

ST 07-25

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)	No.: 00-ST-0000
)	IBT: 0000-0000
v.)	NPL: 0000-000-00-0
)	SSN: 000-00-0000
JOHN DOE, as Responsible Officer of)	
ABC MOTOR SPORTS, INC.,)	Julie-April Montgomery
Taxpayer)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

APPEARANCES: George Foster, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; James E. Dickett of Romanoff & Dickett, Ltd. for John Doe.

SYNOPSIS:

The Department of Revenue (“Department”) issued a Notice of Penalty Liability (“NPL”) to John Doe (“Taxpayer”) pursuant to section 3-7 of the Uniform Penalty and Interest Act (“UPIA”). 35 ILCS 735/3-7. The NPL alleges that Taxpayer was an officer or employee of ABC Motor Sports, Inc. (“Corporation”) who was responsible for wilfully failing to pay the Corporation's Retailers' Occupation and Use Taxes (“ROT/UT”) and remitting numerous checks that were not honored by the bank. Taxpayer timely protested

the NPL. After reviewing the record, it is recommended that the NPL be finalized as issued.¹

FINDINGS OF FACT:

1. Taxpayer does not contest that he was a responsible officer of the Corporation. Tr. p. 8 (Taxpayer’s counsel’s stipulation on the record).

2. Eleven of the twelve assessments identified on the NPL are “conceded” by the Taxpayer as due and owing, and as such, Taxpayer does not challenge these assessments.

These are:

<u>Number</u>	<u>Period</u>	<u>Amount</u>
000000000000000000 (bad check)	6/2003	\$25
000000000000000000 (bad check)	6/2003	\$25
000000000000000000 (bad check)	6/2003	\$25
000000000000000000 (ROT/UT)	6/2003	\$162.68
000000000000000000 (ROT/UT)	6/2003	\$707.47
000000000000000000 (ROT/UT)	6/2003	\$2,474.30
000000000000000000 (ROT/UT)	8/2004	\$72.59
000000000000000000 (ROT/UT)	10/2004	\$278.01
000000000000000000 (ROT/UT)	11/2004	\$4,146.52
000000000000000000 (bad check)	12/2004	\$25
000000000000000000 (ROT/UT)	1/2005	\$31

Tr. p. 10 (Taxpayer’s counsel’s second stipulation on the record); Dept. Gr. Ex.

No. 1 (the “NPL”).

3. Taxpayer is a 1992 graduate of Arizona State University with a B.S. in Management.

Tr. p. 12.

4. Near the end of 1995, Taxpayer started the business of ABC Motors Sports, Inc. Tr.

p. 12.

¹ The Administrative Law Judge who heard this matter left the employ of the Department before a decision was written. The credibility of the sole witness who testified was not a factor in the decision.

5. Taxpayer was the owner, manager and salesman for the Corporation. Tr. p. 13.
6. The Corporation's operations consisted of both the sale and lease of automobiles. Tr. p. 13.
7. The Corporation ceased operations in December 2004. Tr. p. 22.
8. On May 25, 2005, the Department issued NPL number 0000-000-00-0 to Taxpayer. The NPL proposed a total penalty liability of \$454,480.85, including tax, interest and penalty for failure to pay ROT/UT for the months of November 2000, June 2003, August 2004, October 2004, November 2004, and January 2005, as well as, penalties for checks that were not honored by the bank for June 2003 and December 2004. The NPL was admitted into evidence under the certificate of the Director of the Department. Dept. Gr. Ex. No. 1.
9. The basis for the assessed amounts in the NPL is disallowed trade-ins deductions and clerical errors. Tr. p. 17; Taxpayer Ex. Nos. 1 (Department's "Letter of Comments"); 2 (Department's "Summary Analysis" on trade-ins); 3 (Department's "Comparison of Sales to 556 Reports"); 6 (Corporation's "Final Assessment for Sales and Use Tax"); 7-18 (Corporation's ST-556 returns for transactions in which trade-ins were allowed and disallowed).
10. The Department's Form ST-556 ("556") was utilized to report tax due and was usually prepared by the Corporation's secretary or receptionist but these forms were also prepared by salesmen which included Taxpayer. Moreover, some of the 556's were reviewed by Taxpayer. Tr. pp. 14, 28.
11. Taxpayer learned how to account for trade-ins on 556's by asking title clerks from other dealerships. He asked such title clerks for direction and advice on the type of information to be placed on the 556 regarding leased trade-ins but never inquired as to the propriety of when leased trade-ins were or were not to be taken as a deduction on the 556's. While Taxpayer had three salesmen who had experience with the 556, he also did

not ask these salesmen whether a trade-in deduction was warranted on the 556 when the transaction involved a leased vehicle. Tr. pp. 15-16, 46-47.

12. Taxpayer was never told, nor did he ask anyone, when and under what circumstances to take deductions for trade-ins associated with a lease transaction. He just prepared the 556's based upon his own past personal car purchase/lease experience. Tr. pp. 47-48.

13. Taxpayer was not advised that the allowance of a trade-in deduction for a leased transaction is different from the availability of such a deduction for non-leased transactions until the Department conducted its audit. Tr. p. 44.

14. Taxpayer utilized a CPA to prepare the Corporation's income and payroll taxes as well as its financial statements. Tr. p. 14.

15. The Corporation's CPA neither prepared the 556's nor advised how such forms were to be prepared. Taxpayer did not seek the CPA's advice, instruction or review as to how the 556's were to be prepared until the Department's audit identified a problem with how trade-ins associated with leased vehicles were accounted for on the 556's. Tr. pp. 14-15, 50-53.

16. Taxpayer neither contacted nor obtained publications from the Department on how to prepare the 556's and account for trade-ins with regard to leased vehicles. Tr. 51-52.

CONCLUSIONS OF LAW:

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 will therefore be personally liable for the corporation's taxes if the individual had: 1) control, supervision or responsibility for filing the ROT/UT returns and paying the taxes, and 2) wilfully 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)². 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. Purdy Co. of Illinois v. United States, 814 F. 2d 1183, 1186 (7th Cir. 1987). Responsibility is generally found in high level 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. 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. Wilfullness 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). Moreover, the courts have adopted a broad interpretation of the words "wilfully fails." Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Under this broad interpretation, a responsible officer is liable if he fails to inspect the corporate records or otherwise fails to keep informed of the

² 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.

status of the tax returns and payments. Branson at 267. 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 Bublick & Sons, Inc., 68 Ill. 2d 568, 577 (1977).

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.³ Branson at 260. Once the Department presents its *prima facie* case, the burden shifts to the Taxpayer 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 allegedly 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 books and records to support the claim. *Id.*

The parties have stipulated that Taxpayer was a responsible officer. Moreover, as the founder, owner and manager of the Corporation who prepared and reviewed 556's , certainly Taxpayer's actions exhibited that he, in fact, had control, supervision and responsibility for the filing of the Corporation's returns and payment of its taxes. Furthermore, Taxpayer presented no evidence that he was not a responsible officer.

The parties have also stipulated, and Taxpayer has specifically conceded, that eleven of the twelve assessed amounts of the NPL are due. Only SF 0000000000000000

³ 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).

ROT/UT for November 2000, totaling \$446,508.28, is in dispute. The basis for this assessment is mainly disallowed trade-in deductions. Hence, the sole issue to be decided is whether Taxpayer wilfully failed to pay the tax due on transactions for which the trade-in deduction was disallowed.

The Department argues Taxpayer was wilfull in his filing of the returns and payment of the taxes because he had a duty to know what his responsibilities were by making reasonable inquires of the Department or his CPA, and the failure to do so was tantamount to a “reckless disregard” (Tr. p. 55) of his obligations. Taxpayer counters that he was not wilfull because: 1) the tax due was not collected; 2) only certain trade-in deductions were disallowed; 3) he did not actually prepare or recall reviewing the 556’s that had disallowed transactions; 4) the Corporation ceased to exist before issuance of the assessment; 5) he was unaware that certain leased trade-ins did not qualify for deductions; and 6) he acted as “a normal person would” (Tr. p.57) under the circumstances because it would have been impractical for a CPA to have reviewed the voluminous number of 556’s. On this last point, Taxpayer further argues that he cannot be deemed wilfull because his CPA did not know how to account for leased trade-ins on the 556’s; however, Taxpayer could not have known this since he never asked the CPA’s advice on the transactions at issue.

The Department is correct in its assertion that Taxpayer was wilfull and all of Taxpayer’s arguments seem to ignore the rule stated in Wright, *supra*, with regard to wilfullness. This rule requires an evaluation as to whether the responsible officer should have: 1) known that there was a risk that the tax was not being collected/paid and 2) been able to easily exact whether such tax was to be collected/paid.

Taxpayer has a B.S. degree in management. He was not only the founder and owner of the business but its manager. The usual responsibilities of management include both the training and review of one’s employees to ensure proper and accurate work performance. It is essential that a manager know that his employees are performing their

job correctly. This would include the proper completion of forms, like the 556's, that are utilized daily in the Corporation's business. Taxpayer is a manager who was educated in management. He testified that he reviewed some of the 556's but did not quantify the number and frequency of such reviews nor recall the specific 556's reviewed. Taxpayer's testimony was silent as to whether he even provided his employees with training regarding the proper completion of the 556's or even sought the assistance of others for such a task. Taxpayer's testimony also is silent as to whether any training of his staff on any subject, let alone the proper manner in which to account for a trade-in on the 556, occurred. Moreover, his review of his employees' work in this area seems poor, if not totally remiss, and contrary to his educational instruction and job responsibilities.

Taxpayer chose to start a business which he would manage. He opted to utilize a CPA to prepare his income and payroll taxes but failed to seek his CPA's advice on how to properly account for trade-ins with regard to financed and leased vehicles on 556's until the Corporation was actually audited and the issue was presented as a problem. Taxpayer claims his CPA never told him that there is a difference in whether trade-in deductions are allowed for leased and financed vehicles. However, Taxpayer admits he never asked his CPA about trade-ins or any other aspect of the 556's until the Department, as the result of an audit, informed him he had not properly accounted for trade-ins on the 556's. Taxpayer alleges it would have been impractical for a CPA to review the voluminous number of 556's that the business produced. But Taxpayer did not even ask his CPA to review the 556 form and explain the proper manner in which to account for the various transactions that may arise like the accounting of trade-ins for leased or financed cars. It is clear that Taxpayer's CPA neither advised nor prepared the 556's of the Corporation which resulted in the Corporation's tax liability, and as such, Taxpayer cannot hold his CPA accountable for the liability which serves as the basis for the current dispute.

Besides his failure to seek the assistance of a tax professional on the proper completion of 556's, Taxpayer also failed to seek the assistance of the Department. He admits that he did not contact the Department for advice regarding how to properly account for trade-in deductions or even inquire whether the Department had publications on the subject. If Taxpayer had contacted the Department, he could have availed himself of a private letter ruling, pursuant to the Illinois Administrative Code, wherein "specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation[s]" are issued. 2 Ill. Adm. Code 1200.110. But Taxpayer did not even seek any oral advice from the Department or the existence of any written materials, let alone avail himself of posing written questions on how to account for trade-ins on the 556.

Taxpayer instead chose to rely on others, outside of his business, as to the type of information to place on the 556's but never asked the propriety of or basis for the information placed on the 556's, specifically for trade-in deductions. While Taxpayer sought advice from title clerks of other businesses with regard to the 556's, it was not on this particular point of how and when to take trade-in deductions. Taxpayer states he had salesmen who were experienced with these forms but does not state that he sought their advice on how to account for trade-ins on the 556's nor even checked to see that they were, in fact, completing the 556's correctly, inclusive of their treatment of trade-ins. He also states that his clerks and receptionist also completed the 556's but he does not indicate that he inquired of them as to the treatment they gave trade-ins on the 556's. Taxpayer states "[n]o one had ever told me that [a] leased vehicle was looked upon differently than a financed vehicle." Tr. p. 49. He states he just assumed the treatment of leased and financed vehicles were the same. However, a reasonable and prudent manager and businessman, with a management degree, should not assume nor await the word of others as to what he is to do with regard to his own business. This is particularly true when the issue is of significant importance to a business as in this case where trade-in transactions occurred with regularity.

Taxpayer was in a business that had significant tax responsibilities and numerous transactions. Each transaction had serious tax consequences – to tax or not to tax various aspects of the transaction, like a trade-in. Taxpayer admits he made erroneous assumptions about a crucial element of the Corporation’s regular transactions – the trade-in. Taxpayer alleges ignorance of how to account for trade-ins, but ignorance of the law is no excuse for failure to properly account for one’s tax obligations. DuMont Ventilation Company v. Department of Revenue, 99 Ill. App. 3d 263 (3rd Dist. 1981). Taxpayer failed to seek professional advice, from either his CPA or the Department. He chose to rely upon others outside of his business for limited assistance that did not even address the issue of how to properly account for trade-ins. Moreover, Taxpayer did not seek to inquire whether his own staff properly accounted for or could explain to him how and why they recorded trade-ins on the 556’s the way they did. In light of Taxpayer’s failure to seek advice, professional or otherwise, to claim ignorance because no one told Taxpayer what he should have ascertained on his own is disingenuous.

Taxpayer’s arguments imply that he delegated responsibility for the proper completion of the 556’s to his staff. But Illinois law holds responsible officers, like Taxpayer, liable for wilfull failure to account for and remit taxes if they delegate responsibility but fail to inspect business records, like the 556’s, or otherwise fail to keep themselves informed of the status of their tax obligations. Branson, *supra* at 427. Abdication of one’s tax obligations in favor of others, like salesmen, clerks and receptionists, is not acceptable in a responsible person, like Taxpayer. Wright, *supra* at 427.

The exhibits presented by Taxpayer consisted of Department work papers that reflected the basis for the liability; documents which reflected the Corporation’s final federal tax return, final Department assessment and the conduct of the administrative hearing for such assessment; 556’s and accompanying paper work for 2 transactions where the trade-in deduction was allowed; and 556’s and the accompanying paper work

for 10 transactions where the trade-in deduction was disallowed. These documents are not consistent, probable and indicative of actions that reflect the Taxpayer was not wilfull in his failure to perform his tax obligations. To the contrary, these documents either failed to address the issue of wilfull failure (Taxpayer Ex. Nos. 1-6) or reaffirmed that Taxpayer did, in fact, wilfully fail in his tax obligations (Taxpayer Ex. Nos. 7-18). Because Taxpayer abdicated and/or delegated the responsibility for the proper treatment and accounting of trade-in deductions without a proper inspection and review of the 556's, he failed to keep himself informed of the status of his Corporation's tax compliance, and as such, wilfully failed to properly account for trade-ins.

As previously noted, the Department's *prima facie* case was established in this case when the Department's certified record relating to the penalty liability was admitted into evidence. Taxpayer then had the burden of establishing that one or more of the elements of the penalty were lacking. Taxpayer concedes the responsible officer element and has not established that he was not wilfull in discerning when trade-ins were to be taken as deductions. In fact, the evidence reflects that Taxpayer wilfully failed to perform his duties because he ought to have known that there was a grave risk that the taxes were not being correctly accounted for and he was in a position to find out for certain very easily. See Wright, supra.

RECOMMENDATION:

Inasmuch as Taxpayer did not present sufficient evidence to overcome the Department's *prima facie* case, it is recommended that the Notice of Penalty Liability be upheld in total.

OJulie-April Montgomery
Administrative Law Judge

Enter: December 3, 2007