

ST 15-07

Tax Type: Sales Tax

Tax Issue: Responsible Corporate Officer – Failure To File Or Pay Tax

**Illinois Department of Revenue
OFFICE OF ADMINISTRATIVE HEARINGS
James R. Thompson Center
100 West Randolph Street, Level 7-900
Chicago, Illinois 60601
(312) 814-6114**

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

v.

**TAREQ JOHN DOE,
As Responsible Officer of
ABC BUSINESS,
TAXPAYER**

**No. XXXX
Letter ID: XXXX
NPL No. XXXX**

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSABC BUSINESSION

Appearances: Mr. Imtiaz Hasan, Hasan Law Offices, appearing for Mr. John Doe; Mr. George Foster, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to John Doe’s (hereinafter “Mr. John Doe”) protest of Notice of Penalty Liability No. XXXX (hereinafter the “NPL”) issued by the Department on April 1, 2013, to Mr. John Doe as responsible officer of ABC Business (hereinafter “ABC BUSINESS”). The NPL represents a penalty liability for Retailers’ Occupation Tax of ABC BUSINESS due to the Department for various months between September, 2010, and January, 2013. A hearing was held on this matter on October 2, 2014, with Mr. John Doe providing oral testimony. Following submission of all evidence and a review

of the record, ABC Business is recommended that the matter be resolved in favor of the Department. In support thereof, 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 NPL No. XXXX, dated April 1, 2013 which shows a penalty for sales tax liability of ABC BUSINESS of \$XXXX for various months during the period September 30, 2010 through January 31, 2013.¹ Tr. pp. 6-8; Dept. Ex. No. 1.
2. Mr. John Doe was 29 years old at the time of the evidentiary hearing. He was President of ABC BUSINESS, which was a gas station/convenience store. He took a loan from his father to buy the business. In 2009, he was a full-time student at DePaul University. According to his testimony, because of the demands of college, he hired XYZ Business to manage the business. Jack Black was President of XYZ Business. Mr. Jack Black’s responsibilities were “running the daily operations, overlooking the management of all the employees, purchasing inventory, dealing with various vendors, and paying the payroll, paying the sales tax, paying the utilities, and paying the rent.” Tr. pp. 13-16, 19.
3. The “Management/Employment Contract” between ABC BUSINESS and XYZ Business was entered into on October 17, 2009. Section I of the Contract states that XYZ Business will manage, supervise and operate the grocery store “subject to the supervision and pursuant to the orders, advice and directions of [ABC BUSINESS].”

¹ Department’s Counsel stated at the hearing that the “current balance” of the NPL is \$XXX. Tr. p. 10.

Section IV of the Contract called for XYZ Business to pay \$XXXX to ABC BUSINESS annually and to be responsible for paying the daily and monthly expenses of the business including rent, all utilities, invoices, bills and sales taxes. After paying all expenses, including sales taxes and \$XXXX to ABC BUSINESS, XYZ Business could retain all excess revenues “as their compensation for their operation of the business.” Tr. pp. 35-41; Taxpayer’s Ex. J.

4. Mr. John Doe testified that “after two, three months, [Mr. Jack Black] was bouncing checks on me, the payments he was supposed to make to me, and ... we had meetings regarding what was going on, why are you bouncing my checks...” Tr. p. 18.
5. In March, 2011, Mr. John Doe testified that he took back control of ABC BUSINESS from XYZ Business. Mr. John Doe testified that, after an audit of the business, he tried to resolve issues from the audits with XYZ Business. Tr. pp. 32-33, 52-53.
6. On December 14, 2011, ABC BUSINESS filed a “Complaint at Law” against XYZ Business and Mr. Jack Black for breach of contract. The Complaint alleges that “starting in December, 2009 and lasting through April, 2011, XYZ Business failed to pay sales taxes for the goods sold at the gas station.” Tr. pp. 24-28; Taxpayer’s Ex. A.
7. On November 9, 2012, ABC BUSINESS and XYZ Business entered into a settlement in which Mr. Jack Black agreed to pay ABC BUSINESS \$XXXX consisting of a \$XXXX deposit and the remaining \$XXXX to be paid over the following 54 months. Tr. pp. 33-34, 43-48; Taxpayer’s Ex. I.

Conclusions of Law:

The sole issue to be decided in this case is whether Mr. John Doe should be held personally liable for the unpaid retailers' occupation tax of ABC BUSINESS. 35 ILCS 120 *et seq.* The statutory basis upon which any personal liability is premised is Section 3-7 of the Uniform Penalty and Interest Act, which provides as follows:

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 to 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. The Department shall determine a penalty due under this Section according to ABC Business' best judgment and information, and that determination shall be *prima facie* correct and shall be *prima facie* evidence of a penalty due under this Section.
35 ILCS 735/3-7.

ABC Business is clear under the statute that personal liability will be imposed only 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.

The admission into evidence of the NPL establishes the Department's *prima facie* case with regard to both the fact that Mr. John Doe was a "responsible" officer and the fact that Mr. John Doe "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 shifted to Mr. John Doe to overcome the case. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

Mr. John Doe was 29 years old at the time of the evidentiary hearing. He was President of ABC BUSINESS, which was a gas station/convenience store. He took a loan from his father to buy the business. In 2009, he was a full-time student at DePaul University. According to his testimony, because of the demands of college, he hired XYZ Business to manage the business. Jack Black was President of XYZ Business. Mr. Jack Black's responsibilities were "running the daily operations, overlooking the management of all the employees, purchasing inventory, dealing with various vendors, and paying the payroll, paying the sales tax, paying the utilities, and paying the rent." Tr. pp. 13-16, 19. The "Management/Employment Contract" between ABC BUSINESS and XYZ Business was entered into on October 17, 2009. Section I of the Contract states that XYZ Business will manage, supervise and operate the grocery store "subject to the supervision and pursuant to the orders, advice and directions of [ABC BUSINESS]." Section IV of the Contract called for XYZ Business to pay \$XXXX to ABC BUSINESS annually and to be responsible for paying the daily and monthly expenses of the business including rent, utilities, invoices, bills and sales taxes. After paying all expenses, including sales taxes and \$XXXX to ABC BUSINESS, XYZ Business could retain all excess revenues "as their compensation for their operation of the business." Tr. pp. 35-41; Taxpayer's Ex. J.

Mr. John Doe testified that in April, 2011, a Department Auditor contacted him and told him that she was assigned to conduct an audit of the gas station. Tr. p. 21. In March of 2011, Mr. John Doe had taken back control of ABC BUSINESS from XYZ Business. Mr. John Doe testified that he tried to resolve issues from the audit with XYZ Business. Tr. pp. 32-33, 52-53. Mr. John Doe graduated from college in June, 2012. He looked for a job for 4 months and landed a position at Price-Waterhouse Coopers. Tr. p. 20.

Mr. John Doe stipulated at the evidentiary hearing that he was a responsible officer of ABC BUSINESS beginning when he took back control of ABC BUSINESS from XYZ Business and Mr. Jack Black. Tr. p. 57. Mr. John Doe would not stipulate that he was a responsible officer of ABC BUSINESS while XYZ Business managed the business. Tr. p. 58. However, Mr. John Doe's testimony and the documentary evidence admitted at the hearing force me to conclude, without any hesitation, that Mr. John Doe was also a responsible officer of ABC BUSINESS even during the time that XYZ Business managed the business.²

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation. 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. denied*, 400 U.S. 821 (1970). Individuals who hold corporate office and who have authority to make disbursements are presumptively responsible persons for purposes of 26 USC § 6672, the federal responsible officer statute. Hildebrand v. United States, 563 F. Supp. 1259 (D.C. N.J. 1983).

The "Management/Employment Contract" between ABC BUSINESS and XYZ Business was entered into on October 17, 2009. Section I of the Contract states that XYZ Business will manage, supervise and operate the grocery store "subject to the supervision and pursuant to the orders, advice and directions of [ABC BUSINESS]." Taxpayer's Ex. J. ABC Business is reasonable to conclude from this provision in the Contract that when XYZ Business did not pay sales tax to the State of Illinois, ABC Business did this pursuant to the "orders, advice and directions" of ABC BUSINESS and ABC Business President, Mr. John Doe. Mr. John Doe's

² There are 23 months of unpaid sales taxes in the NPL, covering a period from September, 2010 through January, 2013. Only 7 of the 23 months of unpaid sales taxes were incurred while XYZ Business managed the business.

testimony shows that he recognized that he was responsible for ABC BUSINESS even while XYZ Business and Mr. Jack Black managed the gas station. He testified that when he hired XYZ Business, “ABC Business’s still going to operate under my corporation.” “That way I have full control, and I’m not giving away control to Jack Black, and that’s how we did the arrangement.” Tr. p. 16. The testimony clearly shows that the management deal was entered into with Mr. John Doe retaining “full control” over XYZ Business and Mr. Jack Black and the business affairs of ABC BUSINESS.

After the gas station was audited, Mr. John Doe contacted XYZ Business and Mr. Jack Black, in an attempt to “resolve this.” “... And at that point I was thinking, you know, I’m just going to get this guy to pay the Department of Revenue because I’m on the hook for this, because obviously ABC Business was my corporation...” Tr. pp. 22-23. Mr. John Doe’s conclusions are correct here. While ABC BUSINESS was managed by XYZ Business and Mr. Jack Black, ABC Business still was Mr. John Doe’s corporation and he was “on the hook” for the sales taxes. On December 14, 2011, after failing to resolve the matter with Mr. Jack Black, ABC BUSINESS filed a “Complaint at Law” against XYZ Business and Mr. Jack Black for breach of contract. The Complaint alleges that “starting in December, 2009 and lasting through April, 2011, XYZ Business failed to pay sales taxes for the goods sold at the gas station.” “Instead of paying the sales taxes, XYZ Business and Jack Black kept the funds as part of their profit under the contract.” The Complaint alleges further that “ABC BUSINESS was unaware of XYZ Business’s actions until September, 2011, when the Illinois Department of Revenue contacted them.” When Jack Black refused to pay the delinquent taxes, “ABC BUSINESS paid some of the sales tax out of ABC Business owners’ pocket.” “There is a remaining balance for which ABC BUSINESS is obligation (sic) to pay.” Tr. pp. 24-28; Taxpayer’s Ex. A. The

Complaint recognizes that Mr. John Doe was responsible for and had an “obligation” to pay the sales tax while XYZ Business managed the business. As stated previously, Mr. John Doe accepted responsibility for the sales tax for the period when Mr. John Doe took back control of the business from XYZ Business. Tr. p. 57.

In determining whether a taxpayer is a responsible officer, the question is not whether the taxpayer exercised the power he possessed, but rather what power he possessed. Howard v. United States, 83-2 USTC P 9528 (N.D.Texas 1982) affirmed 711 F.2d 729 (5th Circuit 1983). Mr. John Doe testified that he “completely left the management” of the gas station to Mr. Jack Black and XYZ Business. Tr. p. 17. According to Mr. John Doe’s testimony, payments to creditors were completely left to Mr. Jack Black’s discretion. Tr. p. 19. Section I of the “Management/Employment Contract” makes clear that Mr. John Doe possessed the power to supervise, order, advise and direct XYZ Business and Mr. Jack Black in operating the business. In determining whether Mr. John Doe is a responsible officer, the critical issue is that he retained the power to supervise the business according to the Management/Employment Contract. ABC Business was his choice that he did not choose to exercise this power.

As President of ABC BUSINESS, Mr. John Doe clearly had the authority to supervise and control Mr. Jack Black’s and XYZ Business’s compliance functions. Mr. John Doe delegated responsibilities to Mr. Jack Black and XYZ Business, while at all times maintaining the status, duty and authority within ABC BUSINESS to control ABC Business disbursements. Frequently, a party will attempt to negate the inference that he was a “responsible person” by demonstrating that the responsibilities and duties over the collecting, truthfully accounting for and paying over of the taxes were delegated to another individual. The courts have resisted this line of argument. This rejection is due to the recognition that, even when an individual delegates

significant responsibilities to others, he still retains final authority and oversight responsibility over his subordinates. Ghandour v. United States, 36 Fed. Cl. 53, 61-62 (1996). Mr. John Doe retained final authority and oversight responsibility over ABC BUSINESS both during the time that XYZ Business managed the business and, as he admitted, when he took back control of ABC BUSINESS from XYZ Business and Mr. Jack Black.

A taxpayer cannot overcome the Department's *prima facie* case merely by testifying that he delegated the authority to pay taxes to another. Instead, evidence must be presented which is consistent, probable and identified with the corporation's book and records. Central Furniture Mart Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). No documentary evidence was offered to show that Mr. John Doe ever ceased to be a responsible officer of ABC BUSINESS during the liability period. Without this evidence, I must conclude that Mr. John Doe had responsibility for filing tax returns and remitting the tax payments of ABC BUSINESS throughout the entire liability period, September, 2010 through January, 2013.

The second element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson v. Dept of Revenue, 168 Ill. 2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness. To rebut this presumption, the person defending against the penalty must adduce sufficient evidence to disprove willful failure to file returns and pay taxes. 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 the corporate records. *Id.* at 267.

35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay or file taxes. In attempting to clarify what constitutes a willful failure to file or pay taxes, the courts have

adopted a broad interpretation of the words “willfully fails.” Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Willfulness includes “failure to investigate or to correct mismanagement after having notice that taxes have not been remitted to the Government.” Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). “Willfulness” as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970) *cert. denied* 400 U.S. 821 (1970). Also, a person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985).

Mr. John Doe’s conduct was willful under each of the above benchmarks. Mr. John Doe testified that Mr. Jack Black would give him “verbal assurances saying all the sales tax were being paid.” But “just after two, three months he was bouncing checks on me, the payments he was supposed to make to me, and ... we had meetings regarding what was going on, why are you bouncing my checks; ... he kept on showing me all these liabilities and saying ... he had to first meet, like, the payroll, the rental, the utilities, the sales tax liabilities and ... I was the last one on his list, and, you know we went back and forth... and he would pay me partial payments.” Mr. John Doe added that he did not want to “put up” an argument with XYZ Business at that time because he “was in a situation where I couldn’t come in and do this myself, so I was pretty much dependent on him to run the whole operation, so I was trying to work the relationship rather than seize ABC Business.” Tr. pp. 18-20. Mr. John Doe testified further that Mr. Jack Black “bounced so many checks on me” and that many checks payable to him were “NSF.” Tr. pp. 29, 32.

When Mr. Jack Black started bouncing checks two or three months after taking over the business, Mr. John Doe could easily have investigated the financial situation of ABC BUSINESS

by an inspection of the corporate records, which he had the right to do as President of ABC BUSINESS. During the period that XYZ Business and Mr. Jack Black managed the business, Mr. John Doe apparently allowed Mr. Jack Black to make decisions regarding whether or not to pay taxes and did not demand that tax delinquencies be revealed or addressed. There was no testimony or documentary evidence offered at the hearing showing that Mr. John Doe took any steps, from the time Mr. Jack Black started bouncing checks through the remaining time that XYZ Business managed the business, to ascertain whether ABC BUSINESS's sales taxes were being paid. The fact that Mr. John Doe may have adopted a "hear no evil – see no evil" policy does not relieve him of liability for the sales taxes. Wright v. United States, 809 F. 2d 425, 427 (7th Cir. 1987).

Somewhere around March, 2011, Mr. John Doe took back control of ABC BUSINESS from XYZ Business and Mr. Jack Black. Tr. p. 32. When Mr. John Doe took back control, he found that ABC BUSINESS had a "good amount of past due balances and with a few of our vendors ... we were on a 30-day term, and they were not paid." "The newspaper vendors weren't paid. They were not dropping off the newspapers." "Overall, all the bills were not paid and current, besides the rent. I can fairly say that." Tr. p. 32. The NPL shows that sales taxes were not paid for 16 months during the period from April, 2011 through January, 2013, after Mr. John Doe took back control of ABC BUSINESS. Dept. Ex. No. 1. There was no testimony or documentary evidence offered at the hearing showing that Mr. John Doe took any steps, from the time he took back control of ABC BUSINESS from XYZ Business to see that sales taxes were being paid. I must conclude that, during this period, ABC BUSINESS collected taxes and gross receipts from ABC Business customers while making sales to them. I must also conclude that Mr. John Doe, who was admittedly then in charge, authorized ABC BUSINESS to do *something*

with the collected taxes other than turning them over to the Department. By making the choice to prefer other creditors, Mr. John Doe willfully failed to pay ABC BUSINESS's sales taxes.

Department of Revenue v. Heartland Investments, Inc., 106 Ill 2d 19, 29 (1985)

Mr. John Doe's failure to investigate the mismanagement of ABC BUSINESS when XYZ Business was bouncing checks and his subsequent failure to correct mismanagement when he took control of ABC BUSINESS from XYZ Business exhibits a reckless disregard for obvious or known risks, including the risk that sales taxes would not be paid to the State of Illinois. Given Mr. John Doe's capacity as President of ABC BUSINESS, his failure to see that ABC BUSINESS's tax obligations were met when he was well aware that ABC BUSINESS's checks were bouncing and that the business had been mismanaged, is sufficient to establish willfulness within the context of the statute. I conclude that Mr. John Doe has failed to rebut the Department's presumption that he willfully failed to pay ABC BUSINESS's sales taxes.

WHEREFORE, for the reasons stated above, ABC Business is my recommendation that Notice of Penalty Liability No. XXXX be finalized as issued.

Kenneth J. Galvin
Administrative Law Judge

August 6, 2015