

ST 10-10

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

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

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

v.

**JOHN DOE,
Taxpayer**

**No. 09-ST-0000
Account# 0000-0000
Letter ID# 0000000000
NPL ID# 00000000**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Attorney General George Foster on behalf of the Illinois Department of Revenue; John Doe, *pro se*.

Synopsis:

This matter arose after the Illinois Department of Revenue (“Department”) issued a Notice of Penalty Liability (“NPL”) to John Doe (NPL ID# 00000000) regarding the corporate liability of ABC LLC. John Doe (“taxpayer”) timely protested this NPL. Pursuant to a prehearing order, the parties identified the issues to be resolved at hearing as “whether John Doe was a responsible party of ABC LLC pursuant to 35 ILCS 735/3-7 and whether he willfully failed to pay Retailers’ Occupation and/or Use Tax to the [Department] as set forth on [the Notice of Penalty Liability] issued to John Doe, or willfully attempted in any other manner to evade or defeat the tax shown on said notice of penalty liability pursuant to the provisions of 35 ILCS 735/3-7.” Following submission of

evidence and a review of documents of record, it is recommended that the Notice of Penalty Liability issued to John Doe be affirmed and finalized as issued.

Findings of Fact:

1. The Department's *prima facie* case, including all jurisdictional elements, was established by the admission into evidence of Notice of Penalty Liability ID number 00000000 issued February 19, 2009. Department Exhibit ("Ex.") 1. The basis of this penalty liability is unpaid sales and use tax due and owing the State by ABC LLC. *Id.*
2. During the period January 1, 2007 through September 30, 2007 (the "tax period"), John Doe was an officer and part owner of ABC LCC ("ABC"), the operator of a restaurant located in Anywhere, Illinois. Transcript ("Tr.") pp. 10, 15; Department Ex. 1. During this period, the restaurant failed to pay sales and use tax due to the Department in the amount of \$37,686.25. *Id.*
3. During the tax period, the taxpayer owned 50% of the company's stock and 50% of ABC's stock was owned by Jim Doe ("Jim Doe"). Tr. pp. 5, 10, 11.
4. The taxpayer was a signatory on the company's checking account and had the authority to execute and issue company checks. Tr. p. 11.
5. In addition to being an investor in ABC, the taxpayer was also the manager of the company. Tr. p. 15.
6. The taxpayer was responsible for preparing and filing all of the company's tax returns during the tax period at issue. Tr. pp. 5, 9, 11.

7. The taxpayer had complete access to ABC's books and records, and was aware of the company's poor financial condition throughout the tax period in controversy. Tr. pp. 12, 13.
8. The taxpayer met with his co-owner, Jim Doe, at least once a week to go over the company's operations and finances. Tr. pp. 12, 13. During these meetings the taxpayer became aware that the company was not timely paying its creditors. *Id.*
9. The taxpayer was aware of ABC's cash flow problems throughout the tax period in controversy and knew the company was only paying 50% of its bills on time. Tr. pp. 12, 13.

Conclusions of Law:

Illinois law in effect on and after January 1, 1994 provides that the Department may assess a tax penalty imposed by section 3-7 of the Uniform Penalty and Interest Act ("UPIA"), 35 ILCS 735/3-7 ("section 3-7") against certain individuals for the unpaid sales and use tax liability of a retail corporation. Specifically, this provision states, in part, as follows:

- (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.
35 ILCS 735/3-7

The record indicates that a finalized tax liability for unpaid sales and use tax was assessed ABC for the period January 1, 2007 through September 30, 2007 and that the taxpayer was an officer and co-owner of this company at that time. Tr. pp. 5, 10, 11, 15;

Department Ex. 1. Accordingly, given the mandate of section 3-7, the issue to be decided in this case is whether John Doe (“taxpayer”) should be held personally liable for ABC’s unpaid sales and use tax for the tax period at issue.

To impose personal liability for the failure to pay retailers’ occupation tax and use tax under section 3-7, it must be shown that the person being penalized is a responsible party and that the failure to pay was willful. *Id.* By introducing the Notice of Penalty Liability at issue into evidence, the Department established its *prima facie* case against the taxpayer. In Branson v. Department of Revenue, 168 Ill. 2d 247 (1995), the Illinois Supreme Court held that the admission of a Notice of Penalty Liability into evidence established all of the statutory requirements for imposition of the penalty, including willfulness. While the Court was addressing ¶452 ½ which was a provision that preceded Section 3-7 of the UPIA, a comparison of all of these provisions reveals that they are almost identical, and all enumerate corporate officer and employee penalty liability. Moreover, all of these provisions address willfulness and responsibility. Therefore, a similar analysis of section 3-7 of the UPIA, based on the court’s conclusions may be made. Frowner v. Chicago Transit Authority, 25 Ill. App. 2d 312 (1960).

Applying Branson, the Notice of Penalty Liability (“NPL”) introduced by the Department established the Department’s *prima facie* case that the taxpayer was a responsible officer who willfully failed to pay retailers’ occupation tax and use tax during the tax period at issue in this case. The burden then shifted to the taxpayer to overcome the presumption of liability through sufficient, competent evidence that he was not a responsible officer, or that his actions were not willful. *Id.* The taxpayer argues that he was not a responsible party during any of the tax period in controversy and that he did not

act willfully in failing to remit the pertinent taxes. Tr. pp. 5, 6, 22-25. Therefore, he argues that liability for the taxes that have been assessed cannot attach to him. *Id.*

Personal liability under section 3-7 of the UPIA is imposed on one who is “responsible” for the filing of tax returns and payment of taxes shown to be due thereon, who willfully fails to file and/or pay such taxes. Neither this provision nor its predecessor provision, define “responsible” person or “willful” conduct. However, the Illinois Supreme Court, in cases wherein it has considered personal liability, has referred to interpretations of similar language in section 6672 of the Internal Revenue Code (26 U.S.C. §6672), which imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees’ social security and Federal income withholding taxes. Branson, supra; Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19 (1985); Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568 (1977).

Federal courts have addressed officer/ employee liability with respect to who is considered “responsible” for §6672 purposes. The courts have considered specific facts in determining whether individuals were “responsible” for the payment of employee taxes, to wit: 1) the duties of the officer as outlined in the corporate by-laws; 2) the ability of the individual to sign checks of the corporation; 3) the identity of the officers, directors, and shareholders of the corporation; 4) the identity of the individuals who hired and fired employees; and, 5) the identity of the individuals who were in control of the financial affairs of the corporation. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), cert. den. 400 U.S. 821 (1970); Gephart v. United States, 818 F. 2d 469 (6th Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990).

Responsible persons may be those with check writing authority who may or may not be the ones with the responsibility for accounting, bookkeeping or the making of payments to creditors. Monday, supra; Wright v. United States, 809 F. 2d 425 (7th Cir. 1987); Calderone v. United States, 799 F. 2d 254 (6th Cir. 1986). There may be more than one responsible person in a corporation. Monday, supra; Williams v. United States, 931 F. 2d 805, 810 n.7 (11th Cir. 1991).

In determining whether a person is a responsible officer, the courts have indicated that liability is not in all cases limited to those who occupy formal corporate office or traditional employee status. Fiataruolo v. United States, 8 F. 3d 930, 938 (2nd Cir. 1993) (“It should be noted that a person need not hold any particular position in a business and need not actually exercise authority to be held a responsible party for the payment of withheld taxes.”); Adams v. United States, 504 F. 2d 73 (7th Cir. 1974). Rather, liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. Monday, supra.¹

The record indicates that the taxpayer was a co-owner of ABC and held a 50% equity stake in the company. Tr. pp. 5, 10, 11. It also indicates that he was one of only two officers of the company and was the company’s “manager.” Tr. p. 15. The taxpayer further testified that he possessed the authority to write checks drawn on the company’s account and there is no evidence that he needed the approval of his co-owner to exercise

¹ Throughout the trial proceedings in this case, the taxpayer contended that the Department should have “gone after” his co-partner, Jim Doe and infers that its failure to do so undermines the legitimacy of the NPL at issue. Tr. pp. 8, 9, 16, 24. However, section 3-7 expressly provides for joint and several liability in cases of this nature, providing that personal liability may be imposed on “[A]ny [responsible] officer or employee ... who willfully fails” to perform legally obligated tax compliance responsibilities. (Emphasis adde). Accordingly, taxpayer’s argument in this regard is without basis.

this authority. Tr. p. 11. Significantly, the taxpayer was responsible for preparing the corporation's tax returns and reporting taxes due. Tr. pp. 9, 11.

While the taxpayer testified that he had no involvement in the day-to-day operations of the company, and had no control over its finances and business affairs (Tr. pp. 5, 8, 9, 13-17), he introduced no documentary evidence (e.g. corporate by-laws, bank authorizations or employment contracts) to corroborate his claims. Moreover, he introduced no evidence of any kind to explain why his authority as co-owner of ABC was circumscribed or limited in this manner. Furthermore, his claims are inconsistent with his testimony that he served as the company's "manager", a position closely associated with oversight of a business' day-to-day operations.

The taxpayer, as a fifty percent owner of ABC, had a significant stake in the corporation. Given this significant investment interest, I do not find it credible that he would have abdicated all authority to protect his investment by having no say in the company's financial affairs.

An additional indication of the level of the taxpayer's control over the company's affairs is his testimony that he met with Jim Doe, the other co-owner of the corporation, at least once a week. Tr. p. 11. This level of interaction is inconsistent with the degree of oversight one would expect were the taxpayer simply a passive investor in the company, which he professes to be in his testimony. Tr. p. 5. Accordingly, I do not find credible the taxpayer's claim that he exercised no authority over the corporation's finances and

had no authority to help decide what expenses of the corporation would or would not be paid.²

For the reasons enumerated above, I find that the taxpayer has failed to prove that he did not have significant control over the business affairs of the corporation and its financial governance. Based on the record, I cannot conclude that the taxpayer has presented any credible evidence that rebutted the Department's presumptively correct determination that he was an officer of ABC who had control over the financial affairs of company including the ability to see to it that the company's taxes were paid. As a consequence, applying the criteria followed by the courts in addressing officer liability, I conclude that the taxpayer was a "responsible" officer under Section 3-7 of the UPIA.

Even though the Department has established that the taxpayer was a responsible officer of ABC, no liability can attach to his conduct as a responsible officer unless he acted "willfully" in failing to pay the company's taxes. Section 3-7. The willfulness requirement "is satisfied if the responsible person acts with reckless disregard of a known risk that the trust funds may not be remitted to the Government..." Garsky v. United States, 600 F. 2d 86 (7th Cir. 1979). A high degree of recklessness is not required because if it were, the purposes of the statute could be frustrated simply by delegating responsibilities within a business and adopting a "hear no evil – see no evil" policy. See Wright, *supra* at 427. ("A 'responsible person' is liable if he (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easy."). Willfulness can be

² The record also indicates that the taxpayer had extensive experience in the restaurant business. Tr. p. 15. Given the foregoing, I do not find credible the taxpayer's claim that he chose to delegate to his less experienced co-partner complete authority to make decisions as to which creditors to pay.

established by a showing of gross negligence as in a situation in which a responsible party ought to have known of a grave risk of nonpayment and is in a position to easily find out, but does nothing. *See Branson, supra.*

In this case, the taxpayer testified that he was aware of the company's financial problems throughout the tax period in controversy. Tr. pp. 12, 13. He knew that the company was having cash flow problems and that half of its bills were not being timely paid. *Id.* Even with this knowledge, the record contains no evidence that the taxpayer ever asked his co-owner what bills were being paid and what bills were not being paid during the tax period in controversy. The taxpayer made no such inquiries until October 2007 which is after the liability period at issue in this case. Tr. pp. 5, 13, 14. Rather, as he would have one believe, during the tax period at issue, he simply allowed his co-owner to make decisions regarding creditor payments and did not direct that creditor delinquencies, including tax delinquencies, be addressed. Nor is there any evidence that during the tax period in controversy, he inspected the corporation's records or insisted upon being kept informed of the company's tax situation. The fact that the taxpayer adopted a "hear no evil – see no evil" policy does not relieve him of liability. *Wright, supra.* Rather, his failure to see that the company's tax obligations were met during the tax period at issue, a period when he knew that ABC was experiencing financial hardships, is sufficient to establish willfulness within the context of the statute.

The taxpayer attempts to rebut the presumption of willfulness through testimony that his co-owner, Jim Doe, was delegated complete responsibility for payment of the company's taxes. Tr. p. 5. However, the courts have consistently rejected such evidence as a defense to a finding of willfulness by holding that a responsible person

cannot escape an obligation to ensure that taxes are paid by delegating this responsibility to others. Wright, *supra*; Mazo v. United States, 591 F. 2d 1151 (5th Cir. 1979). Applying the criteria enumerated in these cases and the cases noted above, and based on the evidence and testimony summarized above, I conclude that the taxpayer has failed to rebut the Department's *prima facie* case that he acted willfully in failing to remit the taxes in controversy. Accordingly, I find that the taxpayer is liable for the tax penalty that has been assessed.

WHEREFORE, for the reasons stated above, it is my recommendation that the NPL issued to the taxpayer (NPL ID number 00000000) be affirmed and finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: May 20, 2010