

**IT 06-5**

**Tax Type: Income 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. )

**JANE DOE** )

**Respondent** )

**Docket # 00-IT-0000**  
**SS # 000-00-0000**  
**NOD # 0000**

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**RECOMMENDATION FOR DISPOSITION**

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Randy Patchett of Patchett Law Office for Jane Doe.

Synopsis:

The Department of Revenue (“Department”) issued a Notice of Deficiency (“NOD”) to Jane Doe (“respondent”) pursuant to section 1002(d) of the Income Tax Act (35 ILCS 5/1002(d)). The NOD alleges that the respondent was an officer or employee of ABC, Inc. (“XXX” or “corporation”) who was responsible for wilfully failing to pay the corporation's withholding taxes for the first quarter of 1997. The respondent timely protested the NOD, and an evidentiary hearing was held. After reviewing the record, it is recommended that the liability be affirmed.

**Findings of Fact:**

1. The corporation was incorporated in Illinois on March 6, 1996. (Resp. Ex. #29)
2. The respondent began working with Mary Smith in 1995 for a company known as XYZ Leasing (“XYZ”). The respondent started working for XYZ as a receptionist and a few months later became a salesperson for the company. (Tr. p. 10; Resp. Ex. 1A)
3. The respondent worked for XYZ for approximately 6 months, and then the company closed in 1996. XYZ was a company that offered temporary employment services and payroll services. (Tr. pp. 10-11)
4. Mary Smith started XYZ’s business and initially was its only shareholder and officer. John Doe did some accounting work for XYZ. (Resp. Ex. #1, pp. 9, 11, 13)
5. Mary Smith organized XXX, and John Doe assisted with the organization. He referred Mary Smith to the attorney who incorporated it. (Resp. Ex. #1, pp. 18-19)
6. After XYZ ceased to do business, the respondent immediately started working for XXX. There was not a break in her employment. The respondent worked as a salesperson for the corporation and also filled temporary job positions.<sup>1</sup> (Tr. pp. 13-14)
7. XXX had 36 employees. (Resp. Ex. #30; Tr. p. 28)
8. The corporation had four wholly-owned subsidiaries: XXX Agriculture, Inc., XXX Transportation, Inc., XXX Trucking, Inc., and XXX Acquisition Corp.

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<sup>1</sup> Although it is not specifically stated in the record, it appears as though the corporation’s services were similar to those of XYZ.

The last subsidiary later changed its name to XXX World, Inc. (Resp. Ex. #7; Tr. pp. 19-20)

9. On January 24, 1996, the corporation filed Form NUC-1, Illinois Business Registration Application, with the Department. The form indicates that Suzy Snowflake is the president of the corporation and is responsible for filing the returns and paying the taxes. The form shows the respondent as the secretary of the corporation. (Dept. Ex. #1)
10. On January 29, 1996, the respondent signed an "Employee Confidentiality & Non-Solicitation Agreement" for XXX and two other corporations in which she was involved. The Agreement covers confidential information such as computer programs, customer lists and marketing information. (Resp. Ex. #25)
11. On October 7, 1996, the respondent signed an "Incumbency Certificate" wherein she certified that she was the president, secretary, and treasurer of XXX. (Resp. Ex. #14, 29)
12. On October 9, 1996, a Trust Agreement was signed by Mary Smith as Grantor and John Doe and Mary Smith as Co-Trustees. The trust was created for the primary benefit of Mary Smith's daughter, Baby Smith, and the respondent's son, Boy Smith. Although it was signed on October 9, 1996, the agreement states that it was entered into as of March 6, 1996. (Resp. Ex. #6; Tr. p. 27)
13. The trust estate included an 85% interest in the corporation. Under the trust agreement, Baby Smith received 2/3's interest in the trust estate and BoySmith received a 1/3 interest. (Resp. Ex. #6, 7)
14. The corporation had a signature stamp with the respondent's name. The respondent gave permission for the corporation to use the signature stamp for payroll checks. (Resp. Ex. #35; Tr. pp. 21-22)

15. The respondent's signature stamp was used for payroll checks because Mary Smith decided that two signatures were necessary. (Tr. p. 33)
16. The respondent's signature stamp was used for filing form IL-941, Illinois Employer's Quarterly Withholding Tax Return, for the fourth quarter of 1996. (Dept. Ex. #1, p. 6)
17. On October 11, 1996, the respondent and May Smith (n/k/a Mary Smith) signed a "Corporate Authorization Resolution" with the State Bank that authorized the respondent and Ms. Baby Smith to, *inter alia*, open any deposit or checking account in the name of the corporation, endorse checks and orders for the payment of money, withdraw funds on deposit with the bank, borrow money on behalf and in the name of the corporation, and sign, execute and deliver promissory notes or other evidences of indebtedness. (Resp. Ex. #29)
18. On October 16, 1996, Mary Smith wrote a memo to all employees concerning company policies and procedures. The memo stated, *inter alia*, that a limit would be placed on cell phone reimbursement, and if an employee believed that there was a reasonable exception for any increased charges, "they will be reviewed on a case-by-case basis by Jane Doe or Mary Smith." (Resp. Ex. #28)
19. The memo concerning company policies and procedures has a paragraph concerning harassment and states in part as follows: "Should you feel you are being harassed, or should you view any harassment of another co-worker or employee, please notify your immediate Supervisor and/or XXX or Mary Smith." (Resp. Ex. #28)
20. On December 14, 1996, Mary Smith wrote a memo to the respondent that provides as follows:

“Today, John Doe and I had a conversation regarding you. I expressed to John Doe that I felt it was time to give you a partial review. I was telling John Doe about how hard I feel you have been working. I also told him about the great strides you have made in the past four (4) months. John Doe told me he also felt you have made great strides. \* \* \* In the essence of time \* \* \* I felt it important to give you the following increase and you and I will discuss the remainder Wednesday afternoon or Friday. The increase will be:

\$100.00 additional per week  
\$5,200.00 additional per year  
\$40,199.00 a year total” (Resp. Ex. #17; Tr. pp. 31-32)

21. On January 5, 1997, Mary Smith wrote a memo to the respondent that provides, in part, as follows:

“If you and I are to work together in a ‘partnership,’ we must do so with loyalty and trust or else it will never work. \* \* \* I also understand that you have concerns regarding your liability as President. I understand that you do not believe what I told you about the trust, so I have requested Jon to write you a letter to verify this. You can feel free to take all corporate documents to an attorney of your choice to have them reviewed.

I am not sure why you feel that I am using you just for your signature, however, I have reassured you as much as I can that this is not the case. If you are still concerned about this, please let John Doe or myself know and we will get it changed if that is your wish. \* \* \*

I know we have been having a communication problem. \* \* \* I will not make major decisions without discussing them with you first. \* \* \* With regard to your pay, I wish at this point that you and I could be paid more. I did the best I could with your raise. \* \* \*” (Resp. Ex. #9)

22. On July 3, 1997, the respondent resigned from her position as president of the corporation. She also resigned any officer position and/or director position of any of the corporation’s companies and any of its subsidiaries or related companies. She continued to work as an employee of the corporation. (Resp. Ex. #24)
23. On February 14, 2001, in the United States District Court for the Southern District of Illinois Mary Smith entered a plea of guilty to charges of mail fraud

and filing false income tax returns. She was sentenced to a prison term of 24 months on each count to be served concurrently. (Resp. Ex. #31, 32)

24. On June 25, 2003, the Department issued NOD number 4542 to the respondent that proposed a total penalty liability of \$37,518.79, including tax, interest, and penalty, for failure to pay withholding taxes for the first quarter of 1997. The NOD was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1).

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 wilfully fails to file the return or make the payment to the Department or wilfully 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 withholding taxes if (1) the individual had the control, supervision or responsibility of filing the returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

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>2</sup>. See Branson v. Department of Revenue, 168 Ill. 2d 247, 254-56 (1995); 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 (7th 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 (7th Cir. 1970), cert. den. 400 U.S. 821.

In addition, these cases define "wilfull" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson at 254-56; Heartland at 29-30. Wilfull conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. 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 (7th Cir. 1987). Furthermore, whether the person in question wilfully 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 Publick & 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 wilfull behavior. See Heartland at 29-30.

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>3</sup> See Branson

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<sup>2</sup> This section imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

<sup>3</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

at 260. Once the Department presents its *prima facie* case, the burden shifts to the respondent to establish 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 wilfull. *Id.* at 261. In order to overcome the Department's *prima facie* case, the alleged responsible person must present more than his or her testimony denying the accuracy of the Department's assessment. A. R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 833-34 (1st Dist. 1988). The person must present evidence that is consistent, probable, and identified with the respondent's books and records to support the claim. *Id.*

In the present case, the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence. In response, the respondent claims that Mary Smith and John Doe managed the day-to-day operations of the corporation, and they perpetrated a fraud upon her. She contends that Mr. Doe is a fugitive and Ms. Baby Smith went to prison for her dealings with this corporation. She argues that she was not allowed to make decisions regarding money or payroll, and she was an officer of the corporation only because a trust was set up for her son. She testified that she consented to the use of her signature stamp only for payroll checks, and it was used on other documents without her permission. The respondent maintains that the memo concerning her salary shows that Ms. Smith and Mr. Doe controlled the company. She claims that the first time that she became aware that the taxes were not being paid was in June or July of 1997.

Although the respondent contends that she had no control in the corporation, she signed a "Corporate Authorization Resolution" with the State Bank wherein she and Ms.

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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).

Smith received authority to open accounts, endorse checks for the payment of money, withdraw funds and borrow money on behalf of the corporation. The memo concerning company policies and procedures indicates that the respondent was a person who had significant authority in the corporation because she was one of the people who the employees could go to concerning harassment issues and extra cell phone reimbursement. In the memo to the respondent dated January 5, 1997, Mary Smith told the respondent that she understood that the respondent had some concerns regarding her liability as president. Ms. Smith wrote, "If you are still concerned about this, please let John Doe or myself know and we will get it changed if that is your wish."

The authorization with the State Bank gave the respondent significant control over the corporation's finances. The memo concerning her salary did not alter her authority over the company's bank account. On January 5, 1997, Ms. Smith notified the respondent in writing that she had the opportunity to change her responsibilities as president, and she chose not to do so until she resigned in July of 1997. The record does not indicate that she attempted to resign earlier.

The respondent has not presented sufficient evidence to overcome the Department's *prima facie* case. She did submit an affidavit from an employee of the accounting department who stated that he never took directions from the respondent. (Resp. Ex. #13) She also submitted two letters from other employees who stated that the respondent was a "cover" and "simply a yes girl" for Ms. Smith. They indicated that Ms. Smith made all the decisions for the company. (Resp. Ex. #33, 34) The affidavit and letters, however, are hearsay statements that cannot be a basis for finding that the respondent did not willfully fail to pay the taxes. The respondent was the only witness who testified at the hearing, and as noted earlier, the respondent must present more than her testimony denying the accuracy of the Department's assessment in order to support her claim. See A. R. Barnes & Co., *supra*. The remaining documentary evidence does not support her claim. In addition, it is not exactly clear from the record whether the

charges against Ms. Smith for mail fraud and tax evasion were due to her connections with this corporation or XYZ (See Resp. Ex. #1, p. 65). The respondent has not shown how Ms. Smith's plea of guilty to these charges indicates that the respondent did not willfully fail to pay the corporation's taxes.

Recommendation

For the forgoing reasons, it is recommended that the Notice of Deficiency be upheld.

Linda Olivero  
Administrative Law Judge

Enter: March 22, 2006