

ST 14-21

Tax Type: Sales Tax

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

Illinois Department of Revenue
OFFICE OF ADMINISTRATIVE HEARINGS
 James R. Thompson Center
 100 West Randolph Street, Level 7-900
 Chicago, Illinois 60601
 (312) 814-6114

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

JOHN DOE, as Responsible Officer of
ABC BUSINESS, LLC,
TAXPAYER

No. XXXX
Letter ID: XXXX
NPL Penalty ID: XXXX
Letter ID: XXXX
1002 D Penalty ID: XXXX

Kenneth Galvin
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Michael J. Denker, Denker & Muscarello, LLC, appearing on behalf of Mr. JOHN DOE; Mr. George Foster, Special Assistant Attorney General, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to JOHN DOE’s protest of Notice of Penalty Liability (hereinafter the “NPL”) No. XXXX and Assessment and Notice of Intent (hereinafter the “Assessment”) No. XXXX as responsible officer of ABC Business, LLC (hereinafter “ABC Business”). The NPL represents a penalty liability for retailers’ occupation tax of ABC Business due to the Department for the months of December, 2008, January through December 2009, excluding September, and January through March, 2010. The Assessment represents a penalty liability for withholding tax for the first, second and fourth quarters of 2009 and the first and second quarters of 2010. A hearing was held on this matter on December 20, 2013, with Mr. John

Doe providing oral testimony. Following submission of all evidence and a review of the record, it is recommended that the NPL and the Assessment be finalized as issued. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No. XXXX, dated March 5, 2012, which shows a penalty for unpaid retailers’ occupation tax of ABC Business of \$XXXX and Assessment No. XXXX, also dated March 5, 2012, which shows a penalty for unpaid Illinois withholding tax in the amount of \$XXXX.78. Tr. pp. 4-7; Dept. Ex. No. 1.
2. ABC Business’s “Limited Liability Company Annual Report” lists Mr. John Doe and Jack Black as “members.” Each member had a 50% interest. Mr. Jack Black is also listed as managing member, but Mr. John Doe was not aware of this until he learned of it from his attorney in preparation for this evidentiary hearing. Tr. pp. 9-10, 26-27, 33-34; Taxpayer’s Ex. No. 2.
3. ABC Business owned Happy Place, located in Anywhere, which opened in December, 2008. Mr. John Doe initially invested up to \$20,000, which he had in his savings account. Mr. Jack Black completed the State of Illinois’ online Business Registration and accepted responsibility for filing returns and paying taxes. Tr. pp. 6-9, 21-22; Taxpayer’s Ex. No. 1.
4. Mr. John Doe managed the night shift and the evening staff and “handled some paperwork.” He made sure that people were on time, that employees were doing their jobs, that the kitchen was operating and oversaw the activities in the restaurant. Mr. John Doe testified that he “managed the business in the evening.” Tr. pp. 9-10, 31-32.

5. Mr. John Doe was the only authorized check signer for the business. He opened up the checking account for the business at Badlands Bank. Tr. pp. 10-12.
6. The Department sent ABC Business “Final Notices of Tax Due” for the first and second quarters of 2009. These Notices were sent to Mr. Jack Black’s home address. Mr. John Doe testified that he would “find Notices periodically in the office at the restaurant.” “Somewhere on [Mr. Jack Black’s] desk as I was going through and cleaning things up and organizing them, they would be lying there.” Tr. pp. 14-15; Taxpayer’s Ex. No. 3.
7. Mr. John Doe brought in “Stamper” to generate payroll for the business. Mr. John Doe inputted the information to Stamper for them to complete the payroll. Stamper processed the payroll for a few months and then ABC Business went back to manual check writing for payroll. Tr. pp. 15-17, 27-28, 37.
8. Mr. John Doe prepared the sales tax returns for the business. He mailed the returns to the State of Illinois. He was listed as the electronic tax preparer for the Department of Revenue. His electronic signature appears on the quarterly withholding tax returns for March 31, 2009, and June 30, 2009. Tr. pp. 28-31, 35-36; Dept. Ex. No. 2.
9. In October, 2010, Mr. John Doe was offered \$XXXX for his interest in ABC Business. The Bill of Sale states that as of October 31, 2010, Mr. John Doe and Mr. Jack Black and ABC Business will no longer be responsible for the business known as ABC Business, nor will they have the right to any future business located at the same address. “All items and equipment will become the ownership and belong to Begood Company, LLC.” The Bill of Sale makes provisions for outstanding beer and liquor invoices, utility invoices, the “current lease,” and an “outstanding loan.” There is no provision in the Bill of Sale for unpaid taxes. The “Promissory Note,” signed by Mr. John Doe and attached to the Bill of Sale, states that “all loans, debts and

liabilities ... will transfer to Begood, with the exception of past due State liquor and payroll taxes.” Retailers’ occupation tax is not mentioned in the Bill of Sale or Promissory Note. Tr. pp. 18-20; Taxpayer’s Ex. No. 4.

10. Mr. John Doe testified that when the business was opened, he and Mr. Jack Black reached an “informal agreement,” not memorialized in writing, that Mr. Jack Black would be the “final decision-maker.” Mr. John Doe “conceded that ultimately [Mr. Jack Black] would have the authority.” Tr. pp. 34-35.

Conclusions of Law:

The sole issue to be decided in this case is whether Mr. John Doe should be held personally liable for the unpaid retailers’ occupation tax and withholding tax of ABC Business. 35 ILCS 120/1 *et seq.* The statutory basis upon which any personal liability is premised is Section 3-7 of the Uniform Penalty and Interest Act, which provides 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 to 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.

35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NPL and the Assessment establishes the Department’s *prima facie* case with regard to both the fact that Mr. John Doe was a “responsible” person and the fact that he “willfully” failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the case. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

I conclude, based on the testimony and evidence admitted at the evidentiary hearing, that Mr. John Doe was a responsible party of ABC Business. Mr. John Doe had two years of college and had worked in software development prior to his involvement in ABC Business. Tr. pp. 25-26. ABC Business’s “Limited Liability Company Annual Report” lists Mr. John Doe and Jack Black as “members.” Each member had a 50% interest. Mr. Jack Black is also listed as “managing member.” Mr. John Doe testified that the first time he found out that Mr. Jack Black was a “managing member” was when he saw the Annual Report in his attorney’s office in preparation for this hearing.¹ Tr. pp. 9-10, 26-27, 33-34; Taxpayer’s Ex. No. 2.

¹ It is unclear from the record if ABC Business was a “member-managed” LLC. Counsel for Mr. John Doe acknowledged in his closing argument that it had not been determined “what type of entity we are dealing with.” Tr. p.

ABC Business owned Happy Place in Anywhere which opened in December, 2008. Mr. John Doe initially invested up to \$20,000, which he had in his savings account. Mr. Jack Black, who completed the State of Illinois' online Business Registration, accepted responsibility for filing returns and paying taxes. Tr. pp. 6-9, 21-22; Taxpayer's Ex. No. 1. It must be noted that 35 ILCS 735/3-7 does not confine liability to only one person or to the person most responsible. Mr. John Doe testified that he managed the night shift and the evening staff and "handled some paperwork." He made "sure that people were on time, that people were doing their jobs, kitchen was operating and overseeing the activities in the restaurant..." "In the evening sometimes you needed to just watch the people that were in there." Mr. John Doe testified that he "managed the business in the evening." Tr. pp. 31-32. I conclude that Mr. John Doe, while a member of ABC Business, was also an employee of ABC Business and subject to personal liability under 35 ILCS 735/3-7.

Mr. John Doe prepared the sales tax returns for ABC Business. He mailed the returns to the State of Illinois. He was listed as the electronic tax preparer for the Department of Revenue. His electronic signature appears on the quarterly withholding tax returns for March 31, 2009, and June 30, 2009. Tr. pp. 28-31, 35-36; Dept. Ex. No. 2. Clearly, Mr. John Doe was responsible for filing corporate tax returns. Mr. John Doe brought in "Stamper" to generate payroll for ABC Business. Mr. John Doe inputted the information to Stamper for them to complete the payroll. Stamper processed the payroll for a few months and then the business went back to manual check writing for payroll. Tr. pp. 15-17, 27-28, 37.

Mr. John Doe testified that he was the only authorized check signer for the business. He opened up the checking account for the business at Badlands Bank. Tr. pp. 10-12. According to

43. It must be noted that according to the Limited Liability Company Act, 805 ILCS 180 *et seq.*, in a member managed limited liability company, "each member has equal rights in the management and conduct of the company's business." 805 ILCS 180/15-1(a). The organization of ABC Business as an LLC does not shield either the company or Mr. John Doe from the statutory duty to pay taxes to the State.

his testimony, Mr. John Doe tried to have Mr. Jack Black put on the bank account. “I asked him to go over there and sign a signature card and he didn’t want to do that.” “So I ended up being the only one that was signing checks; and even though I was working the night shift, there were a lot of checks that needed to be signed during the day so he kept calling me at home and I’d have to drive in and sign a check so that he could pay the food guy or the liquor distributor, whoever came in.” “So I was running back and forth and I kept pushing him and pushing him to go over and sign the signature card, but he wouldn’t do it.” Mr. John Doe testified that Mr. Jack Black signed Mr. John Doe’s name “on a couple checks and I – that was frustrating because it made it difficult for me to manage the money...” Mr. John Doe testified further that there was “something on [Mr. Jack Black’s] record with bank fraud.” “I don’t know if there was an outstanding warrant or not, but they said because there was a history of bank fraud --- an unresolved bank fraud issue, they wouldn’t give him the authority.” Tr. pp. 11-12.

The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473 (E.D.N.Y 1981), *aff’d*, 671 F.2d 492 (2d Cir. 1982). Individuals who hold corporate office and who have authority to make disbursements are presumptively responsible persons for purposes of 26 USC § 6672, the federal responsible officer statute. Hildebrand v. United States, 563 F. Supp. 1259 (D.C. N.J. 1983).

Mr. John Doe was a member with a 50% interest in ABC Business and the only one in the company who could write a check on the business account. Each time that Mr. John Doe signed a corporate check, he participated in “decisions regarding the payment of creditors and disbursal of funds,” evidencing his status as a responsible party at ABC Business. Monday, *supra*. The fact that Mr. John Doe had the authority to sign corporate checks without the signature of another party is an

indication of his control over and responsibility for ABC Business's assets. He also prepared the sales tax returns and mailed the returns to the State of Illinois. He was listed as the electronic tax preparer for the Department of Revenue and his electronic signature appears on the quarterly withholding tax returns for March 31, 2009, and June 30, 2009. Tr. pp. 28-31, 35-36; Dept. Ex. No. 2. The only conclusion that can be reached here is that Mr. John Doe was a responsible party and that he could have unilaterally written a check to the State of Illinois for unpaid sales and withholding taxes.

But Mr. John Doe's testimony attempted to minimize his responsibilities with regard to writing checks. According to his self-serving and rather unbelievable testimony, he did not have the authority to write a check without Mr. Jack Black telling him to do so. Tr. p. 14. "Well, I wrote checks, but I didn't have authority to determine which necessarily bills were paid." Tr. p. 10. Mr. John Doe was asked if he had the authority to determine who got paid or when they got paid. He responded as follows: "I only had the ability to write the checks for things that [Mr. Jack Black] told me that I could write checks for. So you know, if he said we need money for food, I had to write a check for food. If he needed money to buy this, I'd write a check for that. If he wanted to pay somebody, I'd write a check for them. If he didn't want to pay somebody, then I didn't..." Tr. p. 30. Mr. John Doe filed the sales tax returns for ABC Business, but did not include a check "because I did not have the authority to do that." "Because any time that any money went out of the business, [Mr. Jack Black] had to know about it...that's the way it worked." Tr. pp. 28-29.

It may have been the way the business "worked," but it was Mr. John Doe's choice to make it work this way, and he must now be found responsible for this choice. When pressed on this issue in cross-examination, Mr. John Doe testified that when he agreed to invest, the only stipulation Mr. Jack Black had "was that he was going to be the final decision maker." "He said if there's two of

us, we can't be in dispute about things. He said ultimately ... I'm going to make the decisions. He had experience in the service industry. I did not. I was a computer guy. I didn't know how to run that type of business and didn't know much about it. I was enchanted by it ... so I conceded that ultimately he would have the authority." Tr. p. 35.

Counsel for Mr. John Doe has not referred me to, and my own research does not indicate, any case that holds that the "final decision maker" in an equal-member LLC can legally order the only check-writing member of the LLC to not write a check for taxes. Mr. John Doe cannot hide behind the LLC's organizational documents in this matter, especially in light of his testimony that he did not know that Mr. Jack Black was a "managing member" until he began preparations for this hearing. Tr. pp. 33-34. Whatever agreement Mr. John Doe had with Mr. Jack Black was not memorialized in writing. It was an "informal agreement to avoid any fights" between the two members. In order to "keep the peace," Mr. John Doe agreed to "defer" to Mr. Jack Black.² Tr. pp. 34-35. But Mr. John Doe cannot absolve himself from responsibility for the taxes by arguing that Mr. Jack Black, an equal member of the LLC, would not permit him to write a check for taxes.

Mr. John Doe's testimony about not writing a check without Mr. Jack Black's approval is contradicted by other testimony. He "supposed" that he did not check with Mr. Jack Black every time he wrote a check. He checked with Mr. Jack Black for "any check that was of any significant amount of money." A significant amount of money was a check "over a couple of hundred dollars." Tr. pp. 30-31. He did not have to check with Mr. Jack Black to pay employees. Tr. p. 12. I assume that he did not have to check with Mr. Jack Black to pay himself.

Mr. John Doe was a 50% member of ABC Business during the period at issue in this case. He was the only person in the business with the ability to write a check and therefore, he was the

² Mr. Jack Black was not subpoenaed for the evidentiary hearing. Mr. John Doe testified that he has not filed a lawsuit against Mr. Jack Black. Tr. p. 25.

only person in the business who could write a check to the State of Illinois for taxes. If he truly had an informal, unwritten agreement with Mr. Jack Black that Mr. Jack Black would make the decisions as to who got paid, this did not relieve him of the responsibility for writing a check to the State of Illinois for taxes. If Mr. John Doe chose not to exercise his authority to write a check to the State for taxes, this does not make him less of a responsible party or indicate that he was not a responsible party. The statute does not confine liability to only one person and the statute does not confine liability to the person who may have been designated as the decision maker in an unwritten informal contract. All responsible persons owe a fiduciary obligation to care properly for the funds that are entrusted to them. “A fiduciary cannot absolve himself merely by disregarding his duty and leaving it to someone else to discharge.” Hornsby v. Internal Revenue Service, 558 F. 2d 952 (5th Cir. 1979). ABC Business was under a statutory duty to pay taxes. Mr. John Doe’s agreement with Jack Black to “defer” to him for decision making cannot negate this statutory duty. Mr. John Doe’s failure to remit taxes to the State reflects his full participation in ABC Business’s failure to remit the mandated tax monies.

In summary, the evidence shows that Mr. John Doe was in a responsible position with ABC Business, and as the only check-signer, he knew that taxes were not being paid. In order to overcome the Department’s *prima facie* case, evidence must be presented which is consistent, probable and identified with the corporation’s books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). When the Department established its *prima facie* case, the burden shifted to Mr. John Doe to overcome the presumption of responsibility through sufficient evidence. Branson, *supra*. The documents offered into evidence by Mr. John Doe do not support his position that he was not a responsible party at ABC Business. Without any

documentary evidence to support his case, I must conclude that Mr. John Doe has failed to rebut the Department's presumption that he was a responsible party under the statute.

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL and Assessment into evidence. Branson v. Dept. of Revenue, 168 Ill. 2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness.

35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay or file taxes. In attempting to clarify what constitutes a willful failure to file or pay taxes, the courts have adopted a broad interpretation of the words "willfully fails." Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Under this broad interpretation, responsible officers are liable if they fail to inspect corporate records or otherwise fail to keep informed of the status of the tax returns and payments. Branson, supra. Willfulness also includes "failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government." Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). "Willfulness" as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970) *cert. denied* 400 U.S. 821 (1970). Also, a person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985).

Mr. John Doe's conduct was willful under each of the above benchmarks. Mr. John Doe testified that ABC Business had received "several notices about taxes due because some had been prepared and some weren't. We were getting notices with ... estimated amounts." Mr. John Doe told Mr. Jack Black that "this is going to end up costing us more money." "Why don't we just do it

and make sure we take care of it on a timely basis?” Mr. Jack Black’s response, according to the testimony, was not to “worry about the taxes.” “They’re not important. Companies go years without paying taxes. It’s not important right now.” Tr. pp. 13, 32. After the first year of ABC Business’s operations when it was time to renew the liquor license, Mr. John Doe testified that “we had a lot of taxes due and I had to scrape up money myself to pay for our taxes at that point...” Tr. p. 17. As ABC Business was coming to the end of its second year of operations and had to renew the liquor license again, “we had a shortfall of cash to take care of all the past due amounts that were due to the State.” Tr. p. 18. Final Notices of Tax Due were apparently sent to Mr. Jack Black at home. But Mr. John Doe “would find notices periodically in the office at the restaurant.” “You know, just somewhere on the desk as I was going through and cleaning things up and organizing them, they would be laying there.” Tr. p. 15.

The testimony above indicates that Mr. John Doe was clearly aware that taxes were not being paid. It makes sense that he would have been aware that taxes were not being paid because he was the only one at ABC Business who could pay them. Mr. John Doe was certainly in a position to inspect ABC Business’s books and keep informed of the status of the tax returns and payments. Mr. John Doe’s failure to do so constitutes willfulness under the statute. In spite of his testimony relating several instances where he confronted Mr. Jack Black about the delinquent taxes, no evidence was offered showing any action on Mr. John Doe’s part to correct what was obviously mismanagement at ABC Business. Failure to investigate or to correct mismanagement after having knowledge of it demonstrates willfulness. Mr. John Doe was a 50% member of an LLC in business with another 50% member who had “an unresolved bank fraud issue,” and who advised Mr. John Doe not to worry about the taxes. “They’re not important.” “Companies go years without paying

taxes. It's not important right now." Tr. p. 13. Mr. John Doe's continued participation in ABC Business shows a decidedly reckless disregard for known risks, further indicating willfulness.

Finally, Mr. John Doe testified that the reason that he did not have the money to pay the State taxes is because there were other vendors that had been paid with that money. Tr. p. 33. Preferring other creditors to the State is evidence of willfulness. In October, 2010, Mr. John Doe was offered \$XXXX for his interest in ABC Business. The Bill of Sale states that as of October 31, 2010, Mr. John Doe and Mr. Jack Black and ABC Business will no longer be responsible for the business known as Happy Place. "All items and equipment will become the ownership and belong to Begood Company, LLC." Tr. pp. 18-20; Taxpayer's Ex. No. 4. It was Mr. John Doe's "understanding" at the time of the buyout, "that the purchaser was going to pay the taxes due the State." Tr. p. 20. The Bill of Sale does not mention that the purchaser would be responsible for any unpaid taxes. The Bill of Sale does state that the purchaser will be responsible for all outstanding beer and liquor invoices, all outstanding utilities, an "outstanding loan" and the current lease. The "Promissory Note" attached to the Bill of Sale, signed by Mr. John Doe, states that "all loans, debts and liabilities ... will transfer to Begood, "with the exception of past due State liquor and payroll taxes." Retailers' occupation tax is not mentioned in the Bill of Sale or Promissory Note. Mr. John Doe's "understanding" that the purchaser was going to pay the taxes to the State seems disingenuous in light of the "exception" for past due payroll taxes in the Promissory Note and the omission of a provision for past due retailers' occupation tax from both the Bill of Sale and Promissory Note.

There is no evidence in the record that taxes were remitted to the State when the business was sold. No evidence of a tax payment plan or escrow agreement was admitted into evidence. There was no testimony or documentary evidence showing any positive steps taken by Mr. John

Doe to ensure that the overdue taxes were paid to the State. By not taking steps to ensure that funds were retained to pay the State, Mr. John Doe allowed the available funds to be used to pay other creditors. The Bill of Sale, similar to Mr. John Doe's testimony, evidences the preference of other creditors over the State of Illinois. A person acts willfully by preferring other creditors to the State. The failure to specifically provide for taxes in the buyout again shows a reckless disregard for the risk that accumulated taxes would not be paid. The evidence of willfulness is overwhelming in this case and I must conclude that Mr. John Doe has failed to rebut the Department's presumption that he willfully failed to pay ABC Business's taxes.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. XXXX and Assessment and Notice of Intent No. XXXX issued against JOHN DOE should be finalized as issued.

Kenneth J. Galvin
Administrative Law Judge

September 16, 2014