

OHIO BOARD OF TAX APPEALS

Stephen J. Pally,)
)
 Appellant,)
)
 vs.) (OFFICER LIABILITY)
)
) DECISION AND ORDER
 Thomas M. Zaino,)
 Tax Commissioner of Ohio,)
)
)
 Appellee.)

APPEARANCES:

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Entered December 14, 2001

Mr. Johnson, Ms. Jackson, and Ms. Margulies concur.

This cause and matter comes to be considered by the Board of Tax Appeals upon a Notice of Appeal filed herein on July 12, 2000. This appeal is taken from a final order of the Tax Commissioner, appellee, which found

appellant, Mr. Stephen J. Pallay, to be liable for the sales tax liability of Creative Screen Print, Inc. for the periods of July 1994 through December 1995.

The matter is considered by the Board of Tax Appeals upon the Notice of Appeal, the Statutory Transcript certified to this Board by the Tax Commissioner, the record of the evidentiary hearing and the legal argument provided by counsel.

Creative Screen Print, Inc. (“Creative”) was an Ohio corporation in the business of manufacturing and distributing point-of-sale advertising banners and assorted promotional materials. Stephen Pallay has a background in marketing and production and was interested in obtaining an ownership interest in an ongoing business. Creative’s accountant approached Mr. Pallay concerning employment with that organization. Mr. Pallay was also offered the ability to purchase stock in the future. At the time, the business was wholly owned by John Bodis and was in some disarray. Mr. Pallay agreed to come on board and accepted the position of chief operating officer (“COO”). The duties of the COO were not outlined in the employment agreement executed by Mr. Pallay and Creative. However, the close corporation agreement executed by Mr. Pallay at the time he purchased a 3.8 per cent interest in the corporation described the duties of the COO position as follows:

“The Chief Operating Officer shall report to the President-Chief Executive Officer. The Chief Operating Officer shall have authority and responsibility with respect to the day-to-day management and business affairs of the corporation. The Chief Operating Officer shall have the

right and power to bind the Corporation, subject to the conditions and limitations as provided in this Agreement.” (S.T., p. 22, Appellant’s Exh. C)

At hearing, Mr. Pally explained that he was responsible for manufacture and sales of product. Mr. Pally worked with the sales force, which included internal salespersons and manufacturer representatives, and the design and print staff to create, market and deliver the temporary advertising materials produced by Creative. It was Mr. Pally’s testimony, however, that Creative’s finances were handled by John Bodis, the corporation’s chief executive officer and chairman of the board of directors and a “team” of financial professionals. At hearing, Mr. Pally was able to identify at least two outside accountants and a number of in-house accountants included on that team.

While the company was not financially profitable when Mr. Pally came on board, Creative was able to show a profit for two of the four years during which Mr. Pally served as COO. In 1995 and in accordance with the employment agreement executed by Mr. Pally and the corporation, Mr. Pally exercised his option to purchase 3.8 per cent of the corporation’s outstanding stock¹ from Bodis. According to the employment agreement, the purchase price for the shares was \$140,000. At that time, Mr. Pally also executed the close corporation agreement identified above, which confirmed his title of COO,

¹ Mr. Pally was also given the option to purchase a 3.8 per cent interest in Graphic Applications, Inc. and Creative Ltd Company, apparently two inter-related corporations. Bodis owned 100 per cent of one and a majority interest in the other.

identified his duties in that position and delineated the chain of command for corporate decisions from Mr. Pallay to Bodis.

After 1996, the corporation was unable to sustain the prior year's profit levels. Mr. Pallay was forthright in his explanation for this lack of profitability, recognizing the difficulty in maintaining profit levels and the additional competition in the market. However, Mr. Pallay also placed some responsibility on Bodis who, as chief executive officer, made certain business and financial decisions that Mr. Pallay saw as disruptive to the success of the corporation.

Mr. Pallay testified that from the beginning of his tenure he was not included in meetings in which finances were discussed. This practice did not change with the business' fortunes. Whether the business was profitable or not, Mr. Pallay was not a participant in financial decision-making. While Mr. Pallay did have check signing authority (as did other non-financial team members), Mr. Pallay did not determine which checks should be signed or which bills should be paid, but signed those checks presented for his signature. While there was no evidence that Mr. Pallay signed any sales tax reports or checks, there was evidence that Mr. Pallay signed the 1995 and 1996 corporate franchise tax reports on behalf of Creative. Interestingly, the 1995 report did not list Mr. Pallay as an officer of the corporation. The 1996 report listed Mr. Pallay as secretary of the corporation and Bodis as both president and treasurer.

Based upon his signing of the corporate franchise tax reports, his position as COO and his ownership of 3.8 per cent of the business, Mr. Pallay was found by the Tax Commissioner to be responsible for the corporation's failure to pay sales tax due the state under R.C. 5739.33. That section provides:

“If any corporation *** required to file returns and to remit tax due to the state under this chapter fails for any reason to make the filing or payment, any of its employees having control or supervision of or charged with the responsibility of filing returns and making payments, or any of its officers, *** who are responsible for the execution of the corporation's *** fiscal responsibilities, shall be personally liable for the failure.”

We begin our consideration of this matter by acknowledging the duties imposed upon the Board of Tax Appeals when reviewing a decision of the Tax Commissioner. The Tax Commissioner's findings are entitled to a presumption of correctness and it is incumbent upon a taxpayer challenging a finding of the Tax Commissioner to rebut the presumption and establish a right to the relief requested. *Alcan Aluminum Corp. v. Limbach* (1989), 42 Ohio St.3d 121; *Belgrade Gardens v. Kosydar* (1974), 38 Ohio St.2d 135; *Midwest Transfer Co. v. Porterfield* (1968), 13 Ohio St.2d 138. Moreover, the taxpayer is assigned the burden of showing in what manner and to what extent the Tax Commissioner's determination is in error. *Federated Dept. Stores, Inc. v. Lindley* (1983), 5 Ohio St.3d 213.

As to the law relating to the responsibilities of corporate officers for the delinquencies of a corporation, the general standard, and the one revealed

through a review of case law on the subject, is that to be held personally responsible for the liabilities of a delinquent corporation, a person must be responsible for or in charge of the corporation's fiscal duties, or charged with supervision of such duties. *Weiss v. Porterfield* (1971), 27 Ohio St.2d 117; *Lenart v. Lindley* (1980), 61 Ohio St.2d 110; *Spithogianis v. Limbach* (1990), 53 Ohio St.3d 55; *McGlothin v. Limbach* (1991), 57 Ohio St.3d 72; *DeLassus v. Tracy* (1994), 70 Ohio St.3d 218.

Even if a person does not actually participate in or supervise the corporation's fiscal duties, if his position is one that would ordinarily be responsible for such duties, then the officer may be found to be responsible to the state. *Spithogianis v. Limbach, supra*; *McGlothin v. Limbach, supra*; *Granger v. Tracy* (June 11, 1999), B.T.A. Nos. 98-M-242, 577, unreported.

It is upon this theory of liability that the Tax Commissioner relies. The Tax Commissioner argues that Mr. Pally was the COO in charge of managing the day-to-day business affairs of the corporation. The Tax Commissioner argues:

“While Mr. Pally may not have personally collected the sales taxes due or prepared the monthly sales tax returns or remitted the monthly sales taxes owed by his company, he no less had the control and authority to supervise such business affairs as the company's chief corporate officer responsible for the company's ‘day-to-day management and business affairs.’” (Appellee's brief, p. 6)

The Board does not find the Tax Commissioner's position supported by the record. Testimony at hearing indicated that Creative employed a work force of over 200 during Mr. Pally's tenure. The payment made for his 3.8 per cent

interest in the corporation reflected a corporation with a value of well over \$3,000,000. We acknowledge that Mr. Pallay was the COO, but given the size of this corporation, it is not improbable that the finances of this corporation were managed wholly separate from its operations. Mr. Pallay's description of his duties, which we find credible and consistent with the documentary evidence, reflects a corporation where the "day-to-day management of the company's business affairs" did not encompass financial dealings.

Nowhere does the record support a finding that financial reporting and remittance duties were the responsibility of the COO. Mr. Pallay entered employment with an on-going business and was hired for his expertise in sales and manufacturing operations. His duties as COO never specifically included overseeing tax management, nor did his duties, by practice, devolve to such oversight. There is no evidence that anyone with knowledge of Creative's true financial situation turned to Mr. Pallay and expressed concern as to the success of the corporation. Nor does it appear that anyone either inside or outside the corporation relied upon Mr. Pallay to "fix" any financial problem.

The Board does not find that a 3.8 interest in the corporation, in itself, indicates control or responsibility for sales tax obligations. In *DeLassus, supra*, a 25 per cent minority shareholder was found responsible for the corporation's failure to pay sales tax. However, in that case, the 25 per cent shareholder was also the president of the corporation and was involved in the financial discussions.

In the present matter, Mr. Pallay's minor ownership interest did not cause him to be included in financial decision-making.

Finally, the Tax Commissioner relies upon two administrative code provisions to further buttress his argument regarding responsibility. Under Ohio Adm. Code 5703-9-49(C)(2), a corporate officer is personally liable for sales tax due the state if the officer signs any tax return unless the officer can provide evidence to establish that his duties did not include filing sales tax returns and that someone else in the corporation was explicitly assigned such duties. Under Ohio Adm. Code 5703-9-49(F), officers of a corporation who either collectively or individually own more than 50 per cent interest in a corporation may be held personally responsible regardless of any attempt to delegate such responsibility, if certain conditions apply. The Board has questioned the reasonableness of Ohio Adm. Code 5703-9-49(F) if it is read to expand the class of responsible corporate officers to persons who do not meet the specific requirements of R.C. 5739.33. *Davis v. Tracy* (June 8, 2001), B.T.A. No. 98-P-1037, unreported. However, as we concluded in *Davis*, we are able to resolve this appeal without reference to either administrative code provision. In the present matter, we find that Mr. Pallay did not actually control nor was he charged with supervision of the preparation and submission of returns and/or payments required under Chapter 5739 of the Revised Code. Thus neither Ohio Adm. Code 5703-9-49(C) nor 5703-9-49(F) applies.

Given the testimony, the evidence and the case law, this Board finds that the Tax Commissioner erred when he found Mr. Pally to be a responsible corporate officer. Therefore, the final order of the Tax Commissioner is reversed.

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