In the United States Bankruptcy Court

for the Northern District of Iowa

RICHARD ALAN DALECKY JOYCE M. DALECKY	Bankruptcy No. 96-11561-C
Debtor(s).	Chapter 13

ORDER RE MOTION TO DETERMINE TAX LIABILITY

The above captioned matter came on for hearing on February 13, 1997 on a Motion to Determine Tax Liability filed by Debtors Richard and Joyce Dalecky. Appearing were Attorney Tom McCuskey for Debtors, Attorney Joan Ulmer for the Internal Revenue Service ("IRS"), and John Waters for the Iowa Department of Revenue ("IDOR"). After the presentation of evidence and arguments of counsel, the Court took the matter under advisement. The record remained open at the parties' request and was ultimately closed on April 11, 1997. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B).

STATEMENT OF THE CASE

Debtors request that the Court determine their tax liability to the IRS and IDOR for unpaid payroll taxes and sales taxes of DKD, Inc., a corporation now owned solely by Debtor Richard Dalecky. DKD had unpaid FICA taxes for fourth quarter 1994 and all of 1995 as well as unpaid state sales and withholding tax liabilities pursuant to Iowa Code secs. 421.26 and. 422.16(4). Debtors argue that they are not liable for DKD taxes arising prior to January 1, 1996 when Debtor Richard Dalecky took over control of the corporation. IRS and IDOR assert that Debtor is liable for DKD's 1994 and 1995 tax liabilities as a "responsible person" under existing tax law.

FINDINGS OF FACT

The parties do not dispute most of the underlying facts. DKD, Inc. failed to file quarterly returns and to pay federal withholding taxes for the fourth quarter of 1994 and all quarters of 1995. Subsequent returns were timely filed. The total withholding taxes unpaid by DKD are $15,513.78. IDOR asserts a total claim of $5,473.60 based on unpaid sales tax from May 1995 through the fourth quarter 1995 and unpaid withholding tax for the third and fourth quarters of 1995. Between April and December 1995, DKD paid substantial amounts to other creditors, including Schulte Development, Rick McGraw, Hawkeye Food Systems and Dana Carrothers. During this time, taxes remained unpaid.

Debtor Richard Dalecky incorporated DKD, Inc. in 1993 with Dana Carrothers and Kenneth Sickels. All three were shareholders, officers and directors of the corporation. Debtor was Vice-President. Kenneth Sickels was Secretary and Treasurer until he surrendered his stock to Debtor at no cost in November, 1995. Dana Carrothers was President and CEO until he sold his stock to Debtor for $1.00 in December, 1995.

During the operation of the corporation, Debtor and Sickels retained their outside employment. Carrothers terminated his employment with Rockwell International and managed the day-to-day operations of the business. The corporation ran sub shops and expanded into a video store business.

Debtor, Carrothers and Sickels all had signature authority over DKD's checking account at Farmers State Bank. All three were involved in major business decisions including selection of a franchise, setting up of the business and applying for financing. Carrothers was responsible for running the business and making judgments concerning who to hire and from whom to purchase supplies. He was responsible for paying bills without consulting the other owners.

Although Debtor had authority to sign DKD checks, he never exercised that authority. Carrothers kept DKD's bookkeeping records on a computer and used the computer to generate checks. Debtor did not know the password for the accounts program in the computer. Carrothers did not communicate with Debtor concerning the bank account. Debtor did not attempt to learn the computer program nor did he actively seek information about the computer accounts. Carrothers kept the computer at his home for part of the time he was running the business.

In early 1995, during an informal meeting at a restaurant, Carrothers informed Debtor and Sickels that he was having trouble paying bills and taxes. In May, 1995, the three officers of DKD met with Gene Neighbors of Farmers State Bank and a representative of the SBA concerning borrowing more money. Neither the Bank nor SBA would agree to give DKD another loan. At the end of 1995, both Carrothers and Sickels sold out their interests in DKD to Debtor. The corporation stopped doing business in 1996.

In May 1995, Debtor began paying corporate bills out of his personal funds, intending that the business would pay him back. He also cashed a check payable to DKD in October 1995 to pay corporate creditors. He did not make any payments for taxes during this time.

Debtor communicated with IDOR in September and October 1995 concerning unpaid sales and withholding taxes. He acknowledged that he was aware by February or March 1995 that these taxes were not being paid by DKD. He stated to IDOR that Carrothers had exclusive control over the corporation's finances and bank accounts and he had no access to DKD's checks. Debtor acknowledged that wages were being paid and supplies were being purchased for the business during the time that state taxes were delinquent.

Gene Neighbor, Vice-President of Farmers State Bank, testified that he dealt primarily with Carrothers concerning the DKD account until early 1996 when Debtor took over. Carrothers had primary control of the checkbook until that time. In May 1995, Debtor, Carrothers and Sickels all met with Mr. Neighbor at the Bank discussing unpaid bills, including unpaid withholding taxes. Mr. Neighbor corresponded with IDOR in January 1996 confirming that Debtor was taking over for Carrothers concerning the finances of DKD.

Debtor Joyce Dalecky testified that she discussed the DKD business with her husband only in a general sense. She did no work for DKD until after her husband took over the business in January 1996. She never drew a salary from DKD and has a full-time job at Square D Company.

Dana Carrothers testified that Debtor knew tax debts were not being paid sometime in January or February 1995. Ken Sickels testified that Debtor had disagreements with Carrothers on many issues regarding DKD, Inc. Sickels discovered in July 1995, after turning over the books to Carrothers in November 1994, that taxes were unpaid from the last quarter of 1994. Sickels testified that he and

Debtor got the first indication about trouble in making payments to creditors in March 1995. By late June 1995, unpaid taxes were a significant issue.

FEDERAL TAX LIABILITY FOR WITHHOLDING TAXES

Federal tax liability for the failure to collect and pay over a tax is governed by 26 U.S.C. § 6672(a), which provides in pertinent part:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall . . . be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

Once payroll taxes are collected, they constitute a trust fund in the hands of the employer for the benefit of the government under 26 U.S.C. § 7501. Olsen v. United States, 952 F.2d 236, 238 (8th Cir. 1991). The liability for payment of withholding taxes arises upon the collection of those taxes. Id. To incur liability under § 6672 for unpaid employment taxes, an individual must 1) be a responsible person who 2) willfully fails to pay over withholding taxes to the United States. Keller v. United States, 46 F.3d 851, 854 (8th Cir.), cert. denied, 116 S. Ct. 88 (1995). Debtors have the burden to prove that Richard Dalecky is not liable. Honey v. United States, 963 F.2d 1083, 1087 (8th Cir.), cert. denied, 506 U.S. 1028 (1992).

For purposes of § 6672, a responsible person is one possessed of significant, albeit not exclusive, authority in the field of corporate decision making and action. Kizzier v. United States, 598 F.2d 1128, 1132 (8th Cir. 1979) (citing Slodov v. United States, 436 U.S. 238 (1976)). This is so even if the person is not the actual disbursing officer. Jenson v. United States, 23 F.3d 1393, 1394 (8th Cir. 1994). An individual possessing "the status, duty and authority to avoid a default in collection or payment of the taxes" is a responsible person. Keller, 46 F.3d at 854. An otherwise responsible person does not avoid liability under § 6672 by delegating authority to another. Id. at 854.

The technical authority to sign checks and the duty to prepare tax returns are not enough to create responsibility under the statute. Barton v. United States, 988 F.2d 58, 59 (8th Cir. 1993). Officers who lack tax-paying authority cannot be held liable under § 6672 because of their position alone. Id. In Barton, the court found the IRS placed unwarranted reliance on corporate titles and limited signature authority where another officer had exclusive control of all corporate funds and sole responsibility for paying taxes. Id. at 60.

An act is willfull under § 6672 when the person "acts or fails to act consciously and voluntarily and with the knowledge or intent that as a result of [this] action or inaction trust funds belonging to the government will not be paid over but will be used for other purposes." Honey, 963 F.2d at 1087. Willfulness includes acting with reckless disregard of a known or obvious risk that trust funds may not be remitted to the government. Id. Willfulness does not require a bad motive, but merely a "voluntary, conscious act such as the payment of other creditors in preference to the United States." Elmore v. United States, 843 F.2d 1128, 1132 (8th Cir. 1988).

Evidence of knowledge of payment to other creditors when the responsible person is aware of the failure to pay withholding tax is proof of willfulness. Olsen, 952 F.2d at 239. In Jenson, it was undisputed that after the founder and president of the corporation learned of the corporation's tax liability, he voluntarily and consciously chose to pay certain creditors, i.e. employees, utilities and suppliers, before settling with the IRS. 23 F.3d at 1395. The Eighth Circuit holds that such conduct is sufficient to establish willfulness as a matter of law. Id.

Reckless conduct sufficient to establish willfulness includes a failure to investigate or correct mismanagement after having notice that withholding taxes have not been paid. Keller, 46 F.3d at 854. If a responsible person continues to delegate authority after having clear notice that the taxes remain unpaid, the failure to take measures to ensure the taxes are paid will be considered willful conduct. Id. at 855.

Debtor Richard Dalecky is a responsible person of DKD, Inc. within the meaning of § 6672. The evidence establishes that he possessed significant authority in corporate decision making. Delegating authority to Carrothers to write corporate checks and pay taxes does not avoid Debtor's liability. Carrothers did not have exclusive control of corporate funds or sole responsibility for paying taxes.

Willfulness under § 6672 is established. Debtor had notice that taxes had not been paid by February 1995. Subsequently, Debtor voluntarily chose to pay other creditors, without settling with the IRS. Debtor's failure to ensure that the taxes were paid during this time constitutes willful conduct. Debtors have failed in their burden to prove that Debtor Richard Dalecky is not liable under § 6672. Debtor is liable for DKD, Inc.'s unpaid taxes for the fourth quarter 1994 through fourth quarter 1995 in the total amount of $15,513.78.

IOWA SALES TAX LIABILITY

Iowa Code sec. 421.26 imposes personal liability for the payment of sales tax on any officer of a corporation "having control or supervision of or the authority for remitting tax payments and having a substantial legal or equitable interest in the ownership of the corporation," when that person has intentionally failed to pay the tax. IDOR has adopted an administrative rule listing the following criteria to be used to determine personal liability under sec. 421.26:

> The duties of officers as outlined by the corporate bylaws,
>
> The duties which various officers have assumed in practice,
>
> Which officers are empowered to sign checks for the corporation,
>
> Which officers hire and fire employees, and
>
> Which officers control the financial affairs of the corporation.

Iowa Admin. Code r. 701-12.15. Control of financial affairs may be defined as final control as to which bills should be paid and when; "final control" means significant rather than exclusive control. Id.

Debtor Richard Dalecky, an officer of DKD, Inc., indisputably has a substantial legal or equitable interest in the ownership of the corporation. He was empowered to sign checks and had significant, though concededly not exclusive, control as to which bills should be paid. This control is demonstrated by his actions of paying bills from his personal funds and using a check payable to DKD, Inc. to pay other creditors. These factors establish that Debtor Richard Dalecky is liable under Iowa Code sec. 421.26 for DKD's unpaid sales tax for May 1995 through the fourth quarter 1995.

IOWA WITHHOLDING TAX LIABILITY

Iowa Code sec. 422.16(4) states that every withholding agent who fails to withhold or pay withholding tax shall be personally, individually and corporately liable to the state of Iowa. The definition of a withholding agent includes any individual "that is obligated to pay or has control of paying or does pay . . . wages that are subject to the Iowa income tax." Iowa Code § 422.4. This definition includes any officer or employee of a corporation who has responsibility to pay withholding taxes under Iowa Code sec. 422.16(4) and who knowingly violates that section. Id.

IDOR has adopted an administrative rule defining a "responsible party" for purposes of sec. 422.16 (4). Iowa Admin. Code r. 701-38.1(8). This rule cites Federal law and incorporates some of the principles previously discussed in terms of finding "responsible person" liability for Federal withholding taxes. Id. Such principles include that more than one person may have the duty of withholding and paying the taxes and a responsible party may not shift responsibility by delegating that duty. Id. IDOR asserts that its rules adopt federal criteria for determining responsible party liability.

The Court concludes that Debtor Richard Dalecky is responsible under sec. 422.16(4) for DKD's Iowa withholding tax for the same reasons he is responsible for Federal withholding tax. He is a responsible party, being an officer of the corporation and obligated to pay tax. He "knowingly" violated sec. 422.16(4) when he paid other creditors after having notice that Carrothers was failing to pay Iowa withholding tax. Debtor Richard Dalecky is liable for DKD's unpaid Iowa withholding tax for the third and fourth quarters 1995.

WHEREFORE, Debtor Richard Dalecky is liable for unpaid Federal withholding tax of DKD, Inc. in the amount of $15,513.78.

FURTHER, Debtor Richard Dalecky is liable for unpaid Iowa sales tax and Iowa withholding tax of DKD, Inc. in the total amount of $5,473.60.

FURTHER, Debtor Joyce Dalecky is not liable for any Federal or Iowa tax liabilities of DKD, Inc.

SO ORDERED this 7th day of May, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge