

IT 96-54

Tax Type: INCOME TAX

Issue: Penalty Under 1002(d) - Failure To File/Pay Withholding

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
CHICAGO, ILLINOIS

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|---------------------------|---|-------------------|
| THE DEPARTMENT OF REVENUE |) | |
| OF THE STATE OF ILLINOIS, |) | No. |
| Petitioner |) | |
| |) | |
| v. |) | |
| |) | SSN: |
| TAXPAYER, |) | |
| as responsible officer |) | |
| of CORPORATION |) | Linda K. Cliffel, |
| |) | Admin. Law Judge |

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Gust Dickett for TAXPAYER; Thomas Jacobsen, Special Assistant Attorney General, for the Illinois Department of Revenue.

SYNOPSIS:

This matter comes on for hearing pursuant to the protest of the Notice of Deficiency ("NOD") Number issued by the Department against TAXPAYER on April 7, 1994 as responsible party of CORPORATION (hereinafter referred to as "CORPORATION"). The NOD represents the officers' liability for Withholding Tax admitted by CORPORATION as due to the Department for the fourth quarter 1990 but which is unpaid.

A hearing in this matter was held on February 7, 1995. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. CORPORATION was formed to develop and produce a notebook-sized computer.
(Tr. pp. 16-17, 417)

2. TAXPAYER provided the start-up capital for the company. (Tr. pp. 15, 17-24, 165-166)
3. TAXPAYER was the Chairman of the Board of Directors of CORPORATION. (Tr. pp. 25 and 123)
4. The Directors of the corporation were TAXPAYER, OFFICER, PRESIDENT, VICE PRESIDENT, VP and ACCOUNTANT, the outside accountant for the company. (Tr. pp. 124 and 131)
5. TAXPAYER was given a list of expenditures, which was prepared by PRESIDENT, every week or two. (Tr. p. 153) TAXPAYER would approve the expenditures and issue a check in the aggregate for the amount he had approved. (Tr. p. 165) TAXPAYER' total investment in the company was approximately \$1 million, with incremental contributions being no more than \$30,000. (Tr. pp. 165-166)
6. TAXPAYER determined how many shares of stock each shareholder would receive. (Tr. p. 188) TAXPAYER included OFFICER as a shareholder and director. (Tr. pp. 186-188, 448-449)
7. TAXPAYER hired PRESIDENT and determined his level of compensation. (Tr. pp. 36-37, 79, 150, 152)
8. ACCOUNTANT was hired as the corporation's accountant based on TAXPAYER' recommendation. (Tr. pp 130-131)
9. PRESIDENT had to get permission from TAXPAYER to hire employees of CORPORATION. (Tr. p. 234)
10. The signature authority for the corporate bank account was held by TAXPAYER, OFFICER, PRESIDENT, VICE PRESIDENT, and VP. (Tr. p. 160)
11. Two signatures were required on corporate checks. Typically, PRESIDENT signed the checks and submitted them to OFFICER for countersignature. (Tr. pp. 164-165, 167)
12. A meeting was held in January of 1991 to discuss the payroll tax situation. TAXPAYER agreed to fund the money needed to pay the payroll taxes on the condition that CORPORATION gave him a promissory note in that amount and

PRESIDENT, VP, and VICE PRESIDENT each give up a 5% equity holding in the company. (Tr. pp. 177-178, 182-185, 189-195)

13. On January 31, 1991, the agreement between TAXPAYER, the PRESIDENT AND VICE PRESIDENT, and VP was executed. (Tr. p. 196; Dept. Ex. No. 23)

14. PRESIDENT was fired by TAXPAYER on January 31, 1991. (Tr. p. 196)

CONCLUSIONS OF LAW:

The penalty at issue herein is based upon the withholding tax liability of CORPORATION for the fourth quarter of 1990. The corporation submitted to the Department the required tax return without payment for the amount stated therein. The Department seeks to impose personal liability on Mr. TAXPAYER pursuant to Ill. Rev. Stat. 1991, ch. 120, ¶1002(d),¹ which provides:

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 to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over...For purposes of this subsection, the term "person" includes an individual, corporation or partnership, or an officer or employee of any corporation (including a dissolved corporation), or a member or employee of any partnership, who as such officer, employee or member is under a duty to perform the act in respect of which the violation occurs.

CORPORATION² was created to design and manufacture a notebook-size computer. TAXPAYER was the sole source of capital for CORPORATION. The other principals in the corporation were the following: VP, who provided the idea and the technical knowledge, VICE PRESIDENT, who was in charge of marketing, and PRESIDENT, who was in charge of operations. OFFICER was also an officer and director, and was brought into the venture by TAXPAYER due to their business relationship in OFFICERMark Technologies.

¹ The liability for payroll taxes herein accrued in 1991. Therefore, the statute which applies is Ill. Rev. Stat. 1991, ch. 120, ¶1002(d). The Uniform Penalty and Interest Act, 35 ILCS 735/3-7, which provides for a personal liability penalty, is effective for taxes incurred January 1, 1994 and later.

² CORPORATION was originally formed as COMPUTER.

There are two elements which are required by the statute in order for personal liability to be imposed for the failure to pay withholding taxes. First, the person must be a responsible party and second, the failure to pay must be willful. By introducing the NOD into evidence, the Department has proved its *prima facie* case against TAXPAYER. The burden of proof then passes to TAXPAYER to rebut the Department's *prima facie* case.

From the testimony adduced at hearing, it is clear that TAXPAYER had significant control over the corporation and that he was the one person involved in the venture with any business experience. Although TAXPAYER was never involved in the day-to-day operations of the company, he was far more than a passive investor. TAXPAYER had the power to hire and fire. He set the for compensation PRESIDENT and VP. He also determined how much stock each individual would receive, and made such other decisions as bringing Mr. OFFICER into the company, making him a shareholder and director. As Chairman of the Board he acted as the Chief Executive Officer of the company.

Every expenditure was personally approved by him. PRESIDENT made a list of expenditures every week or two for his review and approval. After reviewing the list and asking questions regarding specific items of expenditures, he would give the company a check in the amount of those expenditures. Thus, his contribution to capital of the company was made on an as-needed basis, with his full knowledge of what bills were being paid and what bills were not. He was well aware of the financial situation of the company at all times by means of these reports.

Internal Revenue Code Section 6672 is similar to the Illinois statute in that it holds corporate officers responsible for the willful failure to pay federal withholding taxes. Cases interpreting Section 6672 hold that a responsible person is one with significant control over the corporation's disbursement of funds. See Hochstein v. United States, 900 F.2d 543, 547 (2d Cir. 1990); Monday v. United States, 421 F.2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970); Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979)

(responsibility is a matter of status, duty and authority, not necessarily knowledge); Wright v. United States, 96-1 USTC ¶50,114 (E.D.N.Y 1995) (Chairman of the Board held to be responsible party).

The Illinois Supreme Court held in Branson v. Department of Revenue, 168 Ill.2d 247 (1995), that the introduction of the Notice of Penalty Liability was sufficient to establish a *prima facie* case of willful failure to pay retailers' occupation taxes. The penalty provisions regarding the willful failure to pay withholding taxes are essentially the same as the retailers' occupation tax provisions, and Branson should apply equally in this case.

In this case, however, there is a great deal of evidence showing willfulness by TAXPAYER. TAXPAYER had direct knowledge that the payroll taxes were not paid in January 1991. Not only was he aware that the taxes needed to be paid, but he entered into an agreement with both PRESIDENT AND VICE PRESIDENT and VP that he would pay the liability if they would surrender to him a portion of their stock holdings and that CORPORATION would give him a promissory note in that amount. In his own defense, TAXPAYER' testimony consisted almost entirely of "I don't recall"'s. He has submitted no evidence on his behalf to rebut the Department's *prima facie* case.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Deficiency be finalized.

Date:

Linda K. Cliffel
Administrative Law Judge