

ST 14-12

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
1002D 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; ABC Businessert Ferolie, Esq. on behalf of JOHN DOE.

Synopsis:

This matter arose after the Illinois Department of Revenue (“Department”) issued a notice of penalty liability, NPL Penalty ID number XXXX and a notice of section 1002(d) penalty, 1002D Penalty ID number XXXX to JOHN DOE (“taxpayer”) regarding the corporate liability of ABC Business Inc. The taxpayer timely protested these notices and requested a hearing on the liabilities set forth therein. Pursuant to the prehearing order entered in this case, the parties identified the issues to be resolved at hearing as “whether taxpayer [JOHN DOE] is a responsible officer and willfully failed to file returns and/or pay taxes.” The issues presented arise pursuant to the provisions of 35 ILCS 735/3-7 which penalizes persons responsible for corporate affairs who “willfully” fail to comply with the state’s tax laws.

A hearing on this matter was held on January 31, 2014 during which the Department presented documentary evidence and the taxpayer testified. Following a review of the taxpayer's testimony and the documents of record, it is recommended that the notice of penalty liability and the notice of section 1002(d) penalty issued to the taxpayer be affirmed and finalized as issued. 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, including all jurisdictional elements, was established by the admission into evidence of the Department's notice of penalty liability NPL Penalty ID number XXX and the Department's notice of section 1002(d) penalty 1002D Penalty ID number XXXX issued May 29, 2012 for the period 7/09 through 6/10. Department Exhibit ("Ex.") 1. The basis of both of these penalty liability notices is unpaid sales, use and withholding taxes due and owing the State by ABC Business Inc. ("ABC BUSINESS"). *Id.*
2. During the period July 1, 2009 through June 30, 2010 (the "tax period"), the taxpayer was an employee, officer, Director and part owner of ABC BUSINESS, a corporation which owned and operated the Happy restaurant located in Anywhere, Illinois. Transcript ("Tr.") pp. 8-10, 13, 22-24; Department Ex. 2. During this period, ABC BUSINESS failed to pay sales and use tax due to the Department in the amount of \$XXXX and failed to pay to the Department withholding tax due in the amount of \$XXXX. Department Ex. 1.
3. The taxpayer owned 25% of the company's stock during the entire tax period in controversy.

¹ Tr. pp. 13, 14; Department Ex. 2.

¹ While the taxpayer testified that he did not become a shareholder until 2010 (Tr. pp. 9-13), as pointed out by the Department's counsel (Tr. pp. 20-22) this testimony is directly contradicted by ABC Business' Federal income tax return for 2009 which indicates that the taxpayer held a 25% investment in this company during that year. See Department Ex. 2.

4. The taxpayer served as the company's secretary beginning in 2010 and was a signatory on the company's checking account, with authority to execute and issue company checks, at that time. Tr. pp. 22, 28, 29; Department Ex. 2. The taxpayer also served as a Director of the company in 2010. Department Ex. 2.
5. In addition to being an investor in ABC BUSINESS, the taxpayer was also a compensated employee of the company and was present at the Happy restaurant ABC BUSINESS owned and operated whenever it was open. Tr. pp. 11, 14, 23, 24.
6. The taxpayer had access to ABC BUSINESS's financial records, and was aware of the company's poor financial condition throughout the tax period in controversy. Tr. pp. 25-32.
7. During 2009, the Happy restaurant ABC BUSINESS owned and operated was managed by Jack Black. Tr. pp. 10, 23. During 2010, it was managed by Harry Berry ("Harry Berry"). Tr. p. 29. Harry Berry was a part owner of ABC BUSINESS, and Jack Black was the son of Fred Black, who was also a part owner of the company. Tr. pp. 10, 11.
8. The taxpayer was hired by ABC BUSINESS because of his restaurant industry experience and was routinely asked for advice regarding the company owned restaurant's finances. Tr. pp. 11, 23, 26-32.
9. The taxpayer regularly met with ABC BUSINESS's managers and other owners regarding expenditures by ABC BUSINESS to operate its restaurant. Tr. pp. 26-31. As a result of these consultations, the taxpayer became aware in 2009 that the company was not timely paying all of its creditors. *Id.*

Conclusions of Law:

Illinois law provides that the Department may assess a tax penalty imposed by section 3-7 of the Uniform Penalty and Interest Act ("UPIA"), 35 ILCS 735/3-7 ("section 3-7") against

certain individuals for the unpaid Retailers' Occupation Tax (i.e. sales tax), use tax and withholding tax liability of a corporation. Specifically, this provision states, in part, as follows:

- (a) 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.
35 ILCS 735/3-7

The record indicates that finalized tax liabilities for unpaid sales, use and withholding tax were assessed ABC Business Inc. ("ABC BUSINESS") as the owner and operator of the Happy restaurant located in Anywhere, Illinois for the period July 1, 2009 through June 30, 2010 and that JOHN DOE ("taxpayer") was a Director, officer, employee and 25% shareholder of the company during that time.² Tr. pp. 8-10, 13, 22-24; Department Ex. 2. Accordingly, given the mandate of section 3-7, the issue to be decided in this case is whether the taxpayer should be held personally liable as a responsible officer for ABC BUSINESS's unpaid sales, use and withholding tax for the tax period at issue.

To impose personal liability for the failure to pay sales, use and withholding tax under section 3-7, it must be shown that the person being penalized is a responsible party and that the failure to pay was willful. 35 ILCS 735/3-7. By introducing the notice of penalty liability and the notice of section 1002(d) penalty at issue into evidence, the Department established its *prima facie* case against the taxpayer. *Id.* In Branson v. Department of Revenue, 168 Ill. 2d 247 (1995), the Illinois Supreme Court held that the admission of a notice of liability as a "responsible officer" into evidence established all of the statutory requirements for imposition of

² The taxpayer became the company's Secretary and a Director of the company in 2010. Tr. p. 22; Department Ex. 2.

the personal liability penalty, including willfulness. While the Court was addressing ¶452 ½ which was a provision that preceded Section 3-7 of the UPIA, a comparison of all of these provisions reveals that they are almost identical, and all enumerate corporate officer and employee penalty liability. Moreover, all of these provisions address willfulness and responsibility. Therefore, a similar analysis of section 3-7 of the UPIA, based on the court's conclusions may be made. Frowner v. Chicago Transit Authority, 25 Ill. App. 2d 312 (1st Dist. 1960).

Applying Branson, the notice of penalty liability and the notice of section 1002(d) penalty introduced by the Department established the Department's *prima facie* case that the taxpayer was a responsible officer who willfully failed to pay sales, use and withholding tax during the tax period at issue in this case. The burden then shifted to the taxpayer to overcome the presumption of liability through sufficient, competent evidence that he was not a responsible officer, or that his actions were not willful. *Id.*

The taxpayer argues that he was not a responsible party during any portion of the tax period in controversy. Tr. pp. 5, 42, 43. Therefore, he argues that liability for the taxes that have been assessed cannot attach to him. *Id.*

Personal liability under section 3-7 of the UPIA is imposed on one who is "responsible" for the filing of tax returns and payment of taxes shown to be due thereon, who willfully fails to file and/or pay such taxes. Neither this provision nor its predecessor provision, defines "responsible" person or "willful" conduct. However, the Illinois Supreme Court, in cases wherein it has considered personal liability, has referred to interpretations of similar language in section 6672 of the Internal Revenue Code (26 U.S.C. §6672), which imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social

security and Federal income withholding taxes. Branson, supra; Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19 (1985); Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568 (1977).

Federal courts have addressed officer/ employee liability with respect to who is considered “responsible” for section 6672 purposes. The courts have considered specific facts in determining whether individuals were “responsible” for the payment of employee taxes, to wit: 1) the duties of the officer as outlined in the corporate by-laws; 2) the ability of the individual to sign checks of the corporation; 3) the identity of the officers, directors, and shareholders of the corporation; 4) the identity of the individuals who hired and fired employees; and, 5) the identity of the individuals who were in control of the financial affairs of the corporation. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), cert. den. 400 U.S. 821 (1970); Gephart v. United States, 818 F. 2d 469 (6th Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990).

Responsible persons may be those with check writing authority who may or may not be the ones with the responsibility for accounting, bookkeeping or the making of payments to creditors. Monday, supra; Wright v. United States, 809 F. 2d 425 (7th Cir. 1987); Calderone v. United States, 799 F. 2d 254 (6th Cir. 1986). There may be more than one responsible person in a corporation. Monday, supra; Williams v. United States, 931 F. 2d 805, 810 n.7 (11th Cir. 1991).

In determining whether a person is a responsible officer, the courts have indicated that liability is not in all cases limited to those who occupy formal corporate office or traditional employee status. Fiataruolo v. United States, 8 F. 3d 930, 939 (2nd Cir. 1993) (“It should be noted that a person need not hold any particular position in a business and need not actually

exercise authority to be held a responsible party for the payment of withheld taxes.”); Adams v. United States, 504 F. 2d 73 (7th Cir. 1974). Rather, liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. Monday, supra.³

The record indicates that the taxpayer was a part owner of ABC BUSINESS and held a 25% equity stake in the company. Tr. pp. 13, 14; Department Ex. 2. It also indicates that he was an employee of the company and that he became a company Director and the company’s secretary during 2010. Tr. pp. 22, 28, 29; Department Ex. 2. The taxpayer further testified that, commencing in 2010, he possessed the authority to write checks drawn on the company’s account and there is no evidence that he needed the approval of any of the other officers or owners to exercise this authority. Tr. pp. 28, 29.

While the taxpayer testified that he had no involvement in or authority over the company’s tax compliance (Tr. pp. 11, 12, 16), he introduced no documentary evidence (e.g. corporate by-laws, bank authorizations or employment contracts) to corroborate his claims. Moreover, he introduced no evidence of any kind to explain why his authority as a part owner of ABC BUSINESS and an officer of the company beginning in 2010 was circumscribed or limited in this manner. Since the company’s other owners were involved in the company’s tax compliance (Tr. pp. 11, 12, 16) it is unclear why the taxpayer did not also have the same managerial responsibility and authority.

³ Throughout the trial proceedings in this case, the taxpayer contended that other owners of ABC Business, rather than the taxpayer, were responsible for the company’s tax compliance during the tax period at issue. Tr. pp. 11, 12, 16, 42, 43. However, section 3-7 expressly provides for joint and several liabilities in cases of this nature, providing that personal liability may be imposed on “[A]ny [responsible] officer or employee ... who willfully fails” to perform his legally obligated responsibilities. (Emphasis added). Accordingly, taxpayer’s argument in this regard is without basis.

Moreover, the record also indicates that, no later than 2010, the taxpayer acquired the authority to sign corporate checks. Tr. p. 28. 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 (E.D.N.Y. 1981), aff'd 671 F. 2d 492 (2d Cir. 1982). Individuals who hold corporate office, as the taxpayer did, who have the authority to make disbursements are presumptively responsible persons for purposes of 26 U.S.C. section 6672, the federal responsible officer statute. Hildebrand v. United States, 563 F. Supp. 1259 (D.C.N.J. 1983).

The taxpayer also testified that he had no authority regarding decisions concerning which creditors of the company would be paid or not paid. Tr. pp. 25, 26, 28, 29. However, the record indicates that the taxpayer had more experience in the restaurant business than the company's other owners. Tr. p. 11. Given the foregoing, I do not find credible the taxpayer's claim that he chose to cede to other, less experienced owners of the company complete authority to make decisions as to which creditors to pay.

The taxpayer, as a twenty five percent owner of ABC BUSINESS, had a significant stake in the corporation. Given this significant investment interest, I do not find it credible that he would have abdicated all authority to protect his investment by having no say in the company's expenditures, tax compliance and other financial affairs.

An additional indication of the level of the taxpayer's involvement in the company's financial decisions is his testimony that he regularly conferred with the other part owners of the corporation regarding the payment of the company's bills. Tr. pp. 26-31. This level of interaction is inconsistent with the degree of oversight one would expect were the taxpayer simply a passive investor in the company. Accordingly, I do not find credible the taxpayer's

claim that he had no right to participate in decisions regarding whether taxes or other expenses of the corporation would or would not be paid.

For the reasons enumerated above, I find that the taxpayer has failed to prove that he did not have any control over the business affairs of the corporation and its expenditures. Based on the record, I cannot conclude that the taxpayer has presented any credible evidence that rebutted the Department's presumptively correct determination that he was an officer of ABC BUSINESS who shared control with the company's other owners over its financial affairs including the ability to see to it that the company's taxes were paid. Indeed, to the contrary, I infer from the pertinent testimony that the taxpayer, as a corporate officer, Director and 25% shareholder having the authority to sign corporate checks, possessed many indicia of a responsible officer under criteria for making this finding that have been established by the courts. As a consequence, I conclude that the taxpayer was a "responsible" officer under Section 3-7 of the UPIA.

Even though the Department has established that the taxpayer was a responsible officer of ABC BUSINESS, no liability can attach to his conduct as a responsible officer unless he acted "willfully" in failing to pay the company's taxes. Section 3-7. The willfulness requirement "is satisfied if the responsible person acts with reckless disregard of a known risk that the trust funds may not be remitted to the Government[.]" Garsky v. United States, 600 F. 2d 86 (7th Cir. 1979). A high degree of recklessness is not required because if it were, the purposes of the statute could be frustrated simply by delegating responsibilities within a business and adopting a "hear no evil – see no evil" policy. See Wright, *supra* at 427. (A '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."). Willfulness can be established by a showing of gross negligence as in a situation in which a responsible party ought

to have known of a grave risk of nonpayment and is in a position to easily find out, but does nothing. See Branson, *supra*.

In this case, the taxpayer testified that he was aware of the company's financial problems. Tr. pp. 26-31. He knew that the company was having cash flow problems and that many of its bills were not being timely paid. *Id.* Even with this knowledge, the record contains no evidence that the taxpayer ever asked the company's other officers and owners what bills were being paid and what bills were not being paid during the tax period in controversy. Rather, as he would have one believe, during the tax period at issue, he simply allowed them to make decisions regarding creditor payments and did not demand that creditor delinquencies, including tax delinquencies, be addressed. Nor is there any evidence that during the tax period in controversy, he inspected the corporation's records or insisted upon being kept informed of the company's tax situation. The fact that the taxpayer may have adopted a "hear no evil – see no evil" policy does not relieve him of liability. Wright, *supra*. Rather, his failure to see that the company's tax obligations were met during the tax period at issue, a period when he knew that ABC BUSINESS was experiencing financial hardships, is sufficient to establish willfulness within the context of the statute.

The taxpayer attempts to rebut the presumption of willfulness through testimony that other owners of the company were delegated complete responsibility for payment of the company's taxes. Tr. pp. 11-13, 16. However, the courts have consistently rejected such evidence as a defense to a finding of willfulness by holding that a responsible person cannot escape an obligation to ensure that taxes are paid by delegating this responsibility to others. Wright, *supra*; Mazo v. United States, 591 F. 2d 1151 (5th Cir. 1979). Applying the criteria enumerated in these cases and the cases noted above, and based on the evidence and testimony

summarized above, I conclude that the taxpayer has failed to rebut the Department's *prima facie* case that he acted willfully in failing to remit the taxes in controversy. Accordingly, I find that the taxpayer is liable for the tax penalties that have been assessed.

WHEREFORE, for the reasons stated above, it is my recommendation that the notice of penalty liability and the notice of section 1002(d) penalty at issue in this case be affirmed and finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: April 28, 2014