

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In Re:)	Bankr. Case No. 91-50242
)	
)	Adversary Case No. 91-5010
MITCHEL E. MORRIS)	
a/k/a MITCH MORRIS,)	Chapter 7
)	
Debtor.)	
)	
MITCHEL E. MORRIS)	MEMORANDUM OF DECISION RE:
a/k/a MITCH MORRIS,)	DETERMINATION OF THE CLAIM OF
)	THE INTERNAL REVENUE SERVICE
Plaintiff,)	
vs.)	
)	
UNITED STATES OF AMERICA,)	
acting by and through the)	
Internal Revenue Service,)	
)	
Defendants.)	

The matter before the Court is the complaint to determine the claim of the Internal Revenue Service filed by Plaintiff-Debtor Mitchel E. Morris. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum and subsequent Order shall constitute findings and conclusions under F.R.Bankr.P. 7052. As set forth below more fully, the Court concludes that Debtor, as a general partner in B,M,M&H Partnership, is responsible for any unpaid payroll taxes, penalties, and taxes arising from the operation of the Downtowner Motor Inn only through December 2, 1986.

I.

Royal Bar, Inc., owned and operated the Downtowner Motor Inn in Casper, Wyoming. Royal Bar was a closely held corporation. The stockholders were Ralph and Robert Schauss and their sister or her husband, Clinton D. Wyatt. Robert Schauss helped manage the

Downtowner. Ralph Schauss was in charge of maintenance at the Downtowner.

Royal Bar filed a Chapter 11 petition in 1985. The Downtowner was offered for sale through Higginbotham Realty while the bankruptcy case was pending. Herbert D. Hollingsworth learned that the Downtowner was for sale and that financing might be available. Hollingsworth informally agreed with S. Fred Morris and his son, Mitchel E. "Mitch" Morris, and later with David L. Blair, to pursue, as partners, the opportunity to purchase the Downtowner. Negotiations between the partners and Royal Bar were conducted by Phil Konings of Higginbotham Realty. Negotiations regarding financing were conducted by Hollingsworth and Fred Morris for the partners and Richard W. Tetherow, Koning's brother-in-law, for the financing group, which included Spectrum Guardian Management Trust and Omnitek Intertrade Corporation. The negotiations resulted in several documents that were executed about the same time.

On May 28, 1986, Tetherow, on behalf of Omnitek, and Fred Morris, on behalf of himself, his son, and Hollingsworth, signed a letter of understanding that Fred Morris, Mitch Morris and Hollingsworth, acting through a yet unformed corporation, intended to enter into a "joint venture Trust" with Omnitek "for the purpose of acquiring the property known as the Downtowner Motel" for \$6,000,000.00. The letter of understanding further stated,

It is understood that capital for the acquisition will be furnished by Spectrum-Guardian Management Trust and Omnitek Intertrade Corporation shall be responsible for the specifics of the purchase. The responsibility of the group of individuals named above shall be to function in

a management capacity and to be completely responsible for the operation of the property on a continuing basis, as Trustors under the managing Trust.

In consideration of the above responsibilities, it is understood that the benefits of the trust shall be divided as follows: 49% to Spectrum-Guardian Management Trust and 51% to the individuals named above through the corporation to be formed

In late May, 1986, Blair, Hollingsworth, Fred Morris, and Mitch Morris each signed a Schedule F "Special and/or Reversionary Trust Agreement" that conveyed the individuals' interests in their partnership, B,M,M&H Partnership, to Omnitek as the Managing Trustee. The Schedule Fs were parts of a "'Intervivos' Operational Trust[,] Irrevocable Trust" drafted by Omnitek. One Schedule F stated that Fred Morris transferred \$40,000.00 to an operating account for the Downtowner that was to be opened. A Schedule B to the Operational Trust provided that the "Beneficial interest of the Trust" was to be distributed annually, or more frequently if appropriate, in accordance with the preceding paragraph #4 and that net income was to be distributed annually with Spectrum Guardian to receive 49%, and each partner of B,M,M&H to receive 12.75%.¹

In mid-June 1986, Fred Morris, Mitch Morris, Blair, and Hollingsworth executed an agreement that created B,M,M&H Partnership. The purpose of the partnership was to enter into a "joint venture agreement" with Spectrum Guardian and Omnitek. The purpose of the joint venture agreement was to form a new Trust. The purpose of the Trust was to acquire the Downtowner.

¹ A signed copy of the Operational Trust was not offered into evidence.

Thereafter, the Partnership was to receive the "beneficial Interests" of the Trust. The Partnership Agreement acknowledged that the Partnership was to be responsible for the operation of the Downtowner.

Also in mid-June 1986, Fred Morris and Hollingsworth for the buyer, B,M,M&H Partnership, and Robert Schauss and Clint Wyatt for the seller, Royal Bar, executed a Preliminary Purchase Agreement for the Downtowner. Under the Preliminary Terms and Conditions attached to the agreement, the Partnership was to take possession of the Downtowner on July 1, 1986 and have "full operational and managerial control" from that date, except that no actions were to be taken that would diminish the value of the property. Spectrum Guardian was to give the realtor a "trust note" for \$6,250,000.00 payable to Royal Bar by July 1, 1986 that was to mature on December 1, 1986 with interest at 8%. Closing was scheduled for December 1, 1986 when the trust note was paid. The Preliminary Purchase Agreement also provided that from July 1, 1986 to closing all profits would be put into an escrow account with Higginbotham Realty and that the balance in the escrow account would be released to the Buyer at closing.

A Trust Note was executed by Spectrum Guardian on July 1, 1986. However, none of the B,M,M&H partners understood exactly how Spectrum Guardian or Omnitek intended to finance the purchase nor did any of them fully understand what their interest in the Downtowner would be after the sale closed.

On July 7, 1986, Robert Schauss, Ralph Schauss, and Blair

executed a statement that Royal Bar authorized B,M,M&H to "make any changes necessary to operate and manage" the Downtowner effective immediately pending approval of the sale agreement by the Bankruptcy Court for the District of Wyoming. The Partnership agreed not to deplete the assets of the Downtowner or disturb the ongoing operation. The Partnership further agreed to consult with Royal Bar before taking any action that would affect the Downtowner. On July 7, 1986, Mitch Morris, Fred Morris, Hollingsworth, and Blair opened a commercial bank account entitled the Downtowner Management Account. Each signed the authorized signature portion of the Depositor's Contract and Signature Card. Only one signature was required for the transaction of account business. The Partnership's name did not appear on the Card.

With the consent of the other B,M,M&H partners, Hollingsworth assumed the key management position at the Downtowner after July 1, 1986, including the oversight of all accounting and the payment of wages. Ralph Schauss continued to oversee maintenance. Hollingsworth often consulted with Fred Morris and Robert Schauss.

Mitch Morris was not an active participant in the negotiations for the sale or the drafting and execution of the partnership documents. Further, he did not assume a managerial role at the Downtowner. Blair left the Partnership on August 26, 1986.

From July 1986 to December 1986, most withholding taxes due from the operation of the Downtowner were paid. Cash flow, however, continued to be a problem.

B,M,M&H Partnership managed the Downtowner until December 1986

when the sale from Royal Bar fell through because Spectrum Guardian did not provide financing to the Partnership as expected. By letter dated December 2, 1986 to the Partnership, Royal Bar declared the Partnership's purchase offer null and void. Royal Bar also wrote a letter on December 2, 1986 to their realty company and canceled the listing for the Downtowner.

The principals of Royal Bar asked Hollingsworth to continue as manager of the Downtowner. He agreed to do so. Hollingsworth also continued to find financing so that he and others could purchase the Downtowner.

On December 6, 1986, Fred Morris, Hollingsworth, and Mitch Morris all signed a Voluntary Dissolution of Partnership Agreement of Partners. The Dissolution stated the Partnership was being dissolved because the deal to purchase the Downtowner had fallen through.

On December 17, 1986, Hollingsworth and Tetherow organized a corporation named Royal West Properties, Inc. In addition to the incorporators, the other directors were Jess Jones and E.R. Reece. Royal West was not successful in purchasing the Downtowner. Hollingsworth quit as manager of the Downtowner in mid-January 1987. Tetherow continued in a management position, with some assistance from Fred Morris, until May 1987 when the mortgage on the Downtowner given by Royal Bar was foreclosed.

Mitch Morris ("Debtor") filed a Chapter 11 petition on July 22, 1991. Debtor commenced this adversary proceeding on August 7, 1991 to determine the claim of the Internal Revenue Service. The

I.R.S. filed a proof of claim on August 30, 1991, as summarized below:

KIND	TAX PERIOD	DATE ASSESSED	TAX	PENALTY TO PETITION DATE	INTEREST TO PETITION DATE
WT-FICA	09/30/86	12/22/86	\$ 0.00	\$ 508.40	\$ 563.24
FUTA	12/31/86	06/22/87	25,693.38	6,466.84	15,906.11
WT-FICA	12/31/86	03/16/87	33,827.02	11,139.81	22,186.75
WT-FICA	03/31/87	05/23/88	84,278.95	50,567.37	63,516.20
WT-FICA	06/30/87	05/23/88	51,382.90	30,841.74	36,465.99

The I.R.S.'s total claim was for \$544,685.55, all arising from unpaid payroll taxes for the Downtowner.

The case was converted to a Chapter 7 on September 30, 1993. A discharge was entered January 4, 1994. The Trustee filed a no-asset report on May 18, 1994.

The adversary trial was held September 27, 1994. Appearances included James P. Hurley for Plaintiff-Debtor and Charles P. Hurley for the I.R.S. Upon receipt of post-petition briefs and responses, the matter was taken under advisement.

The I.R.S. argues B,M,M&H Partnership was the employer of the Downtowner employees for the dates when the taxes were assessed and, therefore, that the Partnership and the general partners, including Debtor, are responsible for the unpaid payroll taxes.²

Debtor sets forth several arguments for his conclusion that the Partnership was not the employer of the Downtowner employees when the taxes were assessed. He argues the Partnership had assigned its interest to Omnitek as the Managing Trustee, the purchase agreement was not in accord with the trust documents later

² The I.R.S. concedes Debtor did not play an active role in the management of the Downtowner and that he was not a "responsible" person under 26 U.S.C. § 6672 who was obligated to pay the payroll taxes.

signed, the purchase agreement exceeded the authority of the Partnership, and Debtor was not a partner when the purchase agreement was signed.

II.

Section 3102 of the Internal Revenue Code requires employers to deduct certain taxes from the wages of employees and pay them to the federal government for Social Security and related programs (Federal Insurance Contribution Act [FICA]). Section 3301 of the Internal Revenue Code requires employers to pay federal unemployment taxes (FUTA) on wages to employees. Section 3402(a) of the Internal Revenue Code requires employers to deduct income taxes from the wages of employees and pay them to the federal government. The employer is liable to the government for these taxes, not to any person. 26 U.S.C. § 3403.

An "employer" who is obligated to withhold taxes is defined as the person for whom an individual performs or performed and service, of whatever nature, as the employee of such person, except that --

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of subsection(a)) means the person having control of the payment of such wages[.]

26 U.S.C. § 3401(d) (in pertinent part). The critical term is "control of the payment of the wages for such services." *Evans v. I.R.S. (In re Southwest Restaurant Systems, Inc.)*, 607 F.2d 1237, 1239 (9th Cir. 1979). Responsibility is intended to be placed at the point of control. *Otte v. United States*, 419 U.S. 43, 50 (1974).

The legal status of a party is not necessarily determinative of whether is the "employer" for withholding tax purposes. *Lane Processing Trust v. United States*, 25 F.3d 662, 666 (8th Cir. 1994). Facts to weigh more heavily include who had meaningful control of the business, including who had control over the wages paid to employees. *Id.* Form should not be elevated over substance. *Id.*; *In re Professional Security, Inc.*, 162 B.R. 901, 904 (Bankr. M.D. Fla. 1993).

An employer may include a partnership, as well as the general partners of a partnership. *Ross v. United States (In re Ross)*, 122 B.R. 462, 464-65 (Bankr. M.D. Fla. 1990).

III.

The Court finds that B,M,M&H Partnership was the employer responsible for withholding taxes from July 1, 1986, through December 2, 1986, when Royal Bar canceled its purchase agreement with the Partnership. Executed documents between the Partnership and Royal Bar displaced Royal Bar as the employer. No principal of Royal Bar continued in a manager or employer capacity during that time. Hollingsworth, as the Partnership's representative, actively managed the Downtowner and oversaw the payment of all expenses, including wages, through December 2, 1986. The evidence was insufficient to find that Spectrum Guardian Management or Omnitek, by the execution of the various "trust" documents, bought the Partnership and thus became the employer at the Downtowner. Therefore, any FICA, FUTA, or income taxes due based on wages paid through December 2, 1986 are the responsibility of the Partnership

and its general partners, including Debtor.

Any delay between July 7, 1986, when the Partnership formally was formed, and mid-June 1986, when the Preliminary Purchase Agreement was executed, is insufficient evidence on which to conclude that Debtor was not bound by the Preliminary Purchase Agreement. Debtor and his business associates' actions in arranging financing, executing the Preliminary Purchase Agreement, and forming the Partnership were sufficiently contemporaneous and demonstrated a common intent among Debtor, Hollingsworth, and Fred Morris to form the Partnership in order to purchase and operate the Downtowner. Similarly, the fact that Debtor and his associates formed a partnership rather than a corporation to further their business interest is not significant in determining whether the Partnership was the employer at the Downtowner between July 1 and December 2, 1986.

The Partnership, and therefore Debtor, is not liable for withholding taxes after December 2, 1986. The Partnership no longer had legal authority to operate the business after that date. More important, Hollingsworth was retained shortly thereafter by Royal Bar, not the Partnership, to continue his management role. Further, any continued involvement by Fred Morris in the Downtowner after December 2, 1986 was a product of Fred Morris' relationships with Hollingsworth and Tetherow. Fred Morris' continued interest in the Downtowner was not evidence that the Partnership continued as the employer, especially where the Partnership was formally dissolved, where Debtor was not involved in the Downtowner at all

after the dissolution, and where Hollingsworth soon worked with Tetherow and others non-partners in his further efforts to acquire the Downtowner. Hollingsworth's or Tetherow's continued use of a bank account originally created by the B,M,M,&H partners or their use of the B,M,M&H Partnership name on business documents likewise are insufficient evidence that the Partnership, with Debtor as one of the general partners, continued as the employer at the Downtowner after December 2, 1986.

Finally, the Court cannot conclude that the I.R.S.'s issuance of Adjustment Computation notices absolves Debtor of all tax liability. The Court is confident that counsel for the I.R.S. accurately stated that the I.R.S. intends to reverse its action.

The Court was not given sufficient evidence to calculate what unpaid withholding taxes are owed from wages paid through December 2, 1986.³ An evidentiary hearing on that issue will be held only if the parties cannot stipulate to the amount of taxes, interest, and penalties due in accordance with these findings and conclusions.

Within thirty days of entry of this Memorandum, Debtor shall submit an order in compliance with these findings and conclusions that sets forth the agreed amount of due or shall inform the Court by letter that an evidentiary hearing is needed to calculate the amount due.

³ The Court also is unclear on why penalties and interest are due for FICA taxes through September 30, 1986, when the tax itself has been paid.

Dated this _____ day of April, 1995.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:
PATRICIA A. JOHNSON, ACTING CLERK

By _____
Deputy Clerk

(SEAL)