito due to the bad publicity he had had.¹⁴ Both Mr. Behnke and Mr. Weber indicated it was never their intention to remove Appellant from the office of President or as a director of Mojito. Moreover, Appellant himself continued to hold himself out as President of Mojito after June of 2005, signing documents in that capacity on behalf of the corporation.¹⁵ We, therefore, find that Appellant meets the first Benoit factor.

Ability to Sign Checks

Appellant argues that, at most, he signed only four checks in 2005, and that he did not sign any checks for Mojito's sales tax liability.¹⁶ Further, he contends that he cannot be held personally liable because financial matters were not his responsibility, and he did not have the requisite knowledge of accounting and tax as did Mr. Behnke.¹⁷ The Commissioner contends that the actual number of checks signed is irrelevant because Benoit considers only the *ability* to sign checks. Furthermore, the Commissioner claims that a partner or shareholder with the requisite level of control and responsibility cannot escape liability by relying on others to take care of that responsibility. We agree.

¹³ Tr. at 209.

¹⁴ Tr. at 146.

¹⁵ During the summer of 2005, Appellant signed a listing agreement for the sale of Mojito. On August 22, 2005, Appellant represented himself as President of Mojito in requesting lease concessions from their landlord.

¹⁶ Tr. at 105.

¹⁷ Tr. at 17.

While we are sympathetic to Appellant's position, we are required to apply the statute and determine whether Appellant is liable regardless of another's liability.¹⁸ Here, Appellant not only had the ability to, but he did in fact, sign checks for Mojito. Appellant had signing authority for Mojito accounts at both Wells Fargo Bank and at Venture Bank.¹⁹ In addition, Appellant issued checks to himself from Mojito's Venture Bank checking account in June, July, and September of 2005.²⁰ While Appellant was uncertain whether his signature was on some of the checks,²¹ he confirmed that "the 'Pay to the order of' handwriting is definitely [his]." ²² Furthermore, Mr. Behnke and Mr. Weber both testified that Appellant had access to Mojito's accounts, through paper checks, through on-line electronic access, or through communication with the bank.²³ Finally, Appellant wrote checks to himself or requested company funds for loan reimbursements, partner draws, or his personal expenses. His access to Mojito's accounts was such that he simply notified his partners of the dates on which he would withdraw fund from Mojito's accounts.²⁴ Thus, the record evidences Appellant had the ability to, and did, sign checks on Mojito's accounts. He, therefore, meets the second Benoit factor.

Ability to Hire and Fire Employees

¹⁸ When more than one person is responsible for the unpaid tax liability, the Commissioner may assess personal liability against any or all persons deemed liable. Minn. Stat. § 270.101, subd. 3 (2004), recodified at Minn. Stat. § 270C.56, subd. 3 (2006) and Minn. Stat. § 290.92, subd. 1(4), subd. 2(a) (2004).

¹⁹ Exs. 32, 34.

²⁰ Ex. 12.

²¹ Tr. at 79.

²² Tr. at 105.

²³ See Tr. at 132, 152, 187, 213-14.

²⁴ Exs. 9, 10, 11, 22.

Appellant claims there is no evidence he had the authority to hire and fire employees, whereas the Commissioner argues that Appellant had the authority, regardless of whether or not he exercised it. Because Appellant was deeply involved in employee matters, we find he had the authority necessary to meet this Benoit factor. Not only was Appellant an officer and director of Mojito, but as President he had responsibility for the general active management of the business of the corporation. He was closely involved in employee matters, including advising his partners about the hourly wage for Mojito's daytime manager and suggesting the partners proactively approach the employees to ask for their loyalty and patience. Appellant also participated in the discussions with his partners regarding which employees' checks would be bounced as Mojito's financial struggles ensued. Thus, we find Appellant meets the third Benoit factor.

Joint Control of Financial Affairs

Appellant claims he did not have control over Mojito's financial affairs. The Commissioner asserts that because the partners had joint control, and personal liability is properly imposed where a person "singly or jointly with others" has control, Appellant had the requisite control to be liable for Mojito's sales taxes. We find that the evidence demonstrates that Appellant had at least as much control over Mojito's financial affairs as did Mr. Behnke and Mr. Weber and, therefore, meets the fourth Benoit factor. During the tax periods at issue, Appellant negotiated with Mojito's creditors, discussed and proposed payment plans or options for other obligations with Mr. Behnke and Mr. Weber. For example, during June of 2005, Appellant negotiated the weekly sum that Reward

Network would take from Mojito's credit card revenues to pay off Mojito's loans.²⁵ Appellant was also in regular contact with Mojito's landlord.²⁶ By mid-summer, 2005, after Appellant claims he was removed from his positions with Mojito, he signed the report to Mojito's investors.²⁷ During this same time, Appellant, holding himself out as the President of Mojito, met with the broker retained to sell Mojito, signed the Exclusive Commercial Leasing Agreement with that broker, and met with potential Mojito buyers.²⁸ Finally, Mr. Behnke and Mr. Weber both refute Appellant's testimony that he was unaware of the extent that Mojito was behind on its sales tax payments to the State of Minnesota until September of 2005. Mr. Weber testified that the three of them (Behnke, Weber, and Appellant) spoke on an almost daily basis and also communicated by email.²⁹ He recalled regular discussions with Appellant about Mojito's outstanding tax liability to the State of Minnesota during the relevant tax periods and testified that payment of Mojito's tax liability "was an ongoing discussion" among them.³⁰ Mr. Behnke testified, consistent with Mr. Weber's testimony, that Mojito's sales tax liability was discussed among them on a regular weekly basis.³¹ He testified that the balance sheets, which were typically prepared on a monthly basis, showing both monthly and year-to-date sales tax liability were

²⁵ Ex. 39; Tr. at 190.

²⁶ Tr. at 104-05, 108; Exs.13, 14.

²⁷ Ex. 17.

²⁸ Exs. 16, 17, 18, 19, 26.

²⁹ Tr. at 142.

³⁰ Tr. at 145.

³¹ Tr. at 211, 224-25.

sent to Appellant.³² We, therefore, find the record amply supports that Appellant meets the fourth Benoit factor.

Entrepreneurial stake in the Company

Appellant does not deny he had an entrepreneurial stake in Mojito. Thus, the fifth factor is met.

Personal Liability

Since Orders of the Commissioner are presumed correct and valid,³³ Appellant bears the burden of demonstrating that the Commissioner's Orders assessing him personally liable for Mojito's unpaid sales tax are incorrect.³⁴ We find Appellant fails to meet his burden of demonstrating that the Commissioner's Orders were incorrect. The evidence supporting his claims was largely his testimony, which contained many internal inconsistencies and lacked corroboration. We are persuaded by the testimony of Mr. Behnke and Mr. Weber. Each month during the tax periods at issue, the Mojito partners evaluated the restaurant's mounting financial pressures. At times, their sales tax arrearages prevented them from buying liquor through Mojito. The partners reviewed financial statements and balance sheets on at least a monthly, and at some point daily, basis.

In a similar case, Carlson v. Commissioner of Revenue,³⁵ the Minnesota Supreme Court upheld an assessment of personal liability for unpaid sales tax against a restaurant's former president, even though that person was not actively

³² Tr. at 191, 193.

³³ Minn. Stat. § 271.06, subd. 6 (2006); Lifer v. Commissioner of Revenue, Docket No. 7417 (Minn. Tax Ct. Sep. 5, 2002).

³⁴ See Larson v. Commissioner of Revenue, 581 N.W.2d 25, 30 (Minn. 1998).

³⁵ 517 N.W.2d 48 (Minn. 1994).

involved in the business until the last two months of its operation. Because the focus is on those persons who have the power and responsibility to see that the taxes are paid, the Court upheld the personal liability assessment of Carlson, finding he had the necessary authority and responsibility at all times even though he chose not to exercise that authority until he had to do so. In this case, the record shows that Appellant had the necessary authority and responsibility for Mojito during the relevant tax periods at issue regardless of whether or not he chose to exercise it.

Conclusion

Based upon the foregoing, we find Appellant jointly in control and responsible for Mojito's financial affairs between March and October 2005. For all the reasons stated above, we affirm the Commissioner's Orders assessing personal liability against Appellant and enter judgment against Appellant for the amounts assessed for unpaid sales tax, penalty, and interest.

S. A. R.