

**ST 08-6**

**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**

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

v.

**JOHN DOE,  
Taxpayer**

**No. 07-ST-0000  
IBT# 0000-0000  
NPL# 0000**

**Ted Sherrod  
Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Special Assistant Attorney General George Foster on behalf of the Illinois Department of Revenue; Bruce Wurmser, Esq. on behalf of John Doe.

**Synopsis:**

This matter is before this administrative tribunal pursuant to the taxpayer's protest of Notice of Penalty Liability ("NPL") number 0000 as responsible officer of ABC Group, Inc. The NPL represents a penalty liability for Retailers' Occupation and related taxes for the period October 1998 through February 2001. A hearing was held on this matter on April 2, 2008 at which John Doe, the taxpayer, testified on his own behalf. Following the submission of all evidence and a review of the record, it is recommended that the NPL at issue in this case be finalized as issued. In support of this recommendation, 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 number 0000, which shows a personal penalty based upon the tax liability of ABC Group, Inc. in the amount of \$25,664.83. The NPL covers the months of October 1998 through February 2001. Department's Exhibit ("Ex.") 1.<sup>1</sup>
2. John Doe ("Doe") is a respiratory therapist licensed to practice respiratory therapy in Illinois. Tr. pp. 11, 81, 82.
3. For several years prior to 1998, Doe worked as a respiratory therapist for XYZ Hospital ("XYZ"), a specialty hospital engaged in the care of chronically ill respiratory patients on ventilators and/or with tracheotomies. Tr. pp. 11 - 13. In addition to the provision of respiratory therapy services, his responsibilities at XYZ included ordering supplies and dealing with reimbursements from Medicare and the Medicaid system. Tr. p. 13.
4. While at XYZ, Doe developed his own program for the provision of respiratory therapist services to chronically ill respiratory patients. The program Doe designed met American Medical Association requirements for the provision of respiratory services on sites other than hospitals. Tr. pp. 16 – 19.
5. In 1998, Doe incorporated his program for the provision of respiratory therapist services as a business by establishing ABC Group, Inc. ("ABC"). Tr. p. 20. ABC

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<sup>1</sup> Unless otherwise noted, findings of fact apply to the tax period in controversy.

- is a Missouri corporation that he formed to provide the necessary services, equipment and supplies to respiratory patients in nursing homes. *Id.* Doe marketed the services of ABC to nursing homes and had both nursing homes and rehabilitation centers as customers. Tr. pp. 23 - 31.
6. Doe was the President and sole shareholder of ABC from its inception and throughout the tax period at issue. He received a salary from the company throughout the tax period in controversy. Tr. pp. 45, 83, 84; Taxpayer's Post-Hearing Brief ("Taxpayer's Brief") p. 9.
  7. As President, Doe was the sole person authorized to sign on behalf of the company and transfer funds from the corporation's bank account. Tr. p. 84.
  8. Doe ran the day-to-day operations of ABC and was solely responsible for determining which creditors of the company would be paid. Tr. pp. 84, 85.
  9. ABC charged its nursing home customers \$82 per day for each ventilator dependent patient, \$62 - \$64 per day for each tracheotomy patient, \$12 - \$14 per day for each suctioning patient and \$8 - \$10 per day for each breathing treatment patient. Tr. pp. 25, 26.
  10. ABC's per diem rates covered equipment and supplies required to provide respiratory services and included all sales taxes, if any, due from the taxpayer. Tr. pp. 21, 27. Pursuant to agreements between ABC and the nursing homes this company serviced, all sales taxes were ABC's responsibility. Tr. pp. 27, 28, 85, 86.
  11. Ninety-five percent of ABC's business was with five Quality Care Management ("QCM") nursing homes, and half of its business was the provision of equipment

- and services to QCM's Willowcreek facility. Tr. pp. 24, 29, 31, 32. Between November 1999 and November 2000, ABC's receipts from the provision of services and equipment to QCM nursing homes fell from \$142,252 to \$25,124. Tr. pp. 37, 38, 47, 48; Taxpayer's Ex. 1.
12. In April and May 2000, QCM, ABC's largest customer, stopped making timely payments for services which created financial problems for ABC. Tr. p. 39; Taxpayer's Post-Hearing Brief p. 3. By May 2000 QCM's outstanding unpaid indebtedness to ABC exceeded \$550,000. Tr. p. 41.
  13. After ABC began having financial difficulties due to QCM's failure to pay, and while it failed to pay all Illinois taxes due and owing, ABC paid telephone bills, copy machine rental fees, its outside accountant, its employees (including the taxpayer) and the Internal Revenue Service. Tr. pp. 88 – 90.
  14. In June 2000, Doe terminated all of ABC's employees except himself and the company's receptionist. Tr. p. 45; Taxpayer's Brief p. 9.
  15. In early June 2000, ABC entered into a new agreement with QCM for the provision of respiratory services pursuant to which QCM agreed to pay ABC all outstanding unpaid indebtedness (which at the time of this agreement, was \$475,000) in eight monthly installments of approximately \$60,000 each. Tr. p. 46; Taxpayer's Brief p. 3. QCM failed to make payments to ABC in accordance with its June 2000 agreement. Taxpayer's Brief p. 4. ABC received \$58,380 in June 2000, \$82,222 in July 2000, \$131,443 in August 2000, \$39,929 in September, 2000, \$28,338 in October 2000 and \$25,124 in November 2000 when QCM made its last payment. Tr. pp. 47 – 49. At the time QCM made its last

- payment in November 2000, it still owed ABC more than \$125,000 plus interest. Tr. p. 48. The monies ABC received between June and November were used to pay utilities, ABC's accountant and the IRS. Tr. p. 50.
16. Doe was aware that, as a result of ABC's financial problems, all taxes that were due and owing to the State of Illinois were not being paid. Tr. pp. 86, 87.
17. During June, 2000 ABC hired Jane Doe, an outside accountant, to review ABC's books and records, determine which taxes were owed or returns were due, and file overdue returns. Tr. pp. 50, 51. Jane Doe worked for ABC from June 2000 until November 2000. Tr. pp. 51, 90.
18. ABC ceased operations in November 2000, but continued to occupy its Belleville, Illinois office rent free until August 2001. Tr. pp. 51 – 53.
19. On or about February 22, 2001, Lisa Dublo ("Dublo"), an auditor employed by the Illinois Department of Revenue, commenced an audit of ABC. Tr. p. 52; Department Ex. 1. During the course of her audit, Dublo determined that ABC owed \$8,681 for unpaid taxes, \$167 for penalties, \$1,201 in interest and \$13,039 for excess tax collections from its customers. *Id.*

**Conclusions of Law:**

The issue in this case is whether John Doe ("Doe") was a responsible person who willfully failed to pay retailers' occupation and related taxes for ABC Group, Inc. ("ABC") as required by statute. The admission into evidence of Notice of Penalty Liability ("NPL") number 0000 establishes the Department's *prima facie* case with regard to both the fact that Doe was a "responsible" officer and the fact that he "willfully" failed to pay taxes that were due. Branson v. Department of Revenue, 168 Ill. 2d 247 (1995).

When the Department establishes its *prima facie* case the burden shifts to the taxpayer to overcome the Department's finding. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1<sup>st</sup> District 1978). To overcome the Department's *prima facie* case, the taxpayer must present consistent, probable evidence, closely identified with books and records. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1<sup>st</sup> District 1987); Vitale v. Department of Revenue, 118 Ill. App. 3d 210 (3d District 1983). Oral testimony without corroborating books and records is insufficient to overcome the Department's *prima facie* case. Mel-Park Drugs v. Department of Revenue, 218 Ill. App. 3d 203 (1<sup>st</sup> Dist. 1991).

The Department seeks to impose personal liability for failure to remit Retailers' Occupation and related taxes ("ROT") to the Department for the period October 1998 through February 2001. The personal liability penalty for the ROT violation determined by the Department is imposed by section 3-7 of the Uniform Penalty and Interest Act ("section 3-7"), which provides 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 statute defines neither "responsible" person nor "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.A. section 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 section 6672 purposes. These courts have considered specific facts in determining whether individuals were "responsible" for the payment of employment taxes, to wit: 1) the duties of the officer as outlined by 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 (7<sup>th</sup> Cir. 1970), cert. den. 400 U.S. 821 (1970); Gephart v. United States, 818 F. 2d 469 (6<sup>th</sup> Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990).

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 the dispersal of funds. See Monday, supra. Liability attaches to those with the power and responsibility within the corporate structure for seeing that the withholding taxes are remitted to the government. *Id.* Accordingly, any corporate officer or employee with the power and authority to avoid a default or to

direct payment of taxes is a responsible person. Feist v. United States, 607 F. 2d 954 (Ct. Cl. 1979).

Applying the aforementioned guidelines to the testimony and evidence presented during the administrative hearing, I conclude that Doe was a responsible party under the statute. Doe testified that he was the president and the sole shareholder of ABC during the months covered by the NPL. Tr. pp. 4, 5, 83, 84. The record indicates that he exercised exclusive authority over the hiring and firing of employees and ran the company's day-to-day operations. Tr. pp. 45, 84, 85. Most importantly, Doe was the only authorized signatory on the corporation's bank account. Tr. p. 84. Such authority is a significant indicator of "responsible officer" status. Gephart, supra at 473 ("It is well established that the test for determining the responsibility of a person under § 6672 is essentially a functional one, focusing on the degree of influence and control which the person exercised over the financial affairs of the corporation and, specifically, disbursement of funds." (emphasis added)). Indeed, Doe testified that, in tandem with his exclusive authority to sign checks, he was solely responsible for determining which creditors of the corporation would be paid. Tr. pp. 84, 85. Based on the foregoing, it must be concluded that Doe had complete control over cash disbursements, and the determination of the priority of the payment of creditors. He had exclusive authority to write checks on the corporate account and could have written checks to cover taxes. With the status of a 100 percent shareholder and president of ABC, the exclusive authority to write checks, and with complete control over the company's finances and day-to-day operations, Doe was clearly a responsible officer of ABC.

In the present case, Doe has not attempted to rebut the Department's determination implicit in the Department's *prima facie* case that he was a responsible officer of ABC. He has also admitted that he knew ABC's taxes were delinquent. Tr. pp. 86, 87. However, the taxpayer vigorously contests the determination that his actions were "willful", contending as follows:

[I]t is clear that the failure of ABC to file some sales tax returns and pay some taxes cannot be construed as a willful failure on the part of the Taxpayer, Jim Doe. When the financial problems first befell ABC in Spring, 2000 and Jim was forced to terminate all but two employees, including the employee who had formerly taken care of the books and tax returns, Jim immediately brought in an outside CPA, Jane Doe, to gather the financial information and records and prepare and file any necessary tax returns. He did not have ABC pay any suppliers with any receipts received from QCM under the coerced transition agreement, but instead used the funds received to pay chunks of taxes to the IRS, the Department, as well as to pay the phone bill so that ABC could keep harassing QCM for payment, and to pay the remaining two employees (himself and his niece-receptionist) and Jane Doe. Smith continued to work on ABC's finances and tax matters until November, 2000, when QCM stopped paying ABC and there were no funds to pay her. Thus, the evidence is clear, and uncontroverted, that during this period Jim took positive steps that were reasonable under the circumstances to get the returns filed and to pay taxes to the IRS and the Department.

Taxpayer's Brief pp. 8, 9

For personal liability to attach under section 3-7, the taxpayer must have "willfully" failed to make tax payments. For the reasons enumerated above, the taxpayer contends that the Department's determination that the taxpayer "willfully" failed to make such payments, and is therefore personally liable, is not supported by the evidence of the taxpayer's actions in attempting to comply with the State's tax law noted above.

The term "willful" has been defined by the Illinois courts in other contexts as being "acts performed knowingly or with knowledge." People v. Clay, 167 Ill. App. 3d

628 (2d Dist. 1988) (addressing “willful” as used in the Illinois Criminal Code). This definition of “willful” parallels the meaning of this term when used in Illinois tax laws. The Illinois courts have previously stated that “[w]illful failure to pay taxes has generally been defined as involving intentional, knowing and voluntary acts, or, alternatively, reckless disregard for obvious or known risks.” Branson, *supra* at 254-255. See also Heartland, *supra* at 29-30. These cases state that a showing of bad faith is not necessary to prove a willful or intentional failure to pay taxes. Branson, *supra* at 255; Heartland, *supra* at 30. To sustain an assessment, it is not necessary to show that there was an intent to defraud. *Id.* Accordingly, the taxpayer’s motive is not a decisive factor in determining whether a taxpayer has acted “willfully.”

Federal interpretations which form the basis for the Illinois courts’ interpretation of section 3-7, conform to the foregoing interpretations of “willfulness.” Ruth v. United States, 823 F. 2d 1091 (7<sup>th</sup> Cir. 1987); Wright v. United States, 809 F. 2d 425 (7<sup>th</sup> Cir. 1987). Pursuant to such authority, once a responsible officer has knowledge that the delinquent corporate taxes are due, each payment to creditors other than the government constitutes “a voluntary, conscious and intentional act to prefer other creditors over [government].” Purcell v. United States, 1 F. 2d 932, 938 (9<sup>th</sup> Cir. 1993). This determination has been held to be legally correct regardless of whether such payments to other creditors were made in good faith. Thomsen v. United States, 887 F. 2d 12, 17-18 (7<sup>th</sup> Cir. 1989).

The taxpayer’s argument can be summarized as follows: as a responsible officer, he had a duty to comply with the state's tax laws, but did not “willfully” breach this duty because he made a conscious and deliberate attempt to pay all taxes due, and took actions

consistent with this duty in paying federal taxes and hiring an accountant to prepare and file Illinois returns. Taxpayer's Brief pp. 8, 9. However, as noted above, a willful, i.e. intentional, breach of a duty as a responsible officer to comply with the State's sales and use tax laws has been determined to arise where an individual decides to use corporate funds to pay other creditors, with knowledge that taxes are due and unpaid. Purcell, *supra*; Thomsen, *supra*. See also Branson, *supra*; Bublick, *supra*.

The record indicates that Doe received a substantial amount from QCM during the months of June through October 2000. With respect to the use of these funds, Doe testified as follows:

Q. Did you have a period of time where you had some money coming in when you were able to decide which – that you could pay some bills and not others?

A. When the monies was (*sic*) coming in, the CPA was the one that was setting up what needed to be paid. And according to that, is where the monies were going out. And the vendors were not getting paid. Majority of that money went to pay the IRS, what was owed to them, and chunks of money that went out to the Illinois Department of Revenue.

Q. You said “the majority.” What was the rest of it you had to pay?

A. To pay the cell phone bill, to pay the telephone company, to pay the rental of the Xerox, the copy machine for the company. ...

Q. So, during the entire time you were operating, some bills were always paid, such as the phone bills and those types of things?

A. That was – Yeah. Those bills go in the hope that I could continue to send ... invoices that you owe me; I can call you on the phone and harass the hell out of you – excuse my language – harass you so you can pay me. ...

Q. Okay. But you continued to pay some bills, such as phone bills and so forth, during the entire time that you continued to operate; is that correct?

A. Yes.

Tr. pp. 88, 89

This testimony is entirely consistent with admissions contained in the taxpayer's brief, wherein the taxpayer states that he used some of the company's funds available after it

began having financial difficulties to pay himself and another employee, the company's outside CPA, and utility and phone bills, rather than to pay taxes due the State. Taxpayer's Brief p. 4.

Based on the foregoing, the Department determined that the taxpayer intentionally paid creditors other than the State with knowledge of delinquent taxes. This determination is supported by substantial evidence including the taxpayer's own testimony. As indicated by the Illinois case law, regardless of the taxpayer's motive for preferring other creditors to the Department, such conduct constitutes the "willful" failure to pay taxes, and thus satisfies the "willfulness" element of the test for determining liability as a responsible officer under section 3-7. Because the Department's findings regarding the willful nature of the taxpayer's failure to pay the delinquent taxes is supported by credible and substantial evidence, the record plainly supports the Department's determination that Doe acted willfully in this case.<sup>2</sup> Accordingly, I find that, based upon the evidence included in the record, the Department properly determined that Doe, a responsible officer of ABC, acted willfully in neglecting to pay all taxes due the State by using funds available to be used for this purpose to pay other creditors including himself.

During the hearing, Doe propounded an offer of proof seeking to establish that ABC was wrongfully denied a credit for overpaid taxes that would have extinguished all

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<sup>2</sup> Doe cites Newsome v. United States, 431 F. 2d 742 (1970) for the proposition that the absence of "reasonable cause" must be established to prove "willfulness" under section 6672. Assuming, without deciding, the correctness of this claim, this case does not support the taxpayer's position because that court expressly states that "reasonable cause" does not include preferring other creditors to the IRS. Newsome, *supra* at footnote 11.

or a substantial part of its unpaid liability at issue in this case. Tr. pp. 58 – 62. The *gravaman* of the taxpayer’s offer of proof is that the Notice of Tax Liability issued to ABC underlying the NPL in this case is erroneous. With regard to the Notice of Tax Liability issued to ABC, the statute provides that the Notice of Tax Liability became final absent the filing of a protest by ABC within 60 days after the Notice of Tax Liability was issued. 35 ILCS 120/4. Once a Notice of Tax Liability becomes final, a taxpayer has 35 days within which to file an administrative appeal in the circuit court. 735 ILCS 5/3-103. In this case, the record does not indicate that ABC ever filed a protest to the Notice of Tax Liability underlying the NPL at issue here, so it became final and conclusive as to all questions concerning its merits. Department of Revenue v. Roman S. Dombrowski Enterprises, 202 Ill. App. 3d 1050 (1<sup>st</sup> Dist. 1990). Even if the taxpayer could challenge the accuracy and correctness of the Notice of Tax Liability issued to ABC giving rise to these proceedings, the taxpayer has not introduced into the record any credible evidence to show that the amounts shown on the returns filed on behalf of ABC which are the basis of the Department’s assessment determination, were incorrect.

In sum, Doe has failed to rebut the Department’s *prima facie* case that he was a responsible officer of ABC who willfully failed to pay taxes due and owing from ABC to the State. Moreover, the merits of a final assessment that is the basis of an NPL may not be reviewed at a hearing on the NPL. Dombrowski, *supra* (holding that a court has no jurisdiction to review the accuracy of an assessment once it becomes final).<sup>3</sup>

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<sup>3</sup> The taxpayer also implies that his conduct cannot be viewed as “willful” because, in reliance upon representations purportedly made to him by the Department, he believed that ABC’s delinquent taxes would be offset by a credit to which ABC was entitled for tax overpayments. Tr. pp. 53 – 77; Taxpayer’s Brief p. 9 (“When the audit was commenced ...Ernie was told that ABC had overpaid its ROT taxes and should get a refund, Ernie reasonably decided to await the audit results[.] A year later, in February 2002,

**WHEREFORE**, for the reasons stated above, it is my recommendation that the Department's Notice of Penalty Liability number 0000 issued to John Doe as a responsible officer of ABC, be affirmed in its entirety.

Ted Sherrod  
Administrative Law Judge

Date: June 23, 2008

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Ernie and his lawyer were told for the first time that ABC would not get a refund ...[.]"). Doe's claim that he was told ABC would be entitled to a refund is hearsay and was ruled inadmissible. Moreover, even if Doe had been told he was entitled to a refund by a Department representative, the taxpayer would have to show that the Department's representations were in writing in order to establish a legal basis for his reliance. 86 Ill. Admin. Code, ch. I, section 130.101 ("Taxpayers may not rely on verbal opinions from Department employees"); 86 Ill. Admin. Code, ch. I, section 140.901. In Winter v. United States, 196 F. 3d 339 (2d Cir. 1999), a case cited by Doe in support of his claim, the Court, in deciding in the taxpayer's favor, found that the taxpayer was notified in writing of a credit extinguishing his liability, and that the taxpayer's belief that his tax liability had been satisfied was therefore reasonable. Since Doe was not notified in writing, this case does not support the taxpayer's contentions.