

IT 12-05

Tax Type: Income Tax

**Issue: Responsible Corporate Officer – Failure To File Or Pay Tax
Penalty Under 1002D – Failure To File/Pay Withholding**

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

THE DEPARTMENT OF REVENUE)	Docket No.	XXXX
OF THE STATE OF ILLINOIS)	NOD Nos.	XXXX
v.)	Tax Periods	XXXX
JOHN DOE , as responsible officer)		
of ABC Business, Inc.,)	John E. White,	
Taxpayer)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Jack Black, DEF Firm, appeared for John Doe; Mehpara Suleman, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis: This matter arose when John Doe (John Doe or Taxpayer) protested the Notice of Deficiency (NOD) the Illinois Department of Revenue (Department) issued to him as a responsible officer of ABC Business, Inc. (ABC Business). The NOD proposed to assess a penalty that was equal to the amount of Illinois income tax, including penalties and interest, the Department determined ABC Business withheld from its employees' wages during the third through fourth quarters of 2008, and which ABC Business failed to pay over to the Department.

At hearing, John Doe appeared as a witness, testified under oath, and also offered documents into evidence. I have reviewed the evidence, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the Director

finalize the NOD, pursuant to statute.

Findings of Fact:

1. During 2006 through 2008, John Doe was ABC Business's corporate secretary. Department Ex. 3 (copies of corporate annual reports ABC Business filed with the Illinois Secretary of State).
2. ABC Business operated a restaurant, lounge and banquet hall in Anywhere, Illinois. Taxpayer Ex. 1 (copies of some of ABC Business's bank statements for June-August of 2008), pp. 1-9 (statements for commercial checking account showing account holder as ABC Business d/b/a XYZ Business); Hearing Transcript (Tr.) p. 16 (John Doe).
3. ABC Business operated in the nature of a partnership, with the partners being John Doe, who was ABC Business's secretary, and Joe Blow (Joe Blow), who was its president. Tr. pp. 16-18 (John Doe); Department Ex. 3.
4. No other ABC Business employee held a corporate office. Tr. p. 70 (John Doe); Department Ex. 3.
5. For the period of approximately 2005 through 2008, Billy Bob was ABC Business's office manager. Tr. pp. 71-73 (Billy Bob). Billy Bob had been employed by the prior owners of the restaurant, before ABC Business began operating the restaurant. Tr. p. 73 (Billy Bob).
6. Billy Bob was familiar with the financial obligations of ABC Business during the last half of 2008. Tr. p. 72 (Billy Bob).
7. Billy Bob would open and review ABC Business's mail. Tr. p. 72 (Billy Bob). He would give ABC Business's bills to Joe Blow, by placing them on Joe Blow's desk.

Id. Joe Blow would then decide which bills to pay, print the appropriate checks, sign them, and give them to Billy Bob to mail. Tr. pp. 72-74 (Billy Bob).

8. John Doe characterized his role in the restaurant as its day-to-day manager, and Joe Blow's role as the person who took care of banking, ordering food, and paying bills. Tr. pp. 17-18 (John Doe). John Doe ordered liquor, worked the front desk as host, worked the office answering phones, and managed bar and restaurant staff. *Id.* He occasionally hired or fired employees. Tr. p. 18 (John Doe).
9. John Doe was authorized to sign checks for ABC Business. Tr. p. 66 (John Doe).
10. Sometime during the period at issue, Joe Blow died. *See* Tr. pp. 18-20 (John Doe).
11. John Doe continued to manage the restaurant ABC Business operated after Joe Blow died, and it stopped doing business in October 2008. Tr. p. 20 (John Doe).
12. During the period that John Doe managed the restaurant, ABC Business continued to pay employees. Tr. pp. 66-70 (John Doe); Taxpayer Ex. 1, pp. 10-20 (copies of some of ABC Business's payroll account statements for July and August 2008).
13. Beginning July 2008, ABC Business's bank identified the account holder of ABC Business's payroll account as ABC Business d/b/a XYZ Business Debtor in Possession. Taxpayer Ex. 1, pp. 10-20.
14. ABC Business filed a form IL-941 titled, Illinois Quarterly Withholding Income Tax Return, for the third quarter of 2008, and one for the fourth quarter of 2008. Department Ex. 2 (copies of ABC Business's forms IL-941s for the third and fourth quarters of 2008).
15. John Doe signed the IL-941s ABC Business filed for the third and fourth quarters of 2008. *Id.*

16. ABC Business filed the IL-941s for the third and fourth quarters of 2008 without payment. Department Exs. 1-2.
17. John Doe knew that ABC Business was paying wages to its employees at the same time ABC Business was not paying over to the Department the tax monies it was required to deduct and withhold from those wages. Department Ex. 2; Tr. pp. 67, 69 (John Doe); 35 ILCS 5/701(a).

Conclusions of Law:

Section 701 of the Illinois Income Tax Act (IITA) requires employers maintaining an office or transacting business within Illinois, and which are required by the Internal Revenue Code to withhold a tax on compensation paid in Illinois to individuals, to deduct and withhold Illinois income tax from such compensation. 35 ILCS 5/701(a). Section 704 requires employers to report and pay over to the Department the amounts deducted and withheld, or the amounts required to be deducted and withheld, from such compensation. 35 ILCS 5/704. Section 705 creates a special trust, for the Department, of the tax monies actually deducted and withheld by an employer. 35 ILCS 5/705. Whether actually deducted and withheld or not, the tax required to be deducted and withheld is the tax of the employer. *Id.*

Section 1002(d) of the IITA provides:

Willful failure to collect and pay over tax. Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for the penalty imposed by Section 3-7 of the Uniform Penalty and Interest Act.

35 ILCS 5/1002(d).

Section 3-7 of the Uniform Penalty and Interest Act (UPIA) provides, in pertinent part:

(a) Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the taxpayer including interest and penalties thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section. Proof of that determination by the Department shall be made at any hearing before it or in any legal proceeding by reproduced copy or computer printout of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. If reproduced copies of the Department's records are offered as proof of that determination, the Director must certify that those copies are true and exact copies of records on file with the Department. If computer print-outs of the Department's records are offered as proof of such determination, the Director must certify that those computer print-outs are true and exact representations of records properly entered into standard electronic computing equipment, in the regular course of the Department's business, at or reasonably near the time of the occurrence of the facts recorded, from trustworthy and reliable information. That certified reproduced copy or certified computer print-out shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax or penalty due.

35 ILCS 735/3-7(a).

Pursuant to UPIA § 3-7(a), once the Department introduced the NOD into evidence under the certificate of the Director (Department Ex. 1; Tr. pp. 4-5, 7), it presented prima facie proof that Taxpayer was personally responsible for ABC Business's unpaid withholding tax liabilities, including interest and penalties. 35 ILCS 735/3-7(a); Branson v. Department of Revenue, 68 Ill. 2d 247, 260, 659 N.E.2d 961, 968

(1995).

The Department's prima facie case is a rebuttable presumption. Branson, 68 Ill. 2d at 262, 659 N.E.2d at 968. After the Department introduces its prima facie case, the burden shifts to the taxpayer to establish that one or more of the elements required for the imposition of the penalty are lacking. Raleigh v. Illinois Department of Revenue, 530 U.S. 15, 18-19, 120 S.Ct. 1951, 1954, 147 L.Ed.2d 13 (2000) (citing Branson, 168 Ill. 2d at 256-61, 659 N.E.2d at 966-68). A taxpayer cannot overcome the Department's prima facie case merely by denying the accuracy of Department's assessment, or by denying conscious awareness that the tax was due by the corporation. Branson, 168 Ill. 2d at 267, 659 N.E.2d at 971. Instead, the taxpayer must present evidence that is consistent, probable, and closely identified with its books and records. PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 33, 765 N.E.2d 34, 48 (1st Dist. 2002); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296-97, 421 N.E.2d 236, 239 (1st Dist. 1981).

Issues and Arguments

The first issue is whether John Doe was a responsible officer of ABC Business. When interpreting the text of UPIA § 3-7's statutory predecessor, Illinois courts have looked at how federal courts construed similar text used in § 6672 of the Internal Revenue Code (the Code). *E.g.*, Branson, 168 Ill. 2d at 254-56, 659 N.E.2d at 965-66. Like IITA § 1002(d), § 6672 of the Code imposes a penalty against responsible persons of a corporation who have a duty to collect, truthfully account for, and pay over federal social security and withholding taxes, and who willfully fail to do so. *Compare* 26 U.S.C. 6672 *with* 35 ILCS 5/1002(d). When considering whether John Doe was a responsible

officer of ABC Business, therefore, I will take into account those factors federal courts have considered when determining whether one is a “responsible person,” under Code § 6672.

In Williams v. United States, 931 F.2d 805 (11th Cir. 1991), for example, the court explained that:

Generally, the courts have interpreted rather broadly who will constitute a “responsible person” under section 6672. *Smith*, 894 F.2d at 1553 (citing *Slodov v. United States*, 436 U.S. 238, 246-50, 98 S.Ct. 1778, 1784-87, 56 L.Ed.2d 251 (1978) and *Liddon v. United States*, 448 F.2d 509, 512 (5th Cir.1971), *cert. denied*, 406 U.S. 918, 92 S.Ct. 1769, 32 L.Ed.2d 117 (1972)). A person is responsible within the meaning of section 6672 if he has a duty to collect, account for or pay over taxes withheld from the wages of a company's employees. [footnotes omitted] *Thibodeau*, 828 F.2d at 1503; *George*, 819 F.2d at 1011. Responsibility is “a matter of status, duty and authority.” *Mazo v. United States*, 591 F.2d 1151, 1156 (5th Cir.), *cert. denied*, 444 U.S. 842, 100 S.Ct. 82, 62 L.Ed.2d 54 (1979). “Indicia of responsibility include the holding of corporate office, control over financial affairs, the authority to disburse corporate funds, stock ownership, and the ability to hire and fire employees.” *George*, 819 F.2d at 1011. ***

Williams, 931 F.2d at 810.

Here, the documentary evidence supports the Department’s determination that John Doe was a responsible person for ABC Business. He was one of only two officers of the corporation. Department Ex. 3. While ABC Business had the formal organization of a corporation, John Doe referred to it as a partnership whose two partners were himself and Joe Blow. Tr. p. 16 (John Doe). John Doe was authorized to sign checks for the corporation and, even though he said he did not do so often, he acknowledged that he signed company checks to pay creditors. Tr. p. 66 (John Doe). He was the restaurant’s day-to-day manager, was responsible for making liquor purchases, worked wherever he was needed, and managed staff. Tr. pp. 17-18 (John Doe). He occasionally hired or fired

employees. Tr. p. 18 (John Doe). And, of course, he signed and filed the two income tax returns which reported the taxes due, and which ABC Business has not yet paid. Department Ex. 2. Based on the evidence, I conclude that John Doe has not rebutted the Department's presumptively correct determination that he was a "person required to collect, truthfully account for, and pay over the tax imposed by [the IITA]" 35 ILCS 5/1002(d).

The second issue is willfulness. The Department's prima facie case presumes willfulness. Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968. To rebut the presumption, the person defending against the penalty must adduce sufficient evidence to disprove willful failure to file returns and pay taxes. *Id.* Whether a responsible officer acts willfully is a mixed question of law and fact. *Id.* at 265, 659 N.E.2d at 970. A responsible officer cannot prove his lack of willfulness simply by denying conscious awareness of a tax deficiency that could have been easily investigated by an inspection of corporate records. *Id.* at 267, 659 N.E.2d at 971.

At hearing, John Doe argued that he cannot have acted willfully since, by the time he learned of the ABC Business's outstanding tax liabilities, ABC Business had no funds with which to pay them. Tr. pp. 84-85 (closing argument). As proof of the company's inability to pay, John Doe testified that both ABC Business and he, personally, had filed for bankruptcy. Tr. pp. 21-23 (John Doe). The documentary evidence corroborates John Doe's testimony about ABC Business's bankruptcy. Taxpayer Ex. 1. Specifically, John Doe admitted into evidence copies of ABC Business's bank statements for June, July and August 2008. *Id.* That exhibit includes partial copies of ABC Business's commercial checking account statement for June 2008. Taxpayer Ex. 1, pp. 1-9 (pages 1-9 of ABC

Business's 21-page commercial checking account for June 2008). It also includes partial copies of ABC Business's payroll account statements for the months of July and August 2008, on which the bank identified ABC Business as the debtor in possession of that payroll account. *Id.*, pp. 10-14 (pages 1-5 of ABC Business's 20-page payroll account for July 2008), 15-20 (pages 1-6 of ABC Business's 31-page payroll account for August 2008); *see also* Yessenow v. Executive Risk Indemnity, Inc., 2011 IL App (1st) 102920, ¶ 32, 953 N.E.2d 433, 443 (2011) ("The bankruptcy code defines a Chapter 11 debtor in possession as the debtor. The debtor, in turn, is defined as the 'person or municipality concerning which a case under this title has been commenced.' Bankruptcy cases can be filed only with respect to pre-bankruptcy persons. Thus[,] the debtor in possession is the debtor, and the debtor is the person ... that filed for bankruptcy.") (*quoting* Biltmore Associates, LLC v. Twin City Fire Insurance Co., 572 F.3d 663, 671 (9th Cir. 2009)).

But John Doe's documentary corroboration of ABC Business's bankruptcy does not end the matter, because bankruptcy does not necessarily eliminate the tax liabilities of a bankrupt or defunct corporation, or the potential personal liability of its responsible officers. *E.g.* Raleigh v. Illinois Department of Revenue, 530 U.S. 15, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000) (affirming Department's assessment of a personal liability penalty to responsible officer/debtor of a defunct corporation determined to owe Illinois tax). To the extent John Doe wanted to show that some determination by a bankruptcy court — his or ABC Business's — had an effect on the issues in this contested case, it was up to him to provide such evidence. He did not do so.

Nor does the evidence showing that ABC Business was named as the debtor in possession of its payroll account for July and August 2008 (Taxpayer Ex. 1, pp. 10-20),

prove that ABC Business had no funds that John Doe could have used to pay ABC Business's tax liabilities. First, since ABC Business was a debtor in possession, that means that it retained the authority to pay creditors. *See Yessenow*, 2011 IL App (1st) 102920, ¶ 32, 953 N.E.2d at 443. John Doe, in turn, was one of the two individual officers who remained in control of ABC Business while it was a debtor in possession. *See* Department Exs. 2-3. Second, the critical fact that the bank records document is that ABC Business was paying its employees during the third quarter of 2008, one of the two periods for which it did not pay over to the Department the Illinois income tax it was required to deduct and withhold from its employees' wages. Taxpayer Ex. 1; Department Ex. 2. Indeed, the fact that ABC Business maintained a payroll account, and paid its employees, dashes John Doe's claim that such funds were unavailable for him to use to pay over to the Department the amounts required to be deducted and withheld from those wages. Taxpayer Ex. 1.

If ABC Business had no available funds, it could not pay its employees. But it *was* paying its employees' wages (Taxpayer Ex. 1, pp. 10-20), and John Doe knew that ABC Business was paying its employees. Department Ex. 2; Tr. pp. 67, 69 (John Doe). Further, John Doe signed and filed ABC Business's IL-941 returns for the periods at issue, so he knew that ABC Business was obliged to pay over to the Department the taxes required to be deducted and withheld from its employees' wages. Department Ex. 2. The returns he signed show that no payments were being made when those returns were filed. *Id.* Thus, when he signed those returns, he knew that ABC Business was not paying over to the Department the tax amounts due. *Id.*

In McLean v. Department of Revenue, 326 Ill. App. 3d 667, 761 N.E.2d 226 (1st

Dist. 2001), the court noted that:

Under Illinois law, if a responsible officer uses collected ... taxes to pay other creditors of the corporation, while knowing that he or she was obligated to file the returns and remit the taxes, the "willful" element ... is satisfied. [citations omitted] "A finding of willfulness does not require a showing of actual knowledge of nonpayment. Reckless disregard for obvious or known risks will suffice. [Citation.] If a responsible person in a position to easily discover nonpayment clearly ought to have known of a grave risk of nonpayment but did nothing, a finding of willfulness is justified." *** A corporate officer who is responsible for filing ... tax returns and remitting the collected taxes may not avoid personal liability for tax penalties for nonpayment of such taxes merely by delegating bookkeeping duties to third parties and failing to inspect corporate records or otherwise failing to keep informed of the status of retailers' occupation tax returns and payments. ***

McLean, 326 Ill. App. 3d at 675-76, 761 N.E.2d at 234-35. Federal courts have distinguished the different types of willfulness referred to in McLean as either (1) "a deliberate choice voluntarily, consciously and intentionally made to pay other creditors instead of paying the Government," or (2) "reckless disregard of a known or obvious risk that [the taxes] may not be remitted to the Government." Ghandour v. U.S., 36 Fed. Cl. 53, 62 (1996) (*quoting* Godfrey v. United States, 748 F.2d 1568, 1577-78 (Fed.Cir. 1984) and White v. United States, 372 F.2d 513, 521 (Ct.Cl. 1967)).

Here, the evidence shows that John Doe had actual knowledge that ABC Business was paying its employees, at the same time it was not paying over to the Department the tax monies required to be withheld from such wages. Taxpayer Ex. 1, pp. 10-20; Department Ex. 2; Tr. pp. 67-70 (John Doe). Thus, the evidence shows that John Doe made the deliberate choice to use ABC Business's available funds to pay to other persons, instead of paying such funds over to the Department. Taxpayer Ex. 1, pp. 10-20; Tr. pp. 67, 69 (John Doe). The Department's prima facie case presumes that John Doe

acted willfully (35 ILCS 735/3-7(a); Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968); the documentary evidence removes any doubt, at least regarding the third quarter of 2008. Taxpayer Ex. 1, pp. 10-20. Regarding the fourth quarter, the statutory presumption carries the day, since John Doe has not offered documentary evidence which rebuts the Department's determination that he willfully failed to pay the taxes ABC Business was required to withhold from its employees' wages. Department Ex. 1; 35 ILCS 735/3-7(a); Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968.

Conclusion

The evidence shows that John Doe was a person who was required to collect, truthfully account for, and pay over the tax imposed by the IITA, and that he willfully failed to pay over to the Department the tax monies that he, personally, reported were due from ABC Business for the third and fourth quarters of 2008. Taxpayer has not rebutted the Department's presumptively correct determination that he is personally liable for ABC Business's outstanding tax liabilities for the quarters at issue, which liabilities include applicable statutory penalties and interest.

I recommend, therefore, that the Director finalize the NOD as issued, pursuant to statute.

Date: June 7, 2012

John E. White, Administrative Law Judge

