

ARIZONA CIVIL COURT

TX 2004-000487

03/28/2005

HONORABLE MARK W. ARMSTRONG

CLERK OF THE COURT
C.I. Miller
Deputy

FILED: _____

ARIZONA STATE DEPARTMENT OF
REVENUE

EDWINUS M VANVIANEN

v.

RCM BUSINESS SYSTEMS INC, et al.

WILLIAM M KING

UNDER ADVISEMENT RULING

This matter was taken under advisement after oral argument held February 11, 2005. The Court has considered plaintiff's motion for summary judgment, defendants' cross-motion for summary judgment and arguments of counsel.

I. THE ISSUE

This is a collection action filed by the Arizona Department of Revenue (ADOR) against RCM Business Systems, Inc. d.b.a. Ranch Computer (RCM). RCM failed to pay an outstanding transaction privilege tax (TPT) that ADOR has determined is owed based upon filed TPT returns. ADOR argues that under Ariz. Rev. Stat. Ann. [hereinafter A.R.S.] § 42-5028, Robert Morrison, President of RCM, is personally liable for the TPT. Further, ADOR contends that under A.R.S. § 25-215, the marital community of spouses Robert and Gracine Morrison is also liable for the TPT.

The Morrisons deny that they are liable to pay TPT. First, the Morrisons never assumed personal liability for any corporate debt of RCM including any TPT owed. Second, even if found personally liable for the corporate debt of RCM, including the TPT owed, that debt was discharged in their Chapter 7 bankruptcy.

II. FACTUAL BACKGROUND

For the TPT periods of January through November 2001, and January, February and

April through June 2002, RCM collected TPT and filed TPT returns, but failed to remit the TPT to ADOR. The TPT that remains outstanding totals \$13,756.58, including taxes and penalties of \$11,137.57 and \$2,619.01, respectively, but excluding accruing interest.

During the TPT periods in issue, Robert Morrison was President of RCM. The Morrisons were the only owners, officers and directors of RCM. On January 2, 2004, ADOR, through counsel, notified Robert Morrison that under Arizona law, he was being held personally liable for the TPT. Shortly thereafter, on February 2, 2004, the Morrisons filed a Chapter 7 bankruptcy. In their bankruptcy, the Morrisons list the TPT as a community, undisputed, and unsecured priority claim. On June 4, 2004, the Morrisons were granted a discharge in their bankruptcy.

On June 22, 2004, after the Morrisons failed to pay the TPT, ADOR filed its Complaint initiating this collection action. Subsequently, on September 24, 2004, the Morrisons filed their answer denying liability for the TPT.

III. ARGUMENTS OF THE PARTIES

- ADOR's Arguments -

A. UNDER A.R.S. § 42-5028, ROBERT MORRISON, PRESIDENT OF RCM, IS PERSONALLY LIABLE FOR THE TPT.

Under A.R.S. § 42-5028, which is a general administrative provision that addresses transaction privilege and affiliated excise taxes:

A person who fails to remit any additional charge made to cover the tax or truthfully account for and pay over any such amount is, in addition to other penalties provided by law, personally liable for the total amount of the additional charge so made and not accounted for or paid over.

Therefore, under Arizona law, a person who is responsible for the collection of TPT, and who neglects to remit the funds to ADOR, can be held personally liable for those funds.

During the TPT periods in issue, Robert Morrison was President of RCM. As such, he was responsible for RCM's activities, including the collection of the TPT, the filing of the TPT returns and the payment of the TPT to ADOR. Here, the TPT was collected and the TPT returns were filed, but the TPT was not paid to ADOR. Consequently, under A.R.S. § 42-5028, Robert Morrison, President of RCM, is personally liable for the TPT.

B. THE TERM "PERSON," AS USED IN A.R.S. § 42-5028, REFERS TO THE PARTY WHO IS RESPONSIBLE FOR COLLECTING TAXES AND WHO FAILS TO REMIT THE FUNDS TO ADOR.

The term "person," as used in A.R.S. § 42-5028, is defined very broadly by A.R.S. § 42-5001. See A.R.S. § 42-5001(8). It includes an "individual, firm, partnership, joint venture, association, corporation, . . ." A.R.S. § 42-5001(8). It is not limited in scope to the TPT licensee/corporate entity (i.e., taxpayer) as the Morrisons argue. Indeed, if the term "person" were to be limited as the Morrisons suggest, then the statute would have substituted "taxpayer" in place of "person." See, e.g., A.R.S. § 42-5001 (18) ("Taxpayer" means any person who is liable for any tax which is imposed by this article.")

Moreover, the term "person," as used in A.R.S. § 42-5028, requires an interpretation that is consistent with the context in which it is used. A reading of the statute makes clear that it is designed to penalize parties who are responsible for collecting taxes intended for ADOR and who fail to pay over the funds. The responsible party who fails to pay is made personally liable for the taxes even though that party may not be the "taxpayer."

This interpretation is supported by the terminology in A.R.S. § 42-5028. First, it is clear that the statute is a penalty provision. The statute, which focuses on the party who fails to pay, specifically states that "in addition to *other penalties* provided by law," the party who fails to pay is "*personally liable*" for the taxes. A.R.S. § 42-5028 (emphasis added). Also, by making the party who fails to pay *personally liable* for the taxes, the statute penalizes parties, such as officers or directors of corporations, who under other circumstances/law might not be liable.

Second, it is logical to conclude from the personal liability language in A.R.S. § 42-5028 that the statute is directed at parties who are responsible for collecting taxes intended for ADOR and who fail to pay over the funds. After all, these parties are by virtue of their position of responsibility, able to regulate a taxpayer's collection and disbursement of taxes intended for ADOR. Thus, when the taxpayer fails to pay taxes it owes, the statute makes the party who is responsible for that failure personally liable for those taxes; in this way, the state's treasury may be made whole. In short, the statute allows ADOR to reach those responsible for, as here, the corporation's failure to pay taxes.

C. UNDER CORPORATE LAW PRINCIPLES AND *STATE V. ANGELO ROBERT MORRISON, PRESIDENT OF RCM, CAN BE HELD PERSONALLY LIABLE FOR THE TPT.*

The Morrisons also rely on corporate law principles and *State v. Angelo*, 166 Ariz. 24, 800 P.2d 11 (App. 1990), as further support of why they are not personally liable for the TPT, a corporate debt, and why only RCM, and not its officers or directors, can be held liable for the TPT. As indicated below, holding the responsible party/officer of a corporation personally liable for taxes is completely consonant with corporate law principles and *State v. Angelo*.

Corporate law principles dictate that directors and officers must discharge their duties "[w]ith the care an ordinarily prudent person in a like position would exercise under similar

circumstances.” A.R.S. §§ 10-830(A)(2), -842(A)(2). Thus, directors and officers, who are responsible for a corporation's business activities, must be careful in discharging their responsibility. Part of that responsibility may include, as in this case, collecting taxes and disbursing those taxes to the taxing authority. An ordinarily prudent person presiding over a business's activities takes care to see to it not only that the taxes are collected, as happened here, but also that they are disbursed to the taxing authority. Failure to use care in seeing to it that the taxes are disbursed to the taxing authority can result in potential penalties, not the least of which is being held personally liable for those taxes. *See, e.g.*, A.R.S. § 42-5028.

Here, Robert Morrison apparently took care to see to it that the TPT was collected, as evidenced by his signature on the TPT returns. However, he failed to use care in seeing to it that the TPT was disbursed to ADOR. As a consequence, he may be held personally liable for the TPT.

The Morrisons also rely on *State v. Angelo* to support their contentions. In *State v. Angelo*, the state indicted corporate officers for the failure to file the corporation's TPT returns under applicable criminal statutes. *State v. Angelo*, 166 Ariz. at 25, 800 P.2d at 12. The superior court dismissed the indictments on the ground that the applicable statutes did not impose a duty on the officers of a corporation to file a TPT return on behalf of the corporation. *Id.* The court concluded that a corporate officer could not be prosecuted for the corporation's failure to file a return. *Id.* at 25-26, 800 P.2d at 12-13. The court of appeals affirmed, based in part on the reasoning that “[a]n omission to act can only be a crime if there is a *duty to act imposed by law*” and that since the corporate officers did not have “a personal statutory duty” to file the return, their failure to act was not a crime. *Id.* at 27-28, 800 P.2d at 14-15 (emphasis added).

Notwithstanding that the applicable criminal statutes in *State v. Angelo* are clearly distinguishable from A.R.S. § 42-5028, the reasoning used is nevertheless useful. The *State v. Angelo* Court's reasoning infers that where a statute imposes a duty upon an officer of a corporation to file a TPT return, or perform any other act, on behalf of the corporation (i.e., “a duty to act imposed by law”), the officer can be held personally liable for failing to perform that act.

As discussed previously, A.R.S. § 42-5028 penalizes parties who are responsible for collecting taxes intended for ADOR and who fail to pay the funds. Therefore, the statute imposes a duty upon responsible parties, such as certain corporate officers acting on behalf of corporations, to pay over taxes intended for ADOR.

In the instant case, Robert Morrison was responsible for RCM's business activities, including collecting taxes intended for ADOR and paying over the funds. Thus, pursuant to A.R.S. § 42-5028, he was under a duty to pay over the TPT on behalf of RCM. Since he failed to do so, he may be held personally liable for the TPT.

D. UNDER A.R.S. § 25-215, THE MARITAL COMMUNITY OF SPOUSES ROBERT AND GRACINE MORRISON IS ALSO LIABLE FOR THE TPT.

Under A.R.S. § 25-215, and with certain exceptions not applicable here, “either spouse may contract debts and otherwise act for the benefit of the community,” and “in an action on such a debt or obligation the spouses shall be sued jointly and the debt or obligation shall be satisfied: first, from the community property...” A.R.S. § 25-215(D). The community property therefore is liable for community obligations entered into by either spouse.

Here, Robert Morrison’s actions as President of RCM were for the benefit of the marital community. Hence Robert Morrison’s failure to pay TPT to ADOR created a community obligation. As a result, under A.R.S. § 25-215 the marital community of spouses Robert and Gracine Morrison is liable for the TPT.

E. UNDER 11 U.S.C. § 523(A)(1)(A), THE DEBT FOR THE TPT WAS NOT DISCHARGED IN BANKRUPTCY.

The Morrisons deny they are liable to pay TPT, in part because they allege that TPT was discharged in their Chapter 7 bankruptcy. However, under 11 U.S.C. § 523(a)(1)(A), the TPT was not discharged in the Morrisons’ bankruptcy.

Under 11 U.S.C. § 523(a)(1)(A), a Chapter 7 bankruptcy discharge “does not discharge and individual debtor from any debt...for a tax...of the kind and for the periods specified in section...507(a)(8) of this title, whether or not a claim for such tax was filed or allowed.” 11 U.S.C. § 523(a)(1)(A). 11 U.S.C. § 507(a)(8) provides that unsecured claims of governmental units are given priority status if they are “for a tax...measured by...gross receipts...for a taxable year...for which a return...is last due...after three years before the date of the filing petition.” 11 U.S.C. § 507(a)(8)(A)(i). Therefore, taxes measured by gross receipts, such as the TPT in issue, for which returns are due within three years preceding the bankruptcy filing date, are given priority status under 11 U.S.C. § 523(a)(1)(A), and the debts for such taxes are nondischargeable in a Chapter 7 case.

Here, the TPT periods at issue cover January through November 2001, and January, February and April through June 2002. Returns for monthly TPT periods are due by the 20th day of the month following each TPT period. A.R.S. § 42-5014(a). The Morrisons filed their bankruptcy on February 2, 2004. Consequently, the returns for the TPT periods were due within three years preceding the bankruptcy and, thus, the TPT is given priority status. Therefore, under 11 U.S.C. § 523(a)(1)(A), the debt for the TPT was not discharged in the bankruptcy.

- RCM’s Arguments -

A. THERE IS NO SPECIFIC PROVISION OF TITLE 42, CHAPTER 1, THAT MAKES AN OFFICER, DIRECTOR OR OTHER PERSON AFFILIATED WITH

A TAX PAYING ENTITY PERSONALLY LIABLE FOR THE ENTITY'S PRIVILEGE TAX OBLIGATION.

For purposes of defining those entities that may be subject to Arizona TPT, A.R.S. § 42-5001 generally describes "person" or "company:"

as an individual, firm, partnership, joint venture, association, corporation, estate or trust, this state, any country, city, town, district, other than a school district, or other political subdivision and any other group or combination acting as a unit, and the plural as well as the singular number.

A.R.S. § 42-5005. Privileges licenses: revocation; violation; classification, further and more specifically defines the entity for which a transaction privilege license is required as a person who is engaged in business:

A. Every person who receives gross proceeds of sales or gross income upon which a privilege tax is imposed by this article, desiring to engage or continue in business, shall make application to the department for a privilege license accompanied by a fee of twelve dollars. Such licenses shall be effective indefinitely. Such persons shall not engage or continue in business until the person has obtained a privilege license.

Despite the general provisions of A.R.S. § 42-5028, there is no specific provision of Title 42, chapter 1, that makes an officer, director or other person affiliated with a taxpaying entity personally liable for the entity's privilege tax obligation.

B. ARIZONA CORPORATE LAW SPECIFICALLY LIMITS THE LIABILITY OF CORPORATE OFFICERS AND DIRECTORS.

Arizona corporate law specifically limits the liability of corporate officers and directors. A.R.S. § 10-830 relating to liability of directors for corporate acts specifically provides that directors are discharged and not liable for any action taken or failure to take action if their acts were done:

1. In good faith.
2. With the care an ordinary prudent person in a like position would exercise under similar circumstances.
3. In a manner the officer reasonably believes to be in the best interests of the corporation.

A.R.S. § 10-842 applies a similar standard in respect to the conduct of corporate officers. ADOR does not allege that the Morrisons have violated these statutes, any other provision of Arizona corporate law, or any other duty that would subject them to personal liability for the corporate debts of RCM.

C. STATE V. ANGELO HELD THAT A CORPORATION, AND NOT ITS OFFICERS, WAS THE “PERSON” LIABLE FOR THE TRANSACTION PRIVILEGE TAX RETURN.

In *State v. Angelo*, 166 Ariz. 24, 800 P.2d 11 (App. 1990), the court held that a “corporation which was conducting the business of prime contracting in Arizona was the ‘person’ liable for the transaction privilege tax return and only the corporation, and not its officers, was subject to criminal liability for failure to do so.” That case also held that the “fact that a transaction privilege tax return of corporation must be verified by oath of authorized agent does not mean that the authorized agents have an obligation to file the return or can be held criminally liable for failure to do so.” It was further held that “Courts may disregard corporate form in civil cases only when there is a unity of interest and ownership and when disregarding the corporate form is necessary to prevent injustice or fraud.”

IV. THE COURT’S FINDINGS AND CONCLUSIONS

The Court agrees with the above arguments of ADOR, finds that there are no genuine issues of material fact, and further finds that ADOR is entitled to judgment as a matter of law.

IT IS THEREFORE ORDERED granting ADOR’s Motion for Summary Judgment and denying RCM’s Cross Motion for Summary Judgment.