

ST 14-02

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: Special Assistant Attorney General George Foster on behalf of 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 (hereinafter referred to as the “taxpayer”) of notice of penalty liability NPL Penalty ID number XXXX issued by the Illinois Department of Revenue (“Department”) on May 2, 2012. The notice of penalty liability represents a penalty liability for Retailers’ Occupation Tax of ABC Business due to the Department for the months of September 2009 through February 2010. A hearing was held on this matter on October 22, 2013 during which testimony and documentary evidence was received. 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 recommendation, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:¹

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 May 2, 2012, which shows a penalty for unpaid sales tax liability of ABC Business of \$XXXX for the period September 2009 through February 2010. Tr. p. 6; Department Group Exhibit ("Ex.") 1. During the hearing in this matter on October 22, 2013, the Department acknowledged and stipulated that the taxpayer has made payments that have reduced the unpaid liability at issue from \$XXXX to \$XXXX, Tr. p. 8.
2. ABC Business ("ABC Business") a corporation registered with the Department to do business in Illinois, is engaged in the business of making wholesale and retail sales in this state. Department Ex. 2. 50% of this company's stock is owned by the taxpayer. Tr. p. 10. The taxpayer is also the President of this company. *Id.*
3. The taxpayer was an authorized check signer for ABC Business during the period covered by the notice of penalty liability ("NPL"). Tr. p. 11.
4. John Doe is the Vice President of ABC Business and owns the remaining 50% of the company's stock that the taxpayer does not own. Tr. p. 10; Department Ex. 2.
5. During the hearing, the taxpayer testified that he normally determined which corporate bills would be paid and that he signed the company's sales tax returns. Tr. p. 11.
6. ABC Business commenced business operations on September 1, 1993. Department Ex. 2. The NUC-1 Illinois Business Registration filed by the corporation when it commenced business lists the taxpayer as being responsible for filing tax returns and paying taxes. *Id.* Specifically, the signature of the taxpayer appears under the sentence "I accept personal responsibility for the filing of returns and the payment of taxes due" on the company's Illinois Business Registration dated June 8, 1993. Department Ex. 2.

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

7. ABC Business ceased business operations in January 2010 and filed for bankruptcy during the summer of that year. Tr. pp. 5, 10.

Conclusions of Law:

The sole issue to be decided in this case is whether John Doe ("taxpayer") should be held personally liable for the unpaid Retailers' Occupation Tax of ABC Business ("ABC Business") for the period September 2009 through February 2010. The statutory basis upon which any personal liability is premised is section 3-7 of the 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 to make the payment to the Department or willfully attempts in any other matter 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 this 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 ("NPL") issued in this case establishes the Department's *prima facie* case with regard to both the fact that the taxpayer 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 District, 1978). The statute does not define the term "responsible officer" or the concept of willful failure. However, in applying this penalty

tax, the Illinois courts look to federal cases involving §6672 of the Internal Revenue Code (“IRC”) which contains language similar to the Illinois statute. Branson, *supra* at 254; Department of Revenue v. Joseph Bublick & Sons, 68 Ill. 2d 568, 576 (1977). The key to liability under IRC section 6672 is control of the finances within the underlying corporation giving rise to derivative responsible officer liability including the power to control the allocation of funds to other creditors in preference to the corporation’s tax obligations. Haffa v. U.S., 516 F. 2d 931 (7th Cir. 1975).

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 financial affairs of the corporation and whether he or she participates in decisions regarding the payment of creditors and the dispersal of ones. 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.*

I conclude, based upon the testimony and documentary evidence admitted at the evidentiary hearing, that the taxpayer was a responsible officer of ABC Business. During the period covered by the NPL, the taxpayer was a 50 percent shareholder of this company’s stock. Transcript (“Tr.”) p. 10. The taxpayer testified that he was also the company’s President. *Id.* The company’s by-laws are not in evidence so the record does not show what duties and responsibilities they vested in the company’s President. However, the president of a corporation is customarily charged with overall responsibility for 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)), and there is no reason to assume that not to be the situation in the instant case.

Indeed, the record in this case supports a finding that the taxpayer exercised significant control over the corporation's financial affairs. Specifically, the taxpayer testified that he

decided what bills would be paid by the company and accepted sole responsibility for filing returns and paying taxes on the corporation's Illinois Business Registration form. Department Ex. 2.

The taxpayer also admitted at the hearing that he had the ability to sign corporate checks. Tr. p. 11. The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473 (D.C.N.Y. 1981), affirmed 671 F. 2d 492 (2nd Cir. 1982). Individuals who hold corporate office and who have the authority to make disbursements are presumptively responsible persons for purposes of 26 U.S.C. §6672, the federal responsible officer statute. Hildebrand v. United States, 563 F. Supp. 1259 (D.C.N.J. 1983). As President, with the ability to sign checks, the taxpayer could have written a check to the state of Illinois for unpaid sales taxes. The aforementioned evidence shows that the taxpayer was in a position with ABC Business to exercise significant authority over the corporation's financial affairs and that he exercised control over the company's decisions regarding the payment of creditors and the disbursement of funds.

In order to overcome the Department's *prima facie* case, evidence must be presented which is consistent, probable and identified with the corporation's books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App 3rd 907 (1st Dist. 1987). When the Department established its *prima facie* case, the burden shifted to the taxpayer to overcome the *prima facie* correct presumption of responsibility through the presentation of sufficient evidence. Branson, *supra*. While the taxpayer testified that he was not a responsible officer, no documents were submitted by the taxpayer at the hearing to support this claim. Consequently, the taxpayer's defense rests solely upon his own testimony. Testimony of the taxpayer denying responsibility alone is insufficient to show that the taxpayer was not a responsible officer of ABC Business. Mel-Park Drugs Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1st Dist. 1991).

Given the evidence noted above that the taxpayer exercised significant control over ABC Business's financial affairs including decisions regarding the payment of creditors and the dispersal of funds, in the absence of any documentary evidence to support the taxpayer's claim that he was not a responsible officer, I conclude that the taxpayer has failed to rebut the Department's presumption that he was a responsible party under the statute.

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 NPL into evidence. Branson, *supra*. The burden then shifted to the responsible party to rebut the presumption of willfulness.

35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay or file taxes. In attempting to clarify what constitutes a willful failure to file or pay, the courts have adopted a broad interpretation of the words "willfully fails." Department of Revenue v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (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 the retailers' occupation tax returns or payments. Branson, *supra*. Willfulness as used in the statute may also indicate a reckless disregard for obvious or known risks. Monday, *supra*.

The taxpayer's conduct was willful under each of the above benchmarks. During the hearing, the taxpayer admitted that the taxes that were due were not paid because they related to receivables that came in after the company closed its doors in January 2010 that the taxpayer failed to keep track of. Tr. p. 14 ("Money continued to come in from receivables, and that money did not – because it happened over a period of time, I would imagine that the sales tax because the company was shut down, those taxes didn't get paid, and that is why we are here."). As a responsible officer, it was the taxpayer's duty to keep track of the company's unpaid sales taxes and his failure to do so constituted willfulness. I further find that such willfulness arose

from a reckless disregard for the obvious risk that taxes would not be paid since the taxpayer knew or should have known that the company had outstanding receivables at the time it closed its door and that receipts generated by these receivables would require the filing of additional sales tax returns and the payment of additional taxes subsequent to the company's cessation of operations.

In the instant case, the taxpayer attempted to rebut the presumption of "willfulness" by testifying that he made every effort to extinguish the unpaid liability of ABC Business giving rise to the NPL at issue. He testified that he made payments to the Department reducing the corporation's unpaid tax liability from \$XXXX to \$XXXX during the corporation's bankruptcy proceedings. Tr. p. 8. He argues that the company's entire liability would have been extinguished during the corporation's bankruptcy had the Department made him aware that it exceeded the amounts he paid. Tr. pp. 5, 6, 8, 9.

I find the taxpayer's arguments unpersuasive. As previously indicated, on the company's Illinois Business Registration form, the taxpayer accepted personal responsibility for the filing of returns and the payment of taxes. Department Ex. 2. Consequently, the responsibility for determining and paying the company's tax liabilities due to the Department rested entirely with the taxpayer pursuant to the company's Business Registration form. Moreover, the taxes due and owing were a legitimate debt of the corporation and the fact that some of the taxes were paid does not absolve the taxpayer of responsibility for those taxes which were not paid.

WHEREFORE, for the reasons stated above, it is my recommendation that the amount due pursuant to the Department's notice of penalty liability at issue be reduced from \$13,519.24 to \$4,314.31 and, as so modified, be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: January 8, 2014