

TAX APPEAL BOARD OF THE STATE OF DELAWARE

LIBERTY PAYROLL & EMPLOYMENT SERVICES, INC.,)	
)	
)	
Petitioners,)	
)	
v.)	Docket No. 1584
)	
DIRECTOR OF REVENUE,)	
)	
)	
Respondent.)	

BEFORE: Todd C. Schiltz, Esq., Chairman, Steven R. Director, Esq., Vice Chairman and Joan M. Winters, CPA, Sindy Rodriquez and Robert Slavin, Members

John D. Travis, president of Liberty Payroll & Employment Services, Inc., for Petitioner.

Jennifer R. Noel, Esq., Deputy Attorney General, for Respondent.

DECISION AND ORDER

Petitioner Liberty Payroll & Employment Services, Inc. (“Liberty”) seeks a refund of certain occupational license taxes (a/k/a gross receipts taxes) it paid in calendar years 2009, 2010 and 2011 (the “Tax Period”).

If Liberty and non-parties Bear-Seasons Pizza & Restaurant Inc., Christiana Seasons Pizza Restaurant, Concord Seasons Pizza Restaurant, Dewey Beach Seasons Pizza Inc., Elsmere Seasons Pizza Restaurant, Midway Seasons Pizza & Restaurant Inc., New Castle Seasons Pizza & Restaurant Inc., Newark Seasons Pizza Inc., Philadelphia Pike Seasons Pizza Inc. and Seasons Pizza & Restaurant Inc. (the non-parties are collectively referred to herein as the “SP Entities”) are “related entities” under 30 *Del. C.* § 2120(b), then payments Liberty received from the SP Entities during the Tax Period should be excluded from Liberty’s taxable gross receipts and Liberty is entitled to a refund.

Whether or not Liberty and the SP Entities are “related entities” under Section 2120(b) depends on who owned Liberty and the SP Entities during the Tax Period. The parties do not dispute who owned the SP Entities, but there is a dispute as to who owned Liberty.

For the reasons set forth below, the Board concludes that Liberty has failed to prove by a preponderance of evidence that Liberty and the SP Entities are “related entities” under Section 2120(b) and, as a result, Liberty’s request for a refund of certain gross receipts taxes it paid during the Tax Period is denied.

Pertinent Statutory Provisions

Delaware taxpayers licensed as general service providers under 30 *Del. C.* § 2301(b) are required to pay a tax on their gross receipts pursuant to 30 *Del. C.* § 2301(d). In pertinent part, Section 2301(d) states that “every person [licensed as a general service provider] shall also pay a license fee at the rate of 0.4147% of the aggregate gross receipts paid to such person attributable to activities licensable under this chapter”¹ The term “gross receipts” is defined as the “total consideration for services rendered, goods sold, or other-income producing transaction within this State, including fees and commissions.” 30 *Del. C.* § 2301(e).

Notwithstanding the broad definition of gross receipts in Section 2301(e), Section 2120(b) of Title 30 states that “[g]ross receipts . . . shall not include amounts received from a related entity.” Section 2120(b) further states that “[e]ntities are related whenever: (1) more than 80 percent in value of the stock . . . interests of each entity is owned directly, indirectly or beneficially by the same 5 or fewer individuals” 30 *Del. C.* § 2120(b).

¹ The gross receipts tax rate changed in the middle of the Tax Period. From January 1, 2009 until July 1, 2009, the applicable rate was 0.384%. For the remainder of the Tax Period, the applicable rate was 0.4147%.

Statement of Facts

Except as otherwise noted, the facts set forth herein are derived from the evidence submitted by the parties in the stipulation of facts and exhibits thereto.

A. Background

Liberty is a Delaware corporation formed by John D. Travis on December 11, 2003. During the Tax Period, Liberty engaged in the business of providing payroll, tax collection and payment and other administrative services to corporate clients in Delaware. As a result of these activities, Liberty was required to obtain a Delaware general service license and pay gross receipts taxes on its gross receipts. (Stipulation of Facts ¶ 1, 3, 4, Ex. A)

During the Tax Period, Liberty provided payroll, tax collection and payment and other administrative services to the SP Entities. Liberty received consideration for these services. The SP Entities are corporations owned by Demetrius Halakos, Evangelos Halakos and Ioannis Halakos, each of whom owns 33.33% of each of the SP Entities. (Stipulation of Facts ¶ 11, Exs. H through Q)

B. Ownership of Liberty

1. Liberty's Delaware Tax Returns

Liberty timely filed its income tax returns with the State of Delaware for calendar years 2009 and 2010. As Delaware requires, Liberty's 2009 and 2010 Delaware returns attached the corresponding federal return it filed with the Internal Revenue Service. (Stipulation of Facts ¶ 6, Exs. B and C)

The original Delaware returns Liberty filed for 2009 and 2010 state that John D. Travis owns 100% of Liberty's issued and outstanding stock. Liberty's 2009 and 2010 original Delaware returns are signed by John D. Travis. (Stipulation of Facts Exs. B and C)

In January 2012, Liberty filed amended Delaware tax returns for the 2009 and 2010 calendar years. The amendments to the Delaware returns were based on purported amendments to Liberty's federal returns and copies of Liberty's purportedly amended federal returns for 2009 and 2010 were attached to Liberty's amended Delaware returns. (Stipulation of Facts ¶ 7, Exs. E and F)² The purportedly amended federal returns attached to the amended Delaware returns reflect that individuals in addition to Mr. Travis owned Liberty stock in 2009 and 2010. (*Id.*) Specifically, the amended Delaware returns submitted in January 2012 reflected that Mr. Travis owned 19% of Liberty's common stock and that each of Demetrius Halakos, Evangelos Halakos and Ioannis Halakos owned 27% of Liberty's common stock in 2009 and 2010 (for a collective ownership interest of 81% of Liberty's common stock). (Stipulation of Facts Exs. E and F)

On or about October 1, 2012, Liberty filed its 2011 Delaware tax return. Based on the record before the Board, this return does not reflect the stock ownership of Liberty and has not been amended. (Stipulation of Facts ¶ 8)

2. Liberty's Federal Tax Returns

The federal income tax returns Liberty filed for calendar years 2007 through 2012 are part of the record in this case. Those returns reflect the following.

a. The 2007 Federal Return

On Schedule E of Liberty's 2007 federal return, Liberty identified John D. Travis as the owner of 100% of Liberty's issued and outstanding common stock. On Schedule K of its 2007 federal return, Liberty responded "yes" to the following question: "At the end of the tax year, did any individual, partnership, corporate, estate, or trust own, directly or indirectly, 50% or more of the corporation's voting stock?" On that same schedule, Liberty listed "100%" on the

² The adjective "purportedly" is used purposefully to describe Liberty's purportedly amended federal returns for 2009 and 2010 because, based on the record before the Board, there is no evidence Liberty filed amended federal returns for 2009 or 2010 with the Internal Revenue Service.

line which asked Liberty to identify the amount of voting stock owned by any individual, partnership, corporate, estate, or trust that owned, directly or indirectly, 50% or more of the corporation's voting stock at the end of the tax year. Schedule K to Liberty's 2007 federal return also required Liberty to name any individual, partnership, corporate, estate, or trust that owned, directly or indirectly, 50% or more of the corporation's voting stock at the end of the tax year. In response to that inquiry, Liberty identified John D. Travis. (Stipulation of Facts Ex. G)

b. The 2008 Federal Return

Schedule E to Liberty's 2008 federal return identified John D. Travis as the owner of 100% of Liberty's issued and outstanding common stock. Schedule K asked Liberty whether "any individual or estate own directly 20% or more or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote?" Liberty did not provide any information in response to this question. (Stipulation of Facts Ex. G)

c. The 2009 Federal Return

Schedule E to Liberty's 2009 federal return identified John D. Travis as the owner of 100% of Liberty's issued and outstanding common stock. Schedule K asked Liberty whether "any individual or estate own directly 20% or more or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote?" Liberty responded "yes" to this question; however, based on the record before the Board, it did not identify the individual or estate owning such an interest notwithstanding the request for this information. (Stipulation of Facts Ex. G)

d. The 2010 Federal Return

Liberty's 2010 federal return states that it was prepared by John D. Travis. Schedule E to Liberty's 2010 federal return identified John D. Travis as the owner of 100% of Liberty's issued

and outstanding common stock. Schedule K asked Liberty whether “any individual or estate own directly 20% or more or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation’s stock entitled to vote?” Liberty responded “yes” to this question. The 2010 federal return supplied to the Board as Exhibit G to the Stipulation of Facts does not identify the individual or estate owning such an interest; however, a more complete copy of Liberty’s 2010 federal return is attached to its 2010 Delaware return, Exhibit C to the Stipulation of Facts, and Schedule G to this copy of the federal return states that John D. Travis owns 100% of Liberty’s voting stock. (Stipulation of Facts Exs. C and G)

e. The 2011 Federal Return

Liberty’s 2011 federal return states that it was prepared by John D. Travis. Schedule E to Liberty’s 2011 federal return is not part of the record before the Board. Schedule K asked Liberty whether “any individual or estate own directly 20% or more or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation’s stock entitled to vote?” Liberty responded “no” to this question. (Stipulation of Facts Ex. G)

f. The 2012 Federal Return

Liberty’s 2012 federal return states that it was prepared by John D. Travis. Schedule E to Liberty’s 2012 federal return is not part of the record before the Board. Schedule K asked Liberty whether “any individual or estate own directly 20% or more or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation’s stock entitled to vote?” Liberty responded “yes” to this question; however, based on the record before the Board, it did not identify the individual or estate owning such an interest notwithstanding the request for this information. (Stipulation of Facts Ex. G)

Although Liberty attached purportedly amended copies of its 2009 and 2010 federal returns to its amended 2009 and 2010 Delaware returns, there is no evidence before the Board suggesting or demonstrating that Liberty ever filed amended federal tax returns for these or any other calendar years for the period 2007 to 2012.

3. The Halakos Brothers' Personal Financial Statements

Personal financial statements of Demetrius Halakos, Evangelos Halakos and Ioannis Halakos as of September 30, 2003, December 31, 2005 and December 31, 2012 are part of the record in this case. Each of the statements was prepared by John D. Travis. The statements reflect that each of the Halakos brothers had no investment in Liberty as of September 30, 2003. This is not surprising as Liberty was not formed until December 11, 2003. (Stipulation of Facts Exs. A, R, S and T)

The financial statements also reflect that each of the Halakos brothers held an investment in Liberty that as of December 31, 2005 was worth \$10,000 and as of December 31, 2012 was worth \$30,000. Although the financial statements detail the extent of the Halakos brothers' interest (*i.e.*, the number of shares they own) in many other investments (*e.g.*, the SP Entities), the financial statements do not reflect the extent of the Halakos brothers' ownership interest in Liberty. (Stipulation of Facts Exs. R, S and T)

There is no evidence before the Board indicating when these personal financial statements were prepared, why they were prepared or whether or how they were used by the Halakos brothers.³

³ The September 30, 2003 personal financial statement of Demetrius Halakos was accompanied by a cover letter dated November 10, 2013. (Stipulation of Facts Ex. R) The September 30, 2003 personal financial statements of Evangelos Halakos and Ioannis Halakos were accompanied by cover letters dated November 10, 2003. (Stipulation of Facts Exs. S and T)

4. No Corporate Records Or Testimony

Although Delaware law requires Liberty to maintain a ledger listing its stockholders by name, address and the number of shares they hold,⁴ Liberty has not included such a ledger or any other corporate documents identifying its stockholders or their holdings in the record before the Board. Stock certificates, board resolutions authorizing the sale of stock, meeting minutes reflecting votes by stockholders and other corporate records should evidence who Liberty's stockholders are and the extent of their ownership interest in Liberty. Liberty did not include any such documents in the record before the Board.

Likewise, no representative of Liberty offered testimony regarding who Liberty's stockholders are and the extent of their ownership interest in Liberty. Given the information set forth in Liberty's Delaware and federal tax returns, the absence of such testimony – as well as the absence of any explanation as to how Liberty purportedly misstated basic facts in its tax returns over a period of several years and why Liberty apparently never filed the amended federal tax returns that form the basis of its requested relief – is notable.⁵

5. Liberty's Stockholders' Equity

Schedule L to Liberty's 2007 and 2008 federal returns states that \$30,000 has been paid to Liberty for its common stock. (Stipulation of Facts Ex. G)

Schedule L to the 2009 federal return states that \$30,000 was paid to Liberty for its capital stock at the beginning of 2009. This same schedule reflects that by the end of 2009 Liberty had (i) received \$150,000 for its common stock and (ii) paid \$120,000 for treasury stock

⁴ 8 Del. C. §§ 219(a); *Rainbow Nav., Inc. v. Pan Ocean Nav., Inc.*, 535 A.2d 1357, 1359 (Del. 1987) (“Delaware corporations have an affirmative duty to maintain a stock ledger”).

⁵ See *Smith v. Van Gorkom*, 488 A.2d 858, 878 (Del. 1985) (“It is a well established principle that the production of weak evidence when strong is, or should have been, available can lead only to the conclusion that the strong would have been adverse”), *overruled on other grounds*, *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

(*i.e.*, that Liberty had repurchased \$120,000 of its issued and outstanding common stock which became treasury stock). (Stipulation of Facts Ex. G)

Schedule L to Liberty's 2010 and 2011 federal returns states that \$150,000 has been paid to Liberty for its common stock and that Liberty had paid \$120,000 for treasury stock.

(Stipulation of Facts Ex. G)

Neither the Stipulation of Facts nor Liberty's federal tax returns contain facts explaining (i) who contributed the initial \$30,000 for Liberty common stock, (ii) the number of shares received for the initial \$30,000, (iii) the number of additional shares sold in 2009, (iv) who purchased the additional shares issued in 2009, (v) the number of shares Liberty repurchased as treasury stock in 2009, or (vi) from whom Liberty repurchased its common stock in 2009.

6. Liberty's Briefs

Liberty's opening brief contains a "Finding of Facts" section which states, among other things, the following:

- "the owners of SP [*i.e.*, the Halakos brothers] contributed \$30K for the common stock of [Liberty] in December 2003. Each share[holder] of SP [*i.e.*, each one of the Halakos brothers] contributed \$10K . . . They purchased 100 shares of stock. (They gifted me [*i.e.*, John D. Travis] 19 shares and held 27 each.)"
- "Liberty's "2009 Federal Tax Return shows the opening balance of common stock as \$30K. The ending balance is \$150K."
- "Each shareholder of SP purchased 100 shares of [Liberty] stock for \$40K."
- Liberty "purchased back \$120K of stock in 2009" and
- "The owners of SP [*i.e.*, the Halakos brothers] reported on their personal tax returns (1040), Schedule D, the sale of stock."

Although not part of the record, Liberty attached a Schedule D for each of the Halakos brothers for 2009 to its opening brief.⁶

Liberty's reply brief states:

- 2004: Individuals Demetrius Halakos, Evangelos Halakos and Ioannis Halakos (from hereon in referred to as Seasons Pizza Shareholders or [SPS]), purchased 100 shares of Common Stock in [Liberty] for \$30,000.
- 2009: State of Delaware Corporate Tax Return verified Common Stock of \$150,000 (Original \$30,000 plus increase in value of \$120,000). We have expanded on the facts presented by the respondent. The following events took place:

SPS purchased \$120,000 of [Liberty] Common Stock (360 shares @ \$333.34/share)

[Liberty] purchased 300 shares @ \$400/share from SPS. SPS reported the sale of stock on their 2009 Individual Tax Return(s), Schedule D, using FIFO method of determining Cost Basis.

* * *

... Since inception, [Liberty] stock ownership is as follows for each SPS:

2004: 27 shares purchased
2009: 120 shares purchased
2009: 100 shares sold
47 shares remaining

There is a discrepancy between Liberty's opening brief and its reply brief as to the number of shares each Halakos brother purchased in 2009. In its opening brief, Liberty stated that "[e]ach shareholder of SP," *i.e.*, each one of the Halakos brothers, "purchased 100 shares of [Liberty] stock for \$40K" in 2009. In its reply brief, Liberty stated that each Halakos brother purchased 120 shares of Liberty common stock in 2009. Furthermore, there is a discrepancy

⁶ Whether the Schedule Ds attached to Liberty's opening brief are true and correct copies of Schedule Ds filed by the Halakos brothers in 2009 is not clear as the Halakos brothers' 2009 federal tax returns are not part of the record before the Board.

between the statements in the reply brief, which suggest that each Halakos brother owned 29.375% of Liberty's stock (see footnote 7), and the purportedly amended federal returns attached to the amended Delaware returns, which state that each Halakos brother owns a 27% interest in Liberty. Given that the number of Liberty shares held by the Halakos brothers during the Tax Period should be easily determined and is central to the resolution of this case, the Board finds these discrepancies troubling.⁷

In any event, although the Board has advised Liberty as to how facts become part of the record and has emphasized that Liberty should include any important facts in the record (*see* Transcript of September 11, 2013 pretrial conference), there are no facts before the Board which support the "Finding of Facts" section of Liberty's opening brief, the statements in its reply brief or the information on the Schedules Ds attached to those briefs.⁸

C. The Director Denies Liberty's Request For A Refund

On or about July 25, 2012, Liberty filed three Claims for Revision seeking refunds of substantially all of the gross receipts taxes it paid during the Tax Period. (Stipulation of Facts Exs. U, V and W) On February 18, 2013, the Director of Revenue issued a notice of disallowance of Liberty's Claims for Revision. (Stipulation of Facts Ex. X) On April 16, 2013, Liberty filed a timely protest to the notice of disallowance claiming that Liberty and the SP

⁷ If, as stated in the reply brief, each Halakos brother owned 47 shares of Liberty's issued and outstanding stock after 2009, then there is an error in the amended Delaware tax returns for the 2009 and 2010 calendar years that Liberty filed in 2012.

The 2009 and 2010 amended Delaware returns state that "SHAREHOLDER INFORMATION WAS INCORRECTLY SHOWN ON ORIGINAL RETURN" and reflect that each Halakos brother owns 27% and that John Travis owns 19% of Liberty's outstanding stock. (Stipulation of Facts Exs E and F). Yet, if, as Liberty contends in its reply brief, each Halakos brother owned 47 shares of Liberty stock after 2009, then the amended 2009 and 2010 returns filed with Delaware should state that each brother owns 29.375% of Liberty's outstanding stock (47/160 issued and outstanding shares) and that John Travis owns 11.875% of Liberty's outstanding shares (19/160 issued and outstanding shares)

⁸ For example, there are no cancelled checks or other documents in the record evidencing the transfer of funds from the Halakos brothers to Liberty when they purportedly purchased Liberty stock or from Liberty to the Halakos brothers when Liberty purportedly repurchased its common stock from them.

Entities were “related entities” under 30 *Del. C.* § 2120(b) because the Halakos brothers owned more than 80% of Liberty and the SP Entities and, as a result, Liberty was not required to pay gross receipt taxes on payments Liberty received from the SP Entities during the Tax Period. (Stipulation of Facts Ex. Y) On May 28, 2013, the Director of Revenue issued a notice of determination denying Liberty’s protest. (Stipulation of Facts Ex. Z) This appeal followed.

Analysis

As stated above, the issue in the case is whether Liberty and the SP Entities are “related entities” under Section 2120(b). More specifically, the issue is whether more than eighty percent in value of the stock of Liberty and the SP Entities is owned, directly, indirectly or beneficially, by the same five or fewer individuals. 30 *Del. C.* § 2120(b). Liberty bears the burden of proof and must establish its case by a preponderance of the evidence. 30 *Del. C.* § 526; Tax Appeal Board Rule XVIII; *Testa v. Director*, No. 1206 (Del. Tax App. Bd. May 15, 1995).

Although Liberty has proven that the Halakos brothers owned more than eighty percent of the SP Entities in 2009, 2010 and 2011, Liberty has failed to prove by a preponderance of the evidence that the Halakos brothers owned more than eighty percent of the value of Liberty’s outstanding stock during the Tax Period. As detailed above, virtually all of the evidence before the Board demonstrates that John Travis owned 100% of Liberty before, during and after the Tax Period. There is no evidence in the record indicating that in 2011 the Halakos brothers owned more than 80% of Liberty. The only evidence suggesting that the Halakos brothers owned more than eighty percent of Liberty in 2009 and 2010 are the amended Delaware returns, which attached purportedly amended federal returns. (Stipulation of Facts Exs. E and F) But, these amended Delaware returns are inconsistent with Liberty’s 2009 and 2010 federal returns on file