

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

IN RE:

WILLIAM HAROLD ISHEE,

Debtor.

CASE NO. 01-11148-WSS

Chapter 7

WILLIAM HAROLD ISHEE,

Plaintiff,

v.

ADV. PROC. NO. 02-01214

STATE OF ALABAMA, DEPT. OF
REVENUE,

Defendant.

**ORDER DENYING RELIEF SOUGHT IN
COMPLAINT TO DETERMINE DISCHARGEABILITY**

Michael B. Smith, Counsel for the Plaintiff/Debtor
Duncan R. Crow, Counsel for the State of Alabama

This matter came on for trial on the Debtor's complaint to determine dischargeability of a debt pursuant to 11 U.S.C. §523. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This matter is a core proceeding pursuant to 28 U.S.C. §157(b)(2). Before the trial, the Plaintiff stipulated that after October 1999, he was the "responsible person" for Ibsen Seed Company, Inc. pursuant to Alabama Code §§40-29-72 and 40-29-73. After considering the pleadings, evidence, testimony and arguments of counsel, the Court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

The complaint deals with the dischargeability of payroll withholding taxes, sales taxes

and penalties owed to the State of Alabama by Ibsen Seed Company, Inc. (“Ibsen Seed”). The Debtor, William Ishee (“Ishee”), purchased 100% of the stock of Ibsen Seed in September 1998, and became president of the company. At the time of the purchase, Ishee was a full-time employee of the Mitchell Company. Ishee graduated in 1984 with a degree in accounting from the University of South Alabama. He became a certified public accountant, and worked as an accountant for seven years after graduating. He then took his present position with the Mitchell Company, where he has worked for the past 16 years.

Ishee did not plan to be involved in the daily operations of Ibsen Seed. He purchased the Ibsen Seed stock on condition that Laurie Reeves remain at Ibsen Seed as the general manager. Her duties included scheduling and overseeing employees, making payroll, paying payroll and sales taxes, and ordering inventory for the store. Ms. Reeves had authority to make deposits and write checks for Ibsen Seed’s two checking accounts, a payroll account and an operating account. Ishee also had signatory authority on the company bank accounts. From the time that he purchased Ibsen Seed’s stock in 1998 to April 2000 when he closed the business, Ishee did not draw any money from the business. He made cash advances to the company, but did not monitor how those funds were used.

When Ibsen Seed’s business began to fail in September 1999, Ishee decided to help Ms. Reeves by handling the checking accounts- paying bills, preparing the payroll and preparing the returns for the state sales tax. While preparing the September 1999 sales tax return, Ishee realized that the sales taxes for Ibsen Seed had not been paid for several months. He contacted Eugene Prichard (“Prichard”) in the Mobile field office for the Alabama Department of Revenue and was “stunned” to learn that the sales tax returns for Ibsen Seed had not been filed since

January 1999. As a result of this contact, Prichard was to calculate the unpaid taxes and contact Ishee with a figure for the interest and penalties. Ishee's contact with Prichard was the first time he learned that Ibsen Seed owed back sales taxes to the State.

Ishee prepared the back sales returns and forwarded them with a cover letter to the Department of Revenue. He did not send payment for the taxes because Ibsen Seed did not have the funds. He also sent the September 1999 sales tax return and paid the tax in full. Ishee sent a transmittal letter with the back sales tax returns indicating that he planned to pay the back taxes. Ishee sent another letter dated May 22, 2000 to Prichard with the sales tax returns for December 1999 to April 2000. No money was sent with the returns.

Ishee is not sure when he realized that the payroll (or withholding) taxes were delinquent. He does not recall talking to Prichard about the payroll taxes in October 1999. The payroll taxes are paid on a different schedule than the sales taxes and he is not sure that the payroll taxes were an issue when he spoke to Prichard. The last payroll taxes were prepared in March 1999. Ishee did not sign the March 1999 return. Ishee prepared the September 1999 payroll taxes and sent it to the state without payment.

The sales taxes are paid on a monthly basis with the tax for a given month due to be paid by the 20th of the following monthly. Therefore, the sales tax for February would be due on March 20th. The payroll taxes are paid on a quarterly basis, and would therefore be due in March, June, September and December of each year. As noted about, Ibsen Seed had a payroll account and an operating account. The bank statements for the payroll account reflect the following deposits and withdrawals:

<u>Date</u>	<u>Deposits</u>	<u>Withdrawals</u>
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June 1999	\$6,680.00	\$6,960.14
September 1999	\$3,985.00	\$3,964.27
December 1999	\$2,344.01	\$2,042.44 ¹

The following is a summary of the withdrawals and deposits for Ibsen Seed’s operating account and the sales and payroll taxes due for the given months:

<u>Date</u>	<u>Deposits</u>	<u>Withdrawals</u>	<u>Sales Tax Due²</u>	<u>Income Tax Due³</u>
March 1999	\$35,544.27	\$33,036.05	\$376.11	\$362.48
June 1999	\$26,547.00	\$26,078.70	\$722.10	-----
September 1999	\$11,631.84	\$11,759.57	\$155.38	\$380.01
December 1999	\$14,435.48	\$14,425.48	\$402.40	\$321.02
March 2000	\$9,943.52	\$9,566.77 ⁴	\$265.16	\$559.84

Ishee testified that the assessment for the payroll and sales taxes came after he closed Ibsen Seed. The notice of final assessment is dated April 23, 2003. He doesn’t know if he had the money to pay the taxes or not when he discovered that the sales tax was unpaid in September 1999.

Barbara Russell (“Russell”) is a revenue compliance agent for the State of Alabama who has personal knowledge of Ibsen Seed’s sales and payroll taxes. The total combined tax is

¹Defendant’s exhibits 17, 18 and 19 were marked for identification only and were not admitted as evidence.

²Amounts do not include penalties and interest.

³Amounts do not include penalties and interest.

⁴Defendant’s exhibits 12, 13, 14, 15 and 16 were marked for identification only and were not admitted into evidence.

\$10,261.32 plus \$389.95 interest and a 100% penalty of \$10,651.27. Upon receipt of the file on Ibsen Seed, Russell noted that Ishee was listed as president of Ibsen Seed and was the sole shareholder of the company. She also saw the letter from Ishee to Prichard. She sent a notice and demand to Ishee for the back taxes. Russell then received notice that Ishee had reopened his chapter 7 petition to file a dischargeability complaint regarding the taxes. Russell believes that Ishee willfully failed to pay the delinquent taxes because he continued to operate Ibsen Seed knowing that the taxes had not been paid. He continued to pay other creditors and suppliers with knowledge that Ibsen Seed owed withholding and sales taxes. He also made no effort to set up a payment plan for the taxes after he discovered that the taxes were delinquent.

Ishee filed his chapter 7 petition on March 8, 2001. He subsequently received his discharge in August 2001, and the case was closed on June 18, 2002. In August 2002, Ishee learned that the State of Alabama Department of Revenue was imputing corporate withholding taxes against him for Ibsen Seed. Ishee reopened his chapter 7 case and filed the present adversary to determine the dischargeability of the imputed taxes.

CONCLUSIONS OF LAW

Under Alabama Code (1970) § 40-29-73, a person who willfully fails to collect or pay taxes imposed by Title 40 of the Alabama Code shall be liable for the amount of the taxes (with penalties and interest), and an additional penalty of up to 100% of the unpaid taxes. An individual who has a duty to collect and pay such taxes is referred to as a “responsible person” under the tax code. The language of §40-29-73 closely tracks the wording of the Internal Revenue Code, 26 U.S.C. §6672, therefore, courts determining whether someone is a “responsible person” under §40-29-73 look to federal case law interpreting “responsible person”

under 26 U.S.C. §6672. See *State of Alabama v. King*, 1995 WL 423171 *9, n. 7 (N.D. Ala. 1995) (“Since the Alabama statutes for trust fund taxes are patterned after the federal statute, Section 6672 of the Code, the court cites only to federal law for interpretation. The analysis applies with equal force to [the debtor’s] obligations to pay the state taxes at issue.”) The issue in the present case is when Ishee became a “responsible person” for Ibsen Seed under §40-29-73. Ishee conceded before trial that he is responsible for any sales and withholding taxes which came due after October 1999 when he began to handle Ibsen Seed’s financial affairs. However, Ishee asserts that he should only be held liable for those taxes incurred after he assumed control of Ibsen Seed.

“Responsible person” status under §6672 is not limited to the person specifically charged with paying payroll taxes. It extends to those individuals within an organization with the power and duty to collect and pay these taxes. “The crucial inquiry is whether the person has the ‘effective power’ to pay the taxes— that is, whether he had the actual authority or ability, in view of his status within the corporation, to pay the taxes owed.” *Barnett v. U.S.*, 988 F.2d 1449, 1454 (5th Cir. 1993) (citations omitted). Some of the factors employed to determine this authority are: (1) whether the individual is an officer or member of the board of directors; (2) whether the person owns a substantial amount of stock in the company; (3) whether he manages the day-to-day operations of the business; (4) whether he has the power to hire and fire individuals; (5) whether he makes decisions as to the disbursement of funds and payment of creditors; and (6) whether the individual has the authority to sign company checks. *Barnett*, 988 F.2d at 1455; see also *George v. U.S.*, 819 F.2d 1008, 1011 (11th Cir. 1987). In the case at hand, Ishee meets several of these criteria. He was the president of Ibsen Seed and owned all of its

stock. He was a signatory on all the company's checking accounts. Ishee admitted that he had the authority to hire and fire employees.

Ishee argues that Laurie Reeves managed the day-to-day operations of the business, and that she made decisions about the disbursement of funds and payment of creditors prior to September 1999. However, Ms. Reeves was Ishee's employee and was exercising the authority that Ishee delegated to her to perform her duties. Although she had great responsibilities at Ibsen Seed, Ms. Reeves had no ownership in the business and ultimately reported to Ishee. "One does not cease to be a responsible person merely by delegating that responsibility to others" *Barnett*, 988 F.2d at 1455, n. 11 (quoting *Gustin v. U.S.*, 876 F.2d 485, 491 (5th Cir. 1989)). Therefore, the Court finds that Ishee is a responsible person for purpose of §40-29-73, and has been a responsible party since purchasing Ibsen Seed in 1998.

The Court must now consider whether Ishee's failure to pay the withholding taxes can be considered willful under §40-29-73. Again, courts generally look to case law interpreting 26 U.S.C. §6672 in determining willfulness under §40-29-73. Ishee argues that his conduct cannot be interpreted as willful failure to pay the withholding taxes because he did not know that the withholding taxes were not being paid. The Eleventh Circuit Court of Appeals held that the willfulness element of §6672 is fulfilled "if the responsible person has knowledge of payments to other creditors after he becomes aware of the failure to remit the withholding taxes." *Thosteson v. U.S.*, 331 F.3d 1294, 1300 (11th Cir. 2003) (citations omitted). The Court elaborated:

Even if a "responsible" person is unaware that withholding taxes have gone unpaid in past quarters, a responsible person who becomes aware that taxes have gone unpaid in past quarters in which he was also a responsible person, is under a duty to use all "unencumbered funds" available to the corporation to pay those back taxes. (Citations omitted) This duty extends not only to funds available to the corporation at the time the responsible person becomes aware but also to any

unencumbered funds acquired thereafter. If the responsible person fails to use such unencumbered funds to satisfy the past unpaid liability, he is deemed personally liable for the taxes that went unpaid in the past while he was responsible.

Thosteson, 331 F.3d at 1300-1301.

Ishee cites *Slodov v. United States*, 436 U.S. 238 (1978), wherein the Supreme Court found that the responsible person did not violate §6672 by spending company funds on expenses other than the unpaid taxes when, at the time that he assumed control of the business, there were no funds to satisfy the tax obligation and the funds generated thereafter were not directly traceable to collected taxes. Ishee also asserts that he tried to resolve the issue of the unpaid taxes by contacting the Alabama Department of Revenue. He was waiting for a full determination of the penalties and interest due on the unpaid taxes from Mr. Prichard.

The Supreme Court's holding in *Slodov* is not dispositive in the present case. Factually, the case is distinguishable because the individual in *Slodov* purchased a company that had existing delinquent taxes and was assured by the previous owners that funds were in the corporate accounts for payment of the taxes. The individual did not become a responsible party until after the taxes were delinquent. The Court determined that an individual could not be held liable under §6672 if the only funds available to pay income taxes were funds acquired after the individual became a "responsible person" under the statute. *Slodov*, 436 U.S. at 254. In contrast, Ibsen Seed failed to pay its taxes after Ishee purchased the company in 1998, and this Court has found Ishee to a responsible person since his purchase of Ibsen Seed in 1998.

Under the Eleventh Circuit's test for determining willfulness under §6672, Ishee became liable for the withholding taxes and penalties when he became aware of the unpaid taxes and paid other creditors rather than paying the taxes. He testified that he learned that Ibsen Seed's

sales taxes had not been paid while preparing the September 1999 sales tax return. However, Ishee could not remember even a general time when he discovered that the withholding taxes, as opposed to the sales taxes, had not been paid. He did note that he had already closed Ibsen Seed by the time that he received the notice of final assessment from the State. Ishee testified that he did not think about the withholding taxes because they were paid quarterly rather than monthly. Having observed Ishee's character and demeanor as a witness, the Court is not convinced that Ishee, a certified public accountant with seven years experience, and an experienced business man, did not realize that the withholding taxes were also delinquent in September 1999. Ishee signed the A-1 form, State of Alabama Employer's Quarterly Return of Income Tax Withheld for the quarter ending September 30, 1999. The date on the form is October 31, 1999. It seems incredible that Ishee would not have checked Ibsen Seed's records to make sure that past withholding taxes had been paid, given the situation with the delinquent sales taxes. "The willfulness requirement is satisfied if the responsible person acts with a reckless disregard of a known or obvious risk that trust funds may not be remitted to the Government . . . such as by failing to investigate or to correct mismanagement after being notified that withholding taxes have not been duly remitted." *Mazo v. United States*, 591 F.2d 1151, 1154 (5th Cir. 1979) (citations omitted). Therefore, the Court finds that Ishee became aware in September 1999 that the withholding taxes for Ibsen Seed had not been paid since March 1999.

Having established when Ishee became aware that the withholding taxes were unpaid, the Court turns to the State's evidence of payments made to other creditors after Ishee learned about the unpaid taxes. Ishee testified that he took over the financial affairs of Ibsen Seed in September 1999. The company's checking account statements from September 1999 to March

2000 show deposits of approximately \$36,000.00 and withdrawals of approximately \$35,800.00. Clearly, Ishee made payments to other creditors after learning that Ibsen Seed's withholding taxes had not been paid. Ishee's payments to other creditors with knowledge that Ibsen Seed's withholding taxes had not been paid establishes the "willful" element of §40-29-73.

Based on the foregoing, the Court finds that the relief sought in the Plaintiff's complaint to determine dischargeability should be denied, and Ishee's debt to the State of Alabama, Department of Revenue should be held to be nondischargeable. It is hereby

ORDERED that the relief sought in the Plaintiff's complaint to determine dischargeability is **DENIED**, and the debt owed the Debtor, William Harold Ishee, to the State of Alabama, Department of Revenue is **NONDISCHARGEABLE**.

Dated: August 1, 2003