

ST 14-19

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
ANYWHERE, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE,
Taxpayer**

**No. XXXX
Account ID XXXX
NPL Penalty ID XXXX
Period 6/09-12/11
1002D Penalty ID XXXX
Period 9/09-9/11
Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General George Foster on behalf of the Illinois Department of Revenue; Akram Zanayed, Esq. on behalf of JOHN DOE.

Synopsis:

This matter is before this administrative tribunal pursuant to a protest filed by JOHN DOE (“taxpayer”) of notice of penalty liability NPL Penalty ID number XXXX and of notice of section 1002(d) penalty 1002D Penalty ID number XXXX issued by the Illinois Department of Revenue (“Department”) on January 29, 2013 for the period 6/09 through 12/11. These notices were issued to JOHN DOE (“taxpayer”) as a responsible officer of ABC BUSINESS Inc. pursuant to section 1002(d) of the Illinois Income Tax Act and section 3-7 of the Uniform Penalty and Interest Act.

The issues to be resolved are: (1) whether the taxpayer was as responsible officer of ABC BUSINESS Inc. and thereby required to collect, truthfully account for and pay over the taxes

involved; and (2) whether the taxpayer willfully failed to collect, truthfully account for and pay over such taxes.

A hearing to consider this matter was held on May 15, 2014 during which the taxpayer and Jack Black testified, and both parties presented documentary evidence. Upon consideration of all of the evidence presented at the hearing, it is recommended that this matter be resolved in favor of the taxpayer.

Findings of Fact:

1. The *prima facie* case of the Department consisting of the notice of penalty liability and the notice of section 1002(d) penalty issued in this case was established by the admission into evidence of the Department's Exhibit ("Ex.") No. 1. The liability is for unpaid Retailers' Occupation Tax due and owing from ABC BUSINESS Inc. d/b/a XYZ Business ("XYZ BUSINESS") for the period 6/09 through 12/11 and for unpaid withholding taxes due and owing from ABC BUSINESS for the period 9/09 through 9/11. Department Ex. 1.
2. During the tax period in controversy, ABC BUSINESS operated a food and liquor store located in Anywhere, Illinois under the assumed name XYZ Business. *Id.*; Transcript ("Tr.") pp. 8, 9. The company was acquired by Jack Black ("Jack Black") in 2004. Tr. p. 9. It ceased doing business in 2013. Tr. pp. 14, 16, 17. During the tax period in controversy Jack Black was the President and sole operating officer of ABC BUSINESS. Tr. p. 28.

3. In 2007, Jack Black borrowed \$XXXX from the taxpayer pursuant to a loan agreement evidenced by a promissory note given by Jack Black to the taxpayer dated March 5, 2007. Taxpayer Ex. 1.
4. In order to provide assets to secure the indebtedness evidenced by the aforementioned promissory note, in 2007 Jack Black transferred 50% of the stock of ABC BUSINESS to the taxpayer. Tr. pp. 9, 30, 32-34. Although the taxpayer held 50% of the company's stock, he did not share in the company's profits and losses. Tr. pp. 9, 10, 28.
5. The taxpayer was not an employee of ABC BUSINESS. Tr. pp. 17.¹
6. Jack Black ran the day-to-day operations of ABC BUSINESS' food and liquor store business and supervised the company's tax and bookkeeping matters. Tr. pp. 17, 18, 28. The taxpayer was not involved in running the company's business affairs. Tr. pp. 28, 40.
7. The taxpayer did not sign any of ABC BUSINESS' tax returns that were filed during the tax period in controversy or pay any of the company's taxes. Tr. pp. 17, 28, 38, 39. The taxpayer was not involved in any way in the preparation of the company's tax returns or the payment of the company's taxes. Tr. pp. 28, 35, 36.
8. The taxpayer was not authorized to sign or issue company checks. Tr. pp. 36-38. However, the company instructed its bank to allow the taxpayer to endorse checks drawn on the company's bank account made payable to the taxpayer. *Id.*
9. The taxpayer first became aware of the sales tax and withholding tax liability of ABC BUSINESS when he received the notice of penalty liability and the notice of section 1002(d) penalty at issue on or about January 29, 2013. Tr. pp. 11, 42, 43.

Conclusion of Law:

¹ Jack Black, the President of ABC BUSINESS, testified that the taxpayer was not an employee of the company. Tr. p. 17. While the taxpayer testified that he was "on the payroll" of ABC BUSINESS, he also testified that he never did any work for the company and never received any salary or other compensation. Tr. p. 31.

There are two types of taxes at issue here. The Department seeks to impose personal liability upon JOHN DOE ("taxpayer") pursuant to section 1002(d) of the Illinois Income Tax Act for the failure to pay withholding taxes accrued and owing by ABC BUSINESS d/b/a XYZ BUSINESS, a food and liquor store located in Anywhere, Illinois. In addition, the Department seeks to impose personal liability on the taxpayer for his failure to remit Retailers' Occupation Tax due and owing from this company.

The personal liability penalty for both taxes is imposed by section 3-7 of the Uniform Penalty and Interest Act which provides 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

It is clear under this statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making tax payments; and (2) who "willfully" fails to file returns or make payments.

The admission into evidence of the notice of penalty liability and the notice of section 1002(d) penalty at issue establishes the Department's *prima facie* case with regard to both the fact that the taxpayer was a "responsible" officer and the fact that he "willfully" failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the Department's case. Masini v. Department of Revenue, 60 Ill. App. 3d 11, 15 (1st Dist. 1978).

The courts have found that the following facts are relevant in determining whether a person is responsible: (1) identity of the officers, directors, and shareholders of the corporation; (2) duties of the officers as outlined by the corporate by-laws; (3) ability of the individual to sign checks of the corporation; (4) identity of the individuals who were in control of the financial affairs of the corporation; and (5) identity of the individuals who hired and fired employees. Schwinger v. United States, 652 F. Supp. 464, 467 (E.D.N.Y. 1987) (citing Silberberg v. United States, 524 F. Supp. 744, 747 (E.D.N.Y. 1981)).²

In determining whether an individual is a “responsible” person, the courts have indicated that the focus should be on whether that person had significant control over the business affairs of the corporation and whether he or she participates in decisions regarding the payment of creditors and dispersal of corporate funds. Monday v. United States, 421 F. 2d 1210 (7th Circuit 1970), Cert, Den. 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that taxes are remitted to the government. Id. I conclude, based upon the testimony and evidence admitted into the record at the evidentiary hearing, that the taxpayer was not a responsible officer of ABC BUSINESS.

The taxpayer contends that he was only a passive investor in ABC BUSINESS and had nothing to do with the management and operation of this company. Tr. p. 45. In support of this contention, the taxpayer introduced into the record a one paragraph promissory note issued to the taxpayer by Jack Black. Pursuant to this promissory note, the taxpayer agreed to lend \$XXXX to Jack Black on March 5, 2007. Taxpayer’s Ex. 1.

² In applying the personal liability penalty provided by section 3-7 of the Uniform Penalty and Interest Act, the Illinois courts have authorized reliance upon Federal court cases involving section 6672 of the Internal Revenue Code (“IRC”) which contains language similar to the aforementioned Illinois statute. Branson, supra; Department of Revenue v. Joseph Bublick & Sons, 68 Ill. 2d 568 (1977).

The taxpayer claims that he was given stock in the company in order to secure the taxpayer's loan to Jack Black. Tr. pp. 32-34. The nature of the loan entered into, a personal loan from the taxpayer to Jack Black, is consistent with the taxpayer's claim that his stock ownership was solely for the purpose of better securing his personal loan because, absent an equity interest in this corporation, he would have had no legal right to reimburse himself for unpaid loan amounts by receiving dividends from the company or liquidating his investment in the company.

In addition to the aforementioned documentation, the taxpayer's claim to have been merely a passive investor is also supported by credible and unrebutted testimony throughout the entire record in this case. Specifically, the record clearly indicates that taxpayer was not involved in the company's day to day operations. Tr. pp. 10, 11, 17, 32, 34, 35, 40. Jack Black, the President of ABC BUSINESS, testified that he was the "sole operating person." Tr. p. 28. Moreover, credible testimony was given by Jack Black that the taxpayer did not participate in any decisions regarding the company's business affairs and operations; Jack Black testified that such decisions were exclusively made by him. *Id.* According to his testimony, Jack Black alone was responsible for making company purchases and paying company bills. Tr. pp. 10, 11.

Significantly, there was also credible and unrebutted testimony that Jack Black alone oversaw the preparation of the company's tax returns and the payment of its taxes during the tax period in controversy. Tr. pp. 17, 28, 35, 36, 38, 39. Jack Black testified that only he and the company's bookkeeper participated in the company's tax return preparation and filing. Tr. pp. 17, 18.

The overall substance of Jack Black's testimony was that the taxpayer had little if any involvement in the company's operations or management. This is consistent with the taxpayer's testimony contained in the record that the taxpayer spent very little time at the company's

business. Tr. pp. 32, 34, 35. Moreover, both the testimony of the taxpayer and Jack Black are consistent with the documentary evidence supporting the taxpayer's claim that he was only a passive investor in the company. Taxpayer's Ex. 1. Based upon the foregoing, I believe that the taxpayer has produced enough evidence to rebut the Department's *prima facie* case by showing that the taxpayer did not have sufficient control over the corporation's finances to establish him as a responsible party.

The taxpayer having introduced evidence sufficient to rebut the Department's *prima facie* case, the burden shifted to the Department to prove its case by a preponderance of the competent evidence. Goldfarb v. Department of Revenue, 411 Ill. 573, 580 (1952). In the instant case, after the taxpayer rested, the Department introduced no evidence that the taxpayer ever assumed personal responsibility for filing ABC BUSINESS' retailers' occupation tax or withholding tax returns or for the payment of its tax liabilities.

As is evident from the above, much of the taxpayer's case hinges upon the testimony of Jack Black, the President of ABC BUSINESS that he alone was the company's only responsible party. I can deduce no advantage to Jack Black that would arise from his claim to have been solely and exclusively responsible for the operations and financial affairs of ABC BUSINESS. Indeed, to the contrary, this testimony was to his potential detriment since he, in effect, admits being the sole responsible officer of the company and thereby exposes himself to the same personal liability penalties at issue in this case. For this reason, I find that his testimony in this case exonerating the taxpayer, was completely credible.

Moreover, the Department had the opportunity to test Jack Black's testimony through cross-examination. However, the record contains no evidence that, during the Department's cross-examination, Jack Black ever contradicted or in any other way undermined the credibility

of his assertions that the taxpayer played no role in the management or operation of what was essentially his company, and that the taxpayer was not involved in the company's business affairs. After considering all the evidence, I conclude that Department has not establish that the taxpayer is liable for the penalties authorized by section 1002(d) of the Illinois Income Tax Act and by section 3-7 of the Uniform Penalty and Interest Act.

My conclusion that the taxpayer was not a responsible party obviates the need to address the issue whether the taxpayer “willfully” failed to file returns or make tax payments. Pursuant to section 3-7 of the Uniform Penalty and Interest Act noted above, liability attaches only to “responsible” parties that willfully fail to file or pay taxes that are due.

Conclusion

I recommend that the Director cancel the notice of penalty liability and the notice of section 1002(d) penalty issued in this case.

Ted Sherrod
Administrative Law Judge

Date: July 3, 2014