

ST 13-05

Tax Type: Sales Tax

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**

v.

**JOHN DOE,
Taxpayer**

**No. XXXX
Account ID XXXX
NPL Penalty ID XXXX
Periods XXXX**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: George Foster, Special Assistant Attorney General, for the Illinois Department of Revenue; John Doe, *pro se*.

Synopsis:

This matter is before this administrative tribunal as the result of a timely protest by John Doe (“John Doe”) of notice of penalty liability NPL Penalty ID number XXXX issued September 6, 2011 by the Illinois Department of Revenue (“Department”). The notice was issued against John Doe as a responsible officer of ABC Business under the Uniform Penalty and Interest Act for the periods August 2009 and September 2009. The issues to be resolved are: 1) whether John Doe was a responsible officer of ABC Business; and 2) whether John Doe’s failure to pay sales taxes due was willful. A hearing on this matter was held on December 19, 2012 during which John Doe testified and both parties presented documentary evidence. At the conclusion of the presentation of its case during the hearing, the Department stipulated that the taxpayer was not liable for the period September 2009. Upon consideration of the evidence and

a careful review of the record, it is recommended that the liability for September 2009 be dismissed based upon the Department's stipulation, and that the liability for August 2009 be upheld in its entirety. 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 notice of penalty liability NPL Penalty ID number XXXX , dated September 6, 2011, which shows a penalty for sales tax liability of ABC Business (" ABC Business") of \$XXXX for the months of August, 2009 and September, 2009. Transcript ("Tr.") p. 4; Department Exhibit ("Ex.") 1.¹
2. ABC Business, an Illinois corporation having its principal place of business and Anywhere, Illinois is engaged in the commercial printing business. Tr. p. 6; Taxpayer's Ex. 2.
3. John Doe ("John Doe") is Vice President, Treasurer and Secretary of ABC Business and owns 50 percent of the company's outstanding shares of stock. *Id.* Jack Black also owns 50 percent of the shares of stock of this company and is the company's President. Taxpayer's Ex. 1, 2.
4. Until August, 2009, ABC Business held a checking account at Anyplace Bank and Trust ("Anyplace Bank") that was funded by a line of credit provided to the company by Anyplace Bank. Taxpayer's Ex. 1. During August, 2009, ABC Business was advised that Anyplace Bank would not renew its line of credit. Tr. p. 6. Checks presented for payment after the bank line of credit funding the ABC Business checking account ceased

¹ Unless otherwise noted, findings of fact apply to the tax periods in controversy.

were not honored and were returned to payees indicating that the checking account upon which these checks were drawn lacked sufficient funds to cover them. Tr. p. 6.

5. During August 2009, ABC Business timely filed its return reporting sales taxes due for August, 2009. Tr. p. 6; Taxpayer's Ex. 1. This return was accompanied with a check payable to the Department in the amount of the taxes due and owing for August, 2009. Tr. pp. 6, 8, 9; Taxpayer's Ex. 1. Because the Anyplace Bank failed to renew the ABC Business credit line, this check was not honored due to insufficient funds in the taxpayer's checking account. Tr. p. 6; Taxpayer's Ex. 1.
6. On September 27, 2009, ABC Business entered into a "Trust Agreement and Assignment for the Benefit of Creditors of the ABC Business Inc." pursuant to which it transferred all of its real and tangible personal property owned by the corporation on that date to Bob Green of XYZ Business for distribution to designated creditors of ABC Business in exchange for their forgiveness of indebtedness due and owing to such creditors by ABC Business. Taxpayer's Ex. 2. The "Trust Agreement and Assignment for the Benefit of Creditors of the ABC Business Inc." does not indicate that the Department was specifically designated as a beneficiary of the trust established for benefit of creditors of ABC Business pursuant to this agreement, or that it contained any express arrangements to assure the extinguishment of all or any portion of the company's indebtedness to the Department for taxes due and owing to the state. *Id.*
7. The assets transferred to ABC Trust included accounts receivable due and owing to ABC Business, which were payable between 30 and 90 days from the date customers of ABC Business were invoiced for printing services. Tr. p. 6; Taxpayer's Ex. 2. Pursuant to the aforementioned assignment for the benefit of creditors, accounts receivable related to

sales by ABC Business during August 2009 were assigned by ABC Business before any revenues generated by these receivables, including any sales taxes, were collected. *Id.*

Conclusions of Law:

The Department seeks to impose personal liability upon John Doe ("John Doe") for failure to remit Retailers' Occupation Tax as required pursuant to 35 ILCS 120/1 *et seq.* The personal liability penalty for this tax is imposed by section 3-7 of the Uniform Penalty and Interest Act, 35 ILCS 735/3-7 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 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 notice of penalty liability establishes the Department's *prima facie* case with regard to both the fact that John Doe was a "responsible" officer 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 it. 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 the corporation and whether he or she participates in decisions regarding the payment of creditors and the dispersal of the company's 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.*

At the evidentiary hearing, John Doe admitted that he was a responsible officer of ABC Business, but vigorously denied that he "willfully" failed to file or remit tax payments. Tr. pp. 6, 7; see also Taxpayer's Ex. 1. Based on John Doe's own admission, I conclude that John Doe had the power and shared the responsibility with his co-owner for seeing that taxes were remitted to the government, and that he was a responsible officer of ABC Business.

In support of his claim that he did not act willfully in failing to pay the taxes that were due and owing for August, 2009 the taxpayer offers the following arguments:

My assertion is that my decision to enter ABC Business Inc. into the Trust Agreement and Assignment for the Benefit of Creditors exempts me from willfully failing to make the payments. My assumptions from the assignment contract [led] me to believe that they would pay the Tax liabilities of the company. ... I filed, and was released in a Chapter 7 Bankruptcy case #10-21663 where I surrendered my home to fulfill my obligation of my personal guaranty with Anyplace Bank and Trust. ... I sincerely believe that I have stated my case that I did not "Willfully" fail to insure that the company's tax obligations were met.

Taxpayer's Ex. 1

The record in this case indicates that on September 27, 2009, ABC Business executed an assignment for the benefit creditors in favor of Bob Green of XYZ Business as trustee. Taxpayer's Ex. 2. According to John Doe, on that date he and his partner, Jack Black, relinquished control over the operations and ongoing business affairs of ABC Business.

Taxpayer's Ex. 1. According to him, after September 27, 2009, he had no authority over the company, no control over its assets, and no decision-making power with regard to the corporation's affairs, all of that having been taken over by the assignee. *Id.*

The record shows that John Doe went to great lengths to assure that the obligations of creditors of corporation, other than the Department, were covered to the maximum extent possible. Doing so involved the taxpayer's surrender of his personal residence in order to fulfill his obligation as personal guarantor of the company's line of credit from Anyplace Bank funding the company's checking account. Taxpayer's Ex. 1. However, no comparable extraordinary measures were taken to assure the payment of the company's sales tax liability to Illinois.

I am unable to conclude, based solely upon John Doe's assignment for the benefit of creditors that he did not "willfully" fail to pay taxes due to the state. However well intentioned John Doe's efforts to make his creditors, other than Department, whole in the wake of ABC Business' financial collapse, the effect of his assignment for the benefit creditors was to remove assets from his personal control and make it impossible for him to fulfill his obligations as a responsible officer to pay all taxes due and owing to the state. This was John Doe's choice, and did not relieve him of responsibility for the payment of these liabilities.

My research does not indicate any case that holds that an admittedly responsible officer can be absolved from a finding of having "willfully" failed to pay taxes merely by making a unilateral and voluntary assignment of assets of a corporation to creditors other than the Department. Indeed, to the contrary, the courts have explicitly held that a responsible officer acts willfully in failing to pay delinquent taxes if he prefers other creditors to the state. Heartland, *supra*. Here John Doe's decision to assign assets resulted in the satisfaction of the claims of creditors other than the Department, which has never been paid.

John Doe's decision to transfer control of all of the assets of ABC Business before verifying that the company's tax liability for August 2009 had been paid was a conscious and deliberate choice made by him and his partner, Mike White. See Taxpayer's Ex. 1, p. 2 ("My partner and I entered ABC Business into a Trust Agreement & Assignment for the Benefit of Creditors."). This choice implicitly entailed a decision to prefer creditors over the Department if necessary, and therefore constituted a conscious and deliberate or "willful" decision on their part. A responsible person is deemed to have acted "willfully" if he "either knew the taxes were not being turned over to the government and nonetheless opted to pay other creditors, or recklessly disregarded a known risk that the taxes were not being paid over." United States v. Kim, 111 F. 3d 1351, 1357 (7th Cir. 1997).

As previously noted, the Department established its *prima facie* case for a finding that John Doe acted willfully when it entered into evidence the Department's notice of penalty liability at issue in this case. Branson, *supra*. The burden then shifted to John Doe to rebut the *prima facie* correctness of the Department's determination. However, no evidence rebutting the Department's finding is contained in record. Specifically, no documentary evidence was offered to show that John Doe made any effort to arrange for the payment of obligations to the Department when he, along with his partner, entered ABC Business into the assignment for the benefit creditors noted above. While John Doe asserts that he was "[led] to believe" that the tax liabilities of the company would be covered by the assignee, no express commitment to assure the payment of such obligations can be found in the agreement the taxpayer and the assignee entered into on September 27, 2009. Taxpayer's Ex. 1, 2. ²

² While the assignment for the benefit of creditors agreement noted above (Taxpayer's Ex. 2) requires the payment of "debts owing to the government ...to the extent such debts are entitled to priority under applicable law", it contains no requirement that sales taxes due to the state of Illinois be paid before any other creditor liabilities are satisfied.

Moreover, no documentary evidence was offered to show that John Doe made any effort to retain a sufficient amount of assets from those assigned, by court order if necessary, to cover ABC Business' sales tax liabilities. No documentary evidence was presented to show that John Doe attempted to safeguard any of the assets as of September 27, 2009 for the payment of sales taxes. Specifically, there is no evidence that the taxpayer sought to have taxes collected by the assignee with the payment of accounts receivable it was assigned that related to the taxpayer's August 2009 sales designated for payment to the state. Nor did the taxpayer attempt to show that there were no funds available to pay the assessment when ABC Business, through the taxpayer and his partner, voluntarily made an assignment for the benefit of creditors. As a responsible officer of ABC Business, John Doe should have taken steps to insure that these payments were made. A fiduciary cannot absolve himself merely by disregarding his duty and leaving it to someone else to discharge. Hornsby v. Internal Revenue Service, 588 F. 2d 952 (5th Cir. 1979). By not taking steps to insure that funds were retained to make state tax payments, John Doe allowed the available funds to be used to pay other creditors thereby exhibiting "willfulness" under the statute.

In sum, as previously noted, a person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the state. Heartland, *supra*. Based on the aforementioned evidence that this is in fact what occurred in the instant case, I conclude that John Doe was responsible for the August sales tax assessment payable to the Department and that, for the reasons noted above, he willfully failed to remit these tax payments.

The assessment at issue covers the months of August and September 2009. During the evidentiary hearing, the Department stipulated that the assignment for the benefit of creditors the taxpayer entered into absolved the taxpayer of liability with respect to taxes due and owing for

September 2009. Accordingly, the Department is only asserting liability due and owing from John Doe for the period August 2009 in the instant case. For the aforementioned reason, the notice of penalty liability at issue must be amended to cancel the Department's assessment for the month of September 2009.

WHEREFORE, for the reasons stated above, it is my recommendation that the portion of the Department's notice of penalty liability at issue covering September 2009 be cancelled, and that the remainder of this notice of penalty liability be affirmed.

Ted Sherrod
Administrative Law Judge

Date: March 28, 2013