BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS

IN THE MATTER OF THE APPEAL OF HIRT, TERRY/GOOD TIMES RESTAURANT & SPORTS CLUB, I FROM AN ORDER OF THE DIVISION OF TAXATION ON ASSESSMENT LIQUOR EXCISE, RETAILERS' SALES AND WITHHOLDINGS TAX	Docket No. 2006-8531-DT

ORDER

Now the above-captioned matter comes on for consideration and decision by the Court of Tax Appeals of the State of Kansas. The Court conducted an evidentiary hearing in this matter on March 6, 2008. The taxpayer appeared by his counsel of record, Benjamin J. Neill of Neill, Terrill & Embree. The Kansas Department of Revenue, Division of Taxation (the "Department") appeared by its counsel of record, Jay D. Befort.

The Court has jurisdiction of the subject matter and the parties, as an appeal has been properly and timely filed pursuant to K.S.A. 2008 Supp. 74-2438.

I.

This appeal is from a personal liability assessment of liquor excise, retailers' sales and withholding tax. The material facts of this case are as follows. In Spring 1999, taxpayer Terry Hirt established a relationship with Anthony and Linda Walters. In August or September 1999, Mr. Walters told Mr. Hirt that he and his wife were in financial trouble and asked Mr. Hirt if he would be willing to back them financially in operating a bar/restaurant business in Baldwin, Kansas. The Walters informed Mr. Hirt that they were unable to get financing themselves. Mr. Hirt also was advised that the Walters were unable to get the required liquor and business licenses. In order to finance the undertaking, Mr. Hirt co-signed a loan for $10,000 and pledged his pickup truck as collateral.

In September 1999, Mr. Hirt executed various documents on behalf of Good Times Restaurant and Sports Club, Inc. On September 16, 1999, he signed three documents as "owner": a Kansas Business Tax Application, a Retail Liquor Excise Surety Tax Bond, and an Escrow Agreement for Guarantee of Kansas Retail Liquor

Excise Tax Liability. On September 22, 1999, Mr. Hirt filed Articles of Incorporation with the Kansas Secretary of State to formally establish the corporate entity. Mr. Hirt was not involved in the operations of the restaurant/bar. In the nine months the business was open he was in the business location approximately eight times. On a few of those occasions he acted as doorman.

In March 2000, the bank notified Mr. Hirt that the loan he had co-signed was in default. Good Times Restaurant and Sports Club closed a month later. The Walters declared bankruptcy. Mr. Hirt first learned about the tax delinquencies in 2002, approximately two years after the restaurant had closed.

In September 2002, the Department assessed personal liability to Mr. Hirt for liquor excise, retailers' sales, and withholding taxes pursuant to K.S.A. 79-2971, K.S.A. 79-3643, and K.S.A. 79-32,107. After exhausting his administrative remedies with the Department, Mr. Hirt appealed to this Court.

II.

The first issue presented is whether the Court should sustain the Department's objection to Mr. Hirt's attempt to admit certain documents not exchanged or disclosed in accordance with K.A.R. 94-2-13. (*See* Trans. p. 49: lines 13-25; p. 50: lines 1-2). The Court's regulations establish clear deadlines for exchange of documents and disclosure of witnesses. The potential consequence for failing to meet these deadlines is exclusion of the documents or witnesses not exchanged or disclosed. *See* K.A.R. 94-2-13(e). We find exclusion of the evidence to be appropriate here. The Department's objection is sustained.

III.

The next issue presented is whether there is a rational basis for the Department's personal liability assessment against Mr. Hirt in view of the evidence and under the applicable legal authorities.

Actions of administrative agencies carry a rebuttable presumption of validity. *Country Club Home, Inc. v. Harder*, 620 P.2d 1140, 1147 (Kan. 1980). The burden to overcome this presumption rests squarely on the party challenging the agency's actions. *Id.* The Kansas Supreme Court recently stated as follows:

> Interpretation of a statute is a question of law. Special rules apply, however, when considering whether an administrative agency erroneously interpreted or applied the law: The interpretation of a statute by an administrative agency charged with the responsibility of enforcing that statute is entitled to

> judicial deference. This deference is sometimes called the doctrine of operative construction . . . . [I]f there is a rational basis for the agency's interpretation, it should be upheld on judicial review . . . [However,] the determination of an administrative body as to questions of law is not conclusive and, while persuasive, is not binding on the courts. Deference to an agency's interpretation is especially appropriate when the agency is one of special competence and experience. However, the final construction of a statute always rests with the courts.

Coma Corp. v. Kansas Dept. of Labor, 154 P.3d 1080, 1083 (Kan. 2007) (internal quotations and citations omitted) (alterations in original). Based on the doctrine of operative construction, the Department's final determination must be affirmed unless Mr. Hirt can prove there is no rational basis for the Department's determination. The applicable statutes are K.S.A. 79-3643, K.S.A. 79-2971 and K.S.A. 79-32,107.

During the period in question, K.S.A. 79-3643 imposed personal liability on the following:

> Any individual who is responsible for the collection or payment of sales or compensating tax or control, receipt, custody or disposal of funds due and owing under the Kansas retailers' sales and compensating tax acts who willfully fails to collect such tax, or account for and pay over such tax, or attempts in any manner to evade or defeat such tax or the payment thereof shall be personally liable for the total amount of the tax evaded...

The statute imposing personal liability for liquor excise tax, K.S.A. 79-2971, is effectively similar to K.S.A. 79-3643. The statute imposing personal liability for withholding tax differs from the other two statutes. Despite differences in the statutes, the parties nonetheless have chosen to address all three assessments by analyzing the elements of liability under K.S.A. 79-3643 as interpreted by K.A.R. 92-19-64a. During the hearing, counsel appeared to agree that the three separate assessments, although governed by different statutes, all require two predicate findings: (1) that Mr. Hirt was a "responsible individual" and (2) that Mr. Hirt acted willfully in failing to collect, account for, or pay the taxes. The Court will accept the parties' analytical framework for purposes of this case.

The first question is whether Mr. Hirt is a "responsible individual." The Department has defined that term to mean "any person with sufficient status, duties, and authority to have significant control over business finances or the disbursement of business funds." K.A.R. 92-19-64a(b). The regulation provides a list

of indicia that are considered in determining whether an individual has significant control over business finances or the disbursement of business funds. An individual is a "responsible individual" if he has any of the following:

(1) a significant ownership interest in a business;

(2) a significant involvement in the day-to-day management of the business;

(3) the authority to sign business checks or tax returns;

(4) the authority to direct payment of business funds to creditors;

(5) the authority to pledge business assets as collateral for loans, advances, or lines of credit for the business;

(6) the authority to bind the business to contracts entered into as part of the day-to-day business operations; or

(7) the authority to hire or fire employees who are authorized to perform any act described in paragraphs (3) through (6) of this subsection.

Mr. Hirt is the only shareholder and the only director listed in the Articles of Incorporation. Mr. Hirt also admits he has a significant ownership interest in the business. Yet he claims that ownership alone is not sufficient to prove that he is a "responsible individual." We disagree. K.A.R. 92-19-64a(b) provides that only one of the indicia must be present in order to establish that a person is a "responsible individual." We find Mr. Hirt is a "responsible individual" under Kansas law.

We now turn to the question of whether Mr. Hirt's conduct warrants the imposition of personal liability for the taxes assessed in this case. In order for liability to accrue, Mr. Hirt must have acted willfully in failing to collect or account for and pay over the taxes. *See* K.S.A. 79-3643(a).

K.A.R. 92-19-64a(e) provides examples of acts and omissions indicating that a responsible individual acted willfully in failing to collect, account for, or pay taxes. Such acts and omissions include the following:

(1) making a deliberate choice that the business should pay other creditors in spite of having knowledge that taxes collected are not being remitted to the state of Kansas;

(2) having knowledge of the tax delinquency and failing to exercise authority to rectify it if funds were available to pay the state of Kansas;

(3) performing a voluntary or intentional act or failing to perform such an act with knowledge that the act or omission will result in the failure of the business to collect, account for, or remit taxes owed to the state of Kansas;

(4) failing to investigate or to correct mismanagement after notice that taxes owed to the state of Kansas are not being remitted; or

(5) embezzling business funds.

This list is not exhaustive. *See id.* ("Acts or omissions showing that a responsible individual acted willfully in failing to collect, account for, or remit taxes *may include* one or more of the following.")

We find no evidence that Mr. Hirt had actual notice or knowledge that taxes were not being collected or paid until approximately two years after the restaurant had closed; thus subsections (1), (2), and (4) do not apply. There also is no evidence that Mr. Hirt embezzled business funds, which makes subsection (5) inapplicable. The issue, then, is whether willful conduct can be found under subsection (3), or without specific reference to the examples contained in the regulation.

Subsection (3) instructs that a responsible individual acts willfully if he voluntarily or intentionally acts or fails to perform an act "with knowledge that the act or omission will result in the failure of the business to collect, account for, or remit taxes owed to the state of Kansas." K.A.R. 92-19-64a(e)(3). The Department argues that willfulness is established in this case by virtue of Mr. Hirt's position as owner, incorporator, principal, depositor and financier. According to the Department, Mr. Hirt's position made him "duty-bound" to discover the restaurant's tax collection and remittance status. The Department does not, however, allege with any specificity any voluntary or intentional acts Mr. Hirt performed, or failed to perform, with knowledge that the acts or omissions would result in non-payment of taxes.

It is a fundamental rule of statutory construction to which all other rules are subordinate that the intent of the legislature governs, if that intent can be ascertained from the plain language of the statute. *State v. Scherzer*, 869 P.2d 729, 735 (Kan. 1994). Our interpretation of the meaning of the statutes in question must therefore begin with the text of the statutes.

We note that the Kansas statutes in question contain language similar to language contained in analogous portions of the Internal Revenue Code. We also note that the arguments offered by both parties are based either on the text of the Kansas statutes and regulations or on federal case law interpreting the analogous

federal statute, 26 U.S.C. § 6672. The parties appear to agree that federal cases interpreting the federal law should be considered when interpreting the Kansas laws in question.

It has long been held that Kansas statutes adopted from another jurisdiction carry with them the construction placed on the statutes by the courts of the jursidiction from which the statutes were adopted. *See Edgington v. City of Overland Park*, 815 P.2d 1116, 1122 (Kan. Ct. App. 1991); *Republic Natural Gas Co.*, 415 P.2d 406, 411 (Kan. 1966); *State v. Underwood*, 693 P.2d 1205, 1209 (Kan. Ct. App. 1985). Here, there is no indication that the Kansas statutes in question were actually adopted from their federal analogues. In fact, while there are similarities between the Kansas and federal laws, there also are many significant differences. We must therefore find the federal cases submitted by the parties to be persuasive, but not binding, authorities.

The willfulness requirement under federal law has been addressed in numerous cases from various jurisdictions. A review of those cases reveals that federal courts roundly conclude that the willfulness requirement under 26 U.S.C. § 6672 may be satisfied if the responsible individual has acted with "reckless disregard of a known or obvious risk" that the applicable taxes are not being paid. *Denbo v. United States*, 988 F.2d 1029, 1033 (10th Cir. 1993); *Malloy v. United States*, 17 F.3d 329, 332 (11th Cir.1994); *Gustin v. United States*, 876 F.2d 485, 492 (5th Cir. 1989); *Caterino v. United States*, 794 F.2d 1 (1st Cir. 1986); *Monday v. United States*, 421 F.2d 1210, 1215 (7th Cir. 1970). Evil motive and specific intent are not necessary elements. *Harrington v. United States*, 504 F.2d 1306, 1311 (5th Cir. 1974); *Monday*, 421 F.2d at 1216. Mere negligence, however, does not rise to the level of willfulness. *Feist v. United States*, 607 F.2d 954, 961 (1979); *Dudley v. United States*, 428 F.2d 1196, 1200 (9th Cir.1970).

Under 26 U.S.C. § 6672, where proof of a reckless disregard for an obvious risk is sufficient proof to establish willful conduct, Mr. Hirt's acts and omissions would arguably provide a rational basis for the Department's personal liability assessments. Under Kansas law, however, more is required to find willful conduct.

In Kansas, reckless disregard or indifference to the consequences of one's actions is wanton conduct, not willful conduct. *See Willard v. City of Kansas City*, 681 P.2d 1067, 1070 (Kan. 1984); *Anderson v. White*, 499 P.2d 1056 (1972). Wanton conduct is less egregious than willful conduct. *See Gruhin v. City of Overland Park*, 836 P.2d 1222, 1225 (Kan. 1992) (wanton conduct requires something more than ordinary negligence but something less than a willful act.) Acts of omission can rise to the level of wanton conduct since reckless disregard and indifference are characterized by a failure to act when action is necessary. *Id.* In contrast, a willful act is one indicating a design, purpose, or intent on the part of a person to do wrong

or cause injury to another. *Anderson* 499 P.2d at 1058; *Holder v. Kansas Steel Built, Inc.*, 582 P.2d 244, 249 (Kan. 1978). Whether conduct in a given case rises to the level of willful conduct is a question of fact. *Id.*

The Court acknowledges that the Department's assessment carries a presumption of validity and is entitled to deference. Nevertheless, the government's taxing authority is penal in nature. *J.G. Masonry, Inc. v. Department of Revenue,* 680 P.2d 291, 294 (Kan. 1984). Tax statutes will not be extended by implication, and their operation will not be enlarged so as to include matters not specifically embraced. *Director of Taxation v. Kansas Krude Oil Reclaiming Co.,* 691 P.2d 1303, 1307 (Kan. 1984). Here, the statutes in question require the responsible individual's conduct to be willful. Willfulness requires an indication of design, purpose, or intent to do wrong or cause injury to another. Based on the weight of the evidence, we find that while Mr. Hirt's conduct might have been negligent – and perhaps even reckless – his conduct was not willful as that term is defined under Kansas law.

There is no evidence that Mr. Hirt ever prepared or approved tax reports or was involved in matters of bookkeeping for the business. There also is no evidence that Mr. Hirt ever directed nonpayment of taxes or suggested that other creditors receive preference over the government. In fact, nothing in the record indicates that Mr. Hirt had any knowledge that taxes were delinquent until two years after the business had closed. Under the evidence we cannot find that Mr. Hirt acted with the design, purpose, or intent to do wrong or cause injury. *See Holder*, 582 P.2d at 249. We must therefore conclude that Mr. Hirt did not willfully fail to collect or account for and pay over the taxes in question. Nor did he attempt to evade or defeat the taxes or their payment.

The Department's personal liability assessment lacks a rational basis under the evidence.

IT IS THEREFORE ORDERED, for the reasons stated above, that the Department's personal liability assessment is reversed.

Any party to this action who is aggrieved by this decision may file a written petition for reconsideration with this Court as provided in K.S.A. 2008 Supp. 77-529. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Court's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to: Secretary, Court of Tax Appeals, Docking State Office Building, Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. *A copy of the petition, together with any accompanying documents, shall be mailed to all parties at the same time the petition is mailed to the Court. Failure to notify the opposing party shall render any subsequent order voidable.* The written

petition must be received by the Court within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute). If at 5:00 pm on the last day of the specified period the Court has not received a written petition for reconsideration of this order, no further appeal will be available.

IT IS SO ORDERED

THE KANSAS COURT OF TAX APPEALS

S E A L

ATTEST:

REBECCA W. CROTTY, JUDGE

J. FRED KUBIK, JUDGE

TREVOR C. WOHLFORD, JUDGE PRO TEM

JOELENE R. ALLEN, SECRETARY

CERTIFICATE OF SERVICE

I, Joelene R. Allen, Secretary of the Court of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket No. 2006-8531-DT and any attachments thereto, was placed in the United States Mail, on this 14th day of May, 2009, addressed to:

Hirt, Terry/Good Times Restaurant & Sports Club, I
28962 NW Chase Rd
Garnett, KS 66032

Benjamin Neill
Neill, Terrill & Embree, L.L.C.
4707 West 135th Street, Suite 240
Leawood, KS 66224

and a copy was placed in capitol complex building mail, addressed to:

James Bartle
General Counsel
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

Jay Befort
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Department of Revenue
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IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.

Joelene R. Allen

Joelene R. Allen, Secretary