

**IT 15-07**

**Tax Type: Income Tax**

**Tax Issue: Responsible Corporate Officer-Failure To File Or Pay Tax**

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

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**THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE and  
JANE DOE**

**Taxpayers**

Docket # XXXX  
Letter ID # XXXX  
Letter ID # XXXX  
Letter ID # XXXX  
Letter ID # XXXX  
1002D ID # XXXX, XXXX,  
XXXX, XXXX

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**RECOMMENDATION FOR DISPOSITION**

Appearances: Jonathan M. Pope, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Jason Bartell and Spencer Watson of Bartell Powell, LLP for John and Jane Doe

Synopsis:

The Department of Revenue ("Department") issued Collection Action Assessments and Notices of Intent ("Notices") to John Doe and Jane Doe ("taxpayers") pursuant to section 1002(d) of the Income Tax Act (35 ILCS 5/1002(d)). The Notices allege that the taxpayers were officers or employees of ABC Business, Ltd. ("corporation") who had the control, supervision or responsibility of filing the corporation's withholding tax returns and paying the taxes to the Department, and they willfully failed to do so. The taxpayers timely protested two of the Notices, and they were granted a late discretionary hearing for the other two Notices. The parties waived their right to an evidentiary hearing and asked that this matter be resolved based on the documents submitted. After reviewing the record, it is recommended that this matter be resolved in favor of the Department, and the Notices be upheld.

Findings of Fact:

1. The corporation was organized on July 3, 2007 and was originally called XYZ Business, Inc. before the name was changed on February 26, 2009 to ABC Business, Ltd. The corporation was in the business of providing ambulance service. (Ex. #8, #26)
2. On March 4, 2009, the taxpayers filed a Form REG-1, Illinois Business Registration Application, for the corporation that shows Jane Doe as the president and John Doe as the vice-president. (Ex. #8, p. 00038)
3. On the REG-1, Jane Doe signed her name under the paragraph that includes the following: “I further attest that I will be responsible for filing returns and paying all taxes due...” (Ex. #8, p. 00039)
4. Between December 5, 2008 and February 27, 2010, Jane Doe had “general control over business affairs and decisions concerning payment.” (Taxpayer’s brief, p. 3)
5. From January 1, 2009 through May 12, 2010, Jane Doe was president of the corporation. (Ex. #27, p. 00226)
6. From May 12, 2010 through December 23, 2010, Mary Green was president of the corporation. (Ex. #27, p. 00226)
7. From December 23, 2010 through to the dissolution of the corporation on January 10, 2013, Jane Doe was again the president. (Ex. #26, #27, p. 00226)
8. Jane Doe admitted that when she was president of the corporation, she “was responsible for all operations.” (Ex. #27, p. 00226)
9. Jane Doe signed the Illinois withholding tax returns for every quarter in 2009 and for the following additional quarters: September 2011, June 2012, and December 2012.<sup>1</sup>

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<sup>1</sup> The returns for December 2011 and March 2012 were not signed. (Ex. #23, p. 00212, 00213)

According to the Department's records, a return was not filed for September 2012. (Ex. #20, #23, #24, #25)

10. Jane Doe owned 49% of the corporation throughout the relevant time periods. Gene Green held the remaining 51%. (Ex. #27, p. 00226)
11. John Doe admitted that from May 12, 2010 through to the dissolution of the corporation in January 2013, he served as one of the company's Directors and had "access to the books and records of the company." (Ex. #26, #27, p. 00226)
12. During 2009, John Doe signed as a guarantor for the purchase of three vehicles to be used by the corporation. (Ex. #35 pp. 00278, 00284, 00285)
13. John Doe's job duties included, *inter alia*, the following: worked with Jane Doe "on managing operations and help[ing] make decisions in regard to the business" and worked with Jack Black "in managing the EMT's and employees." (Ex. #46, p. 07352)
14. On December 9, 2008, an account was opened at Purple Bank ("Purple Bank") for XYZ Business, Ltd. On March 3, 2009, the account was transferred to ABC Business, Ltd. (Ex. #28 p. 00235)
15. When the Purple Bank account was initially opened, Jane Doe and John Doe had signature authority for the account. (Ex. #37, p. 00296)
16. On March 3, 2009, when the Purple Bank account was transferred to the corporation, Jane Doe and John Doe remained as the only two with signature authority for the account. (Ex. #37, p. 00295)
17. On February 27, 2010, Mary Green was added as the third person with signature authority for the Purple Bank account. (Ex. #37, p. 00294)
18. On April 22, 2010, John Doe was removed as an authorized signer, and Jane Doe and Mary Green remained as the only two with signature authority for the Purple Bank account. (Ex. #37, p. 00292)
19. From January 2009 through March 2010, Jane Doe and John Doe signed checks for the Purple Bank account to pay various creditors. One of the checks that John Doe signed

was payable to the Illinois Department of Revenue. Some of the checks that Jane Doe signed were payable to herself or payable to John Doe. (Ex. #38, p. 00310, check #1074, check #1079, check #1081, check #1843, check #1844, check #2099, check #2101 )

20. In March, September, and December 2010, Mary Green signed checks from the Purple Bank account. (Ex. #38, pp. 00708, 00779, 00790)
21. The bank statements for the Purple Bank account for the time period of July 1, 2010 through December 31, 2010 show substantial deposits were made to the account. (Ex. #38 pp. 00768-00788)
22. On January 7, 2011, the corporation filed a Chapter 11 bankruptcy petition, which was signed by Jane Doe. (Ex. #46, p. 07340)
23. On February 4, 2011, the Purple Bank account was closed. (Ex. #28 p. 00235)
24. When the bankruptcy petition was filed, an account was opened at Yellow Bank for the corporation. This account was used until the corporation was dissolved in January 2013. (Ex. #28 p. 00235)
25. A signature card for the Yellow Bank account was unavailable, but Jane Doe and John Doe signed checks from the account. Some of the checks that Jane Doe signed between May 7, 2012 and December 18, 2012 were payable to herself or payable to John Doe. On February 22, 2013, John Doe signed a check "to clear [the] account." (Ex. #41)
26. A third bank account at Blue Bank was opened while Mary Green was president and was only in use from June 2010 through December 2010. Mary Green and Gene Green were the only two people with signature authority on this account. (Ex. #28 p. 00235, #39 p. 00799, #40 p. 00802)
27. The bankruptcy petition listed John Doe as a creditor with an unsecured, non-priority claim in the amount of \$XXXX. This was for a loan in October 2009 to pay taxes and also for a down payment on a vehicle. (Ex. #46, p. 07436)

28. On November 1, 2011, the corporation filed a plan with the bankruptcy court. The plan was confirmed on February 23, 2012 by the bankruptcy court. (Ex. #46, p. 07354; Taxpayers' brief p. 2)
29. Throughout the bankruptcy, the corporation continued to operate its business as Debtor-in-Possession. (Ex. #46, p. 07354)
30. For the years 2009, 2011, and 2012, Jane Doe signed, as president, the Illinois Domestic/Foreign Corporation Annual Reports with the Secretary of State. (Ex. #9, #11, #12)
31. On May 19, 2010, Mary Green signed, as president, the Illinois Domestic/Foreign Corporation Annual Report with the Secretary of State for the year 2010. (Ex. #10)
32. On each Report for the years 2009 through 2012, John Doe was listed as a Director and/or registered agent. (Ex. #9, #10, #11, #12)
33. On November 16, 2010, the Department issued a Collection Action Assessment and Notice of Intent ("Notice") to each taxpayer that proposed a total penalty liability of \$XXXX for failure to pay the withholding taxes for the following time periods: June 2009, September 2009, and December 2009. The Notices were submitted under the certificate of the Director of the Department. (Ex. #1, #3)
34. On September 3, 2013, the Department issued a Notice to each taxpayer that proposed a total penalty liability of \$XXXX for failure to pay the withholding taxes for the following time periods: September 2010, December 2010, June 2012, and December 2012. The Notices were submitted under the certificate of the Director of the Department. (Ex. #2, #4)

Conclusions of Law:

Section 1002(d) of the Income Tax Act provides as follows:

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 provides in part as follows:

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; 35 ILCS 735/3-7(a).

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision or responsibility of filing the withholding returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

Under section 3-7, the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due.<sup>2</sup> Branson v. Department of Revenue, 168 Ill. 2d 247, 260 (1995). Once the Department presents its *prima facie* case, the burden shifts to the taxpayer to establish by a preponderance of the evidence that one or more of the elements of the penalty are lacking, *i.e.*, that the person charged was not a responsible corporate officer or employee, or that the person's actions were not willful. *Id.* at 261; Ruth v. United States, 661 F. Supp. 652, 653 (N.D. Ill. 1986), *affm'd* 823 F. 2d 1091. In order to overcome the Department's *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the Department's assessment. See Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990); Elkay Manufacturing Company v. Sweet, 202 Ill. App. 3d 466, 472 (1<sup>st</sup> Dist. 1990); A. R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1<sup>st</sup> Dist. 1988); Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213 (3<sup>rd</sup> Dist.

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<sup>2</sup> The relevant portion of section 3-7 provides as follows: "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. ... 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).

1983). The person must present evidence that is consistent, probable, and identified with the taxpayer's books and records to support the claim. *Id.*

The taxpayers bear the burden of disproving the Department's determination because it is the taxpayers, not the Department, who have access to the information regarding why the returns were not filed and the taxes were not paid. Branson, at 262. The purpose of the statute is to ensure that the taxes are paid, and "the statute must be broadly construed to permit the government to reach those who are responsible for the corporation's failure to pay the taxes owed." Nakano v. United States, 742 F. 3d 1208, 1212 (9<sup>th</sup> Cir. 2014) *cert. denied*, 134 S. Ct. 2680 (2014); see also Conway v. United States, 647 F. 3d 228, 233 (5<sup>th</sup> Cir. 2011) ("this circuit takes a broad view of who is a responsible person"); Bowlen v. United States, 956 F. 2d 723, 728 (7<sup>th</sup> Cir. 1992) (the statute "casts a broad net of liability").

### **Responsible Person**

Any person who is required to collect, truthfully account for and pay over the tax is referred to as a "responsible person." McLean v. Department of Revenue, 326 Ill. App. 3d 667, 674 (1<sup>st</sup> Dist. 2001). For guidance in determining whether a person is responsible under section 3-7, the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal Revenue Code (26 U.S.C. §6672)<sup>3</sup>. See Branson, at 254-56; Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19, 29-30 (1985). These cases state that the critical factor in determining responsibility is whether the person had significant control over the corporation's finances. See Purdy Co. of Illinois v. United States, 814 F. 2d 1183, 1186 (7<sup>th</sup> Cir. 1987) Responsibility is generally found in high corporate officials who have control over the corporation's business affairs and who participate in decisions concerning the payment of creditors and the dispersal of funds. Monday v. United States, 421 F. 2d 1210, 1214-1215 (7<sup>th</sup> Cir. 1970), *cert. den.* 400 U.S. 821.

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<sup>3</sup> This section imposes personal liability on any person who is required to collect, account for, and pay employees' withholding taxes and who willfully fails to do so.

No single factor is dispositive in determining whether a person had significant control over the corporation's finances; the determination must be made by considering the totality of the circumstances. Winter v. United States, 196 F. 3d 339, 345 (2<sup>nd</sup> Cir. 1999). The relevant circumstances include whether the person (1) is an officer or member of the board of directors, (2) owns shares or possesses an entrepreneurial stake in the company, (3) is active in the management of day-to-day affairs of the company, (4) has the ability to hire and fire employees, (5) makes decisions regarding which, when and in what order outstanding debts or taxes will be paid, (6) exercises control over daily bank accounts and disbursement records, and (7) has check-signing authority. *Id.*

In the present case, Jane Doe admits that during some of the time periods at issue she had general control over business affairs, but she argues that she did not have control when Mary Green was president in 2010. Jane Doe claims that she did not have the final word over the disbursement of funds and did not sign any checks from this time period. Jane Doe states that only Mary Green and Gene Green had complete control of the Blue Bank account. Jane Doe also argues that she was not responsible from the time that the bankruptcy petition was filed through to the dissolution of the company because she was “beholden” to the Chapter 11 bankruptcy plan and did not have control of the corporation. (Taxpayer’s brief, pp. 3-4)

John Doe argues that between December 5, 2008 and February 27, 2010 he had a very limited role with the company, and between February 27, 2010 and December 27, 2010 Mary Green and Gene Green had control of the finances of the company. He claims that in 2009 he only signed a “miniscule amount of checks” from the Purple Bank account. (Taxpayer’s brief, p. 5) He also makes the same argument that Jane Doe made about being beholden to the Chapter 11 bankruptcy plan.

From the documents submitted, the taxpayers have failed to meet their burden of showing they were not responsible parties for the time periods at issue. With respect to Jane Doe, she was president from January 1, 2009 to May 12, 2010 and again from December 23, 2010 through to the dissolution of the corporation on January 10, 2013. She admitted that when she was

president of the corporation, she “was responsible for all operations.” (Ex. #27, p. 00226) She signed the REG-1 on March 4, 2009 and attested that she would be responsible for filing the returns and paying the taxes. She signed the returns for each quarter during 2009 and also for June and December 2012. (Ex. #20, #23, #25) She owned 49% of the company throughout the relevant time period.

Although Jane Doe claims that between February 27, 2010 and December 27, 2010 she did not have control over the corporation because Mary Green was president, on February 27, 2010 Mary Green simply became the third person with signature authority on the Purple Bank account. Mary Green did not become president until May 12, 2010. From May 12, 2010 to December 23, 2010 Mary Green was president, but this does not necessarily mean that Jane Doe was no longer a responsible person. More than one person may be found to be responsible, and “it is not necessary that the individual in question have the final word as to which creditors should be paid.” Winter, at 345, citing Fiataruolo v. United States, 8 F. 3d 930, 939 (2<sup>nd</sup> Cir. 1993). Personal responsibility for the taxes “encompasses all those individuals connected closely enough with the business to prevent the tax default from occurring.” *Id.*

It is not clear from the evidence that Jane Doe relinquished her significant control during the short time period that she was not president. The time periods at issue in this case are the following: June, September, and December 2009, September and December 2010, and June and December 2012. The only tax return for which the due date of the payment occurred when Jane Doe was not president was the return for September 2010.

Being an officer of the corporation is only one factor to consider when looking at the totality of the circumstances. During the time period that Jane Doe was not president, it is not clear whether she still managed the day-to-day activities of the company, had the ability to hire and fire employees, or made decisions regarding the payments to creditors. During this time period Jane Doe still owned 49% of the corporation, and she still had signature authority for the Purple Bank account. The Purple Bank account continued to be used until after the bankruptcy petition was filed in January 2011. After the bankruptcy petition was filed, Jane Doe and John

Doe opened another account at Yellow Bank. From the evidence presented, it is simply not clear that Jane Doe was no longer a responsible person during October 2010 (*i.e.*, the time period when the September 2010 taxes would have been due).

Jane Doe's argument that she was not a responsible person for the time period between the filing of the bankruptcy petition and the dissolution of the company is without merit. She admitted that she was president during this time period, and she is the person who signed the bankruptcy petition. The corporation continued to operate while the bankruptcy was pending. The taxpayers' personal liability for the unpaid withholding taxes "is a totally independent liability from that of the corporation." J.J. Re-Bar Corp. v. United States, 644 F. 3d 952, 957 (9<sup>th</sup> Cir. 2011). The penalty is an obligation that is "separate and distinct from the underlying tax obligation." *Id.* Although Jane Doe claims to have been "beholden" to the bankruptcy plan, the withholding taxes for the year 2011 and the first quarter of 2012 were apparently paid. Furthermore, the court in Conway, *supra*, noted as follows: "At a minimum, [taxpayer] had the authority and duty to seek approval from the bankruptcy court for payment of the post-petition taxes, a step that he has not shown that he ever pursued." Conway, at 234, f.n. 5. Similarly, the evidence in this case does not indicate that Jane Doe took any steps to seek approval from the bankruptcy court to have the taxes paid.

John Doe has also failed to meet his burden of showing he was not a responsible person. He was vice-president and a Director for the corporation. During 2009, he signed as a guarantor for the purchase of three vehicles to be used by the corporation. (Ex. #35) He admitted that from May 12, 2010 through to the dissolution of the corporation in January 2013, he served as one of the company's Directors and had "access to the books and records of the company." (Ex. #26, #27, p. 00226) According to the Illinois Domestic/Foreign Corporation Annual Reports filed with the Secretary of State, John Doe was also a Director for the years 2009 and 2010, and nothing indicates that he did not have the same access to the books and records of the company for those time periods as well. (Ex. #9, #10)

John Doe's job duties included, *inter alia*, the following: worked with Jane Doe "on managing operations and help[ing] make decisions in regard to the business" and worked with Jack Black "in managing the EMT's and employees." (Ex. #46, p. 07352) The evidence does not indicate that these duties changed during the time periods at issue. He had signature authority on the Purple Bank account until April 22, 2010, and he had authority to sign checks for the Yellow Bank account, which was opened when the bankruptcy petition was filed.

John Doe has failed to show that he did not have significant control over the corporation's business. It is unclear why he no longer had signature authority for the Purple Bank account after April 22, 2010, but signature authority is only one factor to consider when determining responsibility. According to the evidence presented, John Doe was an officer and Director for the corporation who had access to the company's books and records and who worked closely with Jane Doe to manage the day-to-day business affairs, manage the employees, and help with the decision-making process. Nothing in the record indicates that these facts changed during the time periods at issue.

The rationale for broadly construing the personal responsibility provision is that it serves the purpose of encouraging "officers, directors, and other high-level employees to stay abreast of the company's withholding and payment of employee's taxes." Barnett v. IRS, 988 F. 2d 1449, 1456-1457 (5<sup>th</sup> Cir. 1993). An individual may be a responsible person even if he or she is not the one *most* responsible for paying the taxes. *Id.* at 1455. Responsibility is determined by looking to a person's status within the corporation. *Id.* at 1454. The crucial inquiry is whether the person, by virtue of his position in the company, could have had "substantial" input into decisions concerning the payment of taxes and the payment of creditors had he wished to exert his authority. *Id.* at 1455. From the evidence presented, John Doe has failed to show that he was not a responsible person for the time periods at issue.

### **Willful Failure to Pay**

The cases define "willful" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson at 254-56; Heartland at 29-30. Willful conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. It also does not require a showing of actual knowledge of non-payment. Cerone v. Department of Revenue, 2012 IL App (1<sup>st</sup>) 110214, ¶ 22 (citing McClean, at 675). Willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F. 2d 425, 427 (7<sup>th</sup> Cir. 1987). Furthermore, whether the person in question willfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at 30; Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568, 577 (1977). Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes willful behavior. See Heartland at 29-30.

The evidence in this case does not support a finding that Jane Doe and John Doe rebutted the presumption of willfulness. During 2009, they both wrote checks to creditors including the Department, and according to the bankruptcy petition, in October 2009 John Doe gave the corporation a \$XXXX loan to pay taxes and also to use for a down payment on a vehicle. That money was apparently used to pay other creditors because three of the quarters at issue in this case are June, September, and December 2009.

The one quarter for which the due date of the return occurred during the time period that Jane Doe was not president is September 2010. At that time, both Jane Doe and John Doe either knew or clearly ought to have known that the taxes were not being paid, and they were in positions to find out very easily. One of the reasons why Jane Doe became president again was because she knew that Mary Green failed to pay the withholding taxes. (Taxpayers' brief p. 2) A corporate officer who is found to be a responsible person cannot avoid personal liability merely by delegating bookkeeping duties to third parties, failing to inspect corporate records or otherwise failing to keep informed of the status of the tax returns and the payments. Cerone, at ¶

22. Jane Doe and John Doe were aware that the business was facing serious financial difficulties and could not pay some of its bills. They had a duty to ensure that the tax returns were filed and paid.

The last three time periods at issue in this case are December 2010, June 2012, and December 2012. The due dates for these quarterly returns occurred after the bankruptcy petition was filed on January 7, 2011. The taxpayers argue that the corporation's funds were encumbered by the filing of the bankruptcy petition, and so it cannot be found that they willfully failed to pay these taxes.

The definition of encumbered funds is as follows:

Funds are encumbered only where the taxpayer is legally obligated to use the funds for a purpose other than satisfying the preexisting employment tax liability and if the legal obligation is superior to the interest of the [Department] in the funds. United States v. Kim, 111 F. 3d 1351, 1359 (7<sup>th</sup> Cir. 1997).

The burden to show the funds are encumbered falls on the taxpayers. *Id.* The taxpayers have failed to meet that burden. After the bankruptcy petition was filed, Jane Doe wrote checks from the Yellow Bank account, and several of the checks were payable to herself or to John Doe. (Ex. #41) These checks were written during the time periods at issue.

In addition, the taxpayers did not present any evidence that they took steps to ensure that the taxes would be paid while the corporation continued to operate after the filing of the petition. In Nakano, *supra*, the court found that the taxpayer willfully failed to pay the taxes after the filing of a Chapter 11 petition because under the bankruptcy provisions, the corporation's operating expenses do not have a higher priority over the taxes. See also Cook v. United States, 52 Fed. Cl. 62, 71-72 (2002) (corporation's bankruptcy did not prevent a finding of willful failure to pay taxes when the bankruptcy court had authorized other expenditures). Jane Doe and John Doe have simply failed to meet their burden of proving that the funds were "encumbered," and a finding that they willfully failed to pay the taxes for the time periods at issue is warranted.

#### Recommendation

It is therefore recommended that the Collection Action Assessments and Notices of Intent issued to John Doe and Jane Doe be upheld.

Linda Olivero  
Administrative Law Judge

Enter: October 29, 2015