

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF WISCONSIN

THOMAS W. DAVIS,

Plaintiff, Counterclaim
Defendant,

OPINION AND ORDER

11-cv-651-bbc

v.

UNITED STATES OF AMERICA,

Defendant, Counterclaim
Plaintiff.

In this civil action under 28 U.S.C. § 1346, plaintiff Thomas W. Davis seeks a refund of federal taxes assessed against him as a penalty under 26 U.S.C. § 6672 for the unpaid employment taxes of Advantage Composites, LLC, of which he was a partial owner and manager. Defendant United States of America filed a counterclaim and third-party claim seeking a judgment that plaintiff and his father, Bruce Davis, owed the federal taxes assessed. Defendant obtained a default judgment against Bruce Davis, dkt. #24, and has now filed a motion for summary judgment against plaintiff Thomas Davis, dkt. #27, that is ready for decision.

Plaintiff argues that he cannot be held liable for Advantage Composites' tax liability, because he did not have authority to direct which creditors the company paid and was unaware that the company was not paying its employment taxes. Because the undisputed

facts demonstrate that plaintiff had significant control over which creditors were paid and acted with reckless disregard for whether the company paid its employment taxes, I am granting defendant's motion for summary judgment.

From the parties' proposed findings of fact, I find that the following facts are undisputed.

UNDISPUTED FACTS

On December 27, 2010, the Internal Revenue Service assessed plaintiff Thomas W. Davis and Bruce Davis, plaintiff's father, a trust-fund recovery penalty of \$64,971.13. Thomas Davis is the only remaining plaintiff; all future references to him will be to "plaintiff." I will refer to Bruce Davis as "Davis.") The penalty was for Advantage Composites, LLC's unpaid employment taxes for the fourth quarter of 2007 and the first and second quarters of 2008. As of November 19, 2012, the balance was \$18,026.67 for the fourth quarter of 2007; \$20,632.76 for the first quarter of 2008; and \$27,873.35 for the second quarter of 2008.

A. Owners and Investors in Advantage Composites

Advantage Composites was a plastics extrusion company that converted plastic waste into new products, typically plastic door thresholds. Davis formed Advantage Composites as a Wisconsin limited liability company in August 2002. At the same time, he formed BTA Duffers Venture Group, LLC as a holding company to wholly own Advantage Composites.

BTA Duffers was owned by Ken Hallgren and Mark Somers, who each held a 25% interest, and Woodridge Venture Group, LLC, which held a 50% interest. Woodridge was jointly owned by Davis, who held a two-thirds interest, and Craig Kettleson, who held a one-third interest.

In 2005, Davis gave each of his sons, plaintiff and Jacob Davis, 19.5% of his interest in Woodridge. He made the gift through another holding company, JTMB, LLC. In January 2007, Kettleson sold his one-third interest in BTA Duffers to JTMB and Woodridge assigned its interest in BTA Duffers to JTMB. As a result, JTMB owned 100% of BTA Duffers and, consequently, 50% of Advantage Composites. Plaintiff's indirect ownership interest in Advantage Composites increased from 6.4% to 9.5%.

Plaintiff lent money to Advantage Composites on many occasions, including a loan of \$6,300 in 2007 and one of a little more than \$10,000 on another occasion. He left his personal credit card with Advantage Composites vendors and would authorize charges to pay company expenses. The company owed plaintiff \$12,031.55 when it went out of business in late 2008. Advantage Composites also owed JTMB \$3 million on an outstanding note payable. Plaintiff retains his 19.5% interest in JTMB, the value of which declined after the failure of Advantage Composites. In his 2007 and 2008 tax returns, plaintiff reported losses from his interest in JTMB.

B. Directors and Management of Advantage Composites

When Advantage Composites was formed in 2002, its named directors were Davis,

Hallgren and Somers. Somers was a passive investor. On average, he visited the factory only four times a year and participated in its financial affairs only as an investor. The company's articles of incorporation list Hallgren as the secretary and treasurer, but in reality he provided only startup capital and engineering expertise. The directors never expected him to be involved in day-to-day management of the company or its financial operations and expected him to be at the factory only one day a week. Family illnesses prevented him from visiting even that often. During the second half of 2007 and in 2008, he visited only periodically or not at all. He was not involved in payroll or employment taxes, never signed company checks and had minimal involvement in determining what creditors were paid and in setting financial policies.

Bruce Davis was Advantage Composites' president, but was not at the factory on a day-to-day basis. From 2002 until 2008, he was involved in three or four other business ventures that required him to travel 30% of the time. From 2002 until the end of 2007, he spent no more than 10% of his time at the factory in Chippewa Falls. As the company began to fail in 2008, he started spending around half his time in Chippewa Falls.

C. Plaintiff's Employment at Advantage Composites

1. Plaintiff's hiring, duties and compensation

Davis hired plaintiff to work for Advantage Composites in 2003. He wanted his son to immerse himself in the company and make recommendations about its employees and its future direction. Plaintiff has a bachelor's degree in business administration and

entrepreneurship. While completing his degree, he took at least two accounting classes. At Advantage Composites, plaintiff served as Davis's representative and "second in command." Although he was never formally an officer or director, plaintiff held himself out as "Director of Procurement," "Vice President of Marketing," "Chief Operating Officer" and "Chief Financial Officer."

In the first three quarters of 2007, Davis spent additional time in New York trying to obtain financing for his other business. During that time, Davis relied on plaintiff to provide him updates about on how the business was fairing.

Although plaintiff worked for Advantage Composites, he was paid by Woodridge through a "Management and Services Agreement" between it and Advantage Composites. Lindgren Decl., dkt. #37-2. Woodridge agreed to provide "a President/CEO and a Plant Manager" for Advantage Composites on an as-needed basis. Plaintiff had "very minimal" involvement with Woodridge at the end of 2007 and no involvement in 2008.

2. Plaintiff's managerial authority

In 2007 and 2008, plaintiff worked at the plant at least 40 hours each week and sometimes more. He worked all three shifts and would often volunteer to fill in for other employees who could not come to work, because he believed it was his responsibility to make sure that the business ran smoothly and made all of its shipments.

Plaintiff had the authority to hire, fire and discipline employees and used that authority on several occasions. Plaintiff participated in the decisions about hiring Dena

Boiteau as the new officer manager, Bob Dittrich as a general manager and two other managers, Keith Hince and Ron Grondzki.

3. Plaintiff's financial authority

In general, plaintiff was not involved in decisions about which bills or vendors Advance Composites would pay, but he did make suggestions about which creditors it was imperative to pay for plant operations. He also encouraged payment for certain creditors with whom he had a good working relationship. He believed the most important priorities were the company's payroll, electric bill and payments for raw plastic materials. On one occasion, plaintiff wanted to withhold payment from the electric company because he believed an electrician stole components, but his opinion was overruled.

Plaintiff was authorized to write and sign checks on behalf of Advantage Composites. Because Davis was not often at the plant, he wanted plaintiff to sign checks as a "second layer of control" so the office manager was not responsible for issuing and signing checks. He expected plaintiff to refuse to sign unauthorized checks. Plaintiff also had the authority to direct Boiteau to issue checks and to write a check to himself, which he did on one occasion in June 2008 for \$1,000.

In 2003, plaintiff was added as a signatory to Advantage Composites' business checking account at First National Bank. The company used this account for only two months during the relevant periods and closed it in on February 28, 2008. Between September 28 and October 5, 2007, Advantage Composites issued checks from the First

National Bank account totaling more than \$12,000. By December 31, 2007, this account held only \$35.81, which was paid to the state of Wisconsin through a tax levy.

In September 2006, Davis added plaintiff as a signatory to Advantage Composites' checking account at Associated Bank. Plaintiff and Davis were the only signatories on this account. Between February to July 2008, Advantage Composites deposited \$854,510.25 in the account and issued \$476,362.35 in checks. Plaintiff signed 580 of the 781 checks issued in that period. In the months of February, March and April 2008, plaintiff signed more than 90% of the checks issued from this account. Between February and July 2008, plaintiff also went to Associated Bank and authorized the bank to issue 14 cashier's checks from the account for a total of \$121,047.48.

4. Plaintiff's procurement authority

One of plaintiff's responsibilities at Advantage Composites was to procure plastic waste material for the company's extrusion process. He called and visited businesses to seek out plastic waste material suppliers, acting as the initial contact. Once plaintiff had set up the relationship, the vendors would work out the logistics with the office manager.

Plaintiff established a business relationship with Don Chapman at C4 Polymers and worked out an agreements for C4 Polymers to sell plastic scrap materials to Advantage Composites. Plaintiff told Chapman that he was the chief financial officer and held himself out as being in charge of Advantage Composites. When Advantage Composites was late with payments, Chapman and C4 Polymer's CFO called plaintiff to inquire about payment. In

June 2008, plaintiff asked C4 Polymers to send a load of materials on credit, but C4 Polymers was unwilling to extend credit to Advantage Composites because of its history of delinquent payment. Plaintiff promised Chapman that Advantage Composites would pay and because Chapman believed plaintiff represented the company, Chapman agreed to personally guarantee Advantage Composites' debt to C4 Polymers.

Plaintiff was also Advantage Composites' contact person for another company, Pro Ex Extrusion. On August 20, in a letter to Pro Ex Extrusion, plaintiff wrote, "in our recent owners['] meeting, we had the opportunity to discuss the outstanding balance owed to Pro Ex Extrusion." He promised payment of the outstanding balance and invited Pro Ex's representative to call him about any questions.

D. Advantage Composites' Tax Debts

Advantage Composites incurred employment tax debts as early as 2004. It was the subject of Notices of Federal Tax Lien were filed against it arising from employment tax debts it had accrued during certain quarters of 2004 and 2005.

During the periods at issue, Dena Boiteau, the office manager, was responsible for processing Advantage Composites' payroll. She entered the amount of payroll into the company's accounting software, which calculated the federal withholding automatically. Boiteau then printed out the payroll checks and submitted them to plaintiff for his signature. When the company had money, Boiteau paid employment taxes at the same time. During the relevant time, plaintiff signed Advantage Composites' payroll checks. He also signed

checks made out to the United States Treasury for employment taxes and checks made out to Associated Bank for Advantage Composites' Form 941 taxes. Sometimes Advantage Composites issued payment to Associated Bank instead of directly to the Treasury so that the bank could issue a certified or cashier's check.

On January 30, 2008, plaintiff signed Advantage Composites' Form 941 Employer's Quarterly Federal Tax Return for the fourth quarter of 2007. He signed as "Management." Plaintiff reported that the company paid \$100,734.47 in wages and owed \$26,131.77 in taxes for the quarter, but had paid only \$4,8444.74 in total deposits, for a balance due of \$21,287.03. Plaintiff signed the form under penalty of perjury, declaring that he had "examined the return, including accompanying schedules and statements" and it was true and correct to the best of his knowledge. Davis signed Advantage Composites' Forms 941 for the first and second quarters of 2008.

Advantage Composites received letters, phone calls and visits from IRS employees about its past-due employment taxes.

E. Plaintiff's Knowledge of Financial Condition

Plaintiff knew Advantage Composites was experiencing serious financial trouble as early as 2007. Boiteau told him on March 15, 2007 that the company's check book balance was negative after paying its electric bill, payroll and other expenses. During the last year of operations, everyone at the company knew that it was struggling financially. Davis said, "[i]t was so obvious you had to be a blind mouse not to see what a struggle it was."

In September 2007, Davis asked plaintiff and other employees “in close” to stop cashing their paychecks. Plaintiff never cashed his paychecks from September 2007 through his departure in 2008. Nevertheless, he continued working because it was his father’s company and he did not want to see his father fail. Plaintiff left Advantage Composites in the summer or early fall of 2008 because “the writing was on the wall.”

Plaintiff often answered the phone when creditors of Advantage Composites called to demand payment. Creditors would “harass” him or give him “flak” about the past-due bills. Somers or Hallgren would call plaintiff to ask how things at Advantage Composites were going. He gave them updates about which creditors were upset about non-payment and told them the company needed to find a way to pay the creditors. In January 2008, plaintiff called C4 Polymers and asked it not to cash three checks from Advantage Composites. In 2008, plaintiff knew the trucking companies that Advantage Composites worked with threatened to stop shipping the company’s products or refused to ship the products because of past-due bills. He knew that the electric company threatened to shut off Advantage Composites’ power at least once in 2008 because of the past due electric bill. In March 2008, plaintiff stopped payment on a check to C4 Polymers because Advantage Composites needed money for payroll.

Davis held informal meetings to discuss Advantage Composites’ finances with plaintiff and the four other managers, Dittrich, Boiteau, Hince and Grondzki. They discussed the bills that needed to be paid and that were “causing them grief” in the plant. Davis wrote out the company’s accounts payable and receivable in some detail on the

whiteboard, because he wanted plaintiff and the others to see the company's financial status on a 45- and 60-day basis, including its cash flow and obligations. (The parties dispute whether Davis listed past-due employment taxes on the whiteboard. Plt.'s PFOF, dkt. #44, ¶ 158.) Davis does not recall speaking with plaintiff about the past-due federal employment taxes, but he believed the unpaid taxes were "common knowledge." Plaintiff would report to Davis that Advantage Composites' creditors were calling him and were upset that they were not being paid. Plaintiff asked Davis to seek more capital contributions for Advantage Composites from Somers and Hallgren to pay Advantage Composites' bills.

Boiteau would seek plaintiff's opinion on financial matters. She expressed her frustration about Advantage Composites' finances, complaining to plaintiff that creditors were demanding payment but the company had insufficient funds to pay them. On February 6, 2008, Boiteau emailed plaintiff telling him that for that week, "including payroll," Advantage Composites would be short \$51.05. On February 12, she emailed to tell him that she had received a check and thus had enough money to issue a check to one of Advantage Composites' suppliers.

Boiteau produced aged payables reports on a regular basis. She sometimes showed plaintiff the aged payables report, the account balance statement or other financial reports. He could have asked her to see the aged payables report at any time and had the authority to ask her to prepare an accounts receivable report, a financial report or a report detailing the status of the Advantage Composites' bank accounts. He often asked Boiteau how much

money was in the company's bank account. Plaintiff also could have obtained a balance statement from Associated Bank or First National Bank about the company's accounts.

OPINION

Federal law requires employers to deduct income tax and Federal Insurance Contributions Act tax from employees pay checks. 26 U.S.C. §§ 3402, 3101(a). These "trust fund" taxes for Social Security and Medicare must be held exclusively for the United States and must not be used to pay other business expenses, including operating expenses, wages or salaries. 26 U.S.C. § 7501(a). Employers are required to report the amount withheld quarterly on a Form 941 employment tax return. 26 C.F.R. § 31.6011(a)–4.

If an employer does not pay the withheld taxes to the United States, the government collects the unpaid taxes from the business and persons connected with the business responsible for the failure to pay. In relevant part, 25 U.S.C. § 6672 provides:

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 . . . shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

An individual is liable under § 6672 if he (1) was "responsible" for collecting, accounting for and paying over the tax and (2) failed willfully to carry out that responsibility. Bowlen v. United States, 956 F.2d 723, 728 (7th Cir. 1992). Once an assessment is made, the taxpayer bears the burden of proving he is not liable. Adams v. United States, 504 F.2d 73,

75 (7th Cir. 1974).

A. Responsible Person

A person is “responsible” under § 6672 if he “retains sufficient control of corporate finances that he can allocate corporate funds to pay the corporation’s other debts in preference to the corporation’s withholding tax obligation.” Bowlen, 956 F.2d at 728. This provision “casts a broad net of liability” that encompasses “all those connected closely enough with the business to prevent the default from occurring.” Id. (citation omitted). “The concept of responsibility . . . focuses on whether the taxpayer could have impeded the flow of business to the extent necessary to prevent the corporation from squandering the taxes it withheld from its employees.” Thomas v. United States, 41 F.3d 1109, 1113 (7th Cir. 1994). Whether the person actually exercised the power is irrelevant; the fact that he possessed the power is sufficient. Purdy Company of Illinois v. United States, 814 F.2d 1183, 1188 (7th Cir.1987).

A person need not have exclusive authority, the final say or even be the most responsible person, as long as he has “significant” control. Id.; Adams, 504 F.2d at 75; Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987). “Relevant factors” for assessing a person’s control include ownership of stock, holding of corporate office, the ability to disburse funds, the ability to sign checks or prevent their issuance by withholding a signature, the ability to hire and fire employees, control over disbursement of payroll, the

ability to take out loans and the authority to sign tax returns. I.R.S. v. Charlton, 2 F.3d 237, 240 (7th Cir. 1993). Whether a taxpayer was a responsible person is a question of fact. Id.

Plaintiff owned 9.5% of Advantage Composites. He worked full-time at the plant as second in command to his father, who was on site only 10% of the time. Although plaintiff held no official corporate office, he held himself out as “Director of Procurement,” “Chief Operating Officer” and “Chief Financial Officer.” He negotiated contracts with the company’s suppliers and was the person they talked to about the company’s debts. Plaintiff discussed the company’s finances with Davis and other managers and argued for payments to specific creditors. He had authority to hire and fire employees. He did not run the payroll, but he was trained in the payroll procedures and signed the company’s tax return for the fourth quarter of 2007.

Plaintiff was one of two persons authorized to sign checks and disburse funds from the company’s accounts. The only other authorized signatory was in the office at most once a week, so plaintiff signed 74% of Advantage Composites’s checks during the relevant periods. For three months, he signed more than 90% of its checks. He had the authority to write checks on his own and to directed the office manager to issue a check. He issued checks on his signature alone and authorized Associated Bank to issue 14 cashier’s checks for a total of \$121,047.48.

Despite these facts, plaintiff argues that he was simply a rubber stamp for decisions made by Davis, who controlled which creditors were paid. This argument rests on the

Davis's and plaintiff's deposition testimony. Davis said that he retained "overall decision making authority on all bills," Davis Dep., dkt. #33, 200:11-16, and plaintiff never had "the responsibility or the authority from me to be responsible for any monies the company spent or didn't spend." Id. at 247:19-22. He testified that plaintiff did not decide whom to write checks out to or for how much, id. at 250:1-18, and "unless it was an emergency, there was already a discussion as to what was authorized to sign and send." Id. at 141:10-13. Davis said that he decided whom to pay when funds were low, although others would make those decisions when he was not present. Id. at 230:1-231:2. Davis also testified specifically that he was responsible for insuring the taxes were paid, id. at 212:6-11, decided not to pay them and "probably" instructed Boiteau not to pay the company's federal tax bill. Id. at 176:15-177:9; 165:21-166:5. Davis said that plaintiff did not participate in the decision whether to pay the taxes. Id. at 203:18-21. Plaintiff testified similarly that no one ever asked him whether to pay the withholding taxes and he lacked authority to pay them. Davis Dep, dkt. #32, 248:6-13.

On the basis this testimony, a reasonable jury might infer that plaintiff did not have the ultimate authority to direct the company's payments and did not participate in Davis's decision not to pay the taxes. However, this testimony is not sufficient to avoid summary judgment. Plaintiff's situation is analogous to the two plaintiffs in Bowlen, 956 F.2d 723. Although each owned one-third of a company and signed all of its checks, they argued that they were not responsible for its unpaid taxes because the third owner ran day-to-day

operations and prepared the checks for their signature. Id. at 728. The court of appeals affirmed the district court's directed verdict that the plaintiffs were responsible because they retained their ownership interest, held positions as officers and directors, were authorized signatories, signed checks and signed a note on behalf of the company. Id.

Plaintiff retained his ownership interest. His interest is non-controlling, but so were the ownership interests of the plaintiffs in Bowlen. Plaintiff was authorized to sign checks, write checks and make drafts on the company accounts. He signed almost three-quarters of the company's checks, wrote out one check to himself and authorized fourteen bank drafts. Moreover, he ran the company's day-to-day operations, negotiated with its suppliers, hired and fired employees and signed its tax return. Plaintiff could have refused to sign the checks or simply written out the check himself. On one occasion, he stopped payment on a check to a creditor so that the company would have additional funds for payroll. Even if Davis authorized all of the checks and plaintiff lacked official authority to contravene his father's orders, no reasonable jury could conclude that plaintiff did not have significant control over which creditors received payment.

Plaintiff makes several other arguments that are unavailing. First, on one occasion he lobbied to withhold payment from the electric company but was overruled. The fact that plaintiff's influence was not successful on a single occasion does not show that he did not have significant control. Second, plaintiff points out that during the relevant period, he was unpaid because his father asked him to stop cashing his checks. However, in Jefferson v.

United States, 546 F.3d 477, 480-81 (7th Cir. 2008), the court upheld summary judgment against an uncompensated president of a board of directors, who exercised less control than plaintiff, signing only two of 975 checks during the relevant time. Last, plaintiff argues that Woodbridge paid his salary, not Advantage Composites, but the immediate source of plaintiff's compensation is not relevant to whether he had significant control to prevent Advantage Composites from squandering the taxes it withheld from its employees.

B. Willfulness

According to the Seventh Circuit Court of Appeals, a person's failure to pay employment taxes is "willful" under § 6672 if the decider was "voluntary, conscious and intentional," if he knew the taxes were not being remitted yet paid other creditors, or if the person "recklessly disregarded a known risk that the taxes were not being paid over." Jefferson, 546 F.3d at 481 (quotations and citations omitted). The plaintiff need not know that the taxes were not being paid. Jefferson, 546 F.3d at 482 (citing United States v. Kim, 111 F.3d 1351, 1357-58 (7th Cir.1997)).

Plaintiff testified that he was unaware that Advantage composites was not paying its withholding taxes. Even if this is true, it is not enough to avoid summary judgment. In Jefferson, 546 F.3d at 427-28, the court upheld summary judgment against a board president who asserted that he did not know the company was not paying its taxes, although he knew it had failed to pay taxes in the past, knew it could not cover its expenses and had access to

monthly reports for the board meeting showing that the company's tax liability was increasing. In Wright, the court of appeals upheld the court's findings after a bench trial that the taxpayer acted willfully when he knew the company had a history of not remitting taxes and its financial status was deteriorating, yet he continued to sign company checks to creditors for eighteen months without making any effort to find out whether the taxes were paid.

Plaintiff was aware of Advantage Composites' financial difficulties. He attended management meetings in which Davis explained the company's liabilities in detail and often spoke with the officer manager about the finances. He discussed with his father and the other managers which creditors should be paid. Beginning in September 2007, plaintiff stopped cashing his own paychecks at his father's request. Plaintiff was also aware of a risk that the federal taxes were not being paid. Plaintiff even signed Advantage Composites' tax return for the fourth quarter of 2007 showing that the company owed \$21,287.03 in trust fund taxes. Lindgren Decl., dkt. #39-9. The officer manager showed plaintiff reports documenting the company's unpaid debts and plaintiff could have asked her to see additional financial reports at any time. (The parties dispute whether he opened letters from the IRS to Advantage Composites. Plt.'s Resp. to Def.'s PFOF, dkt. #44, ¶ 165; Plt's PFOF, dkt. #45, ¶ 16. However, this fact is immaterial in light of the facts that are undisputed.)

Plaintiff argues that the tax return does not show that he knew Advantage Composites had not paid the outstanding balance, but that is not the relevant standard. "[I]f a

responsible officer knows that the corporation has recently committed such a delinquency and knows that since then its affairs have continued to deteriorate, he runs the risk of being held liable if he fails to take any steps either to ascertain, before signing checks, what the state of the tax withholding account is, or to institute effective financial controls to guard against nonpayment.” Wright, 809 F.2d at 427. After January 30, 2008, plaintiff knew that Advantage Composites had an unpaid tax balance and knew it was choosing among its creditors. He was in a position to find out easily whether the withholding taxes had been paid but he made no effort to do so. These undisputed facts are sufficient to conclude as a matter of law that plaintiff acted with reckless disregard for whether Advantage Composites remitted its taxes and therefore acted “willfully” under § 6672.

ORDER

IT IS ORDERED that defendant United States of America’s motion for summary judgment, dkt. #27, is GRANTED. The clerk of court is directed to enter judgment declaring that plaintiff Thomas W. Davis is indebted to the United States in the amount of

\$66,532.78, plus interest and statutory additions accruing according to law from the date of assessment.

Entered this 28th day of January, 2013.

BY THE COURT:
/s/
BARBARA B. CRABB
District Judge