

**ST 14-11**

**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**

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<b>THE DEPARTMENT OF REVENUE</b>	)	Docket No.	XXXX
<b>OF THE STATE OF ILLINOIS</b>	)	IBT No.	XXXX
v.	)	NPL No.	XXXX
<b>JOHN DOE</b> , as responsible officer	)		
of ABC Business, LLC,	)	John E. White,	
Taxpayer	)	Administrative Law Judge	

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Anthony Pinelli, Law Offices of Anthony Pinelli, appeared for John Doe; George Foster, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

**Synopsis:**

This matter arose when John Doe (John Doe or Taxpayer) protested the Notice of Penalty Liability (NPL) the Illinois Department of Revenue (Department) issued to him as a responsible officer of ABC Business, LLC (ABC Business). The NPL assessed a penalty equal to the amount of ABC Business's retailers' occupation tax liabilities that the Department determined were due for the months of August 2007 through December 2008. The penalty assessed against Taxpayer was a personal liability penalty, issued pursuant to § 3-7 of Illinois' Uniform Penalty and Interest Act (UPIA).

John Doe was the only witness who testified at hearing, and he also offered documentary evidence. I have reviewed all of the evidence, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the Director reconsider and revise the amount assessed in the NPL, to correspond to those periods for which John Doe was responsible and acted willfully, and finalize it as so revised.

## **Findings of Fact:**

### **Facts Regarding ABC Business's Unpaid Illinois Tax Liability**

1. ABC Business manufactured and sold vinyl doors and windows for remodeling and for new construction. Department Ex. 1 (consisting of: (1) the Director's certificate of records; (2) a three-page copy of the NPL; and (3) a three-page copy of the Auditor's Conclusions, dated May 7, 2009, prepared regarding the Department's audit of ABC Business), p. 5 (of exhibit).
2. The penalty assessed against John Doe is equal to the amount of tax, penalties and interest determined to be due from ABC Business for the period from August 2007 through December 2008. Department Ex. 1, pp. 2-4.
3. The Department determined the amount of tax, penalties and interest due from ABC Business following an audit of ABC Business's business. Department Ex. 1, pp. 5-7.
4. The Department conducted its audit after ABC Business had ceased doing business, and after it had filed for bankruptcy. *Id.*; Taxpayer Exs. 2A (certified copy of document titled, "Objection of Illinois Department of Revenue to Entry of Final Order Approving Use of Cash Collateral and Post-Petition Financing" that the Department filed, as a creditor, in ABC Business's bankruptcy proceeding on January 27, 2009), 2B (certified copy of document titled, "Global Notes Regarding Debtor's Bankruptcy Schedules and Statement of Financial Affairs[,]") that was filed for ABC Business, on January 16, 2009, in its bankruptcy case).
5. The Department is a claimant/creditor in ABC Business's bankruptcy. Taxpayer Exs. 2A, 2B (schedule E, sheet 10).
6. On January 22, 2010, the Department filed its amended claim in ABC Business's bankruptcy. Department Ex. 2 (copy of Department's January 22, 2010 amended claim).
7. Jack Black (Jack Black), ABC Business's controller, was ABC Business's representative

during the period leading up to the audit. Department Group Ex. 1, p. 5; Taxpayer Ex. 1 (copies of documents Taxpayer obtained from the Department's audit file in this matter), pp. 4 (copy of first page of the auditor's audit history worksheet), 8 (copy of completed and signed waiver of statute of limitations form).

8. On October 6, 2008, Jack Black signed a waiver of the statute of limitations form, for ABC Business's convenience. Taxpayer Ex. 1, p. 8.
9. The auditor attempted to begin the audit of ABC Business in early November 2008. Department Ex. 1, p. 5. In response to that request, Jack Black asked for a delay till February 2009, because ABC Business was undergoing a federal tax audit in early November. *Id.*
10. ABC Business did not file its monthly Illinois sales and use tax returns for the months of July through December 2008. Department Ex. 1, p. 6.
11. To estimate taxable receipts for the period during which ABC Business failed to file monthly returns, the auditor used a block average method, which took into account ABC Business's sales for the last six months of 2005, 2006 and 2007. Department Ex. 1, p. 6. As a result of that estimate, the Department assessed tax, penalties and interest for that six month period. *Id.*; *see also* Department Ex. 2, p. 1 (showing monthly breakdown of the amounts of tax, penalties, and interest assessed against ABC Business, as well as the dates of such assessments).
12. The Department's audit also took into account the Illinois sales and use tax returns ABC Business filed regarding the period from August 2007 through June 2008, and for which ABC Business made payments. Department Ex. 1, p. 5. Following audit, the Department corrected those returns, and assessed tax, penalties and interest. *See id.*
13. The Department's audit concluded in May 2009. Department Ex. 1, p. 6 (auditor's

conclusions is dated May 7, 2009).

14. The NPL is dated November 2, 2009. Department Ex. 1, p. 2.

15. The NPL issued to John Doe provides, in part, as follows:

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This statement lists our most recent information about your unpaid balance, available credits, or returns you have not filed. A payment voucher is included so you may pay the balance due.

ST-1 Sales Tax				Account ID: 3587-2055		
Period	Tax	Penalty	Interest	Payments/Credits	Balance	
31 Aug 2007	XXX	XXX	XXX	(XXX)	XXX	
30 Sep 2007	XXX	XXX	XXX	(XXX)	XXX	
31 Oct 2007	XXX	XXX	XXX	(XXX)	XXX	
30 Nov 2007	XXX	XXX	XXX	(XXX)	XXX	
31 Dec 2007	XXX	XXX	XXX	(XXX)	XXX	
31 Jan 2008	XXX	XXX	XXX	(XXX)	XXX	
29 Feb 2008	XXX	XXX	XXX	(XXX)	XXX	
31 Mar 2008	XXX	XXX	XXX	(XXX)	XXX	
30 Apr 2008	XXX	XXX	XXX	(XXX)	XXX	
31 May 2008	XXX	XXX	XXX	(XXX)	XXX	
30 Jun 2008	XXX	XXX	XXX	(XXX)	XXX	
31 Jul 2008	XXX	XXX	XXX	—	XXX	
31 Aug 2008	XXX	XXX	XXX	—	XXX	
30 Sep 2008	XXX	XXX	XXX	—	XXX	
31 Oct 2008	XXX	XXX	XXX	—	XXX	
30 Nov 2008	XXX	XXX	XXX	—	XXX	
31 Dec 2008	XXX	XXX	XXX	—	XXX	

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Department Ex. 1, pp. 2-3.

16. The Department's January 22, 2010 amended claim in ABC Business's bankruptcy contains an attachment that provides more information than is included within the statement that is part of the NPL. *Compare* Department Ex. 1 *with* Department Ex. 2.

17. The attachment to the Department's amended bankruptcy claim provides, in pertinent and substantive part, as follows:

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Period	Assessed*	Tax Type	Calculated to Bankruptcy Petition Date			Lien	
			Tax	Penalty	Interest	Date	County
8/31/07	1/9/08	ROT/UT	0	XXX	XXX		
9/30/07	5/29/08	ROT/UT	0	XXX	XXX		
10/31/07	5/14/08	ROT/UT	XXX	XXX	XXX		
11/30/07	4/30/08	ROT/UT	XXX	XXX	XXX		
12/31/07	5/16/08	ROT/UT	XXX	XXX	XXX		
1/31/08	6/9/08	ROT/UT	XXX	XXX	XXX		
2/29/08	6/13/08	ROT/UT	XXX	XXX	XXX		
3/31/08	6/13/08	ROT/UT	XXX	XXX	XXX		
3/31/08	7/29/09	ROT/UT	XXX	XXX	XXX		
4/30/08	9/18/08	ROT/UT	XXX	XXX	XXX	11/30/08	Any
4/30/08	7/29/09	ROT/UT	XXX	XXX	XXX		
5/31/08	9/28/08	ROT/UT	XXX	XXX	XXX	11/30/08	Any
5/31/08	7/29/09	ROT/UT	XXX	XXX	XXX		
6/30/08	10/29/08	ROT/UT	XXX	XXX	XXX	11/30/08	Any
6/30/08	7/29/09	ROT/UT	XXX	XXX	XXX		
7/31/08	7/29/09	ROT/UT	XXX	XXX	XXX		
8/31/08	7/29/09	ROT/UT	XXX	XXX	XXX		
9/30/08	7/29/09	ROT/UT	XXX	XXX	XXX		
10/31/08	7/29/09	ROT/UT	XXX	XXX	XXX		
11/30/08	7/29/09	ROT/UT	XXX	XXX	XXX		
12/31/08	7/29/09	ROT/UT	XXX	0	0		

\* If "Assessed" = "Priority" then equitable tolling applies

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Department Ex. 2, p. 2.

**Facts Regarding John Doe’s Work With, and Responsibilities For, ABC Business**

18. Prior to his graduation from graduate school in 2006, John Doe was employed by XYZ

Business (XYZ BUSINESS). Hearing Transcript (Tr.), pp. 10-11 (testimony of John Doe).

19. XYZ BUSINESS’s business was to provide consulting and advisory services to companies

that were experiencing financial distress. Tr. p. 11. ABC Business was one of XYZ

BUSINESS’s clients in 2006, and John Doe worked with ABC Business for XYZ

BUSINESS. *Id.*

20. After working with ABC Business for about four to six months, Gene Green (Gene Green),

ABC Business’s president and chief executive officer, offered John Doe a job with ABC

Business. Tr. pp. 11-12; Taxpayer Ex. 1.

21. When describing what John Doe's duties would be at ABC Business at the time Gene Green offered John Doe a job, Gene Green and John Doe discussed whether John Doe's title would be chief operating officer (COO) or chief restructuring officer (CRO), because his primary role would be to reduce ABC Business's operating expenses, and to try to increase its capital financing, so as to make the company profitable. Tr. p. 14.
22. During the audit period, John Doe was ABC Business's COO, the Plan Administrator for ABC Business's 401(k) plan, and a non-voting manager of the ABC Business LLC. Taxpayer Ex. 4 (John Doe's resignation letter); Tr. pp. 12-13.
23. John Doe received common stock in ABC Business amounting to approximately 5%, after vesting. Tr. p. 13.
24. One of the ways John Doe reduced ABC Business's operating expenses was by trying to reduce the number of its employees. Tr. pp. 15, 17.
25. When John Doe began working as an officer for ABC Business, John Doe spent a significant amount of time trying to reduce ABC Business's payroll. Tr. p. 15. When John Doe first started at ABC Business, it had approximately 500 to 700 employees. Tr. p. 17. By November 2008, ABC Business had less than 250 employees. *Id.*
26. Another way John Doe tried to reduce ABC Business's operating expenses was by trying to reduce the number of product lines that ABC Business manufactured. Tr. p. 16.
27. John Doe's efforts to attract financing, that is, to seek investors who would be willing to invest in, or lend monies to, ABC Business, was affected by his success at reducing ABC Business's operating expenses. Tr. pp. 15-16.
28. In February of 2007, ABC Business obtained a line of credit from House Bank, which was

later bought by Building Bank (Building Bank). Tr. pp. 29-31; Taxpayer Ex. 3A.

29. In a document titled, Background/State of Affairs, that Building Bank drafted in December 2008 to summarize ABC Business's history with Building Bank, Building Bank wrote, in pertinent part:

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- Numerous defaults & waiver/resets of covenants during the life of the transaction.
- The company has shown negative EDIBTA since the inception of the loan in 2/07.
- At the time of the underwriting, sales/EBITDA were forecasted as follows[:] FYE 12/06 sales - \$XX (actual \$XX), EBITDA - <\$XX>; FYE 12/07 sales - \$XX (actual \$XX), EBITDA – XX (actual <\$XX>). Through 6/08, sales are \$XX, EBITDA <\$XX>
- October 2008, company presented its first wind down plan, with revised plans presented on 11/25 & 12/2.

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Taxpayer Ex. 3A (I take notice that EBITDA is an acronym meaning “earnings before interest, taxes, depreciation and amortization”). ebitda. Dictionary.com. The American Heritage® Abbreviations Dictionary, Third Edition. Houghton Mifflin Company, 2005. <http://dictionary.reference.com/browse/ebitda> (accessed: January 31, 2012).

30. Between February 2007 and November 2008, ABC Business amended its line of credit with Building Bank six times. Tr. pp. 29-30; Taxpayer Ex. 3A.

31. Toward the end of John Doe's work for ABC Business, he was ABC Business's representative in contract negotiations with the union representing ABC Business's employees. Tr. pp. 17-18.

32. During 2008, John Doe was aware that ABC Business was not taking in enough revenues to meet its expenses. Tr. pp. 20-21.

33. John Doe did not sign ABC Business's monthly Illinois tax returns. Taxpayer Ex. 1, pp. 10, 16 (copies of first page of ABC Business's filed Illinois sales and use tax returns for the

months of June and February 2008), 17 (copy of [NPL] checklist prepared by the Department regarding this matter); Tr. p. 33.

34. John Doe did not sign checks drawn to pay the tax shown due on ABC Business's Illinois tax returns. Tr. p. 33; *see also* Taxpayer Ex. 1, p. 17.

35. John Doe requested the issuance of a subpoena for certain books and records from Building Bank, and such documents were admitted at hearing. Taxpayer Exs. 3A-3B. The Building Bank documents admitted as evidence did not pertain to the period when John Doe was employed by ABC Business. *Id.*

36. John Doe resigned from ABC Business effective November 30, 2008. Taxpayer Ex. 4. His resignation letter provided as follows:

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Dear Mr. Gene Green:

Effective November 30, 2008, I hereby resign as:

- Chief Operating Officer of ABC Business LLC.
- Plan Administrator for ABC Business LLC's 401(k) plan.
- Non-voting Manager of IVW, LLC and ABC Business LLC.
- Any and all other positions, titles, and responsibilities associated with my roles with ABC Business LLC, IVW, LLC, and NFI LLC.

I appreciate the opportunity to have worked with ABC Business LLC over the past three years.

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Taxpayer Ex. 4.

37. The Department issued its NTL to ABC Business in May 2009. *See* Department Ex. 1, p. 7.

38. The NTL became final on July 29, 2009. *See* Department Ex. 2 (identifying those taxes assessed on July 29, 2009).

### **Conclusions of Law:**

When the Department introduced the NPL into evidence under the certificate of the

Director, it presented prima facie proof that John Doe was personally responsible for ABC Business's unpaid tax liabilities. 35 ILCS 735/3-7; 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.*

Section 3-7 of the UPIA provides that a personal liability penalty may be imposed upon:

- [1] Any officer or employee of any corporation ... who has the control, supervision or responsibility of filing returns and making payment of ... the tax[es] ... imposed ... **and** who willfully:
- [2] fails to file such return **or**
- [3] [fails] to make such payments to the Department **or**
- [4] ... attempts ... in any other manner to evade or defeat the tax ....

35 ILCS 735/3-7(a) (emphasis and brackets added).

At hearing, John Doe argued that he was not a responsible officer of ABC Business (Tr. pp. 44-49), and that the tax for which he is being penalized was based on an unreasonable audit. Tr. pp. 49-52. I address Taxpayer's arguments about responsibility first.

Initially, Taxpayer argues that the statutory presumption afforded the Department's NPL does not supply any evidentiary proof as to a person's control, supervision, or responsibility for filing a corporation's returns or making tax payments. Tr. p. 45 (closing argument). That is incorrect. The presumption of correctness that attaches to the Department's prima facie case extends to all elements of taxability. Branson, 168 Ill. 2d at 260, 659 N.E.2d at 968 ("by operation of the statute, proof of the correctness of such penalty, including the willfulness element, is established by the Department's penalty assessment and certified record relating thereto."); Soho Club, Inc. v. Department of Revenue, 269 Ill. App. 3d 220, 232, 645 N.E.2d

1060, 1068 (1<sup>st</sup> Dist. 1995) (Department's introduction of Notice of Tax Liability establishes prima facie proof that taxpayer is engaged in the occupation that is subject to taxation). Thus, after the Department admitted the NPL into evidence under the certificate of the Director, the burden shifted to John Doe to offer competent evidence to show, at least on this fact question, that he was not an officer or employee of ABC Business who had "the control, supervision or responsibility of filing returns and making payment of ... the tax[es] ... imposed." 35 ILCS 735/3-7. If he fails to offer such competent evidence, he would not overcome the statutory presumption, and the fact issue would be resolved against him. Branson, 168 Ill. 2d at 260, 659 N.E.2d at 968; *see also* Arts Club of Chicago v. Department of Revenue, 334 Ill. App. 3d 235, 246, 777 N.E.2d 700, 709 (1<sup>st</sup> Dist. 2002) (the absence of evidence in the record regarding a issue on which taxpayer has the burden of proof weighs in the Department's favor).

Moving now to the fact issue itself, I have found no Illinois case in which a court has addressed the factors to consider when determining whether a particular person is an "officer or employee ... 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 ...." 35 ILCS 735/3-7(a). When interpreting the text of UPIA § 3-7's statutory predecessor, however, Illinois courts have looked at how federal courts construed similar text used in § 6672 of the Internal Revenue Code (the Code). *E.g.*, Branson, 168 Ill. 2d at 254-56, 659 N.E.2d at 965-66. 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. *Id.* When considering whether John Doe was a responsible officer of ABC Business, therefore, I will take into account those factors federal courts have considered when determining whether one is a "responsible person," under Code § 6672.

One succinct description of the factors to consider when determining whether a person is a responsible person under § 6672 is found in Williams v. United States, 931 F.2d 805 (11<sup>th</sup> Cir. 1991), in which the court explained as follows:

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Generally, the courts have interpreted rather broadly who will constitute a “responsible person” under section 6672. *Smith*, 894 F.2d at 1553 (citing *Slodov v. United States*, 436 U.S. 238, 246-50, 98 S.Ct. 1778, 1784-87, 56 L.Ed.2d 251 (1978) and *Liddon v. United States*, 448 F.2d 509, 512 (5th Cir.1971), *cert. denied*, 406 U.S. 918, 92 S.Ct. 1769, 32 L.Ed.2d 117 (1972)). A person is responsible within the meaning of section 6672 if he has a duty to collect, account for or pay over taxes withheld from the wages of a company's employees. [footnotes omitted] *Thibodeau*, 828 F.2d at 1503; *George*, 819 F.2d at 1011. Responsibility is “a matter of status, duty and authority.” *Mazo v. United States*, 591 F.2d 1151, 1156 (5th Cir.), *cert. denied*, 444 U.S. 842, 100 S.Ct. 82, 62 L.Ed.2d 54 (1979). “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.” *George*, 819 F.2d at 1011. \*\*\*

Williams, 931 F.2d at 810.

Here, there is no dispute that John Doe was ABC Business’s chief operating officer. Tr. p. 13. He was an ABC Business shareholder, and he was a manager of the limited liability company that was ABC Business. Taxpayer Ex. 4; Tr. p. 13. While managing ABC Business, John Doe’s chief responsibilities included trying to reduce ABC Business’s expenses, and working closely with ABC Business’s creditors and lenders to improve ABC Business’s financial position. Tr. pp. 15-16, 19-20, 29-31. John Doe knew that, during 2008, ABC Business was not taking in revenues sufficient to meet its expenses. Tr. pp. 20-21. Obviously, ABC Business’s Illinois sales and use taxes were one of ABC Business’s regular expenses. *See* Department Ex. 1, pp. 2-3.

Notwithstanding John Doe’s admitted status and responsibilities, John Doe argues that he had no responsibility for ABC Business’s Illinois tax liabilities — either filing its returns or

paying the tax required to be shown due on them. On these points, John Doe was asked the following questions directly and gave the following answers:

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Q During the year 2008, did you receive any notices in your capacity as COO of delinquencies to the State of Illinois?

A No

Q Was it your responsibility at any time that you worked at ABC Business to complete tax returns for sales taxes or ROTA taxes to the State of Illinois?

A No.

Q Was it your responsibility to sign checks to the State of Illinois for taxes while you worked at ABC Business?

A No.

Q Did you ever sign a tax return or a check for ABC Business while you worked there?

A No.

Q And was there a person who did complete the tax returns and send them to the State of Illinois?

A Yes.

Q Who was that?

A Jack Black.

Q How do you spell his last name?

A B-l-a-c-k.

Q And did Mr. Jack Black have a title with the company?

A I think it was controller.

Q Did you ever have any discussions with Jack Black in the year 2008 regarding the timely submission of sales tax returns to the State of Illinois?

A No.

Q Was it ever brought to your attention that in the second half of 2008 ABC Business was not timely remitting its returns.

A No.

Q At any time in your employment, did you have discussions with either Mr. Jack Black or Mr. Gene Green about the timeliness of payments to the State of Illinois for taxes?

A No.

Q Were you ever asked by Mr. Gene Green to make a recommendation in terms of restructuring regarding the payment of sales taxes to the State of Illinois?

A No.

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Tr. pp. 33-35.

John Doe offered documentary evidence that corroborated some of the facts reflected within his testimony. Specifically, he offered into evidence copies of two monthly Illinois returns

ABC Business filed during the audit period, which Jack Black signed. Taxpayer Ex. 1, pp. 10-11, 16. He also offered a copy of a document the Department prepared when compiling its file in this matter, titled, “[NPL] Liability Checklist,” in which the Department noted that John Doe did not sign ABC Business’s returns. Taxpayer Ex. 1, p. 17. This documentary evidence corroborates Taxpayer’s argument that he was not the officer or employee who personally prepared and filed ABC Business’s Illinois sales tax returns.

But while John Doe established that another person actually signed and filed ABC Business’s returns, that does not mean that he has proven that he had no control or supervision over filing ABC Business’s returns, and over the payment of the taxes imposed on ABC Business. Nor does his testimony stand un rebutted on this point, as he alleges. Specifically, on cross-examination, John Doe was asked the following questions and gave the following answers:

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Q The controller that you referred to, what was his name again?

A Jack Black.

Q Now, he basically reported to you and Mr. Gene Green; is that correct?

A I think the best way to describe it is we were a small team, and folks kind of interacted.

There wasn’t a formal reporting structure, so all of the executives, whether it be sales or manufacturing or accounting all kind of worked in conjunction with each other.

Q But, basically, you and Mr. Gene Green oversaw the controller, would that be accurate?

A I think that would be a fair statement, yes.

Q And would it be fair to say that you never checked during the time that you were at ABC Business to see if tax returns were being filed? Is it a fair statement?

A It wasn’t a component of my responsibility.

Q But whether it was or wasn’t, you never checked to see if sales taxes were being filed; is that correct?

A I wasn’t involved is anything with sales tax.

Q Just that question, did you ever check to see if sales taxes were being filed? If sales tax returns were being filed, did you ever check to see?

A No, I didn’t become involved in that.

Q And did you ever check to see during the time that you were at ABC Business, did you ever check to see if the sales taxes were being paid?

A No, I did not.

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Tr. pp. 38-39.

Here, John Doe has conceded that his responsibilities included overseeing the functions of ABC Business's controller. Tr. p. 38. His managerial oversight over the employee who actually paid ABC Business's taxes makes perfect sense; John Doe could hardly be expected to be able to reduce ABC Business's expenses without knowing what its expenses were. And while John Doe offered documentary evidence to corroborate his testimony that he was not the person who personally signed and filed ABC Business's monthly tax returns, he did not offer any documentary evidence to corroborate his implied argument that since he never signed a check to pay ABC Business's taxes, he could not have had any control, supervision or responsibility for making payment of the taxes imposed on ABC Business.

One fact that is particularly probative on this point, moreover, is John Doe's admitted status as a manager of the ABC Business LLC. Illinois law is clear that, unless a manager's authority is restricted by the LLC's operating agreement, any manager has the authority to sign an instrument on behalf of the company. 805 ILCS 180/13-5(b)(1), (c). If ABC Business's operating agreement prohibited John Doe from signing checks for ABC Business, that document would have been strongly probative evidence that John Doe lacked the authority to pay ABC Business's taxes. But no such business record was offered at hearing. As a former shareholder, moreover, John Doe had the right to obtain a copy of ABC Business's operating agreement from the company, in the event he did not already possess one. 805 ILCS 180/10-15. Alternatively, John Doe could have sought a subpoena for that document, just as he could have asked for a subpoena for copies of ABC Business's bank records identifying the individuals who were

authorized to sign checks for the company. John Doe had certain bank records subpoenaed (Taxpayer Exs. 3A-3B), but those documents were reflective only of what occurred after he left ABC Business. Regarding his actual authority *during* the audit period, however, John Doe offered no bank records, or other regularly kept books and records, to show that he lacked the status, authority, or power to pay ABC Business's expenses.

On this point, I address John Doe's citation to and reliance on the decision in Sweilem v. Department of Revenue, 372 Ill. App. 3d 475, 865 N.E.2d 459 (1<sup>st</sup> Dist. 2007). He cites this case for the proposition that his testimony describing his responsibilities for ABC Business cannot be ignored or disregarded here, since it was not rebutted at hearing. In Sweilem, the appellate court reversed the Department's administrative determination that NPLs issued to two corporate officers, but not to their attorney, were finalized as a matter of law after the individuals failed to timely protest them. *Id.* at 476, 489-90, 865 N.E.2d at 461, 472. The case was initiated via a writ of certiorari to the Illinois circuit court, after the individuals' attorney's request to file a late protest of the NPLs was denied. The circuit court remanded the matter to the agency for a hearing "to determine whether the Department complied with section 12 of the [Retailers' Occupation Tax] Act [(ROTA)]." Sweilem, 372 Ill. App. 3d at 477, 865 N.E.2d at 462. Section 12 of the ROTA provides, in pertinent part, "[f]ollowing the initial contact of a person represented by an attorney, the Department shall not contact the person concerned but shall only contact the attorney representing the person concerned." 35 ILCS 120/12 (formerly Ill.Rev.Stat. ch. 120, ¶ 12). After considering the evidence and arguments presented at the hearing on remand, the Sweilem court agreed that there had been an initial contact by an attorney for the two individuals regarding a matter under Department review, and that the Department thereafter failed to issue the NPLs to that attorney, as required by ROTA § 12. Since the Department did

not comply with ROTA § 12, those NPLs did not become final as a matter of law, and the individuals had not waived their right to contest them. The court thereafter remanded the matter to the Department for further proceedings consistent with the court's judgment.

What the court made plain in Sweilem was that the only evidence of the initial contact that was offered at the Department's hearing was the testimony offered by the individuals, and their attorney, regarding an initial contact between the Department and the individual taxpayers. That initial contact occurred following a tax assessment issued to a corporation, Jet Foods, whose unpaid liability formed the basis for the NPLs. The court also considered significant the fact that the Department had purged its file containing documents collected and/or admitted into evidence during the initial contact regarding Jet Foods, while the individuals' challenge of the NPLs was proceeding in court. As the court noted,

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In the instant case, however, the only testimony presented relative to this issue was that taxpayers received a notice to appear on a certain day in the State of Illinois Building, they appeared represented by counsel, who had previously represented Jet Foods in various other matters with the Department and, according to Farid's unrebutted testimony, filed a power of attorney with the Department. Moreover, we will not presume, in the Department's favor, that a power of attorney never existed when it destroyed the files and documents that would serve as evidence to support or refute the claim.

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Sweilem, 372 Ill. App. 3d at 488, 865 N.E.2d at 470-71.

Clearly, the facts and issues in Sweilem are not like the facts and issues here. The issue in Sweilem, in essence, involved an examination of whether the agency provided proper notice of a penalty assessment. Here, in contrast, the initial issue involves an examination of the nature of John Doe's status, duty, and authority to act for ABC Business. The Department is not in the best position to know the nature and extent of John Doe's actions for ABC Business. John Doe had better access to ABC Business's books and records, just as he had superior knowledge of

what books and records would document whether he lacked the status, duty, and authority to ensure that ABC Business timely filed its monthly tax returns and timely paid its tax liabilities. *See* Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968-69 (the individual responsible for paying the collected taxes and filing the returns, not the Department, has better access to the information regarding why the returns were not filed and the taxes not paid).

John Doe concedes that he had managerial oversight of the person who prepared, signed and filed ABC Business's monthly returns. Tr. p. 38. He also acknowledges that his primary responsibilities included managing the company's creditors, and reducing its expenses by reducing the number of its employees. Tr. pp. 15-16, 19-20, 29-31. These facts show that he had the status, duty and authority for supervising and controlling these activities for the company. John Doe, moreover, never offered any documentary evidence to establish that he lacked the authority to pay ABC Business's creditors, like the Department. Finally, the Illinois Supreme Court has held that a person must offer more than mere testimony to rebut the Department's prima facie case. Branson, 168 Ill. 2d at 260, 659 N.E.2d at 968. Because the facts and issues in Sweilem are so unlike the facts and issues in this case, I cannot agree that Sweilem supports his argument that, based on his mere testimony, he has established that he was not a responsible officer of ABC Business. To the contrary, the evidence offered at hearing, and the reasonable inferences to be drawn from John Doe's failure to offer documentary evidence that should have been available to him as ABC Business's stockholder, manager, and COO, show that John Doe was a responsible officer of ABC Business. 35 ILCS 735/3-7(a); Branson, 168 Ill. 2d at 260, 659 N.E.2d at 968.

As a final note on this issue, the evidence shows that John Doe resigned from ABC Business effective November 30, 2008. Taxpayer Ex. 4. After that date, therefore, he no longer

had any status, duty or authority to act for ABC Business. The NPL, however, includes a penalty that is based on tax assessed to ABC Business for the months of November and December 2008. Department Ex. 1. ABC Business's returns for those months would have been due, respectively, on December 20, 2008 and January 20, 2009. *See* 35 ILCS 120/3 (retailer's returns due on 20<sup>th</sup> day of the month following the month in which receipts were received). Since John Doe was not any kind of officer or employee of ABC Business's at that time, he cannot have been responsible for filing ABC Business's returns for those months, or for paying such taxes when those returns were due. Thus, I recommend that the Director find that John Doe was not a responsible officer of ABC Business regarding the months of November and December of 2008. 35 ILCS 735/3-7.

The next 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.

As already noted, when construing the meaning of terms used in the statutory predecessor to UPIA § 3-7, Illinois courts have looked to federal cases construing and applying Code § 6672. *E.g.*, Branson, 168 Ill. 2d at 261, 659 N.E.2d at 968. The federal court of claim's reasoning in Ghandour v. United States, 36 Fed. Cl. 53 (1996), offers particularly helpful guidance on the question of willfulness:

#### B. *Willfulness*

[A]fter it has been determined that an individual was a "responsible person," the court must next ascertain whether that person acted "willfully" in

failing to collect, truthfully account for, and pay over the withheld payroll taxes. I.R.C. § 6672(a). The Supreme Court has construed § 6672 as requiring an element of “personal fault” before an individual can be held liable for the penalty. *Slodov*, 436 U.S. at 254, 98 S.Ct. at 1788. As the Court of Claims explained, however-

it is not necessary that there be present an intent to defraud or to deprive the United States of taxes due, nor need bad motives or wicked design be proved in order to constitute willfulness.

*White*, 372 F.2d at 521. On the other hand, “mere negligence” is insufficient to constitute willfulness under I.R.C. § 6672. *Godfrey*, 748 F.2d at 1577. Rather, the requisite “personal fault” 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,” *White*, 372 F.2d at 521, *quoted in Godfrey*, 748 F.2d at 1577, or (2) “reckless disregard of a known or obvious risk that [the taxes] may not be remitted to the Government.” *Godfrey*, 748 F.2d at 1578 (quoting *Mazo*, 591 F.2d at 1154).

#### 1. *The “Deliberate Choice” Standard*

First, an individual has acted willfully if he made a deliberate and intentional choice to prefer other creditors over the government. Because the required preference of other creditors over the government must have been deliberate, *i.e.*, voluntary and intentional, it follows that the deliberate choice standard of willfulness can only be met if the responsible individual had *actual knowledge* of the specific tax delinquency for which the penalty was assessed. It is not sufficient that a responsible person knew of an earlier delinquency that was paid in full. *See Godfrey*, 748 F.2d at 1577. Moreover, if the choice by a corporate official to pay others instead of the taxes is to be found to have been deliberate, it follows that there must have been unencumbered funds available to pay the taxes at the time the taxes came due. If, on the other hand, when a responsible person learns of the taxes due, there are no funds available to pay over said owing taxes to the IRS, he need not “order the impossible,” and the failure to pay the taxes will not be deemed willful under the deliberate choice standard. *Id.*

In assessing willfulness under I.R.C. § 6672, the focus is on “the taxpayer’s diligence in attending to the duty to pay employment taxes.” *Hammon*, 21 Cl.Ct. at 27. In this connection, the use of “available corporate money for other business purposes,” *Powell v. United States*, 9 Cl.Ct. 58, 62 (1985) (emphasis added), when a responsible person has knowledge of a current tax liability, will constitute a “willful” failure to collect, account for, and pay over the due employment taxes, under the deliberate choice standard.

#### 2. *The “Reckless Disregard” Standard*

Second, where a responsible person recklessly disregards a known or obvious risk that the taxes will not be paid to the IRS, and the taxes are in fact not paid, he has been “willful” as that term is used in I.R.C. § 6672, and may be assessed a penalty under that section. In *Hammon*, 21 Cl.Ct. at 29-30, the Claims Court laid out the test for recklessness under § 6672, delineating the

following three elements:

(1) the responsible person's knowledge (or reason to know) of a risk that taxes will not be paid, (2) a reasonable opportunity to discover and remedy the problem, and (3) a failure to undertake the reasonable efforts to ensure payment.

*See also Whiteside*, 26 Cl.Ct. at 573-74. The Seventh Circuit, in *Wright v. United States*, 809 F.2d 425, 427 (7th Cir. 1987), expounded a very similar test, holding that the "responsible person" is liable if he (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easily.

Under either formulation, it is clear that the responsible individual must have had at least constructive knowledge of a *risk* that the employment taxes would not be paid, and must have had an opportunity to act on that knowledge to discover any problems in payment.

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Ghandour, 36 Fed. Cl. at 62-63 (emphases original).

Here, the tax assessed against ABC Business was based on two separate determinations. The first involved the auditor's estimate of ABC Business's gross receipts for the six month period during which it failed to file returns. Department Ex. 1, p. 6. The other determination was that ABC Business had incorrectly charged different tax rates regarding receipts reported as having been received at its different Illinois locations. *Id.* The auditor's correction of this error led to an increase in the amount of tax ABC Business previously reported as being due, and paid, regarding those prior periods, as well as the assessment of penalties and interest. *Id.*

On the issue of willfulness, John Doe made two arguments. First, in a written memorandum offered at hearing, John Doe points out that, after he left ABC Business, the company was able to obtain a final advance of funding from Building Bank, that was thereafter used to pay ABC Business's employees. Taxpayer's Memorandum in Opposition to Assessment of Liability for Tax and Penalty (Taxpayer's Brief), p. 7; Taxpayer Ex. 3B. John Doe argues that these facts show that Gene Green was the person who willfully preferred other creditors over the Department. *Id.* I agree that that evidence supports John Doe's argument, but it does not establish

that John Doe did not also act willfully. Illinois law recognizes that there can be more than one responsible officer of a corporation. *E.g.*, Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366, 734 N.E.2d 945 (1<sup>st</sup> Dist. 2000) (affirming assessments issued to three corporate officers). Thus, John Doe’s ability to show how another responsible officer of ABC Business might have acted willfully does not necessarily render him unaccountable.

John Doe next argues that he cannot have acted willfully regarding a tax assessment that was unreasonable on its face. Tr. pp. 51-52 (closing argument). On this point, however, Illinois law is clear that the amount of a final tax liability may not be collaterally attacked at the collection stage. People ex rel Scott v. Pintozzi, 50 Ill. 2d 115, 127, 277 N.E.2d 844, 851 (1972). Of course, if ABC Business, or its trustee, had challenged the amount of the Department’s claims in bankruptcy, the bankruptcy court has the power to resolve that fact issue itself. *E.g.*, In re Stoeker, 179 F.3d 546, 549 (7<sup>th</sup> Cir. 1999) (“The Bankruptcy Code expressly authorizes bankruptcy courts to decide tax issues, 11 U.S.C. § 505(a)(1), and although state taxes are not specified, the courts have interpreted the statute to cover them.”); *aff’d sub nom*, Raleigh v. Illinois Department of Revenue, 530 U.S. 15, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000). Just as obviously, if the bankruptcy court had determined that the correct amount of tax due was less than the amount the Department determined and claimed due, John Doe would be liable for no more than the amount finally determined to be due for each such period. *See id.*; 35 ILCS 735/3-7. But since neither party has alleged that the bankruptcy court has done so, I am obliged to presume that the correct amounts of tax due are reflected on the Department’s most recently amended claim in bankruptcy. Pintozzi, 50 Ill. 2d at 127, 277 N.E.2d at 851; Department Ex. 2.

Based on the evidence, I cannot conclude that John Doe acted willfully by making a deliberate choice to use ABC Business’s available funds to pay creditors other than the

Department. On the other hand, the same evidence that was relevant to the issue of his status, duty, and authority to act for ABC Business strongly supports a conclusion that John Doe recklessly disregarded the very grave risk that ABC Business would not pay taxes for the periods for which it failed to file its Illinois returns during 2008. Department Ex. 1; Taxpayer Ex. 3A; Tr. pp. 15-16, 29-31, 38-39. The reasoning of the Seventh Circuit Court of Appeals in Wright v. United States (paraphrased in Ghandour, *supra*, pp. 20-21), and of the Illinois Supreme Court in Branson is similarly applicable here. Wright v. United States, 809 F.2d 425, 427 (7th Cir. 1987); Branson, 168 Ill. 2d at 267, 659 N.E.2d at 971 (“we do not intend to imply that a corporate officer who is responsible for filing retailers’ occupation tax returns and remitting the collected taxes may avoid personal liability under section 13½ merely by delegating bookkeeping duties to third parties and failing to inspect corporate records or otherwise failing to keep informed of the status of the retailers’ occupation tax returns and payments.”). John Doe was a responsible officer who clearly ought to have known that there was a grave risk that ABC Business’s Illinois taxes were not being paid for the months regarding which it failed to file returns, and he was in a position to find out for certain very easily. Department Ex. 1; Taxpayer Ex. 3A; Tr. pp. 38-39.

On the other hand, the evidence does not reflect that John Doe acted willfully for the entire audit period. First, and as discussed earlier, John Doe cannot have acted willfully regarding the months of November and December 2008, because he was no longer a responsible officer of ABC Business on the dates the returns were due for those months.

Second, I do not recommend that the Director find that John Doe acted willfully for failing to pay the tax, penalties and interest that the Department determined were due regarding the months before ABC Business stopped filing its monthly returns. That recommendation is based on the following facts, which are supported by the Department’s own records.

The Department issued its NTL to ABC Business in May 2009 (Department Ex. 1, p. 7), which became final on July 29, 2009. Department Ex. 2 (identifying the taxes assessed on July 29, 2009). All of the tax determined to be due from ABC Business during the periods for which it had previously filed monthly Illinois returns, and paid Illinois taxes shown due on such returns, was determined long after John Doe resigned from ABC Business. Department Exs. 1-2.

Section 3-7 authorizes the imposition of a personal liability penalty where a responsible officer 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. 35 ILCS 735/3-7. To the extent that John Doe had managerial oversight of Jack Black, the person who prepared, signed and filed ABC Business's Illinois monthly returns during the periods for which ABC Business filed them, the evidence shows that John Doe's management oversight had the effect of causing ABC Business to willfully file its monthly returns, and to willfully pay its tax liabilities for those months. Department Ex. 1, pp. 2-3. Thus, the same evidence cannot support a conclusion that John Doe willfully failed to file ABC Business's returns for those months, or that he willfully failed to pay the taxes ABC Business paid.

There is only one other type of willful action that can trigger liability, and that is if a responsible officer willfully attempts in any other manner to evade or defeat the tax. 35 ILCS 735/3-7. The evidence, however, does not support a conclusion that John Doe acted willfully in that manner. In Department of Revenue v. Corrosion Systems, Inc., 185 Ill. App. 3d 580, 584-85, 541 N.E.2d 858, 861 (4<sup>th</sup> Dist. 1989), the Illinois appellate court wrote:

There is support in the Federal sector for excusing personal liability on the ground of mistaken belief of whether the tax was owed. "[N]o showing of evil motive or intent to defraud the United States is required [citation]; but it must be shown that the responsible officer knew the taxes were due." (*Alioto*, 593 F.Supp. at 1406.) In *Alioto*, a corporate officer argued, among other things, that he was simply unaware that taxes were due on a certain date.

While finding a factual dispute as to what the officer actually knew, the court stated: “If [the officer] was not aware that the taxes were due, then he would be entitled to prevail as a matter of law.” (*Alioto*, 593 F.Supp. at 1407.) Apparently, the rule under Federal law is that the government must show the officer knew the taxes were due in order to establish willfulness. We consider the rule based on reason and now adopt it.

Corrosion Systems, Inc., 185 Ill. App. 3d at 584-85, 541 N.E.2d at 861.

Here again, the evidence shows that ABC Business filed its returns, and paid its taxes, for the months of August 2007 through June 2008. Department Ex. 1, pp. 2-3. The Department knew that John Doe had no personal responsibility for the actual preparation of ABC Business’s monthly returns, or for signing the ABC Business checks drawn to pay those taxes. Taxpayer Ex. 1, p. 17 (copy of the Department’s [NPL] checklist). Rather, he had oversight authority over the person who did prepare such returns. Tr. p. 38. In short, the evidence shows that John Doe did not know, or recklessly disregard any grave risk, that Jack Black may have been incorrectly calculating the amount of tax that should have been shown due on the monthly returns that ABC Business filed, and paid, regarding those months. Department Ex. 1, pp. 2-3; Taxpayer Ex. 1, pp. 10, 16-17; Corrosion Systems, Inc., 185 Ill. App. 3d at 584-85, 541 N.E.2d at 861.

**Conclusion:**

Based on the evidence, I conclude that John Doe recklessly disregarded the grave risk that ABC Business would not pay the tax due for the months of July through October 2008, because ABC Business failed to file its monthly returns for those periods. He was a responsible officer who acted willfully regarding ABC Business’s tax liabilities for those months. I respectfully recommend that NPL number XXXX be revised to eliminate any tax, penalties and interest except for the amounts due regarding those four months, and that it be finalized as so revised.

December 30, 2013

John E. White  
Administrative Law Judge