

STATE OF NORTH CAROLINA 2017 FEB 15 PM 3: 52

COUNTY OF WAKE

Office of
Administrative Hearings

IN THE OFFICE OF
ADMINISTRATIVE HEARINGS
10 REV 4058

LOUIS W. CHERRY, III,
Petitioner,

V.

NORTH CAROLINA DEPARTMENT
OF REVENUE,
Respondent

DECISION

This contested case was commenced on July 16, 2010 when Petitioner filed a petition for a contested case hearing appealing Respondent's June 8, 2010 Notice of Final Determination. On July 25 and July 26, 2011, Administrative Law Judge Melissa Owens Lassiter conducted a contested case hearing in this matter. On October 10, 2011, Petitioner filed its proposed Decision, while on October 19, 2011, Respondent filed its proposed Decision with the Office of Administrative Hearings.

APPEARANCES

For Petitioner: Robert H. Merritt, Jr.
Bailey & Dixon, LLP
434 Fayetteville Street, Suite 2500
Raleigh, North Carolina

For Respondent: Tenisha S. Jacobs
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APPLICABLE LAW

N.C. Gen. Stat. § 105 Subchapter I, Levy of Taxes, Article 9 *et. seq.*

N.C. Gen. Stat. § 150B-1 *et. seq.*

ISSUE

Whether Respondent substantially prejudiced Petitioner's rights, exceeded its authority or jurisdiction, acted erroneously, failed to use proper procedure, acted arbitrarily or capriciously, or failed to act as required by law or rule by issuing Notices of Assessment against Petitioner to hold Petitioner personally and individually liable under N.C. Gen. Stat. §105-242.2 for the sales and use taxes, and withholding taxes owed by Vin, Inc., a now defunct North Carolina corporation?

WITNESSES

Transcript Vol. No.	Witness	Transcript Page References
Vol. 1, July 25, 2011	Louis W. Cherry, III	16-118
Vol. 1, July 25, 2011	Leigh Ann Snead	119-184
Vol. 1, July 25, 2011	Karrah Long	184-220
Vol. 2, July 26, 2011	Karrah Long	225-246
Vol. 2, July 26, 2011	Robert Christian Peel	265-338
Vol. 2, July 26, 2011	Louis W. Cherry, III	340-353

EXHIBITS ADMITTED INTO EVIDENCE

Petitioner's Exhibits	
Exhibit No.	Description
1	Articles of Incorporation of Vin, Inc.
2	Consent of Directors and Shareholders of Vin, Inc. to Action Without a Meeting

3	By-Laws of Vin, Inc.
4	Stock Certificate No. 1 issued to Louis W. Cherry for 50 shares of the common stock of Vin, Inc.
5	Stock Certificate No. 2 issued to Robert Christian Peel for 50 shares of the common stock of Vin, Inc.
6	Form 2553, Election by a Small Business Corporation
7	Sales and Use Tax Returns and Withholding Tax Returns for Vin, Inc. for periods 7/1/08 – 9/30/08, presented to Louis Cherry to sign on 1-2-09
8	ITAS Notes entered by Leigh Ann Snead on 12-30-08
9	Sales and Use Tax and Withholding Tax Notebook from NCDOR Records
10	ITAS Notes entered by Leigh Ann Snead on 12-31-08
11	Sales and Use Tax Returns and Withholding Tax Returns for Vin, Inc. for periods 7/1/08 – 9/30/08, presented to Louis Cherry to sign on 1-2-09
12	"Responsible Person – Audit Remarks" prepared by Karrah Long dated 7/17/09
13	Deposition Transcript of Leigh Ann Snead dated 3-8-11
14	Deposition Transcript of Karrah Long dated 3-8-11

Respondent's Exhibits	
Exhibit No.	Description
1	Notice of Final Determination dated June 8, 2010
2	Notices of Sales & Use Tax Assessments for periods 7/1/08 – 11/30/08 and Period 1/1/09 – 1/31/09
3	Notices of Tax Assessments for Withholding Tax for Period 7/1/08 – 7/31/08 and Periods 9/1/08 – 11/30/08
5	ITAS Notes entered by Karrah Long on 11/20/08

8	Annual Report for Vin, Inc. for period ending 12-31-08
9	Annual Report for Vin, Inc. for period ending 12-31-09
10	Annual Report for Vin, Inc. for period ending 12-31-07
13	Vin, Inc. Directors' Resolution Authorizing the Borrowing of Money dated 6-28-99
14	Louis Cherry personal check no. 7683 dated 2-1-09 payable to the NC Dept. of Revenue in the amount of \$5,697.12 for Sales and Use Taxes and Withholding Taxes for period 12-1-08 through 12-31-08
15	Letter dated January 8, 2009 from Robert Christian Peel and Louis Cherry to Leigh Ann Snead regarding proposed payments to NC Department of Revenue
16	Louis Cherry personal check no. 7676 dated 1/9/09 payable to the NC Dept. of Revenue in the amount of \$5,000.00 for Vin, Inc.
20	Facsimile cover sheet from Lisa Sawyer, CPA to Karrah Long dated 11-20-08 transmitting Forms NC-5 for North Carolina Withholding for April, May, June, July and September and Forms E-500 for Sales and Use for July, August and September
21	Facsimile cover sheet from Lisa Sawyer to Leigh Ann Snead dated 1-29-09 transmitting NC Withholding form for December 2008 and Sales Tax form for November and December 2008
23	Deposition Transcript for Louis Cherry dated 3-22-11
24	Petitioner's Response to Respondent's First Set of Interrogatories

FINDINGS OF FACT

Based upon careful consideration of the sworn testimony of the witnesses presented at the hearing, the exhibits received and admitted into evidence, and the entire record in this proceeding, the undersigned makes the following findings of fact:

Parties

1. Petitioner is an architect and a resident of Wake County, North Carolina.
(Hr'g Tr. 17:19-20)

2. Respondent is a State agency in North Carolina responsible for administering the taxes imposed in Chapter 105 of the North Carolina General Statutes, Subchapter I.

Procedural Background

3. On or about August 5, 2009, Respondent issued Notices of Sales and Use Tax Assessments to Petitioner, personally assessing Petitioner for sales and use taxes owed by the corporation Vin, Inc., ("Vin") for the months of July, August, September, and November of 2008. (Respt.'s Ex. #2)

4. On or about November 4, 2009, Respondent issued Notices of Sales and Use Tax Assessments to Petitioner, personally assessing Petitioner for sales and use taxes owed by Vin for the months of October 2008 and January 2009. (Respt.'s Ex. #2)

5. On or about August 5, 2009, Respondent issued Notices of Withholding Tax Assessments to Petitioner, personally assessing Petitioner for withholding taxes owed by Vin for the months of July, September, October, and November of 2008. (Respt.'s Ex. #3)

6. Petitioner timely protested all of the aforementioned sales and use tax assessments, and withholding tax assessments by requesting a Departmental Review from Respondent pursuant to N.C. Gen. Stat. § 105-241.11. All of the foregoing proposed assessments were consolidated for purposes of Departmental Review, with the following months and balances under such review:

Sales and Use Tax Assessments

<u>Month</u>	<u>Balance Due</u>
July 2008	\$8,761.32
August 2008	\$6,822.31
September 2008	\$5,846.11
October 2008	\$3,856.55
November 2008	\$5,310.52
January 2009	\$3,617.60

Withholding Tax Assessments

<u>Month</u>	<u>Balance Due</u>
July 2008	\$1,936.83
September 2008	\$2,107.49
October 2008	\$1,780.66
November 2008	\$2,122.79

7. On June 8, 2010, Respondent issued a Notice of Final Determination, alleging the correctness of the Department's sales and use tax assessments, and withholding assessments against Petitioner as a "responsible person" under N.C. Gen. Stat. §§ 105-241.9, and 105-242.2.

8. On July 16, 2010, Petitioner filed a petition for a contested case hearing initiating this proceeding pursuant to N.C. Gen. Stat. § 105-241.15 and Article 3 of Chapter 150B.

Vin and Its Taxes

9. On December 8, 1998, Robert Christian Peel and Petitioner formed a North Carolina corporation known as Vin, Inc. (Petr's Ex. # 1) The Articles of Incorporation for Vin were executed by the corporation's attorney, Richard P. Nordan, as Incorporator. (Petr.'s Ex. #1) Vin had two (2) directors, Mr. Peel and Petitioner. (Hr'g Tr. 21:8)

10. When Vin became incorporated, Mr. Peel was already operating his own separate retail wine business known as the "Carolina Wine Company." (Hr'g Tr. 19:15-16; 320:16-17). Mr. Peel and Petitioner formed Vin, Inc. to operate a new restaurant that would combine "casual fine dining with a really good, strong wine program." (Hr'g Tr. 19:7-21; 275:4-5) Contributing funds for "two hundred and fifty thousand dollars," Petitioner and Mr. Peel opened Enoteca Vin restaurant in Raleigh, North Carolina. (Hr'g Tr. 19)

11. At all relevant times, Petitioner was employed full-time as an architect in Raleigh, North Carolina, originally with Hager-Smith Architects, then later with his own firm, Cherry-Huffman Architects. (Hr'g Tr. 18:4-11) In the spring of 2011, Cherry-Huffman merged with another architectural firm known as RATIO Architects. (Hr'g Tr. 18:4-11) Petitioner has never run a restaurant business, and has never managed a restaurant. (Hr'g Tr. 18:17-21)

12. On or about February 23, 1999, Vin held its Organizational Meeting, and elected Mr. Peel as President, and Petitioner as Secretary. (Petr.'s Ex. #2) Mr. Peel and Petitioner served as President and Secretary of Vin, respectively, throughout Vin's existence. Petitioner never held any office at Vin other than secretary. (Hr'g Tr. 31:7-9)

13. At the Vin's Organizational Meeting, the directors also adopted bylaws for Vin, and authorized the issuance of the shares of Vin. Fifty (50) shares of common stock were issued to Mr. Peel, and fifty (50) shares of common stock were issued to Petitioner. (Petr.'s Ex. #2; Hr'g Tr. 23) The bylaws were never amended or modified. (Hr'g Tr. 24:21-22)

14. Article IV, Section 6 of Vin's Bylaws identified the duties of the corporate secretary. Article IV, Section 6 stated those duties as follows:

Section 6. Secretary. The Secretary shall: (a) keep the minutes of the proceedings of the shareholders and of the Board of Directors in one or more books provided for that purpose; (b) see that all notices are duly given in accordance with the provisions of these by-laws or as required by law; (c) be custodian of the corporate records and of the seal of the corporation and see that the seal of the corporation is affixed to all documents the execution of which on behalf of the corporation under its seal is duly authorized; (d) keep a register of the post office address of each shareholder which shall be furnished to the Secretary by such shareholder; (e) sign with the President, certificates for shares of the corporation, the issuance of which shall have been authorized by resolution of the Board of Directors; (f) have general charge of the stock transfer books of the corporation; and (g) in general perform all duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the President or by the Board of Directors.

(Petr.'s Ex. # 3)

15. Nowhere in Vin's bylaws was the secretary assigned any duties over the financial affairs of the corporation, or assigned any duties with respect to collecting, deducting, accounting for, or paying sales and use taxes or withholding taxes. (Petr.'s Ex. #3)

16. Specifically, Article IV, Section 6(g) of Vin's bylaws provided that the secretary shall:

[I]n general perform all duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the President or the Board of Directors.

(Petr.'s Ex. #3)

17. Petitioner was never assigned any corporate duty to deduct, account for, or pay sales or use taxes or withholding taxes for Vin by Mr. Peel, Vin's President, or by

the Board of Directors of Vin. (Hr'g Tr. 33:13; 35:9; 295:12-21). Neither Mr. Peel nor Vin's directors ever assigned Petitioner any duties in addition to those described in Vin's Bylaws. (Hr'g Tr. 295:12-21).

18. The only duties Petitioner had as Vin's secretary were the ministerial duties described in Article IV, Section 6, of Vin's bylaws. (Petr.'s Ex. #3) Those duties included keeping minutes of shareholder and board meetings, seeing that notices were given as required by the bylaws and the law, acting as custodian of the corporate records and corporate seal, making sure the corporate seal is affixed to corporate documentation, keeping a register of shareholders and their addresses, signing share certificates, and having general charge of the stock transfer books. (Petr.'s Ex. #3, Article IV, Section 6)

19. Petitioner was an investor in Vin, but was not involved in the day-to-day operation or management of Vin's restaurant. (Hr'g Tr. 18:17-25; 19:1-3; 37:13-25; 38:1)

20. Vin opened a bank account at Fidelity Bank, with bank account number ending in 12901, to operate the Enoteca Vin restaurant (Hr'g Tr. 80:15-25; 81:1-11). The bank statements for this account were sent to the address of the restaurant. Both Mr. Peel, the President of Vin, and Petitioner had signature authority on this operating account. Others, including Mr. Peel's wife, Laura Peel, also had signature authority on this operating account. There is no evidence that Petitioner exercised his check-signing authority on this account. (Hr'g Tr. 304-09)

21. Mr. Peel signed Vin's application submitted to Respondent for a sales and use tax number. (Petr.'s Ex. #9; Tab 1; Hr'g Tr. 309:7-25)

22. Mr. Peel's wife, Laura Peel, served as the bookkeeper for Vin, signed Vin's sales and use tax returns and withholding tax returns in the capacity of manager, owner, and President of Vin, and signed the checks submitted with those tax returns. (Petr.'s Ex. #9, Tabs 3-25 and Tabs 53-58; Hr'g Tr. 312-16)

23. In 2008, Petitioner received a call from Vin's manager indicating there was a "cash flow" issue at Vin regarding a "shortfall in payroll." (Hr'g. Tr. 83) To address this issue, Petitioner placed his own personal funds into Vin's corporate checking account. *Id.* Near "the end of 2008," and into 2009, Vin's restaurant began experiencing more serious cash flow issues as the restaurant "was losing money." (Hr'g. Tr. 288-89)

24. In 2008, Vin did not pay sales and use taxes or withholding taxes for the months identified in Finding of Fact No. 6.

25. On or about November of 2008, Karrah Long, a revenue officer with Respondent, investigated Vin's nonpayment of those sales and use taxes, and withholding taxes for the aforementioned months. On November 20, 2008, Ms. Long talked with Ms. Lisa Sawyer, an employee of Vin's accountant, R. Scott Grady, CPA, PLLC. (Hr'g Tr. 107, 231) According to Ms. Long's notes of that conversation, Ms. Sawyer advised Long that she had talked with Petitioner, a partner, and he:

[T]old her that they were going to be getting a loan for the – from the bank and hoped to have all delinquent returns, et cetera, paid within the next few weeks.

(Pet'r. Ex 12; Hr'g Tr. 233-34)

26. After their conversation, Long received a fax from Ms. Sawyer with a number of Vin's delinquent North Carolina sales and use tax returns, and withholding

taxes. (Resp Ex 20; Hr'g. Tr. 235) On December 23, 2009, Ms. Long "left a message at [Vin] for [Petitioner]." (Hr'g. Tr. 243-44)

27. On or about December 30, 2008, Leigh Ann Snead, a revenue officer in Respondent's Collection Division and Long's supervisor, pursued collection of Vin's unpaid taxes. (Hr'g Tr. 124:5-11) On or about December 30, 2008, Ms. Snead telephoned Petitioner, and left a message for Petitioner to call her. (Petr.'s Ex. #8, p. 2; Hr'g Tr. 38:11-25)

28. On December 30, 2008, Ms. Snead called Petitioner because of her investigation to identify Vin's corporate officers. Ms. Snead identified Vin's corporate officers for possible application of "responsible person" liability under N.C. Gen. Stat. § 105-242.2. (Hr'g Tr. 121-23) Ms. Snead searched the records at the office of the North Carolina Secretary of State, and found that Petitioner was listed as Vin's secretary on documents filed with that office. (Hr'g Tr. 125)

29. On or about December 31, 2008, Petitioner spoke with Ms. Snead for the first time. Ms. Snead told Petitioner that Vin had delinquent sales and use and withholding taxes, and that he needed to meet with Ms. Snead to discuss them. (Hr'g Tr. 41:25; 142:3) Petitioner agreed to meet with Ms. Snead at her office on January 2, 2009. (Hr'g Tr. 145:7-9)

30. Until his December 31, 2008 conversation with Ms. Snead, Petitioner was not aware of Vin's tax "delinquency problem" of the unpaid sales and use and withholding taxes. (Hr'g Tr. 39:21-25; 40:1-12) When Ms. Snead called, Petitioner had never prepared a sales and use tax return, or a withholding tax return for Vin, had never signed a sales and use tax return, or a withholding tax return for Vin, had never signed

a check in payment of Vin's sales and use taxes, or withholding taxes, and did not know how to prepare a sales and use tax return, or a withholding tax return for Vin. (Petr.'s Ex. #9, Tabs 2-45 and Tabs 53-85; Hr'g Tr. 36:8-19; 137-38)

31. All of Vin's sales and use tax returns, and withholding tax returns filed with Respondent had been prepared by a bookkeeper of Vin, or by Mr. Peel's wife, had been signed by the individual who prepared them, and had been paid by a Vin check signed by the person who prepared the return. (Petr.'s Ex. #9, Tabs 2-45 and Tabs 53-85; Hr'g Tr. 36:8-19; 137-38)

32. Upon learning that Petitioner was the secretary of Vin, Ms. Snead proceeded to look up Petitioner's personal income tax records on file with Respondent, (Hr'g Tr. 126-27; 141:4-24), Petitioner's "wage history file" reflecting the income of Petitioner's architectural business, Cherry-Huffman Architects, as well as Wake County real estate data on Petitioner's personal residence and its value. (Hr'g Tr. 142:12-25)

33. On January 2, 2009, Petitioner met with Ms. Snead at her office. At that meeting, Ms. Snead and Petitioner discussed Vin's sales and use tax and withholding tax delinquencies. (Hr'g Tr. 44-45) During the meeting, Ms. Snead did not ask Petitioner any questions to determine if he had any duty to deduct, account for, or pay sales and use taxes or withholding taxes of Vin. (Hr'g Tr. 45-47)

34. During the January 2, 2009 meeting, Ms. Snead told Petitioner that he was personally responsible and liable for Vin's delinquent sales and use taxes, and withholding taxes, because he was an officer of Vin. (Hr'g Tr. 45:10-14; 47:5-9; 148:20-25) She then presented Petitioner with a number of sales and use tax returns and withholding tax returns for Vin's unpaid taxes for Petitioner to sign. (Petr.'s Ex. # 7; Hr'g

Tr. 48:2-10) These returns were generated by, or completed by Ms. Snead, based on the tax returns that Vin's accountant, Ms. Sawyer, had previously signed and sent to Respondent. (Hr'g Tr. 154: 7-14; Petr.'s Ex. # 9, Tabs 46-49 and 86-88) Petitioner had no knowledge of any of the returns and information Lisa Sawyer had given Ms. Snead. (Hr'g Tr. 44:22-25; 45:1-9)

35. Ms. Snead did not present any options to Petitioner with respect to his signing, or not signing, the returns she presented to him at the January 2, 2009 meeting. (Hr'g Tr. 51:12-26)

36. Petitioner thought the January 2, 2009 meeting with Ms. Snead at her office was "pretty scary." Petitioner "felt very intimidated by the circumstances and was told by an officer of the state that [he] had these responsibilities [for Vin's taxes]." (Hr'g Tr. 48:25; 49:1-6)

37. Petitioner wanted to be "cooperative and diligent" in the intimidating circumstances of his January 2, 2009 meeting with Ms. Snead, so he signed each of the returns she presented. (Petr.'s Ex. #7; Hr'g Tr. 49:2-6). Petitioner felt compelled to sign the returns Ms. Snead requested Petitioner sign, and did not feel that he had any other option. (Hr'g Tr. 51:9-16; 55:2-9; 101:1-2; 102:10-25; 103:1-7)

38. At the January 2, 2009 meeting between Petitioner and Ms. Snead, no payments were made in conjunction with the returns for which Ms. Snead procured Petitioner's signature. Ms. Snead told Petitioner that he "had to come up with a payment plan." (Hr'g Tr. 116:16-20)

39. By letter dated January 8, 2009, Vin responded to Ms. Snead's instructions, and proposed a payment plan for Vin's unpaid sales and use taxes, and

withholding taxes. Mr. Peel, as President of Vin, and Petitioner as Secretary of Vin signed this letter. (Respt.'s Ex. 15) Petitioner signed the proposed payment plan, because Ms. Snead had told him that he was "personally responsible" for Vin's unpaid taxes. (Hr'g Tr. 103:16-19)

40. In accordance with the payment plan, Petitioner wrote two personal checks to the Department of Revenue to be applied to Vin's unpaid sales and use taxes, and unpaid withholding taxes. Petitioner wrote one personal check on January 9, 2009, and one personal check on February 1, 2009. (Respt.'s Ex # 14 and 17) Petitioner wrote these personal checks based on his belief, created by Ms. Snead, that it was his "personal responsibility" to pay these taxes. (Hr'g Tr. 105:12-16).

41. Petitioner told Mr. Peel that they had to close the restaurant, and sell its assets. Mr. Peel agreed. (Hr'g Tr. 97:15-17) Petitioner also learned that Mr. Peel was using the funds of Vin for Mr. Peel's separate business, Carolina Wine Company.

42. Petitioner opened a bank account at Fidelity Bank, with an account number ending in 7134, to deposit the funds from the sale of the restaurant's assets, and to keep Mr. Peel from having access to those funds. All of the funds from the sale of the restaurant's assets were deposited into that account, and were paid to Respondent by a check drawn on that account dated June 1, 2009. (Hr'g Tr. 95:2-9; 113-116; Petr's. Ex. # 12)

43. On January 22, 2009, the restaurant operated by Vin closed. Vin was administratively dissolved on July 21, 2011.

44. After the January 2, 2009 meeting, at which Ms. Snead informed Petitioner that he was "personally responsible" for Vin's unpaid sales and use taxes and

withholding taxes, and before the issuance of the Notices of Assessment to Petitioner, Respondent's Revenue Officer Karrah Long conducted a factual investigation to determine whether Petitioner was personally responsible for Vin's sales and use taxes, and withholding taxes. (Hr'g Tr. 186:6-21; 188:-89)

45. The details of Ms. Long's factual investigation are contained in the "Responsible Person-Audit Remarks" document which Long completed (Hr'g Tr. 189:15-19; Petr.'s Ex. #12). The significance of the Long's "Responsible Person-Audit Remarks" was to provide "a set of guidelines that [Respondent] uses to prove that a person was a corporate officer, and that we can transfer liability." The conclusions Ms. Long reached in the audit remarks formed the basis for Respondent's decision to hold Petitioner liable under N.C. Gen. Stat. § 105-242.2. (Hr'g Tr. 188:7-11; 191:19-23)

46. The documents attached to the "Responsible Person-Audit Remarks," as pages 002 through 009, were the documents Ms. Long used in forming the conclusions listed in the "Responsible Person-Audit Remarks." (Hr'g Tr. 189:15-19; 190-91) Page 6 of the "Responsible Person-Audit Remarks," entitled "Document Log," lists the information Ms. Long used in reaching her conclusions. (Hr'g Tr. 189:1-2) The "Document Log" cites the following three items that Ms. Long used to make her conclusions:

- a. One "business check" dated June 1, 2009, signed by Petitioner, and made payable to Respondent. Petitioner wrote this check on the account he opened specifically to protect the proceeds of the sale of Vin's assets from Mr. Peel, so the proceeds could be paid to Respondent. (See Finding of Fact No. 42)

Petitioner submitted this check to Respondent to pay for Vin's withholding taxes over five (5) months after the business had closed. (Petr.'s Ex. #12)

b. A "withholding [tax] return" of Vin that Ms. Snead presented to Petitioner at the January 2, 2009 meeting. At this meeting, Petitioner felt intimidated by Respondent, and felt compelled to sign the return. (Hr'g Tr. 157-58; Petr.'s Ex. # 11, p. 7; Petr.'s Ex. # 12)

c. An "annual report" of Vin filed with the North Carolina Secretary of State, which Petitioner signed as "secretary" on or about June 11, 2009. This document is not a sales and use tax return, or a withholding tax return. Petitioner signed this document almost six months after Vin's restaurant closed. (Petr.'s Ex. # 12)

47. In the "Responsible Person-Audit Report," Ms. Long concluded that:

It has been determined that [Petitioner] was secretary of Vin, Inc. during the period the North Carolina sales and use and withholding taxes were collected but not remitted to the Department. Based upon the records of the Department, the periods under review have not been paid. Therefore, under authority of N.C. Gen. Stat. §105-242.2 the North Carolina Department of Revenue is assessing the unpaid taxes for Vin, Inc. both personally and individually to [Petitioner].

(Petr.'s Ex. #12)

48. Ms. Long's aforementioned conclusion was based on Ms. Long's assumption that Respondent could assess Vin's unpaid taxes against Petitioner, on an

individual and personal basis, since Petitioner was the secretary of Vin, Inc, and thus, a corporate "officer" liable for unpaid corporate taxes, pursuant to N.C. Gen. Stat. § 105-242.2(a)2c.

49. A tab labeled "Documented tp conversations" is located on Page 2 of the "Responsible Person-Audit Remarks." (Petr.'s Ex. # 12; Hr'g Tr. 238-39) However, there is no entry or documentation under this tab. In fact, there is:

[N]othing in the record that any conversation was held to determine whether or not Petitioner had a duty to collect, account for, or pay sales and use taxes or withholding taxes for Vin, Inc.

(Hr'g Tr. 239:14-22) In other words, no one with Respondent talked with Petitioner about this disputed tax matter before January 2, 2009. (Tr. pp 239-240) In addition, the word "duty" does not appear anywhere in the "Responsible Person-Audit Remarks." (Petr.'s Ex. #12)

50. When Ms. Long prepared the "Responsible Person-Audit Remarks," she had not read N.C. Gen. Stat. § 105-242.2 (Hr'g Tr. 197:1-13), and was not familiar with the language in the statute that allows a transfer of liability to the secretary of a corporation only if the secretary has the duty to deduct, account for, or pay the applicable taxes. (Hr'g Tr. 198-99)

51. When Ms. Long prepared the "Responsible Person-Audit Remarks," she had no evidence indicating that Petitioner had any corporate duty to deduct, account for, or pay either sales or use taxes or withholding taxes for Vin during the tax periods in question. (Hr'g Tr. 203-05)

52. At the contested case hearing, Ms. Long was surprised to learn that the corporate secretary is not included in the list of officers in N.C. Gen. Stat. §105-242.2(a)(2)a that are liable for taxes owed by the corporation of which they are officers without regard to their specific duties. (Hr'g Tr. 220:5-12). That list names only the president, the treasurer, and the chief financial officer of a corporation.

53. Mr. Peel was the President and a director of Vin during the entire ten-year period that Vin was in business. (Hr'g Tr. 20:-21; 295:3-8)

54. At hearing, Mr. Peel initially denied involvement in the financial affairs of Vin. He suggested that the financial affairs were the province of Petitioner. (Hr'g Tr. 275-78) Mr. Peel claimed that Petitioner exercised financial oversight of Vin, that all Vin's bank statements came to Petitioner, and that Petitioner endeavored to see that Vin's bills were paid, and that Vin's taxes were being handled. (Hr'g Tr. 278:10-15)

55. On cross-examination, Mr. Peel changed his testimony, stating that he meant Petitioner was keeping up with the bills, because Petitioner received the bank statements, and the bank statements would reflect what bills were being paid. (Hr'g Tr. 301-02)

56. Mr. Peel also claimed that during the ten-year period that Vin was in existence, he could not remember ever seeing a bank statement for Vin. (Hr'g Tr. 303-04) However, Mr. Peel's testimony was inconsistent with Vin's actual records and other evidence produced at hearing. The preponderance of the evidence showed that:

- a. Vin's bank statements were never sent to Petitioner at his house; instead, they were mailed to the address of the restaurant. (Hr'g Tr. 304-309)

b. Petitioner did not sign any of the checks referenced by Mr. Peel. (Hr'g Tr. 306-07)

c. Mr. Peel actually signed Vin's application for a sales and use tax number with Respondent. (Petr.'s Ex. #9, Tab 1; Hr'g Tr. 309:7-25)

d. Mr. Peel's own wife, Laura Peel, signed Vin's tax returns, and paid the sales and use taxes, and withholding taxes of Vin. (Hr'g Tr. 312-16; Petr.'s Ex. 9, Tabs 3-25 and Tabs 53-58) Laura Peel also served as bookkeeper for Vin, and signed relevant tax returns in the capacity of manager, owner, and President of Vin. (Hr'g Tr. 312-16)

e. In early 2009, Carolina Wine Company went out of business shortly before Vin's restaurant closed. At hearing, Peel admitted that while he operated Carolina Wine Company, he accepted full payment from customers for wine, but he never delivered the ordered wine to those customers, including at the time he closed Carolina Wine Company.

57. Discrepancies in Mr. Peel's testimony including, but not limited to, those in previous Findings Of Fact, render his testimony unreliable. On cross-examination, Mr. Peel also admitted that he took funds from Vin, and used the credit of Vin to buy wine for his own separate company, Carolina Wine Company. This admission further taints Mr. Peel's testimony, and corroborates Petitioner's testimony that he learned in January 2009 that Mr. Peel was taking funds from Vin. (Hr'g Tr. 326:5-20; 113-14)

58. On rebuttal, Petitioner contradicted Mr. Peel's testimony. Petitioner reiterated how he was not responsible for financial oversight of Vin (Hr'g Tr. 341:7-16), that bank statements were not sent to him (Hr'g Tr. 314:17-23), that he did not oversee

the bill paying function at Vin (Hr'g Tr. 343-44), and that Petitioner did not meet separately with the bookkeeper or managers of Vin (Hr'g Tr. 341-42). Petitioner explained how the meetings with bookkeepers and managers were sporadic, and did not focus on the details of Vin's particular obligations, including sales and use or withholding tax obligations that had become delinquent. (Hr'g Tr. 342-43)

59. A preponderance of the evidence demonstrated that Petitioner was never an intermediary between Vin's accountants and Respondent. (Hr'g Tr. 344-45)

CONCLUSIONS OF LAW

1. The parties are properly before the Office of Administrative Hearings, and jurisdiction and venue are proper. To the extent, the Findings of Fact contain Conclusions of Law, or that the Conclusions of Law are Findings of Fact, they should be so considered without regard to the given labels. Any such Findings of Fact are hereby incorporated into this section as a Conclusion of Law.

2. Under Article 5 of the North Carolina Revenue Act ("Act"), N.C. Gen. Stat. §105-164.1 *et. seq.*, retailers have a statutory duty to collect "the tax due on an item when the item is sold at retail." N.C. Gen. Stat. §105-164.7.

3. Article 4A of the Act, N.C. Gen. Stat. §105-163.1 *et. seq.* imposes a similar duty on employers with regards to North Carolina withholding taxes. N.C. Gen. Stat. §105-163.2 requires employers to "withhold" the "State income taxes payable by the employee on the wages" from the wages of its employees.

4. Based on these two statutes, retailers and employers are therefore third parties designated by statute to collect, hold and remit the money to the State. In doing so, they act as trustees on behalf of the State and hold the taxes collected in trust for

the State. (See N.C. Gen. Stat. § 105-163.2, "The amount of State income taxes withheld by an employer is held in trust for the State"); N.C. Gen. Stat. § 105-164.7 ("A retailer is considered to act as a trustee on behalf of the State when it collects tax from the purchaser of a taxable item.")

5. To prevent these trustees from diverting the taxes it collects in trust for the State for their own private use, many states, including North Carolina, have extended the statutory duty to collect and hold such taxes in trust for the State to certain responsible individuals within the business structure of the third party.

6. In North Carolina, "responsible person" liability is specifically addressed in N.C. Gen. Stat. § 105-242.2. This contested case involves the application and interpretation of N.C. Gen. Stat. § 105-242.2 to Petitioner, a secretary of a now-defunct corporation.

7. N.C. Gen. Stat. §105-242.2 reads, in pertinent part, as follows:

§ 105-242.2. Personal liability when certain taxes not paid:

(a) Definitions. – The following definitions apply in this section:

(1) Business entity. – A corporation, a limited liability company, or a partnership.

(2) Responsible person. – Any of the following:

- a. The president, treasurer, or chief financial officer of a corporation.
- b. A manager of a limited liability company or a partnership.
- c. An officer of a corporation, a member of a limited liability company, or a partner in a partnership who has a duty to deduct, account for, or pay taxes listed in subsection (b) of this section.
- d. A partner who is liable for the debts and obligations of a partnership under G.S. 59-45 or G.S. 59-403.

(b) Responsible Person. – Each responsible person in a business entity is personally and individually liable for all of the taxes listed in this subsection. If a business entity does not pay a tax it owes after

the tax becomes collectible under G.S. 105-241.22, the Secretary may enforce the responsible person's liability for the tax by sending the responsible person a notice of proposed assessment in accordance with G.S. 105-241.9. The taxes for which a responsible person may be held personally and individually liable are:

- (1) All sales and use taxes collected by the business entity upon its taxable transactions.
- (2) All sales and use taxes due upon taxable transactions of the business entity but upon which it failed to collect the tax, but only if the person knew, or in the exercise of reasonable case should have known, that the tax was not being collected.
- (3) All taxes due from the business entity pursuant to the provisions of Articles 36C and 36D of Subchapter V of this Chapter and all taxes payable under those Articles by it to a supplier for remittance to this State or another state.
- (4) All income taxes required to be withheld from the wages of employees of the business entity.

(Emphasis added)

8. In *Colonial Pipeline v. Clayton*, 275 N.C. 215, 226-27, 166 S.E. 2d 671, 679 (1969), the N.C. Supreme Court espoused the fundamental principle that:

In the interpretation of statutes levying taxes, it is the established rule not to extend their provisions by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt, they are construed most strongly against the government, and in favor of the citizen.

9. Since N.C. Gen. Stat. § 105-242.2 is a taxing statute, there is no room to extend the provisions of N.C. Gen. Stat. § 105-242.2 "by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out." *Id.* at 226-229. As such, the provisions of N.C. Gen. Stat. § 105-242.2 cannot be applied through innuendo, implication, or through the utilization of unsubstantiated assumptions.

10. N.C. Gen. Stat. § 105-242.2(a)(2)a provides that the corporate officer of president, treasurer, or chief financial officer is liable as a "responsible person" for corporate taxes without regard to their duties. This list does not hold the "secretary" of a corporation as a "responsible person" without regard to his/her duties. As a result, the clear ordinary meaning of N.C. Gen. Stat. § 105-242.2(a)(2)a does not apply to Petitioner since he was neither the president, treasurer, or chief financial officer of Vin at all times relevant to this case.

11. The secretary of a corporation can be a "responsible person" who is personally and individually liable under N.C. Gen. Stat. § 105-242.2, only if the secretary meets the definition of a "responsible person" under subpart (a)(2)c of that statute. N.C. Gen. Stat. § 105-242.2(a)(2)c holds a corporate officer liable for the specified taxes if the officer "has a duty to deduct, account for, or pay" sales and use taxes, motor fuel taxes, and withholding taxes.

12. Respondent bears the burden of establishing that Petitioner met the statutory definition of "responsible person" under N.C. Gen. Stat. § 105-242.2(a)(2)c, and that Petitioner had a "duty to deduct, account for, or pay" Vin's sales and use taxes and withholding taxes.

13. Because North Carolina appellate courts have yet to engage in the judicial construction of N.C. Gen. Stat. § 105-242.2(a)(2)c, based on facts similar to those herein, it is appropriate to look "to other jurisdictions to review persuasive authority," "that coincides with North Carolina's law." *Skinner v. Preferred Credit*, 172 N.C. App. 407, 413, 616 S.E. 2d 676, 680 (2005)

14. In determining whether a person has sufficient control to conclude the individual has the "duty to deduct, account for or pay" the trust taxes of a corporation, Courts interpreting statutes comparable to N.C. Gen. Stat. § 105-242.2, have considered the following factors: (1) the person's position with the power structure of the corporation, (2) the authority of the officer established by the corporation's governing documents (e.g., by-laws and articles of incorporation) and (3) whether the person actually exercised control over the finances of the business. *Safayan*, 654 N.E.2d at 273; see also *Kinnie*, 994 F.2d at 283. The factor of "exercise of control" over the finances of the business would include "whether the person controlled the corporate bank account, signed corporate checks and tax returns, or determined when and in what order to pay creditors." *Safayan*, 654 N.E.2d at 273.

15. Responsible person liability "requires the existence of only significant, as opposed to absolute control of the corporation's finances." *Kinnie*, 994 F.2d at 283.

16. Significantly, the factors considered by the other courts - status, duty and authority - coincide with the manner in which "responsibility" is set out in the N.C. Administrative Code for purposes of determining responsible person liability under N.C. Gen. Stat. § 105-242.2. 17 N.C.A.C. § 6C.0204 provides that proving "responsibility" is a "matter of status, duty, and authority, not knowledge".

17. As to factor of Petitioner's position within the power structure of Vin, a preponderance of the evidence showed that Petitioner was a director and secretary who exercised no power over the day-to-day operation of Vin. There was no evidence proving that Petitioner came to Vin's restaurant daily, hired or fired employees, ordered materials and supplies, prepared invoices, paid suppliers' bills or other business

expenses, or participated in the day-to-day operations of Vin's restaurant. Petitioner invested his money, provided the architectural drawings for the restaurant, but did not operate Vin's restaurant. Petitioner's meetings with bookkeepers and managers were sporadic, and did not focus on the details of Vin's particular obligations.

18. As to Petitioner's authority as secretary, a preponderance of the evidence established the bylaws and articles of incorporation did not require Petitioner to perform any duties regarding Vin's financial matters, including duties relating to sales and use taxes, or withholding taxes. (Hr'g. Tr. 31:7-9) Vin's President, Mr. Peel, and Vin's Board of Directors, never assigned any additional duties to Petitioner, including duties for sales and use taxes, or withholding taxes. (Hr'g. Tr. 33: 13; 35:9)

19. Respondent's records corroborated Petitioner's testimony by demonstrating that Petitioner had no involvement in the signing, or paying of either sales and use taxes, or withholding taxes for Vin before Ms. Snead's January 2, 2009 meeting with Petitioner.

20. As to Petitioner's actual exercise of control over Vin's finances, a preponderance of the evidence established that Petitioner was not involved in the day-to-day operations of Vin, and did not prepare, or participate in preparing, any sales and use tax or any withholding tax returns for Vin. The evidence showed that Petitioner would not know how to prepare such returns. (Hr'g. Tr. 36: 8-19) There was no evidence proving that Petitioner exercised any check-signing authority during the operation of Vin's restaurant. The only time Petitioner signed any checks to pay for Vin's finances was when Petitioner wrote his own personal checks to Respondent for unpaid sales and use taxes, and unpaid withholding taxes, in an effort to resolve Vin's unpaid

tax matter with Respondent. Petitioner did so only after Respondent told Petitioner he was responsible for Vin's unpaid taxes.

21. In this case, Respondent argued that Petitioner's execution of boilerplate bank documents, in connection with obtaining a loan for Vin, and execution of Annual Reports filed at the NC Secretary of State's office (Hr'g. Tr. 64-75), made Petitioner a "responsible person." However, signing the corporation's annual report or loans documents does not automatically bestow any duty on Petitioner, as the corporate secretary, to be responsible for any of Vin's corporate taxes. Other than those two occasions, there was no other evidence at hearing proving that Petitioner was involved with any regularity or specificity in Vin's financial matters, especially Vin's sales and use or withholding taxes. Given the depth of involvement required for day-to-day management, Petitioner's occasional involvement in Vin's business and financial affairs was insufficient to create personal liability of Petitioner for Vin's sales and use taxes, and withholding taxes under N.C. Gen. Stat. § 105-242.2(a)(2) c.

22. Respondent attempted to connect Petitioner with personal responsibility for Vin's sales and use taxes, and withholding taxes through the testimony of Vin's President, Robert Christian Peel. However, Mr. Peel's testimony was so replete with inconsistencies that none of his testimony was believable or credible.

a. First, Mr. Peel denied ever seeing a bank statement for the Vin, even though he was the President and director of the company for its ten-year existence. (Hr'g. Tr. 303-304)

b. Second, Mr. Peel claimed that he had no involvement in Vin's financial affairs, and that Petitioner was responsible for Vin's finances. Specifically, he

contended that all bank statements for Vin were sent to Petitioner's house (Hr'g. Tr. 304-309), and that Petitioner was in charge of paying the bills (Hr'g. Tr. 301-02). Yet, after reviewing 75 tax returns of Vin, Inc, many of which were signed by Peel's wife, Peel retracted his assertion that Petitioner was responsible for Vin's taxes and for paying such taxes. (Petr's. Ex. 9, Tabs 2-45 and 53-85; Hrg. Tr. 306-307) Ultimately, Peel admitted that he was a responsible person for Vin's taxes as President of that corporation. (Hrg. Tr. 330-01)

c. Most importantly, Mr. Peel admitted that he misused monies or credit of Vin to buy wine for customers of Peel's other business, Carolina Wine Company. Peel acknowledged that as the president and sole stockholder of Carolina Wine Company, he frequently made loans and provided wine to Vin. At the same time, Peel acknowledged that due to his lack of bookkeeping, he actually did not know how much money he loaned to Vin, until he was forced to "figure it out" as part of his bankruptcy petition for Carolina Wine Company.

d. Mr. Peel conceded that he accepted full payment from Carolina Wine customers for wine they ordered, and never delivered that wine to those customers. (Hrg. Tr. 320-32)

23. The preponderance of the evidence established that Respondent misapplied N.C. Gen. Stat. § 105-242.2 when it twice failed to inquire about Petitioner's duties as the secretary of Vin.

a. First, Respondent's employee, Ms. Snead, informed Petitioner that he was responsible for Vin's unpaid taxes, without first inquiring whether Petitioner's duties, as secretary of Vin, included a duty to deduct, account for, or pay Vin's

sales and use taxes, or withholding taxes under N.C. Gen. Stat. § 105-242.2(1)(2)c.

b. Second, when Ms. Long completed the "Responsible Person-Audit Remarks," and issued the Notices of Assessment against Petitioner for Vin's unpaid taxes, she failed to make the required statutory inquiry under N.C. Gen. Stat. § 105-242.2(a)(2)c to determine whether Petitioner's duties as secretary of Vin, included a duty to deduct, account for, or pay Vin's sales and use taxes or withholding taxes. Instead, Ms. Long assumed that Petitioner's status of corporate secretary automatically made him a "responsible person."

24. After Ms. Snead told Petitioner that he was responsible for Vin's unpaid taxes, Petitioner signed a proposed payment plan, and used personal checks to pay Respondent for Vin's unpaid taxes. Nevertheless, Petitioner's actions do not establish that Petitioner is a "responsible person" under N.C. Gen. Stat. § 105-242.2(a) (2) c for Vin's unpaid taxes. Instead, Petitioner's actions demonstrate that Petitioner believed Ms. Snead's representation that he was responsible for the sales and use, and withholding taxes of Vin, Inc., and show how Petitioner acted in accordance with this belief, by doing what Ms. Snead advised Petitioner to do; to wit, signing a proposed payment plan, and paying Vin's unpaid taxes with his personal checks.

25. A preponderance of the evidence proved that Petitioner did not have significant involvement in Vin's financial obligations to prove Petitioner had a duty to "deduct, account for, or pay" Vin's sales and use taxes, or withholding taxes. As such, Petitioner is not a "responsible person" under N.C. Gen. Stat. § 105-242.2 with respect to these taxes.

26. For the foregoing reasons, Respondent's assessments against Petitioner for Vin's taxes are invalid, and Respondent cannot hold Petitioner liable for Vin's sales and use taxes or withholding taxes under N.C. Gen. Stat. § 105-242.2.

27. Respondent was not substantially justified in assessing Petitioner for Vin's unpaid sales and use taxes and withholding taxes

28. Respondent exceeded its authority and jurisdiction, acted erroneously, acted arbitrarily and capriciously, and failed to act as required by law or rule in assessing Petitioner for the unpaid taxes of Vin.

DECISION

Based on the foregoing Findings of Fact and Conclusions of Law, the undersigned hereby determines that Respondent should **REVERSE and VACATE** its assessments against Petitioner for Vin's unpaid sales and use taxes, and withholding taxes.

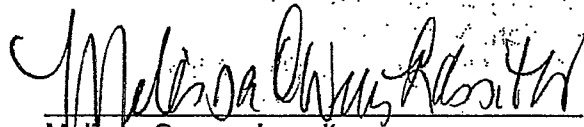
NOTICE AND ORDER

The North Carolina Department of Revenue will make the Final Decision in this case. That agency is required to give each party an opportunity to file exceptions to this Decision of the Administrative Law Judge and to present written arguments to those in the agency who will make the Final Decision. N.C. Gen. Stat. § 150B-36(a)

It is hereby ordered that Respondent serve a copy of the Final Decision on the Office of Administrative Hearings, 6714 Mail Service Center, Raleigh, North Carolina, 27699-6714, in accordance with N.C. Gen. Stat. § 150B-36(a).

That agency is required by N.C. Gen. Stat. § 150B-36(b) to serve a copy of the Final Decision on all parties and to furnish a copy to the parties' attorneys of record and to the Office of Administrative Hearings.

This the 15th day of February, 2012


Melissa Owens Lassiter
Administrative Law Judge


CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing **DECISION** was served upon the following persons by depositing it in the U.S. Mail, prepaid postage and addressed as follows:

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This the 16th day of February, 2012.


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