

KEYWORD: Financial

DIGEST: Applicant's financial problems continue to raise security concerns as he has refused to resolve debts of approximately \$46,000 to the Internal Revenue Service (IRS) for unpaid taxes for 1998 and 1999 tax years when he was president of a company with authority to authorize payment of bills. Instead the IRS found even after he became aware of delinquent tax payments, he signed checks to repay another company over \$4 million while taxes remained unpaid. Thus, the IRS held him liable as he made the decisions over what to pay based on the amount of money available after he took over as president. Since this IRS ruling in June 2004, Applicant chose not to pay the taxes and file a claim for refund or to pursue any other appeal with the IRS. Thus, he has not demonstrated sufficiently that he has made a good-faith effort to resolve his debts. Clearance is denied.

CASENO: 04-04532.h1

DATE: 06/12/2006

DATE: June 12, 2006

In Re:

SSN: -----

Applicant for Security Clearance

ISCR Case No. 04-04532

DECISION OF ADMINISTRATIVE JUDGE

KATHRYN MOEN BRAEMAN

APPEARANCES

FOR GOVERNMENT

Nichole Noel, Esquire, Department Counsel

FOR APPLICANT

Jim Ellis, Esquire, The Burkhardt Law Offices

SYNOPSIS

Applicant's financial problems continue to raise security concerns as he has refused to resolve debts of approximately \$46,000 to the Internal Revenue Service (IRS) for unpaid taxes for 1998 and 1999 tax years when he was president of a company with authority to authorize payment of bills. Instead the IRS found even after he became aware of delinquent tax payments, he signed checks to repay another company over \$4 million while taxes remained unpaid. Thus, the IRS held him liable as he made the decisions over what to pay based on the amount of money available after he took over as president. Since this IRS ruling in June 2004, Applicant chose not to pay the taxes and file a claim for refund or to pursue any other appeal with the IRS. Thus, he has not demonstrated sufficiently that he has made a good-faith effort to resolve his debts. Clearance is denied.

STATEMENT OF THE CASE

The Defense Office of Hearings and Appeals (DOHA) issued a Statement of Reasons (SOR) to Applicant on June 22, 2005. The SOR detailed reasons why the Government could not make the preliminary positive finding that it is clearly consistent with the national interest to grant or continue a security clearance for Applicant.⁽¹⁾ The SOR alleges specific concerns over finances (Guideline F). Applicant responded to these SOR allegations in a notarized Answer submitted on July 13, 2005, and requested a hearing.

After Department Counsel stated the case was ready to proceed on August 17, 2005, the case was assigned to me on August 24, 2005. On September 14, 2005, DOHA issued a Notice of Hearing and set this case to be heard on October 13, 2005, in a city near where Applicant lives and works. On September 15, 2005, Applicant's counsel entered his appearance and asked for a continuance in the matter for six months because of a pending issue with the Internal Revenue Service (IRS). However, on September 21, 2005, the Department Counsel indicated that she opposed the motion for continuance as there was "no expectation that the process will be concluded in a reasonable time." On September 22, 2005, I denied the request to a continuance as he had not demonstrated a good cause basis.

At the hearing the government offered six exhibits (Exhibits 1-6) which were admitted into evidence without objection. Applicant testified and called two witnesses; he offered eight exhibits (Exhibits A-H) which were admitted into evidence without objection. Applicant's counsel asked that I take Administrative Notice (AN) of *Campbell v. Nixon*, 207 F.Supp. 826 (AN I) and also of a decision of another DOHA Administrative Judge (DISCR Case No. 01-03617 (November 29, 2001) (AN II). As the Government had no objection I took administrative notice of both cases even though I explained that a decision of a DOHA trial judge had no precedential value. (TR 24-25) The transcript (TR) was

received on October 26, 2005.

FINDINGS OF FACT

After a complete and thorough review of the evidence in the record, and upon due consideration of that evidence, I make the following findings of fact:

Applicant, 56 years old, has been employed by Federal Contractor #1 in State #1 as a program manager from October 2000 to present. He completed a Security Clearance Application (SF 86) on March 1, 2001. Previously, he was unemployed from January to October 2000. From 1996 to December 1999 he worked for Federal Contractor #2. He explained that Mr. C, who had bought the company and renamed it, asked him to move to State #2 in July 1998 and become acting president of Federal Contractor #2. He served as company president until December 1999 when the company went bankrupt. From June 1995 to June 1996 he was vice president of Federal Contractor #3 which was bought by Mr. C⁽²⁾ and renamed Federal Contractor #2. Previously, he had been granted a top secret clearance in April 1993. Earlier, he served in the military from April 1973 to July 1995. (Exhibit 1; TR 27-28; 48; 57) At the time of the hearing he testified that he had a secret clearance. (TR 27)

Applicant received a BA from a university in State #3 granted in December 1972. He was married in June 1974. He has three children born in 1975, 1977, and 1978. (Exhibit 1)

Finances

Applicant claimed he had no knowledge of any financial problems at the time he completed his SF 86 in March 2001. (TR 42; Exhibit E) Applicant was notified in July 2001 of the IRS attempt to collect unpaid employment taxes from Defense Contractor #2 and notified that the outstanding amount for the tax period ending in September 1998 was \$60,714 with a penalty of \$44,125; and for the tax period ending in December 1999 the amount outstanding was \$2,454 with a penalty of \$1,920. (Exhibit 3; TR 58) When he got that letter, he contacted Mr. S, a lawyer in State #2 who was handling the matter for him and for the company. (Exhibit A; TR 58)

Applicant appealed his personal liability, but the IRS Appeals Office ruled against him on June 10, 2004, and advised that after he had paid the amount due, he could file a claim for refund within two years from the time the tax was paid. The IRS ruling⁽³⁾ explained the reasons for his personal tax liability:

The facts show you took over as president in 7-9-1998 and remained so through 12-31-1999. You owned 3.5% of the stock issued during these periods. As President, you had full authority to hire/fire/manage employees, direct/authorize payment of bills, open & close bank accounts, make/authorized bank deposits, sign checks, etc. You were aware of delinquent payment shortly after becoming president and you stated to the investigating officer that you authorized/directed payment of other bills while tax due, but unpaid based on the amounts of funds available from (Parent Company X). You further stated (Bank 1) would not release or subordinate its due payments to permit other payments and would not provide funds to pay taxes. Therefore funds were borrowed from Company X to make payroll every two weeks. All income was being used to pay on the Bank 1 loan to get it current. Also during these periods operating expenses, payroll and interest on the loan from Bank 1 were paid. A review of the checks written show you signed checks to repay Company X over \$4M while these taxes remained unpaid. You made the decisions as to what to pay based on the amount of money available after he (*sic.*) took over as president. Under these facts and circumstances, you meet the requirements to be held liable under IRC Section 6672 for the unpaid trust fund taxes that accrued after 7-9-1998.

(Exhibit 4; TR 59) On that same date Applicant was notified of the \$44,125 tax due for 1998 and the \$1,910 tax due for 1999. (Exhibits 5, 6) Applicant did not disclose this IRS debt until he was interviewed by the Defense Security Service (DSS) in July 2004. He then explained that when he was president of Defense Contractor #2 he had the responsibility to pay the taxes. At one point the taxes were not paid due to lack of funds. He acknowledge that in June 2004 IRS notified him that he owed \$46,036. The case was transferred to an IRS field agent. In July 2004 Applicant stated that he planned to make payment arrangements with the field agent to try to make a lump sum payment. He stated he intended to satisfy this debt as he had the resources. His combined monthly net income was \$12,169; his monthly expenses were \$2,226; his monthly debt payments were \$6,159 with a net monthly remainder of \$3,784. He had assets in real estate of \$400,000 and other assets for a total of \$630,321. (Exhibit 2; TR 69-70) Despite his July 2004 statement to DSS that he had sufficient resources, at the hearing Applicant claimed he did not have the money to pay the \$46,000 IRS debt. He does not have a tax lawyer representing him on the IRS appeal he hopes to make. (TR 78-80)

SOR 1.a.. Applicant owes IRS \$44,125 in unpaid taxes for the tax period ending September 1998. (Answer; Exhibits 2, 3, 4, 5)

SOR 1.b. Applicant owes IRS \$1,910 in unpaid taxes for the tax period ending December 1999. (Answer; Exhibits 2, 3, 4, 6)

Applicant also argued that he has not paid the tax debt as he believes he does not owe the money as he claims⁽⁴⁾ that he had no real control over the company funds. (TR 66-67) Instead, Appellant argues that Mr. C should be held liable for these tax liabilities as he is a millionaire and was the owner. (TR 73) At the hearing in October 2005 Applicant testified that when he moved to State #2 and became acting president⁽⁵⁾ of Federal Contractor #2, he assumed responsibility for making sure all taxes were paid for employees' salaries beginning in July 1998. However, he did not review the company books before he accepted the position. He learned of the tax problem first in October⁽⁶⁾ 1998 and learned that the company "had not been paying taxes for some time." He consulted the accountant who advised him that the company did not have the cash flow to pay taxes. (Answer; Exhibit C; TR 28-30; 49-50) At that point he consulted with r. C, who owned several companies; Federal Contractor #2 was one of those companies. He also called Mr. R⁽⁷⁾ who

had been his predecessor as vice-president and was then in another position. Mr. J had previously been acting as president but was more of a figure-head and advisor on banking. (TR 30-32) In extenuation Applicant testified that every Tuesday morning Mr. C hosted a presidents meeting of all of his companies and would decide what should be paid. (TR 33-36; 53-54; 74-75)

Applicant claimed he threatened to quit over the tax issue; but, in fact, he did not quit. (TR 50) Mr. C then assured Applicant that the taxes would be paid, so he continued in his role as president. At some point \$60,000 was paid to IRS. (TR 36) Two weeks after the company made that payment, in January 1999 IRS visited the company as that payment alerted them to the fact that the company had not kept their taxes current. (TR 37-38; 51-53) Subsequently, Applicant⁽⁸⁾ had an account set up in March 1999 where taxes were paid to IRS on a monthly basis. Applicant believed he had an understanding with Mr. C that taxes would be paid subsequently, so he stayed as president. (Exhibit D; TR 40-42; 55-56; 70-71; 78)

Applicant's main job as president was to close out an audit of 45 government contracts. However, the result was the company did not collect any money; instead the Defense Contract Audit Agency (DCAA) audit found that the company owed the government \$300,000. He did not believe the money was paid as the company went into bankruptcy. (TR 76-78)

A predecessor at Defense Contractor #2, Mr. R, testified that he also believed that Mr. C would pay taxes based on his discussions with Applicant. Mr. R is also being held liable by the IRS for \$60,000 in unpaid taxes for one quarter when he was in an executive position at Defense Contractor #2. He began receiving letters from the IRS in 2000. To avoid a tax lien, Mr. R paid \$400 in back taxes in February or March 2005 and then filed an IRS appeal for a refund based on his view that he should not be held liable for the taxes. His refund claim was denied and now he is appealing that decision. Since April 2005 his case has been under review by the IRS. (TR 92-100, 105, 107-108; 109-113; 115-116) Mr. R testified that the parent company would direct the subsidiaries where money should be spent. He believes Defense Contractor #2 could have been in the black if Mr. C had not transferred a portion of that money to other companies. (TR 100-106; 113-115; 116-119)

Applicant believes that the IRS is pursuing Mr. C for the Section 941 trust fund taxes as he learned that the IRS filed a federal tax lien against all real property owned by Mr. C in State #2. Applicant believes that the IRS is pursuing Mr. C, the parent company and Mr. R as well as himself for the tax lien. However, Mr. R has paid a portion of his tax debt and subsequently been in an appeal process with the IRS. (Exhibit F; TR 43-44)

Applicant's wife also began working for Federal Contractor #3 in 1996 as a computer programmer and then moved to Federal Contractor #2 when it was bought. When her husband became president and moved to State #2, she also moved and became a clerk in November 1998 and worked with the DCAA auditors. In February 1999 she also handled the payroll and accounting systems. She also did software development for Mr. C, the owner of five companies, to track the money. She then learned that Federal Contractor #2 had not been paying the payroll taxes. After Mr. C agreed payroll taxes could be paid, she was involved in the electronic transfer of the payment to IRS in 1999. She made copies of Exhibit D to show when payroll taxes were made. Since no tax lien has been filed against their property, she and her husband are refusing to pay any of the tax debt as they are disputing their liability. She believes her husband showed bad judgment in trusting Mr. C. Otherwise he has shown good business judgment and has been honest. (TR 124-134;

While Applicant called the IRS and asked that the company files be transferred to State #1, so he could pursue another tax appeal, IRS has not contacted him. Also, he has not paid the amount he owes the IRS, as he preferred to take a "wait and see approach" while the IRS is pursuing other people who might be liable. (TR 59-63; 65) Applicant believes he has one more appeal with the IRS, but he has not pressed the IRS to meet with him while the matters are pending in State #2 with Mr. C. Applicant claims he does not believe he should be liable as only Mr. C could decide ⁽⁹⁾ what should be paid. Applicant has had no other tax problems. (TR 44-47)

References

The vice president of operations for Applicant's current company stated that he has known Applicant for ten years both in the military and as a government contractor. He stated that Applicant is a man of great integrity. His personal and professional performances have been superb. (Exhibit G)

Applicant's supervisor stated that he first met Applicant when he was a military officer. He respects Applicant's judgment and hard work. He has also demonstrated his integrity. (Exhibit H)

POLICIES

Enclosure 2 of the Directive sets forth adjudicative guidelines to consider in evaluating an individual's security eligibility. They are divided into conditions that could raise a security concern and may be disqualifying and conditions that could mitigate security concerns in deciding whether to grant or continue an individual's access to classified information. But the mere presence or absence of any given adjudication policy condition is not decisive. Based on a consideration of the evidence as a whole in evaluating this case, I weighed relevant Adjudication Guidelines as set forth below:

Guideline F - Financial Considerations

The Concern: An individual who is financially overextended is at risk of having to engage in illegal acts to generate funds. Unexplained affluence is often linked to proceeds from financially profitable criminal acts.

The responsibility for producing evidence initially falls on the Government to demonstrate that it is not clearly consistent with the national interest to grant or continue Applicant's access to classified information. Then the Applicant presents evidence to refute, explain, extenuate, or mitigate in order to overcome the doubts raised by the Government, and to demonstrate persuasively that it is clearly consistent with the national interest to grant or continue the clearance. Under the provisions of Executive Order 10865, as amended, and the Directive, a decision to grant or continue an applicant's security clearance may be made only after an affirmative finding that to do so is clearly consistent with the national interest. In reaching the fair and impartial overall common sense determination, the Administrative Judge may draw only those inferences and conclusions that have a reasonable and logical basis in the evidence of record.

CONCLUSIONS

Financial Considerations

The Government established disqualifying conditions⁽¹⁰⁾

that could raise a security concern and may be disqualifying including Applicant's (1) history of financial problems and his (3) inability or unwillingness to satisfy his debt to the IRS for \$46,000 in penalties for his failure to pay payroll taxes when he was president of Federal Contractor #2 from 1998 to 1999. Even after being put on notice about the government's concerns over his finances, he made no effort to resolve these debts after the IRS Appeals office found him liable in June 2004 and after he assured DSS in July 2004 that he had the means and intended to satisfy this tax debt.

While Applicant's circumstances have some sympathetic elements as he claims he was president of a company where the owner had questionable business practices, Applicant failed to show due diligence before he assumed this key role. Subsequently, he chose to stay as president even after he learned in October 1998 that the payroll taxes were not being paid and to rely on the owner's assurances that they would be paid even though he was aware of Mr. C's other questionable business practices. Since the June 2004 IRS ruling that found him liable, he has taken no further action to contest this debt even though he was advised by IRS that he could make a payment and seek a refund. Indeed, his business colleague, Mr. R, did choose that route and paid a minimal payment to insure that he was not subject to a tax lien and could have further IRS appellate review of his case and his defenses. All of the issues concerning Applicant's tax liability are within the jurisdiction of IRS, not DOHA; but he has not pursued that remedy. He initially relied on the corporate tax lawyer to protect his interests after he was put on notice in 2001 of the IRS attempt to collect the unpaid employment taxes. Since the adverse IRS ruling in 2004, he has taken a "wait and see approach" and has not even retained a personal tax lawyer to advise him on this matter.

Thus, after looking at all of the testimony, in the final analysis, Applicant failed to mitigate⁽¹¹⁾ these financial concerns. While he argues some of the conditions that led to this debt were beyond his control, the IRS investigated this matter and, nevertheless, found him liable in June 2004. Subsequently, he failed to initiate a good-faith effort to repay overdue creditors or otherwise resolve debts. While Applicant argues that this debt is an isolated example, given the size of the debt and the fact that it extended from 1998 to 1999 and given his subsequent inaction, Applicant can not mitigate merely on the assertion that his conduct was isolated. For example, Applicant did not show that he has received or is receiving counseling for the problem. Consequently, there is not as yet a clear indications that the problem is being resolved or is under control. Thus, Applicant has yet to demonstrate that he is financially responsible.

In sum, Applicant failed to initiate a good-faith effort to repay his IRS debt or otherwise resolve this debt in a timely manner. While he is highly regarded at his current company, there is no indication that they are aware of the size of this IRS debt. I do not find either *Campbell v. Nixon*, 207 F.Supp. 826 (AN I) or the decision of another DOHA Administrative Judge (DISCR Case No. 01-03617 (November 29, 2001) relevant to this matter.

After considering the Adjudicative Process factors⁽¹²⁾

and the Adjudicative Guidelines, I rule against Applicant under SOR subparagraphs 1.a. and 1.b. under SOR Paragraph 1.

FORMAL FINDINGS

After reviewing the allegations of the SOR in the context of the Adjudicative Guidelines in Enclosure 2 and the factors set forth under the Adjudicative Process section, I make the following formal findings:

Paragraph 1. Guideline F: AGAINST APPLICANT

Subparagraph 1.a.: Against Applicant

Subparagraph 1.b.: Against Applicant

DECISION

In light of all the circumstances presented by the record in this case, it is not clearly consistent with the national interest to grant or continue a security clearance for the Applicant. Clearance is denied

Kathryn Moen Braeman

Administrative Judge

1. This procedure is required by Executive Order 10865, as amended, and Department of Defense Directive 5220.6, dated January 2, 1992 (Directive), as amended by Change 4, April 20, 1999.
2. A former colleague, Mr. R, who testified for Applicant explained that he first met Applicant when he worked for Defense Contractor #3 in 1995. After Mr. C bought that company, Mr. R initially became vice president for contracts and later became executive vice president of Defense Contractor #2 where he also knew Applicant. After Mr. R left to work for another company that Mr. C owned, Applicant became president of Defense Contractor #2. Mr. R did not alert Applicant to the corporate practice at Defense Contractor #2 where payroll taxes were not being paid. (TR 83-84; 108-109; 120-122)
3. Applicant testified that he did not see any factual errors in the June 2004 IRS ruling. However, he insisted that he should not be liable as he could only make payments that Mr. C, the owner, told him to make. (TR 74-76) Clearly, the IRS did not accept this argument in their June 2004 opinion.
4. This claim is refuted by the IRS Appeals Office ruling in June 2004 which Appellant has not appealed. (Exhibit 4)
5. As president, Applicant was paid approximately \$70,000 per year. (TR 80)
6. Initially, Applicant testified he learned of the company's tax problems in December 1998; he changed the date to September 1998 in cross-examination and then to October 1998. He was not sure when the IRS came to interview him initially. (Exhibit C; TR 28-30; TR 68)
7. Applicant called Mr. R to testify who confirmed that there were meetings chaired by Mr. C where decisions were made on what bills to pay. Mr. R learned that payroll taxes were not being paid when he was executive vice president of Defense Contractor #2 as Mr. C decided not to pay these payroll taxes. Mr. R did not challenge these decisions. He explained that Mr. C would juggle money back and forth between the companies he owned. Mr. R and his wife now own a company where they resell computer equipment to the federal government. (TR 82, 86-92)
8. Applicant did not keep any records when he left in 1999 as the records belonged to Contractor #2. (TR 64-65) However, his wife obtained some records when she did some work for Mr. C; however, she did not advise Mr. C that she was keeping these records. (TR 72-74; Exhibit D)
9. This claim is contradicted by Applicant's testimony and exhibit that showed he did set up a company account to pay taxes in 1999. (Exhibit D; TR 40-42; 55-56; 70-71)
10. **E2.A6.1.2. Conditions that could raise a security concern and may be disqualifying include:** E2.A6.1.2.1. A history of not meeting financial obligations; E2.A6.1.2.2. Deceptive or illegal financial practices such as embezzlement, employee theft, check fraud, income tax evasion, expense account fraud, filing deceptive loan statements, and other

intentional financial breaches of trust; E2.A6.1.2.3. Inability or unwillingness to satisfy debts; E2.A6.1.2.4. Unexplained affluence; E2.A6.1.2.5. Financial problems that are linked to gambling, drug abuse, alcoholism, or other issues of security concern.

11. **Conditions that could mitigate security concerns include:** E2.A6.1.3. 3. The conditions that resulted in the behavior were largely beyond the person's control (e.g., loss of employment, a business downturn, unexpected medical emergency, or a death, divorce or separation); E2.A6.1.3. 4. . . . there are clear indications that the problem is being resolved or is under control; and E2.A6.1.3. 6. The individual initiated a good-faith effort to repay overdue creditors or otherwise resolve debts.

12. Also, I have evaluated his conduct and considered the following factors: E.2.21.1. The nature, extent, and seriousness of the conduct; E2.2.1.2. The circumstances surrounding the conduct, to include knowledgeable participation; E2.2.1.3. The frequency and recency of the conduct; E2.2.1.4. The individual's age and maturity at the time of the conduct; E2.2.1.5. The voluntariness of the participation; E2.2.1.6. The presence or absence of rehabilitation and other pertinent behavioral changes; E.2.2.1.7. The motivation for the conduct; E.2.2.1.8. The potential for pressure, coercion, exploitation, or duress; and E.2.2.1.9. The likelihood of continuation or recurrence. (E.2.2. Adjudication Process)