

ST 13-06

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
Period XXXX
Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Marc Muchin, Special Assistant Attorney General, on behalf of the Illinois Department of Revenue; James Schwartz, Esq. on behalf of John Doe.

Synopsis:

This matter comes on for hearing pursuant to a protest filed by John Doe (“John Doe”) of notice of penalty liability NPL Penalty ID number XXXX issued by the Department on January 6, 2011, finding that John Doe was liable for the amount assessed as a responsible officer of ABC Business. The notice of penalty liability represents a penalty liability for Retailers’ Occupation Tax of ABC Business due to the Department for the period November, 2003 through December, 2007. A hearing was held on this matter on December 3, 2012, with John Doe providing oral testimony. Following the submission of all evidence and a review of the record, it is recommended that the notice of penalty liability at issue be finalized as issued. In support of this determination, 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 January 6, 2011, which shows a penalty for unpaid sales tax liability of \$XXXX for the period November 2003 through December 2007. Department Ex. 1.¹
2. ABC Business ("ABC Business"), an Illinois corporation located in Arlington Heights, Illinois, is engaged in the conduct of a commercial printing business. Transcript ("Tr.") p. 25; Department Ex. 2.
3. John Doe ("John Doe"), an Illinois resident residing in Anywhere, Illinois, has been involved with ABC Business from the inception of the company in 1989. Tr. p. 24; Department Ex. 2. John Doe's duties with ABC Business include conducting and supervising: 1) hiring (Tr. pp. 43, 44, 54), 2) the purchase of items needed for print production (Tr. p. 26), and 3) the preparation and filing of the company's tax returns (Tr. pp. 40, 41).² ABC Business' tax returns were signed by John Doe. Tr. p. 41.
4. ABC Business was incorporated on July 17, 1989. Department Ex. 2. On August 30, 1989, this corporation filed an "Illinois Business Taxpayer Application for Registration" with the Department. *Id.* This document indicates that "John Doe" is the President of this company. *Id.* The signature "John Doe" appears at the bottom of the last page of this document and is under a legend stating: "Under penalties as provided by law, which include a fine, or imprisonment, or both, I declare that I have examined this application and to the best of my

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

² While John Doe testified that financial and tax matters were handled by an employee of ABC Business named Jack Black, and that John Doe reported to him, I do not find this testimony credible because John Doe is listed in the ABC Business' corporate records as the company's only executive officer (President). Department Ex. 2-7. Moreover, John Doe's denial that he supervised Jack Black is contradicted by statements John Doe made during the Department's deposition of him taken in connection with this case. Tr. pp. 35-37.

knowledge and belief, it is true, correct and complete.” *Id.* Appearing next to the signature “John Doe” is the date August 30, 1989. *Id.*

5. On November 26, 2003, ABC Business filed an annual report with the Illinois Secretary of State. Department Ex. 3. This document lists “John Doe” as the President and Secretary of ABC Business. *Id.* The signature “John Doe” appears at the bottom of this document and is next to a box stating: “Under the penalty of perjury and as an authorized officer, I declare that this annual report, pursuant to the provisions of the Business Corporation Act, has been examined by me and is, to the best of my knowledge and belief, true, correct and complete.” Department Ex. 3. The record contains identical annual reports for 2004, 2005 and 2006, all of which name John Doe as President. Department Ex. 4-6. All of these documents contain the signature “John Doe” and contain the aforementioned declaration above or beside this signature. *Id.* The record also contains an unsigned “State of Illinois Domestic / Foreign Corporation Annual Report” indicating that “John Doe” is the President, Secretary and sole Director of ABC Business. Department Ex. 7.

Conclusions of Law:

The sole issue to be decided in this case is whether John Doe (“John Doe”) should be held personally liable for the unpaid Retailers’ Occupation Tax of ABC Business (“ABC Business”) due and owing pursuant to the Retailers’ Occupation Tax Act, 35 ILCS 120/1 *et seq.* The statutory basis upon which any personal liability is premised is section 3-7 of Uniform Penalty and Interest Act, 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 tax payments; and 2) "willfully" fails to file returns or make payments.

The admission into evidence of the notice of penalty liability at issue 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 the Department's case. 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 funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), cert. denied 400 U.S. 821 (1970).³ Liability attaches to those with the power and responsibility within the corporate structure for seeing that taxes are remitted to the government. *Id.*

I conclude, based upon the testimony and other evidence admitted at the evidentiary hearing, that John Doe was a responsible officer of ABC Business. While John Doe testified that

³ I cite herein Federal case law because the Illinois Supreme Court, in cases where it has considered personal liability under Illinois law, has referred to Federal case law interpretations of section 6672 of the Internal Revenue Code, 26 U.S.C.A. section 6672, which imposes personal liability in a manner similar to section 3-7 of the Uniform Penalty and Interest Act, 35 ILCS 735/3-7. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985); Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill. 2d 568 (1977).

he did not believe he was President of this company, this testimony is contradicted by testimony given during a deposition taken of John Doe by the Department on December 28, 2011, during which he admitted being President and the sole shareholder of this company. Tr. pp. 34-36, 41-43. Moreover, all of the taxpayer's annual reports contained in the Department's books and records for the tax period in controversy list John Doe as President of ABC Business, and the signature "John Doe" is prominently affixed to all of these documents and to the corporation's Illinois Business Tax Application for Registration which the company filed on August 30, 1989. Department Ex. 1-6.

John Doe testified during the hearing that these signatures are not his. Tr. pp. 21-24. As previously noted, the burden of proof shifted to the taxpayer to prove that the Department's determination of liability was incorrect once the Department submitted the notice of penalty liability issued in this case. Masini, *supra*. While John Doe had the burden of disproving that the signatures on the documents the Department presented were incorrect, during the hearing, no sample of John Doe's handwriting was offered into evidence by him. No handwriting expert was called as a witness by John Doe. There was no testimony or documentary evidence admitted at the hearing showing that John Doe filed suit against any person for falsely signing his name to any ABC Business corporate documents. Moreover, the signature of John Doe on the protest, which he is legally presumed to have timely filed to accord jurisdiction over this matter upon this tribunal (35 ILCS section 735/3-7(b); 35 ILCS 120/4), appears to be identical to the signatures affixed to the documents bearing his signature that are contained in the record.⁴ As a consequence of the foregoing, I find that John Doe failed to prove, based upon John Doe's

⁴ During the hearing, the administrative law judge took judicial notice of the taxpayer's protest contesting the Department's assessment determination in this case (Tr. p. 47), and this document is therefore part of the record of the proceedings in this matter.

testimony alone, that the signatures on the corporate documents introduced into the record identifying him as President of ABC Business are not his.

ABC Business' bylaws are not in evidence, and the record does not show what duties and responsibilities were vested in the President by them. However, a President of a corporation is usually charged with the overall responsibility for the management of the corporation. Krantz v. Oak Park Trust & Savings Bank, 16 Ill. App. 2d 331 (1st Dist. 1958); Brown v. Fire Insurance Co. of Chicago, 274 Ill. App. 414 (1st Dist. 1934). Indeed, the record in this case supports a finding that John Doe, as a consequence of his status as President, exercised such authority over ABC Business' corporate affairs. John Doe admitted as much during the deposition of him taken by the Department on December 28, 2011, which is summarized in the transcript of the hearing in this case as follows:

On line 17 of page seven in the deposition I said, "Okay. Now did you – just a general question. If you know the answer, did you have general control of the corporate business affairs?" And you answered, "I'm sorry, did I?" ... I go to line 22. It says, "Did you have general control of ABC Business, Inc. This is page seven, line 22, and I asked the question, "Did [you] have general control of ABC Business, Inc. as president?" You answered on page eight "I mean, my employees would do things, but I guess, yes, I did have ...[.]"
Tr. p. 36.

Despite his status as President of ABC Business, and his admitted general control over all of this corporation's affairs, at hearing John Doe argued that he was not responsible for the company's tax and financial affairs or the payment of its creditors. During his testimony, he maintained that such duties and responsibilities were exclusively exercised by a person named Jack Black. Tr. pp. 26, 27. The record indicates that Jack Black was an employee of ABC Business that John Doe hired. Tr. pp. 35, 36.

There were several key areas of John Doe's testimony at the hearing, however, that directly contradicted his testimony given during the Department's deposition of him in

connection with this case on December 28, 2011. These contradictions involve John Doe's level of participation in the company's financial and tax matters. Specifically, the following questions and answers were given during the hearing regarding the foregoing:

Q. Now, to the best of your recollection, from the time you started to the time ABC Business, Incorporated ceased doing business, did you sign any forms to any regulatory agencies or the State of Illinois or to the Internal Revenue Service to the best of your recollection?

A. Not to the best of my recollection.

Q. Do you know who did?

A. No.

Q. Were there others at the company that you knew of who handled these financial matters?

A. Yes.

Q. Who were they?

A. Jack Black.

Q. And he would be the person who handled all the financials?

A. To the best of my knowledge. I answered to him.

Q. And all the financial reporting and anything was done by him to the best of your knowledge?

A. Yes.

Tr. pp. 26, 27.

John Doe's responses at the hearing directly contradicted his testimony at the December 28, 2011 deposition. In particular, the transcript, at pages 35 through 41, indicates that the following deposition testimony was given.

Q. I'm going to go on, reading on page seven, line six. It says, "Now, you mentioned in Answers to Interrogatories a person named Jack Black. What was his position?" You gave the answer, "He was managing the operation." And then I stated, "Managing the operation in what sense? Was he an officer, employee?" And you answered, "No, basically an employee."

And I asked the question, "Did he report to you?" And you answered, "Yes."

And I asked you the question, "Did you hire him?" And you said, "yes." ...

Q. And I asked the question following that, "Did you disperse funds?" You said, "What do you mean?" I asked, "Did you pay the creditors the bills of the corporation? Were you a check signatory?"

You answered, "Did I personally do it?" And I asked, "Or did you order Mr. Jack Black or another employee to do that?" And you said, "Yes, whoever was handling that would pay bills, things like that."

...

And then it goes on to page nine. It says, "And you were a 100 percent shareholder of the corporation during the audit period?" And then on page nine, line 18 I asked the question, "Did you sign tax returns during the audit period when the corporation was in operation?"

You answered ... "I think if I was the person that would have had to do that, then I would have." ...

Then I asked the question on page ten, line one, "But if there were tax returns, you would be the one to sign them?"

And you answered, "An accountant was issuing the tax returns. There was a hired accounting office doing them,"

And then I asked the question, "By you retaining an accounting firm?" And you answered, "yes." Is that correct?

A. That's correct, if that what I answered.

....

Then I asked you the question "..."[D]id you file tax returns during the audit period this corporation was in operation?"

You answered on line 18, "They were filed, yes."

I asked you the question, "Are you the person that filed them or ordered them to be filed?"

And you answered the question, "The accounting firm." Is that correct?

A. Yes.

Then I asked you the question, "Okay. So how did that work? I mean, how did the accounting firm get the information to prepare the tax returns?"

You answered ... I think it would have been e-mailed to them."

I asked the question, "E-mailed to them by you?"

And you answered the question, "By one of the employees there."

I said "Okay. Did you review the returns once the accounting firm had prepared them?"

And you answered the question, "Yes, I would have reviewed them." Is that correct?

A. If that's what I answered.

Q. Then I asked the question at line 11 on page 11, "As president/owner, you would do that?" And you said, "Yes." Is that correct?

A. If that's what I said there ...[.]

Q. And then I said, "And you signed them?"

And you answered on line 15 of page 11, "I think so. If it required my signature, then I would have signed them, yes. I think I did."

Tr. pp. 35-37, 39-41, (Impeachment of John Doe using his testimony from his deposition taken December 28, 2011)

As a result of the Department's impeachment, noted above, I find that John Doe's testimony at hearing denying that he was responsible for the company's financial matters, including the payment of creditors, and tax matters, was not credible. Since I find that John

Doe's denial of responsibility for the oversight of ABC Business' financial and tax matters was not credible, I conclude that he has failed to rebut Department's presumptively correct determination that he exercised oversight over such matters in his capacity as President of the company.

In sum, I find that the record in this case supports a finding that John Doe was the person within the corporate organization of ABC Business that had significant control over the business affairs of the company, that he supervised the payment of creditors and the dispersal of funds, that he reviewed and signed ABC Business' tax returns, and that he supervised the company's tax and financial functions. As noted above, these are the hallmark characteristics of a responsible officer. Monday, *supra*. Given the foregoing, I find the Department's presumed correct determination that John Doe was a responsible officer of ABC Business is supported by the evidence contained in record and that the Department's *prima facie* case regarding his capacity as a responsible officer has not been rebutted.

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presented a *prima facie* case for willfulness with the introduction of the notice of the penalty liability at issue into evidence. Branson, *supra*. The burden then is on the responsible party to rebut the presumption of willfulness. *Id.*

Section 3-7 of the Uniform Penalty and Interest Act fails to define what constitutes a willful failure to pay or file taxes. In attempting to clarify what constitutes a willful failure to file and pay taxes, the courts have adopted a broad interpretation of the words "willfully fails." Department of Revenue ex rel People v. Corrosion Systems Inc., 185 Ill. App. 3d 580, 582 (4th Dist. 1989). Under this broad interpretation, responsible officers are liable if they fail to inspect

corporate records or otherwise fail to keep informed of the status of their corporations' retailers' occupation tax returns and payments. Branson, *supra*. "Willfulness" as used in section 3-7 of the Uniform Penalty and Interest Act may also be indicated by a reckless disregard for obvious or known risks. Monday, *supra*. John Doe's conduct was willful under each of the above benchmarks.

As President of ABC Business, John Doe had authority to retain the company's accountants (see deposition testimony at Tr. pp. 40, 41, noted above). As a consequence, John Doe certainly was in a position to inspect corporate records and keep informed of the status of tax returns and payments. Based upon the authorities noted above, John Doe's failure to do so constituted willfulness under section 3-7 of the Uniform Penalty and Interest Act.

John Doe contends that he effectively delegated his responsibility for overseeing the company's tax and financial matters to Jack Black, which the record indicates was an employee that John Doe hired. Tr. pp. 26, 27, 35, 36. However, even if John Doe delegated his responsibilities to Jack Black, his conduct was still willful. Responsible officers are liable if they delegate their oversight duties to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of tax returns and payments. Branson, *supra* at 267. If the taxes were not paid by Jack Black, an employee that John Doe hired and supervised, then I must conclude that these expenses were not paid with John Doe's approval, which satisfies the willfulness requirement under the statute. A responsible person cannot escape his or her obligation to insure that taxes are paid simply by delegating his or her responsibilities to others. Wright v. U.S., 809 F. 2d 425 (7th Cir. 1987).

During the hearing, John Doe testified as follows:

Question: why did it (ABC Business) go out of business? To the best of your knowledge, did it run into financial problems?

Answer: the work slowed down. We definitely saw a decline in work, and we knew things weren't that good.

Tr. p. 56.

John Doe's testimony regarding his knowledge of the company's poor financial condition also demonstrates willfulness. The company's deteriorating financial condition, of which John Doe was aware, should have been an indication to John Doe, as a responsible officer, that an investigation was warranted as to whether taxes were being remitted. Failure to investigate or correct mismanagement after having knowledge of cash flow problems demonstrates willfulness. Monday, supra at 1215 ("Willfulness as used in the statute may indicate a reckless disregard for obvious or known risks.").

There was no testimony or documentary evidence showing any positive steps that John Doe took to pay taxes. John Doe's failure to investigate or correct mismanagement, after having knowledge of the company's financial problems, indicates a reckless disregard for the risk that taxes were not being paid to the state of Illinois. John Doe was a responsible person in a position to easily discover the nonpayment of the company's tax obligations. He clearly ought to have known of the grave risk of nonpayment, but he did nothing. Under these circumstances, a finding of willfulness is justified. Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366 (1st Dist. 2000).

John Doe's failure to inspect and keep informed of the company's tax compliance activities and his failure to take action to investigate these procedures in light of the company's financial problems are sufficient grounds to find that John Doe willfully failed to pay taxes under the statute. Consequently, I conclude that John Doe has failed to rebut the Department's presumptively correct determination that he willfully failed to pay ABC Business' retailers' occupation taxes that were due and owing during the tax period in controversy.

Summary

The evidence of record shows that John Doe was in a responsible position with ABC Business in which he knew or should have known whether taxes were being paid. In order to overcome the Department's *prima facie* case, evidence must be presented which is consistent, probable and identified with documents such as books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). When the Department established its *prima facie* case, the burden shifted to John Doe to overcome the presumption that he was a responsible officer who willfully failed to pay taxes through the presentation of sufficient evidence to support this claim.

The record shows that no documentary evidence was caused to be admitted by John Doe at the hearing to show that John Doe was not a responsible officer or that he did not act willfully. Nor did John Doe present any credible testimony to support this claim. Without any testimonial or documentary evidence to support his contentions, I must conclude that John Doe has failed to rebut the Department's presumptively correct finding that he was a responsible authority that willfully failed to pay taxes due and owing to the state. For the foregoing reasons, a finding John Doe has failed to rebut the Department's case and is therefore liable as a responsible officer of ABC Business is warranted.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's notice of penalty liability at issue in this case be affirmed.

Date: March 25, 2013

**Ted Sherrod
Administrative Law Judge**