

ST 14-09

Tax Type: Sales Tax

Tax Issue: Responsible Corporate Officer – Failure To File Or Pay

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
ANYWHERE, 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 (“taxpayer”) of notice of penalty liability NPL Penalty ID number XXXX issued June 4, 2012 by the Illinois Department of Revenue (“Department”). The notice was issued against the taxpayer as a responsible officer of ABC Company, Inc. under the Uniform Penalty and Interest Act for the period July 2010 through April 2011. The issues to be resolved are: 1) whether the taxpayer was a responsible officer of ABC Company, Inc.; and 2) whether the taxpayer’s failure to pay sales taxes due was willful. A hearing on this matter was held on December 10, 2013 during which the taxpayer testified and both parties presented documentary evidence. Upon consideration of the evidence and a careful review of the record, it is recommended that the

Department's notice of penalty liability at issue in this case 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 introduction into evidence of Notice of Penalty Liability NPL penalty ID number XXXX, dated June 4, 2012, which shows a penalty for unpaid sales tax liability of ABC Company, Inc. ("ABC Company") of \$XXXX for the period July 2010 through April 2011. Department Exhibit ("Ex.") 1.
2. ABC Company, an Illinois corporation that had its headquarters in Anywhere, Illinois, and its principal operations in Anyplace, Illinois, was engaged in the business of providing engineered roof trusses, floor joists and wall panels to residential and commercial new construction and rehab projects from 1970 until 2011. Tr. p. 22; Taxpayer Ex. 1.
3. JOHN DOE ("taxpayer") was the sole owner and *de facto* chief executive officer of the company throughout its existence. Tr. p. 27. The taxpayer was also the President of the company during the tax period in controversy. Taxpayer Ex. 2 (Deed in Lieu of Foreclosure Agreement signed by the taxpayer as "President" of ABC Company on or about April 12, 2011). In 2007, the taxpayer hired his son, Jack Doe, as an employee of the company. Tr. p. 20.
4. Prior to his retirement in 1998 or 1999, the taxpayer was in charge of the company and was solely responsible for all company operations. Tr. pp. 19-20. After his retirement, the taxpayer continued to monitor the profit and loss results and serve as the company's *de facto* chief executive officer and as its President. Tr. pp. 20 -22, 27; Taxpayer's Ex. 2.

5. In 2007, ABC Company ceased to be profitable and began encountering difficulties paying its bills and sales taxes. Tr. pp. 22-23.
6. Beginning in 2007, the taxpayer began contributing personal funds to ABC Company. Tr. pp. 25-26. During 2007 through 2011, the taxpayer contributed between \$3 million and \$4 million to the company. Tr. p. 10.
7. In 2011, the taxpayer ceased subsidizing the company with personal funds and the company closed its operations and discontinued doing business. Tr. pp. 25-26.
8. On April 12, 2011, ABC Company entered into an “Assignment for the Benefit of Creditors Agreement” pursuant to which it transferred all of its real and tangible personal property owned by the corporation on that date to XYZ Company for distribution to various creditors of ABC Company. Taxpayer Ex. 1.
9. On April 12, 2011, ABC Company also entered into a “Deed in Lieu of Foreclosure Agreement” pursuant to which it agreed to “sell, grant, transfer, assign and convey” to Green Bank real and personal property described in this agreement. Taxpayer Ex. 2.
10. Neither the “Assignment for the Benefit of Creditors Agreement” nor the “Deed in Lieu of Foreclosure Agreement” contained any express arrangements to ensure the extinguishment of all or any portion of the company's indebtedness to the Department for sales taxes due and owing to the State of Illinois. Taxpayer Ex. 1, 2.

Conclusions of Law:

The Department seeks to impose personal liability upon JOHN DOE (“taxpayer”) for failure to remit Retailers’ Occupation Tax (“ROT”) 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 (“UPIA”), 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 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 it. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

The Department's *prima facie* case is a rebuttable presumption. Branson, *supra* at 262. After the Department introduces its *prima facie* case, the burden shifts to the taxpayer to establish that one or more of the elements required for the imposition of the penalty are lacking. Id. at 261-62. A taxpayer cannot overcome the Department's *prima facie* case by merely denying the accuracy of the Department's assessment, or by denying conscious awareness that the tax was due from the corporation. Branson, *supra* at 267.

Mere testimony is insufficient to rebut the Department's *prima facie* case. Mel-Park Drugs v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991). Instead, the taxpayer

must present documentary evidence; i.e. evidence that is consistent, probable, and closely identified with its books and records to rebut the Department's determination of liability. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1st Dist. 1988).

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).¹ 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, the taxpayer admitted that he was the sole shareholder and *de facto* chief executive officer of ABC Company throughout its existence. Tr. p. 27. He also admitted that he "ran the company" until his retirement in 1998 or 1999. Tr. pp. 19, 20. While JOHN DOE contends that he ceased to have a leading role in the active management of the company after he retired (Tr. pp. 20-22), the record in this case casts doubt upon this claim because it indicates that the taxpayer was President of ABC Company as late as April 12, 2011. See Taxpayer Ex. 2, "Deed in Lieu of Foreclosure Agreement" which was signed by the taxpayer as "President" of ABC Company on or about April 12, 2011.

In the present case, the Department's *prima facie* case with respect to the taxpayer's status as a responsible officer was established when the Department's certified record relating to the notice of penalty liability at issue was admitted into evidence. Branson, *supra*. In response,

¹ The Illinois Supreme Court has sanctioned the citation of cases interpreting section 6672 of the Internal Revenue Code, 26 U.S.C.A, section 6672, imposing federal income tax liability upon corporate officers, for guidance in determining whether a person is liable as a responsible officer under section 3-7 of the Uniform Penalty and Interest Act, 35 ILCS 735/3-7. Branson, *supra* at 254-56; Department of Revenue v. Heartland Investments, 106 Ill. 2d 19, 29-30 (1985).

the taxpayer presented testimony, but no documentary proof, that he was not involved in the payment of ABC Company's tax liabilities during the tax period in controversy. Tr. p. 10.

Unfortunately, the taxpayer, who bears the burden of proof sufficient to rebut the Department's *prima facie* case, submitted insufficient evidence to support his claim. As noted above, the taxpayer must present evidence that is supported by the taxpayer's books, records or other documents showing that the taxpayer did not have control over the payment of taxes.

The only items of documentary evidence presented on behalf of the taxpayer at the hearing were an "Assignment for the Benefit of Creditors Agreement" and a "Deed in Lieu of Foreclosure Agreement"; agreements ABC Company entered into at the time it terminated its business in April 2011. Neither of these documents contain any information that negates the *prima facie* correctness of the Department's determination that the taxpayer was a responsible officer. Indeed, to the contrary, the only pertinent evidence is the "Deed in Lieu of Foreclosure Agreement" executed on or about April 12, 2011 in which the taxpayer identified himself as the "President" of ABC Company. Taxpayer Ex. 2. This documentary evidence supports rather than refutes the Department's determination.

The taxpayer also testified during the hearing that, while he remained the company's *de facto* chief executive officer after he retired, most of his management responsibilities were transferred to his son, Jack Doe when his son was hired in 2007. Tr. pp. 9-10, 20. As previously noted, mere testimony of this nature without corroborating documentation is insufficient to rebut the Department's *prima facie* case. Mel-Park Drugs, *supra*. Moreover, even if it were entitled to decisive probative weight, this testimony would not negate a finding that the taxpayer was a responsible officer of ABC Company because, in a corporation, there may be more than one responsible officer. Monday, *supra*. Section 3-7 of the UPIA, noted above, does not confine

liability to only one person in the corporation or to the person that is most responsible. Consequently, the aforementioned testimony only posits that Jack Doe may have been a responsible officer, and fails to prove that the taxpayer was not also a responsible officer of ABC Company.

Additionally, the record in this case indicates that the taxpayer was the *de facto* chief executive officer of the company and that he was also the company's President. The President or chief executive officer of a company ordinarily has significant control over a corporation's affairs, and the documentary evidence that has been introduced does not negate the inference to be drawn from the taxpayer's title and status within the company that he had such significant authority.

With the exception of the documentary evidence noted above, the only other evidence offered to support the taxpayer's claim that he was not a responsible officer is the taxpayer's own testimony that he did not have any control over the payment of the company's taxes or the preparation and filing of the company's tax returns. This evidence is insufficient to overcome the Department's *prima facie* case. Jefferson Inc. Co. v. Johnson, 139 Ill. App. 3d 626 (1st Dist. 1985); Mel-Park Drugs, supra; A.R. Barnes & Co., supra; Masini, supra; Copelivitz. v. Department of Revenue, 41 Ill. 2d 154 (1968). To prove his claim, the taxpayer needed to present corroborating documentation such as corporate by-laws delineating the duties and responsibilities vested in the President, or bank cards or other bank records showing that the taxpayer did not have the authority to direct the payment of bills during the tax period at issue. Without such evidence, it must be found that the taxpayer has not rebutted the Department's finding that he was a responsible officer of ABC Company during the tax period at issue. *Id.*

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. 35 ILCS 735/3-7 (imposing liability upon “[A]ny officer or employee of any taxpayer ... who has supervision or responsibility for filing returns and who willfully fails to file the return or make payment to the Department ...[.]” Emphasis added). The Department presents a *prima facie* case for willfulness with the introduction of the notice of penalty liability into evidence. Branson, *supra*. The burden then shifts to the responsible party to rebut the presumption of willfulness.

35 ILCS 735/3-7 does not delineate what constitutes a willful failure to file or pay taxes. In attempting to clarify what constitute a willful failure to file or pay, the courts have adopted a broad interpretation of the term used in this statute, “willfully fails.” Department of Revenue ex. Rel. People 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 ROT returns and payments. Branson, *supra*. Willfulness also includes “failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government.” Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). In addition, “willfulness” as used in the statute may also be indicated by a reckless disregard for obvious or known risks. Monday, *supra*.

The taxpayer’s conduct was willful under each of the above benchmarks. As President, *de facto* chief executive officer and sole shareholder of ABC Company, the taxpayer was certainly in a position to inspect the corporate records and keep informed of the status of the company’s tax returns and payments. The taxpayer’s failure to do so constitutes willfulness under the statute.

Although the taxpayer testified that he delegated all of his managerial responsibilities over the company's tax compliance to his son Jack Doe, his conduct was still willful. Responsible officers are liable when they delegate bookkeeping duties to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of the company's tax returns and payments. Branson, *supra* at 267. If the taxes were not paid by Jack Doe, an employee that the taxpayer hired, and whom he, as President, had the authority to supervise, I must conclude that they were not paid with the taxpayer's tacit approval. Such conduct satisfies the willfulness requirement under the statute. A responsible person cannot escape his obligation to ensure that taxes are paid simply by delegating the responsibility to others. Wright v. United States, 809 F. 2d 425 (7th Cir. 1987).

During the hearing, the taxpayer testified as follows:

Q. You said the company was having trouble paying all their bills on a monthly basis; is that correct?

A. That's correct.

Q. Did you make inquiries as to whether the sales taxes were being paid?

A. Not specifically, no.

Q. In fact, you said the company was having such financial difficulties that you were forced to put a lot of your own money into the company beginning in – at a certain point?

A. That's correct.

Q. What point was that?

A. It was probably in '07 when we first started losing money and I would just keep funding and funding and funding.

Q. Until what point did you continue to have to put money into the business because it was having financial problems?

A. I don't know. I really don't know because I put everything in it.

Q. Was it until at least 2010?

A. No. We kept going until probably we had our doors open. I think it was through April of '11.

Q. Were you putting money into the company until that time?

A. I'm sure I was.

Q. Okay.

A. Maybe the last part of '10 it was close(d).

Q. At least until then you knew – At least up until then you knew about the financial difficulties the company was having?

A. Yes. I think right around August '10 I put money in. Not a good investment.
Tr. pp. 19-20.

The record in this case indicates that the taxpayer put between 3 million and 4 million dollars of his own money into the company between 2007 and 2011 in an attempt to keep the company afloat. Tr. p. 10.

The taxpayer's testimony above also demonstrates willfulness. A manufacturing company that constantly loses money should be an indication to a responsible officer that investigation is warranted as to whether taxes are being paid and remitted. Failure to investigate or to correct mismanagement after having knowledge of cash-flow problems demonstrates willfulness. "Willfulness" as used in the statute may indicate a reckless disregard for obvious or known risks. Monday, supra. The taxpayer's failure to investigate and correct mismanagement, after having knowledge of the company's losses and cash flow problems, indicates a "reckless disregard" for the risk that taxes were not being paid.

There was no testimony or documentary evidence showing any positive steps the taxpayer took to pay the taxes or to see that arrangements were made to pay them when the company ceased operations and entered into various agreements to extinguish its indebtedness to creditors. Taxpayer Ex. 1, 2. The taxpayer was a responsible person in a position to easily discover the nonpayment of ABC Company's taxes. 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). The taxpayer's failure to take action in light of ABC Company's losses and cash flow problems is sufficient to find willfulness under the statute and I conclude that the taxpayer

has failed to rebut the Department's presumption that he willfully failed to pay ABC Company's sales taxes.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's notice of penalty liability, NPL Penalty ID number XXXX at issue in this case be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: March 28, 2013