

ST 13-15

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)	Docket No.	XXXX
OF THE STATE OF ILLINOIS)	IBT No.	XXXX
v.)	NPL No.	XXXX
JOHN DOE , as responsible)		
officer of John Doe, Inc.,)		
d/b/a ABC Business,)	John E. White,	
Taxpayer)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Michael Greco, Attorney at Law, appeared for John Doe; George Foster, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter involves John Doe’s (John Doe or Taxpayer) protest of the Notice of Penalty Liability (NPL) the Illinois Department of Revenue (Department) issued to him as a responsible officer of John Doe, Inc. d/b/a ABC Business (the Company). The NPL assessed a penalty equal to the amount of the Company’s reported retailers’ occupation and/or use tax liabilities for the months of November and December 2003. The penalty assessed against Taxpayer was a personal liability penalty, issued pursuant to § 3-7 of Illinois’ Uniform Penalty and Interest Act (UPIA).

The hearing was held at the Department’s offices in Chicago. Taxpayer was the only witness. I have reviewed the evidence in the record, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the NPL be finalized as issued.

Findings of Fact:

1. The Company conducted business as a branded, fast-food restaurant that also offered catering services. Department Ex. 1 (copy of NPL issued to John Doe); Department Ex. 2 (copy of the Company's completed Department form NUC-1); Hearing Transcript (Tr.), pp. 14-15, 18.
2. John Doe was the Company's sole owner. Tr. pp. 14, 29; *see also* Department Ex. 2.
3. John Doe had signature authority for the Company's bank account. Tr. p. 26.
4. In February 2001, the Company applied for a license to make retail sales in Illinois, by completing and filing a form NUC-1, Illinois Business Registration, with the Department. Department Ex. 2.
5. On the NUC-1 form, John Doe is identified as the Company's president, secretary and treasurer. Department Ex. 2, p. 1, line 9.
6. John Doe signed a section of the NUC-1 form which provided, "I accept personal responsibility for the filing of returns and the payment of taxes due." Department Ex. 2, p. 2, line 14. On the last page of the form, John Doe signed his name under a statement that provided, "Under penalties of perjury, I state that I have examined this application and, to the best of my knowledge, it is true and correct." *Id.*, p. 4.
7. John Doe hired an accountant, Mary Mabel, to perform services for the Company, which included keeping books, paying the Company's bills, and preparing and filing the Company's tax returns. Department Ex. 2, p. 3 (notifying the Department to send the Company's tax forms to Mary Mabel); Tr. pp. 14-15, 27, 38-39.
8. John Doe provided Mary Mabel with a stamp of his signature, which he authorized her to use when drawing Company checks, and when preparing the Company's tax returns. Tr. pp. 27, 38-39.

9. John Doe retained his Company titles and offices during 2003. Department Ex. 2, pp. 1-2; Tr. pp. 15, 26.
10. John Doe managed the Company's day-to-day restaurant operations, including payroll, scheduling employees, and ordering supplies. Tr. pp. 14-15.
11. During the months of November and December 2003, the Company collected gross receipts and use taxes from its customers, when making retail sales to them. Department Ex. 2; Tr. pp. 31-32.
12. During the months of November and December 2003, John Doe had actual knowledge that the Company had more expenses than it had revenues, and that it was behind in paying suppliers and other creditors. Tr. pp. 25-26, 29-30.
13. During the months of November and December 2003, John Doe authorized the use of Company funds to pay withholding taxes, insurance, employee wages, and other expenses. Tr. pp. 30-33.
14. The Company filed a tax return for each of the months of November and December 2003, but did not include a check with each return, or otherwise pay the tax it reported as being due on each return. Department Ex. 1; Tr. pp. 31-32.
15. The penalty assessed against John Doe is equal to the amount of tax the Company reported as being due on the two tax returns it filed for November and December 2003, plus penalties and interest. Department Ex. 1; Tr. pp. 31-32.

Conclusions of Law:

Section 3-45 of the Illinois Use Tax Act (UTA) requires retailers maintaining a place of business in Illinois to act as the Department's agent to collect the use tax that is owed by customers who purchase tangible personal property from them, at retail, for use or consumption in Illinois. 35 ILCS 105/3-45. Under § 8 of the UTA, a retailer required to collect use taxes from customers is liable for such tax, whether it collects it or not, except when it pays its own tax imposed by the Retailers' Occupation Tax Act (ROTA) regarding the same transactions. 35 ILCS 105/8. Once a retailer collects use taxes from customers, it holds such tax amounts in trust for the Department. *Id*; 35 ILCS 105/9. This case involves a situation where the Company, an Illinois retailer, collected use tax from customers during the months of November and December 2003, and filed returns to report the tax amounts due for those months, but failed to pay over such amounts to the Department. Department Ex. 1; Tr. pp. 31-32. The Company no longer exists and the taxes remain unpaid, so the Department is trying to collect them from John Doe, pursuant to § 3-7 of the UPIA. Department Ex. 1; 35 ILCS 735/3-7.

Section 3-7(a) of the UPIA provides, in pertinent 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. 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. ***

35 ILCS 735/3-7(a).

Pursuant to § 3-7(a), when the Department introduced the NPL into evidence under the certificate of the Director, it presented prima facie proof that John Doe was personally liable for the Company's unpaid taxes. 35 ILCS 735/3-7(a); Branson v. Department of Revenue, 168 Ill. 2d 247, 260, 659 N.E.2d 961, 968 (1995). The Department's prima facie case is a rebuttable presumption. Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968. After the Department introduces its prima facie case, the burden shifts to the taxpayer to establish that one or more of the elements of the penalty are lacking. *Id.*

When interpreting the text of UPIA § 3-7's statutory predecessor, Illinois courts have long compared it to similar text used in § 6672 of the Internal Revenue Code (the Code). Branson, 168 Ill. 2d at 254-55, 659 N.E.2d at 965 (comparing meaning of "willfully" as used in Code § 6672 and in ROTA § 13½); Joseph Bublick & Sons, Inc., 68 Ill. 2d at 576, 369 N.E.2d at 1283 (same); McLean v. Department of Revenue, 326 Ill. App. 3d 667, 674, 761 N.E.2d 226, 233 (1st Dist. 2001) (*citing* Aardema v. Fitch, 291 Ill. App. 3d 917, 920, 684 N.E.2d 884, 887 (1st Dist. 1997) to equate a "responsible person," under Code § 6672, with a responsible officer or employee, under ROTA § 13½). Section 6672 of the Code imposes a penalty against responsible persons of a corporation who have a duty to collect, truthfully account for, and pay over federal social security and withholding taxes, and who willfully fail to do so. *E.g.* Monday v. United States, 421 F.2d 1210, 1214 (7th Cir. 1970). "Two requirements must be met before one can be liable under section 6672. The taxpayer must: (1) be a 'responsible person' under the statute, and (2) have 'willfully' failed to pay over the taxes due." Kinnie v. United States, 994 F.2d 279, 283 (6th Cir. 1993) (*quoting* 26 U.S.C. § 6672(a)). The same requirements exist under UPIA § 3-7(a). 35 ILCS 735/3-7(a).

When considering whether John Doe has rebutted the Department's presumptively correct determination that he was a responsible officer of the Company, I take into account the factors federal courts have considered when determining whether one is a responsible person under § 6672 of the Code. In Williams v. United States, 931 F.2d 805 (11th Cir. 1991), for example, the court explained that, “[r]esponsibility is ‘a matter of status, duty and authority.’ [citations omitted] ‘Indicia of responsibility include the holding of corporate office, control over financial affairs, the authority to disburse corporate funds, stock ownership, and the ability to hire and fire employees.’ ” Williams, 931 F.2d at 810.

In Ghandour v. United States, 36 Fed. Cl. 53, 60-61 (1996), the federal court of claims provided a more complete description of the types of status, duty, and authority that would warrant a conclusion that an individual was a responsible person of a corporation. Specifically, the court explained that, “An individual’s status is to be determined by reference to such things as his title or position within the corporate structure (*e.g.*, an officer or director), as well as his ownership stake in the employer corporation.” *Id.* at 60. Regarding duty, the court wrote:

*** A person’s duty under § 6672 must be viewed in light of his power to compel or prohibit the allocation of corporate funds.” [all citations omitted] In this connection, a person’s duties are to be evaluated in terms of those affairs of the corporation over which that individual had responsibility, *i.e.*, the job description. For instance, duty may be determined by reference to corporate by-laws and resolutions, ..., or to the duties actually performed by an individual in the course of business. ... Ultimately, the crucial inquiry is whether a person had a duty to oversee, manage, or administer the financial affairs of the company, specifically with reference to the paying of creditors and taxes.

Id. at 61 (internal quotation marks omitted). Finally, regarding authority, the court explained that, “where a person has authority to sign the checks of the corporation, or to prevent their issuance by denying a necessary signature, or where that person controls the disbursement of the payroll, or controls the voting stock of the corporation, he will generally be held responsible.” *Id.*

John Doe offered no books and records at hearing, and instead offered only his own testimony. As a matter of Illinois law, however, mere testimony is not enough to rebut the Department's prima facie case. PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 33, 765 N.E.2d 34, 48 (1st Dist. 2002) (a taxpayer has the burden of overcoming the Department's prima facie case through documentary evidence, meaning books and records, and not mere testimony). In this case, moreover, John Doe's testimony supports the Department's determination that he was a responsible officer of the Company.

On direct examination, John Doe testified that Mary Mabel, the Company's accountant, was the person who was responsible for preparing and filing the Company's ROT returns, and for writing checks to pay its taxes. Tr. pp. 14-15, 17. He said that Mary Mabel controlled the Company's banks statements and checks, and that he did not participate directly in the payment of sales taxes. Tr. pp. 15-16. He could not recall whether Mary Mabel told him that the Company had not paid sales taxes for November and December of 2003. Tr. p. 16. He said he did not recall receiving any notices from the Department that the Company had not paid its ROT for those months. Tr. pp. 17, 25. In a nutshell, John Doe's testimony portrayed Mary Mabel as the person who was responsible for failing to pay the Company's taxes for the months at issue. For the following reasons, however, his testimony is not sufficient to show that he was not a responsible officer of the Company.

First, although Mary Mabel was an accountant who actually prepared the Company's income and sales tax returns (Department Ex. 2, p. 3), John Doe's testimony made clear that Mary Mabel performed those services for the Company because that was what he, John Doe, directed her to do. More specifically, on cross-examination, John Doe said that he hired Mary Mabel (Tr. p. 27), and that she performed accounting services for the Company pursuant to his

authority. *Id.* She also paid the Company's bills under his authority. Tr. pp. 27, 30. He had signature authority to sign the Company's checks. Tr. p. 26. When Mary Mabel drew Company checks to pay Company bills, she had and used a stamp with John Doe's signature on it, to sign the checks. Tr. p. 27. After Mary Mabel prepared the Company's tax returns, John Doe said that she would send them to him to sign. Tr. p. 28. Later, on re-direct, John Doe said that, when he previously testified that Mary Mabel gave him tax returns to sign, he meant income tax returns. Tr. p. 37. He said he could not recall whether he actually signed the Company's sales tax returns for the two months at issue, or whether Mary Mabel signed his name on them, using the signature stamp. Tr. pp. 38-39. In sum, John Doe conceded that Mary Mabel did what he authorized her to do.

Second, what John Doe's testimony shows is that he delegated responsibilities to Mary Mabel, while at all times maintaining the status, duty, and authority within the Company to control its disbursements. This point, too, was addressed by the court in Ghandour:

Frequently, a party will attempt to negate the inference that he was a "responsible person" under § 6672(a) by demonstrating that the responsibilities and duties over the collecting, truthfully accounting for, and paying over of the taxes was delegated to another individual. The courts, however, have resisted this line of argument. *See United States v. McCombs*, 30 F.3d 310, 320 (2nd Cir.1994); *Sulger*, 24 Cl.Ct. at 538-39. This rejection is due to a recognition that, even where an individual delegates significant responsibilities to others, he still retains final authority and oversight responsibility over his subordinates. In *Sulger*, the Claims Court explained that:

The evidence at trial simply does not support a conclusion that plaintiff ever divested himself of the power and ultimate authority to determine what bills should be paid and when. Plaintiff and the board of directors never handed absolute financial authority over to [a subordinate].

There simply was never the type of complete delegation of authority that could support a conclusion that plaintiff no longer had the requisite authority to be a "responsible person." 24 Cl.Ct. at 538-39. Accordingly, it is not sufficient that a party point to *another* "responsible person," as more than one individual may be found to have been a "responsible person" within an employer company. *Gephart*, 818 F.2d at 473; *Godfrey*, 748 F.2d at 1574-75; *Scott v. United States*, 354 F.2d 292, 296

(Ct.Cl.1965); *Hammon*, 21 Cl.Ct. at 24. Rather, in order to avoid liability, an individual must show that he was completely divested of the power to see to it that the taxes were paid.

Ghandour, 36 Fed. Cl. at 61-62.

John Doe's testimony that he gave Mary Mabel a stamp with his signature, to use on Company checks and tax returns, reflects that his signature was required on such documents. Tr. pp. 27, 38-39. John Doe had signature authority to sign the Company's checks (Tr. p. 26), but no evidence was offered to show that Mary Mabel was authorized or required to sign the Company's checks. Further, it was John Doe who authorized the use of Company funds to pay withholding taxes, insurance, employee wages, and other expenses during November and December 2003. Tr. pp. 30-33. During that time, the Company had about 8 to 10 employees. Tr. p. 31. Thus, while Mary Mabel might have been the person who drew and issued Company checks to pay wages or the Company's bills during that time, John Doe was the person with the duty to authorize such payments, on behalf of the Company. Tr. pp. 27, 30-33; Department Ex. 2; 805 ILCS 5/8-50. Giving the signature stamp to Mary Mabel did not deprive John Doe of any such duty; it just made it easier for her to do what John Doe directed her to do. Tr. p. 27; Ghandour, 36 Fed. Cl. at 61-62.

Finally, John Doe's attempt to paint Mary Mabel as the person who was responsible for the Company's tax liabilities fails because it is inconsistent with John Doe's own, prior statements made when applying for the Company's license to sell at retail in Illinois. Department Ex. 2. John Doe prepared, signed, and filed that application with the Department, and it contains John Doe's signed statement that, "I accept personal responsibility for the filing of returns and the payment of taxes due." Department Ex. 2, p. 2, line 14. On the last page of the form, John Doe signed his name under a statement that provided, "Under penalties of perjury, I state that I

have examined this application and, to the best of my knowledge, it is true and correct.” *Id.*, p. 4. These prior, written, statements by John Doe are inconsistent with his position at hearing, which was that someone else was responsible for filing the Company’s sales tax returns, and for paying its taxes. That document, therefore, is an admission, by John Doe, of the facts stated. In re Cook County Treasurer, 166 Ill. App. 3d 373, 379, 519 N.E.2d 1010, 1014 (1st Dist. 1988). Department Exhibit 2 constitutes substantive evidence that John Doe was the individual who was personally responsible for filing the Company’s tax returns and for paying its taxes. Department Ex. 2; In re Cook County Treasurer, 166 Ill. App. 3d at 379, 519 N.E.2d at 1014.

The second issue is willfulness. The Department’s prima facie case presumes willfulness. Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968. To rebut the presumption, the person defending against the penalty must adduce sufficient evidence to disprove willful failure to file returns and pay taxes. *Id.* Whether a responsible officer acts willfully is a mixed question of law and fact. *Id.* at 265, 659 N.E.2d at 970. A responsible officer cannot prove his lack of willfulness simply by denying conscious awareness of a tax deficiency that could have been easily investigated by an inspection of corporate records. *Id.* at 267, 659 N.E.2d at 971.

Both federal courts and Illinois courts have agreed that willfulness may be shown in one of two ways, “(1) ‘a deliberate choice voluntarily, consciously and intentionally made to pay other creditors instead of paying the Government,’ ... or (2) ‘reckless disregard of a known or obvious risk that [the taxes] may not be remitted to the Government.’ “ Ghandour, 36 Fed. Cl. at 62; accord Branson, 168 Ill. 2d at 266-67, 659 N.E.2d at 970-71; Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366, 375-76, 378, 734 N.E.2d 945, 952, 954 (1st Dist. 2000).

Here, John Doe testified, under oath, that he did not have any actual knowledge that the Company had not paid the tax amounts reported to be due on the returns it filed for the last two

months in 2003. While there was absolutely no documentary evidence admitted to support that testimony, both federal and Illinois courts have construed the deliberate choice type of willful action as requiring evidence that the responsible person had actual knowledge that a corporation's taxes were not being paid, at a time when the person authorized or allowed corporate funds to be paid to others. Ghandour, 36 Fed. Cl. at 62 (and cases cited there); Estate of Young, 316 Ill. App. 3d at 375-76, 378, 734 N.E.2d at 952, 954. I acknowledge that this record does not identify the person(s) who actually received the tax monies and gross receipts the Company collected when making sales during November and December 2003, but the evidence does show that John Doe had actual knowledge that the Company collected taxes and receipts from such customers when it made sales of food to them during those months. Department Exs. 1-2. John Doe said he did not recall whether Mary Mabel gave him the returns the Company filed for those months to sign, or whether she signed them using his signature stamp. Tr. pp. 38-39. But his lack of recollection about critical fact questions is not proof that he lacked actual knowledge that the Company had tax liabilities for those two months. *See* Tr. pp. 16-17, 38-39. Nor is it proof that he did not know that those liabilities were not being paid when the returns were filed. *Id.*

The evidence shows that John Doe had actual knowledge that, during each of the months at issue, the Company collected taxes and gross receipts from its customers when making sales to them. Department Ex. 2; Tr. pp. 31-32. The evidence also shows that, by the date the return for each of those months was due to be filed, the Company did not have the collected taxes available to pay over to the Department. Department Ex. 1; Tr. pp. 31-32. Finally, John Doe conceded that, during the taxable period, he authorized the use of Company funds to pay withholding taxes, insurance, employee wages or other expenses. Tr. pp. 29-33. The reasonable inference to

draw from such evidence is that John Doe deliberately chose to authorize the Company to do *something* with the collected taxes other than paying them over to the Department. By making that deliberate choice, John Doe willfully failed to pay the Company's taxes. Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19, 29, 476 N.E.2d 413, 418 (1985).

But if am wrong that the evidence is sufficient to conclude that John Doe made a deliberate choice to pay the taxes the Company collected from customers in November and December 2003 to some unidentified person(s), rather than pay them over to the Department, the evidence does show that John Doe acted willfully by recklessly disregarding the obvious risk that the Company would not pay either the use taxes it collected from customers, or its own ROTA liabilities.

John Doe conceded having personal knowledge that the Company was unable to pay all of its creditors during the last months the restaurant was open. Tr. pp. 17-18. He was the person who was purchasing supplies for the restaurant, and he was the person in charge of the Company's payroll. Tr. pp. 14-15. John Doe said that he spoke with Mary Mabel about which bills should be paid, but his testimony made it seem as though Mary Mabel was telling John Doe who to pay. Tr. pp. 29-30. For example, John Doe was asked the following questions and gave the following answers:

Q: At the time you concluded operations of the ABC Business that was operated by John Doe, Inc., do you recall having any discussion with Mary Mabel about sales taxes that had to be paid.

A: Not that I recall, like I said. I don't want to say yes, I don't want to say no.

Q: Did you have discussions with her about suppliers that were demanding to be paid?

A: No, because I already knew. I dealt with the suppliers. I didn't deal with paying state taxes or any other — writing out any kind of checks. But because I was the one having to order food, I would talk to them on the phone. So I had a gist of what money was owed for whether it was chicken supplier, whether it was to any other supplier.

Tr. pp. 25-26.

Q: And when bills were to be paid by the corporation, did you determine which bills would be paid, the order of payment?

A: The only thing Cathy would tell me is let's say there was ABC supplier for food, what money was owed, meaning I naturally wanted to keep the business open as long as I possibly could. When it got time where I was sinking, we closed up business. And that was it.

Q: That's not my question though. If there were bills to be paid during the time the corporation was operating in 2003 up until the holidays and you closed — when a bill was to be paid, I imagine there were bills to be paid?

A: Correct.

Q: How did you determine which bills would be paid?

A: I'm assuming she felt whatever was urgent enough to keep the doors open. I'm assuming. I don't mean to speak for her. But there wasn't a formula of this person should get paid, this person shouldn't get paid. There wasn't a formula like that.

Tr. pp. 29-31. John Doe's repeated responses to questions asking about his own actions, by referring to Mary Mabel's actions, were evasive. I did not believe John Doe's testimonial suggestion that Mary Mabel was determining which of the Company's creditors would be paid during the last two months of 2003.

Since John Doe had actual knowledge that the Company had more expenses than it had revenues, it was incumbent upon him, the person with ultimate authority over the Company's affairs, to make sure that the collected use taxes, or the Company's own ROT liabilities, were actually paid to the Department when they were due. Department Ex. 2; Branson, 168 Ill. 2d at 267-68, 659 N.E.2d at 971; Estate of Young, 316 Ill. App. 3d at 376-77, 734 N.E.2d at 953. And even if Mary Mabel was the person who was deciding who to pay with the Company's diminishing funds, John Doe still had the power to control her actions. He knew that his signature was required on Company checks, and he gave Mary Mabel the signature stamp, and permission to use it, to sign such checks. Thus, he was in the position to control which Company checks were drawn and issued, simply by telling Mary Mabel to not use the signature stamp any

more, or by choosing which checks she could draw and issue. He did neither. By failing to monitor how the Company's funds were being spent at a time when he knew the Company had more expenses than revenues, he recklessly disregarded the risk that the taxes the Company collected from customers would never be paid to the Department.

Conclusion:

Based on the evidence, I conclude that John Doe was a responsible officer who willfully failed to pay the Company's tax liabilities for November and December 2003. I respectfully recommend that NPL number XXXX be finalized as issued.

August 19, 2013

John E. White
Administrative Law Judge