

ST 14-20

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 6/30/09-11/21/09**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Marc Muchin on behalf of the Illinois Department of Revenue; John Doe, *pro se*.

Synopsis:

This matter comes on for hearing pursuant to a protest of a Notice of Penalty Liability (“NPL”) issued by the Illinois Department of Revenue (“Department”) to John Doe as a responsible officer of ABC Business. The NPL represents a penalty liability for unpaid Retailers’ Occupation Tax for the period June 30, 2009 through November 21, 2009. A hearing was held in this matter on September 24, 2013 with John Doe testifying and the Department presenting documentary evidence. Following the submission of all oral testimony and of documentary evidence, and a review of the record, it is recommended that the NPL issued to John Doe be 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, inclusive of all jurisdictional elements, is established by the admission into evidence of notice of penalty liability NPL Penalty ID number XXXX issued to John Doe dated July 9, 2012, which shows a penalty for sales tax liability of ABC Business ("ABC Business") of \$XXXX for the period June 30, 2009 through November 21, 2009. Transcript of Hearing on September 24, 2013 ("Tr.") p. 9; Department Exhibit ("Ex.") 1. The underlying corporate tax liability arises from ABC Business' sales on June 30, 2009 and on November 21, 2009. *Id.*
2. ABC Business, an Illinois subchapter S corporation having its principal place of business in Illinois, was, during the tax period in controversy, engaged in the retail sale of vehicles, boats and motorcycles. Department Ex. 2. The company commenced business on August 7, 2006 and ceased operations subsequent to the tax period in controversy, no earlier than 2010. Tr. p. 24; Department Ex. 2.
3. John Doe was the President, Secretary and Treasurer of ABC Business and owned 100% of the company's stock.¹ Department Ex. 2.
4. John Doe had authority to issue and sign company checks, was responsible for paying all of the corporation's debts and made all decisions regarding which company bills would and would not be paid. Tr. pp. 28, 29.
5. During the tax period in controversy, John Doe supervised the preparation and filing of the company's tax returns and payment of the company's taxes. Tr. p. 27.

¹ While John Doe testified that his wife was the President of ABC Business (Tr. p. 26) and, in answers to the Department's interrogatories, indicated that she owned a majority of this company's stock (Department Ex. 3), this evidence is contradicted by documentary evidence contained in the record (Department Ex. 2) and is not supported by any documentation showing a transfer of ownership from the taxpayer to his wife or her succession to the company's Presidency. For these reasons, I have accorded no weight to this testimony and evidence.

Conclusions of Law:

In the instant case, the Department seeks to impose personal liability for unpaid trust taxes upon John Doe (“John Doe”) as a responsible officer of ABC Business (“ABC Business”) pursuant to section 3-7 of the Uniform Penalty and Interest Act (“UPIA”), 35 ILCS 735/3-7 for failure to pay ABC Business’ Retailers’ Occupation Tax due on sales made on June 30, 2009 and November 21, 2009. Department Ex. 1. Section 3-7(a) of the Uniform Penalty and Interest Act (“UPIA”) provides, in pertinent part:

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 737/3-7(a)

The statute does not define who has the responsibility for filing returns and making payments, or what constitutes willful failure to pay. However, in applying the penalty tax, the Illinois courts look to federal cases involving section 6672 of the Internal Revenue Code (“IRC”) which contains language similar to the aforementioned Illinois statute. Branson v. Department of Revenue, 168 Ill. 2d 247 (1995); Department of Revenue v. Joseph Bublick & Sons, 68 Ill. 2d 568 (1977). The key to liability under IRC section 6672 is control of finances within the corporation including the power to control the allocation of funds to other creditors in preference to the company’s tax obligations. Haffa v. U.S., 516 F. 2d 931 (7th Cir. 1975). The issue of willfulness is concerned with the state of the responsible person’s mind. Sawyer v. U.S., 831 F. 2d 755 (7th Cir. 1987). “Willful failure to pay taxes has generally been defined as involving

intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks.” Branson, *supra* at 255.

During the evidentiary hearing in this case, the Department introduced notice of penalty liability NPL Penalty ID number XXXX. Tr. p. 9. When the Department introduced this notice of penalty liability into evidence under the certificate of the Department’s Director of Revenue, it presented *prima facie* proof of all of the elements necessary for a determination that John Doe was personally liable for the unpaid withholding taxes due and owing from ABC Business, a company where he served as the sole officer and in which he held 100% of the stock during the tax period in controversy. Branson, *supra* at 260.

The Department’s *prima facie* case is a rebuttable presumption. *Id.* at 262. After the Department introduces its *prima facie* case, the burden shifts to the taxpayer to establish that one or more of the elements required for the imposition of the penalty are lacking. Branson, *supra* at 261-62. A taxpayer cannot overcome the Department’s *prima facie* case by merely denying the accuracy of the Department’s assessment, or by merely denying conscious awareness that the tax was due from the corporation. Branson, *supra* at 267. Instead, the taxpayer must present evidence that is consistent, probable, and closely identified with its books and records. PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16 (1st Dist. 2002); Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1st Dist. 1981).

As noted above, section 3-7(a) of the UPIA sets forth two tests for determining whether a person has personal liability for unpaid taxes incurred by a corporation. First, the person must be responsible for accounting for and paying the tax due. Second, the individual must willfully fail to file returns or pay tax. In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether the person has significant control over the

business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and the disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.* The key to liability is control of finances within the corporation including the power to control the allocation of funds to other creditors in preference to the company's tax obligations. Haffa, *supra*.

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 officer 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)).

The record in the instant case is replete with evidence of John Doe' status as a responsible officer. Specifically, I conclude that he was a responsible officer based upon the following facts:

1. He was the company's only officer, serving as its President, Secretary and Treasurer, and owned 100% of the company's stock. Department Ex. 2.
2. He had check writing authority and was a signatory on the company's bank accounts. Tr. pp. 28, 29.
3. He possessed and exercised exclusive control over all of the company's financial affairs and supervised the company's tax compliance and tax payment functions. Tr. pp. 27-29.

I find these facts sufficient to conclude that John Doe met most of the criteria outlined in the pertinent case law for being classified as a responsible officer. Schwinger, *supra*; Silberberg, *supra*.

The taxpayer contends that Jack Black (“Jack Black”), ABC Business’ office manager, was primarily responsible for filing the company’s tax returns and remitting its taxes. Tr. pp. 22, 23. However, the taxpayer, in answers to interrogatories the taxpayer acknowledged to be true and correct during the evidentiary hearing (Tr. pp. 26, 27), admitted that he supervised Jack Black in the performance of his tax compliance functions. Department Ex. 3 (Answer to Department’s Interrogatory 8). Moreover, as previously noted, in the present case, the Department’s *prima facie* case with respect to John Doe’ status as a responsible officer was established when the Department’s certified record relating to the notice of penalty liability at issue was admitted into evidence. Branson, *supra*. In response, John Doe presented testimony, but no documentary proof, that he did not have control over the payment of ABC Business’ tax liabilities.

Unfortunately, John Doe, who bears the burden of proof sufficient to rebut the Department’s *prima facie* case, submitted insufficient evidence to support his claim. As noted above, the taxpayer must present evidence that is supported by books, records or other documents showing that the taxpayer did not have control over the payment of taxes. In the instant case, the only evidence of any kind presented by the taxpayer is his testimony that Jack Black had primary control over and responsibility for the payment of the corporation’s taxes.

Even if John Doe’ testimony were accepted as definitive evidence that Jack Black was a responsible party, this evidence would not absolve John Doe of liability because, in a corporation, there may be more than one responsible officer. Monday, *supra*. Section 3-7 does

not confine liability to only one person in the corporation or to the person that is most responsible. Consequently, the aforementioned testimony only provides evidence that Jack Black may have been a responsible officer, and fails to prove that John Doe was not also a responsible officer of ABC Business.

In sum, the only evidence supporting the taxpayer's claim that he was not a responsible officer is the taxpayer's own testimony that he was not primarily responsible for the corporation's tax preparation, filing and other compliance. This testimony, in the absence of any corroborating books, records or other documentation, 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. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988); 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 a Power of Attorney delegating tax compliance to Jack Black and authorizing him to execute the company's tax returns, copies of tax returns signed by Jack Black or cancelled checks signed by Jack Black remitting taxes to the state. Without such evidence, it must be found that John Doe has not rebutted the Department's *prima facie* correct finding that he was a responsible officer of ABC Business during the tax period at issue. *Id.*

The second and remaining element which must be met in order to impose personal liability on John Doe is the willful failure to file tax returns and pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the notice of penalty liability into evidence. By operation of the statute, proof of the correctness of the penalty, including the willfulness element, is established by the Department's penalty assessment

and certified record relating thereto. Branson, *supra* at 260. Again, the Department's *prima facie* case is a rebuttable presumption. After the Department introduces its *prima facie* case, the burden shifts to the taxpayer to overcome the presumption of willfulness through sufficient evidence. Branson, *supra* at 262.

At the evidentiary hearing, John Doe attempted to rebut the Department's *prima facie* case of willfulness by arguing that the basis of the underlying corporate liability for unpaid taxes giving rise to the notice of penalty liability at issue was erroneous. Tr. pp.14-21. However, the Illinois law is clear that in an action to collect unpaid tax, the issue of the amount due cannot be retried. The Department's assessment is not subject to collateral attack in a suit to collect the tax. In People ex re. Scott v. Pintozzi, 50 Ill. 2d 115, 126-127 (1971), the Court noted that there are two phases to a tax proceeding. The first phase involves the imposition of tax liability against the underlying corporate taxpayer. In the instant proceeding, the underlying corporate taxpayer was ABC Business. Notices of Tax Liability were issued to ABC Business on November 17, 2011² and ABC Business had the right to request an administrative hearing within 60 days of the date of these notices pursuant to 35 ILCS 120/4 and litigate the corporate liability delineated therein. There is no evidence in the record that John Doe protested these Notices of Tax Liability although, as a responsible officer, he had the authority to do so. The first phase of ABC Business's tax proceeding is completed and the corporate tax liability is final.

The second phase of the tax proceeding is the collection of the tax and in this case, the Department elected to collect the tax from ABC Business' responsible officer. In Department of Revenue v. Dombrowski, 202 Ill. App. 3d 1050, 1053-54 (1st Dist. 1990), the responsible officer sought judicial review of the corporate liability as a defense to his responsible officer case. The

² This Tribunal takes Judicial Notice of Notices of Tax Liability issued to ABC Business on November 17, 2011 giving rise to the liability underlying the notice of penalty liability in this case pursuant to Ill. Evid. Rule 20, and these Notices of Tax Liability are included in the record.

Court noted that because the officer had not taken advantage of the statutorily available opportunities to protest the corporate liability, he was foreclosed from reviewing the assessment by way of defense in the responsible officer action. According to the established case law in Illinois then, John Doe may not challenge the amount of the tax deficiency in this proceeding as this tribunal is not empowered to review the corporate liability. Accordingly, John Doe' challenge to the underlying corporate liability assessment that forms the basis of the notice of penalty liability at issue does not rebut the Department's *prima facie* case of willfulness.

The courts have held that a person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the state. Heartland v. Department of Revenue, 106 Ill. 2d 19 (1985). Specifically, in Heartland, the court states as follows:

In a provision similar to section 13 ½ [now 35 **ILCS** 735/3-7], [section 6672 of the Internal Revenue Code](#) of 1954 ([26 U.S.C. sec. 6672 \(1982\)](#)) imposes personal liability on a corporate officer if he “willfully fails to collect * * * or truthfully account for and pay over” a corporate employee's social security and Federal income withholding taxes. In Bublick, the court found that cases arising under [section 6672_of the IRC](#) provided guidance in determining the meaning of the “willful failure” requirement of section 13 1/2. A reading of such cases indicates that willful failure to pay taxes has generally been defined as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks.[Citations omitted]. These Federal cases specifically find that according other corporate creditors preferential treatment over governmental tax obligations constitutes willful behavior.

In light of these cases and the plain language of section 13 1/2, the court in Bublick held that the willful-failure requirement is satisfied with a showing of a “voluntary, conscious and intentional failure” to file retailers' occupation tax returns or make tax payments.

The evidence presented in both cases now before this court indicates that each defendant was a corporate officer, responsible for filing retailers' occupation tax returns and making payment of the taxes imposed. In addition, the defendants were all making retail sales and collecting taxes from their

customers. Thus, at the time tax payments were initially due, sufficient funds were available to satisfy the corporations' retailers' occupation tax liability. Nevertheless, each of the defendants chose to utilize these funds to pay other creditors.

We find that the evidence clearly supports a finding that the defendants, in each case now before this court, knowingly, voluntarily and intentionally failed to make required tax payments to the Department, in violation of their statutory obligation.

Heartland, *supra* at pp. 29-30.

The record in this case 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. 28,29. There is also evidence in the record that the taxpayer paid other bills with available funds rather than the company's taxes. Specifically, the record indicates that ABC Business remained in business throughout the tax period in controversy, and did not cease to do business until, at the earliest, 2010. Tr. p. 24. I infer from this fact that the company continued to pay its employees and vendors, and any bank loan payments that would have been due during 2009, when the tax liabilities at issue accrued and remained unpaid. The record also indicates that John Doe authorized all checks issued to pay corporate bills during the tax period in controversy. Tr. pp. 28, 29. In authorizing the payment of other creditors while the company's taxes remained delinquent, John Doe made a voluntary, conscious and intentional decision to prefer ABC Business's other creditors over the State during the period at issue in this case. His actions in doing so constituted a willful failure to pay Illinois taxes in violation of UPIA section 3-7. Joseph Bublick & Sons, Inc., *supra* at 577 ("a voluntary, conscious and intentional failure satisfies the requirements of 'willfully fail,' as those words are used in [UPIA section 3-7].").

Conclusion

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's notice of penalty liability issued John Doe be affirmed in its entirety and be finalized as issued.

**Ted Sherrod
Administrative Law Judge**

Date: July 28, 2014