

ST 14-14

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 5/12-7/12
1002D Penalty ID XXXX
Period 9/12

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Heidi Scott on behalf of the Illinois Department of Revenue; JOHN DOE, *pro se*.

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 requested and was granted an initial review of these assessments pursuant to 86 Ill. Admin. Code, ch. I, section 200.175. Pursuant to the prehearing order entered in this case, the parties identified the issues to be resolved at hearing as whether the taxpayer had “control, supervision or responsibility of filing returns and making Illinois withholding income tax payments and sales tax payments during the periods May 1, 2012 through September 30, 2012” and whether the taxpayer “willfully fail[ed] to file returns and

make payments to the Department, or ...willfully attempt[ed] in any manner to evade or defeat the tax.”

A hearing in this matter was held on March 29, 2014 during which the Department and the taxpayer 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 XXXX and the Department’s notice of section 1002(d) penalty 1002D Penalty ID number XXXX issued February 8, 2013 for the period 5/12 through 9/12. Transcript of March 29, 2014 hearing (“Tr.”) pp. 9-11; Department Exhibit (“Ex.”) 1. The basis of these penalty liability notices is unpaid sales, use and withholding taxes due and owing to the State by ABC Business, Inc. (“ABC Business”). *Id.*
2. ABC Business was founded by the taxpayer and his business partner, Jack Black, as XYZ Company Inc. in 1989. Tr. p. 7; Department Ex. 2. In 1993, Jack Black transferred his interest in ABC Business to Jane Doe, the taxpayer’s wife, after which the taxpayer and his wife each held a 50% interest in the company. Tr. pp. 33, 47.
3. The taxpayer was an officer of ABC Business and a member of its Board of Directors from its inception in 1989 until 2010. Tr. pp. 19-21; Department Ex. 2; Taxpayer’s Ex. 2, 3.

4. Pursuant to a Bill of Sale and Transfer Statement dated January 23, 2009, the taxpayer transferred his entire ownership interest in ABC Business to his wife, Jane Doe, giving her complete control of the company, and the taxpayer had no ownership interest in ABC Business during the tax period in controversy. Tr. p. 20; Taxpayer Ex. 4.
5. In addition to owning ABC Business, Jane Doe also owned DEF Business of Illinois, Inc. (“DEF Business”). Transcript of Hearing Proceedings held 7/26/11 in Department of Revenue v. JOHN DOE, Gene Green, Terry Berry and Jane Doe, Administrative Hearing Decision No. XXXX, Illinois Department of Revenue, Office of Administrative Hearings, January 12, 2012 (“7/26/11 Transcript”) pp. 138, 139, 168, 190.¹ During tax years preceding the tax period in controversy, the Chief Financial Officer (“CFO”) of both of these companies was Terry Berry. 7/26/11 Transcript pp. 188, 191. Gene Green also was responsible for the financial affairs of these companies and kept their books and records in tandem along with the books and records of GHI Business Inc. (“GHI Business), another company the taxpayer’s wife owned. 7/26/11 Transcript pp. 31, 222, 226-228. The taxpayer was the President of DEF Business. JOHN DOE, Gene Green, Terry Berry and Jane Doe, *supra*.
6. Terry Berry prepared the tax returns for both DEF Business and ABC Business. 7/26/11 Transcript p. 223; JOHN DOE, Gene Green, Terry Berry and Jane Doe, *supra*, p. 10.
7. The management of DEF Business engaged in weekly management oversight of the business activities of ABC Business. 7/26/11 Transcript p. 258.
8. The accounting functions of ABC Business were under the direct control of DEF Business personnel. 7/26/11 Transcript pp. 134, 135, 265-267.

¹ At the request of the Department, and without objection, this transcript of an earlier hearing proceeding involving the taxpayer has been included in the record as Department Ex. 4. Tr. pp. 15-17.

9. During the period 12/06 through 3/08, DEF Business failed to pay payroll taxes due and owing to the State of Illinois. Department of Revenue v. JOHN DOE, Gene Green, Terry Berry and Jane Doe, supra. As a result of that company’s failure to pay taxes, in January 2012 the taxpayer as President of DEF Business, Jane Doe, the sole shareholder of DEF Business and of ABC Business, and Terry Berry and Gene Green, the managers of the financial affairs of both DEF Business and ABC Business, were determined to be responsible officers and held to be liable for the unpaid taxes of DEF Business noted above. *Id.*
10. The taxpayer had the power to execute checks drawn on ABC Business’s account with the Standard Bank, and signed at least 34 such checks during the tax period in controversy. Tr. pp. 37-40, 47-49; Department Ex. 3. None of these checks were issued to the Department to cover ABC Business’s tax liability for this tax period. Department Ex. 3.

Conclusions of Law:

Section 3-7 of the Uniform Penalty and Interest Act (“UPIA”), 35 ILCS 735/3-7 (“section 3-7”) provides, 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 in the instant case indicates that finalized tax liabilities for unpaid sales, use and withholding tax were assessed against ABC Business, Inc. (“ABC Business”) for the period 5/12 through 9/12, and that JOHN DOE (“taxpayer”) was involved in the operation of this company during that time. Tr. pp. 22, 37-41. 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 the company's unpaid sales, use and withholding taxes 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 the imposition of 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).

For guidance in determining whether a person is responsible under section 3-7, the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal Revenue Code (28 U.S.C. § 6672). See Branson, *supra* at 254-55; Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19, 29-30 (1985). Federal case law states that the critical factor in determining responsibility is whether the person had “significant” control over the corporation's finances. See Purdy Co. of Illinois v. United States, 814 F. 2d 1183, 1191 (7th Cir. 1987) (“It is sufficient that the person involved have significant control over the disbursement of corporate

funds.”). Significant control does not mean exclusive or absolute control over the disbursement of funds. Thomas v. U.S., 41 F. 3d 1109, 1113 (7th Cir. 1994) (“Having significant control does not mean having exclusive control over the disbursement of funds or the final say over whether taxes or bills are paid.”). All that is required is that the person could have impeded the flow of business payments necessary to prevent the corporation from squandering the taxes that it should have paid to the Department. *Id.*

Once the Department presents its *prima facie* case, the burden shifts to the taxpayer to establish that one or more of the elements of the penalty are lacking, i.e., that the person charged was not a responsible party, or that the person’s actions were not willful. Branson, *supra* at 261. In order to overcome the Department’s *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the accuracy of the Department’s assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1st Dist. 1988). The person must present evidence that is consistent, probable, and identified with the respondent’s books and records, i.e. documentary evidence, to support its claim. *Id.*

In the present case, the taxpayer failed to present sufficient documentary evidence to show that he did not have significant control over the corporation’s finances. To rebut the Department’s *prima facie* case, the taxpayer offered documentary evidence to show that he ceased to be an officer, director or shareholder of ABC Business prior to the tax period in controversy. Taxpayer’s Ex. 2-4. The record in this case indicates that the taxpayer divested himself of his entire ownership interest in the company on January 23, 2009 pursuant to a Bill of Sale and Transfer Statement which the taxpayer executed on that date. Taxpayer’s Ex. 4. The taxpayer also testified that at or about the same time as his stock divestiture, he ceased to be a corporate officer and director. Tr. pp. 19-21. I find that this testimony is corroborated by the

company's annual reports that were filed subsequent to the taxpayer's stock divestiture indicating that the only officer at that time was the taxpayer's wife, Jane Doe. Taxpayer's Ex. 2, 3.

The documentation entered into the record shows that, prior to the tax period in controversy, the taxpayer had severed all of his prior formal relationships with the company. From the evidence presented by the taxpayer, I deduce that his claim for relief in this case is that he should not be held liable as a responsible person because he had no formal affiliation with the company during the tax period at issue, serving only as an unpaid consultant. Tr. p. 40. However, in determining whether a person is responsible, the courts have indicated that liability is not in all cases limited to those who occupy formal corporate 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 v. United States, 421 F. 2d 1210 (7th Cir. 1970), cert. den. 400 U.S. 821 (1970).

While the taxpayer testified that he had no authority over the company's tax compliance (tr. pp. 22, 23), he introduced no documentary evidence (e.g. corporate by-laws or bank authorizations) to corroborate this claim. Moreover, he introduced no evidence of any kind to explain why his authority was limited in this manner even though he was a founder and long time owner of the company, and presumably possessed far more expertise regarding the company's affairs than his wife, the company's only officer.

Moreover, the record indicates that, after ceasing to be an officer and director, the taxpayer nevertheless continued to possess and exercise authority to sign corporate checks during

the tax period in controversy. Tr. pp. 37-40; Department Ex. 3. 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). The taxpayer's ability to sign corporate checks leads to the reasonable conclusion that the taxpayer was connected closely enough to the corporation's finances that he could have paid the taxes the company collected that were due and owing and thereby prevented the company's failure to pay taxes from occurring. The ability to prevent the corporation from squandering the corporation's collected taxes paying other bills is an indicia of significant control. Thomas, supra. For this reason I conclude that the taxpayer had significant control over the corporation's finances under one of the tests for making this determination enumerated in the federal case law. *Id.*

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. 22, 23. However, the record indicates that the taxpayer was a founder of the company and presumably had far more experience with the company's operations than his wife, the company's only officer during the tax period in controversy. Tr. p. 7; Department Ex. 2. Given the foregoing, I do not find credible the taxpayer's claim that he chose to cede to her complete authority to make decisions as to which creditors to pay. Consequently, I have accorded no weight to the taxpayer's claim that he had no right to participate in decisions whether taxes or other expenses of the corporation would or would not be paid.

With the exception of evidence that the taxpayer ceased to occupy a formal position with the company during the tax period in controversy (which does not absolve the taxpayer of liability), the only other evidence supporting the taxpayer's claim that he was not a responsible

officer is the taxpayer's own testimony that he was not in control of the company's finances or tax compliance. Tr. pp. 19-23. This mere testimony 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 v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991); A.R. Barnes & Co., supra; Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978); 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 exclusively vested in the company's officers, or bank cards or other bank records showing that the taxpayer did not have the authority to direct the payment of tax bills without the additional authorization of a company officer 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 Business during the tax period at issue.

As previously noted, by Illinois statute, personal liability will be imposed 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. Section 3-7. The Department's *prima facie* case presumes willfulness. Branson, supra at 262. To rebut this presumption, the person defending against the penalty must adduce sufficient evidence to disprove willful failure to file returns and pay taxes. *Id.* A responsible person cannot prove lack of willfulness simply by denying awareness of a tax deficiency that could have easily been investigated by an inspection of corporate records. *Id.* at 267.

Cases define "willful" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks. Branson, supra at 254-56; Heartland, supra at 29-30. Willful conduct does not require bad purpose or intent to defraud the

government. Branson, *supra* at 255; Heartland, *supra* at 30. Rather, 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, 91 (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 v. United States, 809 F. 2d 425, 427 (7th Cir. 1987) (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*.

The record in this case indicates that, in addition to ABC Business, the taxpayer's wife also owned DEF Business of Illinois, Inc. (“DEF Business”), a company headed by the taxpayer. 7/26/11 Transcript pp. 138, 139, 168, 190; JOHN DOE, Gene Green, Terry Berry and Jane Doe, *supra*. Both of these companies were previously at least 50% owned by the taxpayer, and his transfer of his stock in both to his wife related to the taxpayer’s personal bankruptcy which occurred in 2008. Tr. p. 20; 7/26/11 Transcript 209-210. Moreover, the record is replete with evidence that the financial management of both of these companies was the same and that the financial matters of these companies were undertaken in tandem by jointly managing the finances of these companies. 7/26/11 Transcript pp. 134, 188, 223, 226-228, 258, 265-267.

Within five years before ABC Business’s failure to pay taxes in the instant case, DEF Business, a company whose tax compliance was jointly managed with ABC Business’s by the same persons that filed ABC Business’s tax returns, failed to file returns and pay taxes due and

owing for the period 12/06 through 3/08. JOHN DOE, Gene Green, Terry Berry and Jane Doe, supra.² As a consequence of this non-compliance, the taxpayer, as President of DEF Business, his wife, DEF Business's owner, Terry Berry, who served as the CFO of both ABC Business and DEF Business and Gene Green, who was also responsible for managing the financial affairs of both companies, were determined to be liable as responsible officers as a consequence of their managerial lapses that contributed to DEF Business's failure to pay taxes. *Id.* The determination of responsible officer liability involving the taxpayer, his wife and two of the managers of financial affairs at both DEF Business and ABC Business was made in January 2012, four months before the beginning of the period during which ABC Business failed to file returns and pay taxes giving rise to the instant case. *Id.* Given that the financial governance and tax compliance of DEF Business and ABC Business, both companies owned by the taxpayer's wife, were completely integrated, and managed by the same financial managers, the problems at DEF Business should have alerted the taxpayer of a grave risk that taxes due from ABC Business were also not being properly attended to. This is particularly true in light of the fact that the taxpayer's wife, who was President of ABC Business during the period at issue here, and both of the previous managers of ABC Business's financial affairs were found liable as responsible officers of DEF Business for failing to properly manage the tax compliance obligations of that company.

Even with the knowledge that another company owned by his wife and having the same persons responsible for tax compliance as ABC Business had failed to pay taxes, the record contains no evidence that the taxpayer ever asked his wife, the President of ABC Business, or the managers of ABC Business's financial affairs if any tax bills were not being paid during the tax

² The record in this case indicates that Terry Berry, the CFO of both DEF Business and ABC Business, prepared tax returns for both of these companies. 7/26/11 Transcript p. 223; JOHN DOE, Gene Green, Terry Berry and Jane Doe, supra, p. 10.

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 tax delinquencies be revealed or 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. On the contrary, his failure to see that the company's tax obligations were met when he knew that another company having integrated management and tax compliance with ABC Business had previously defaulted on its tax liabilities is sufficient to establish willfulness within the context of the statute.

The taxpayer attempts to rebut the presumption of willfulness through testimony that his wife exercised complete responsibility for payment of the company's taxes. Tr. pp. 19-23. 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).

The Courts have also found that giving preferential treatment to other creditors rather than paying the corporation's known tax liabilities constitutes willful behavior as a matter of law. Heartland Investments, supra. See also Department of Revenue v. Joseph Publick & Sons, 68 Ill. 2d 568 (1979); Ruth v. United States, 823 F. 2d 1091 (7th Cir. 1987). The record indicates that the taxpayer had the authority to issue corporate checks and was, therefore, in a position to direct that the taxes be paid. Tr. pp. 37-40, 47-49; Department Ex. 3. There is also evidence in the record that the taxpayer paid other bills with the available funds rather than the company's taxes. Department Ex. 3. During the hearing the taxpayer produced no evidence other than his own self

-serving testimony denying any knowledge of unpaid taxes to negate the obvious inference from the record that his preferential payment of funds to other creditors while taxes remained unpaid amounted to willfulness as a matter of law under Heartland.

While the taxpayer testified that he had no knowledge of the company's financial condition, no access to the company's books and records, no knowledge that the company's taxes had not been paid and no authority to pay them, given the taxpayer's continuing involvement in the company's operations after ceasing to be an officer and director of the company, I do not find this testimony to be credible. The taxpayer's connection with the business and to the President and sole officer of the company, his wife, indicates that he was clearly in a position to know both the financial condition of the company and that there was a grave risk that the taxes were not being paid. Moreover, the only evidence supporting the taxpayer's claim that he did not know taxes were due and therefore did not act willfully is the taxpayer's testimony. As previously noted, the taxpayer had the burden to produce more than his own self serving testimony denying the Department's assessment to rebut the Department's *prima facie* case. Jefferson Inc. Co., *supra*; Mel-Park Drugs, *supra*; A.R. Barnes & Co., *supra*; Masini, *supra*; Copelivitz., *supra*. In the instant case, the record contains no documentary evidence (e.g. the corporation's by-laws, corporate minutes or other documentation indicating that the taxpayer had limited authority and no access to the company's books and records) that would substantiate the taxpayer's claim that he did not know that the company's taxes were unpaid when he preferred other creditors over the company's tax obligations. Consequently, the taxpayer has failed to show that he did not act willfully as a matter of law when he paid other creditors rather than the Department.

In sum, in the instant case, the taxpayer has failed to produce any evidence other than his own testimony that his actions were not willful. Accordingly, the Department's *prima facie* case for willfulness stands un rebutted.

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: June 5, 2014