

ST 15-09

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 6/11-7/12
1002D Penalty ID XXXX
Period 12/10

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

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

Synopsis:

This matter is before this administrative tribunal as the result of a protest filed by John Doe (“Taxpayer”), contesting penalties assessed the Taxpayer as a responsible officer of ABC Business Inc. equal to that company’s unpaid Retailers’ Occupation Tax (“ROT”) for the period June 2011 through July 2012 and unpaid withholding taxes for the fourth Quarter of 2010. The penalties assessed were personal liability penalties levied pursuant to section 3-7 of the Illinois Uniform Penalty and Interest Act, 35 ILCS 735/3-1 *et seq.*

A hearing on this matter was held on May 28, 2015 during which John Doe testified and both the Department of Revenue and the Taxpayer submitted documentary evidence. I have reviewed all of the evidence, and I am including in this recommendation findings of fact and

conclusions of law. I recommend that the Director cancel the notice of penalty liability for unpaid ROT at issue and affirm the penalty assessed for unpaid withholding taxes issued in this case. 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 to the Taxpayer on March 3, 2014. Department Exhibit ("Ex.") 1. The notice of penalty liability ("NPL") arose from unpaid sales tax liabilities of ABC Business Inc. ("ABC Business") for the period June 2011 through July 2012. *Id.* The notice of section 1002(d) penalty arose from unpaid Illinois withholding taxes for the fourth quarter of 2010. *Id.*¹
2. ABC Business, a corporation having its principal place of business in Illinois was during the tax periods at issue, engaged in servicing and repairing motor vehicles and in making retail sales of automobiles parts. Tr. pp. 18, 37, 46, 50; Department Ex. 1.
3. During the tax periods in controversy, ABC Business was owned by Gene Green and Mary Green. Tr. pp. 46, 47.
4. Gene Green and Mary Green were the only officers of ABC Business. Tr. pp. 17, 47. During the tax periods in controversy, Gene Green served as the company's President and Mary Green was the company's secretary and treasurer. Tr. pp. 10, 11, 18, 19. The Taxpayer was employed by ABC Business as its manager. Tr. pp. 47, 49, 50, 55.
5. Gene Green and Mary Green are the parents of the Taxpayer. Tr. p. 47.

¹ Unless otherwise noted, findings of fact apply to the tax periods at issue in this case.

6. In his capacity as ABC Business's manager, the Taxpayer was authorized to execute checks drawn on ABC Business's bank account. Tr. p. 50; Taxpayer's Ex. 7.
7. On July 6, 2011, ABC Business Jr. Inc., ("ABC Business Jr."), an Illinois based corporation located in Illinois, received a business license from that city. Taxpayer's Ex. 2.
8. ABC Business Jr. regularly paid monthly sales taxes to the Illinois Department of Revenue commencing with taxes due for the month of July, 2011. Taxpayer's Ex. 3. This company paid \$XXXX in taxes for that month. *Id.*

Conclusions of Law:

In the instant case, the Department seeks to impose personal liability for unpaid taxes of ABC Business Inc. ("ABC Business") upon John Doe ("Taxpayer") pursuant to section 3-7(a) of the Uniform Penalty and Interest Act ("UPIA"), 35 ILCS 735/3-7. Section 3-7(a) states, in pertinent part, 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 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)

Section 3-7(a) does not define who has the responsibility for filing returns and making payments, or what constitutes willful failure to pay. However, in applying this 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 taxpaying 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 a notice of penalty liability and a notice of liability pursuant to 35 ILCS 5/1002(d) ("section 1002(d) penalty") assessing tax pursuant to section 3-7 of the UPIA. Department Ex. 1. When the Department introduced the notice of penalty liability and the notice of section 1002(d) penalty 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 the Taxpayer was personally liable for the unpaid taxes due and owing from ABC Business, a company where he served as the company's manager. Tr. pp. 47, 49, 50, 55.

The Department's *prima facie* case is a rebuttable presumption. Branson, *supra* 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, a taxpayer must present evidence that is consistent, probable, and closely identified with its books and

records. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1st Dist. 1988).

The Taxpayer argues that he never had authority over the financial affairs of the corporation or the preparation and filing of the company's tax returns. Tr. pp. 18, 19. Before addressing these arguments, I must assess the competency of the evidence the Taxpayer has proffered for admission into the record in support of these claims.

COMPENTENCY OF TAXPAYER'S EVIDENCE

Before beginning an analysis of the Taxpayer's contentions, I must address the evidentiary value of, that is, the weight to be given the evidence that has been introduced into the record, without objection, by the Taxpayer in this case. In support of his claim that he was not a responsible officer of ABC Business, the Taxpayer has entered into the record certified court documents from the Cook County Circuit Court, namely Taxpayer's Ex. 5 ("Stipulated Facts" in The ABC Business, Inc. v. ABC Business Jr. Inc., Docket number 2011 CH 39815 dated April 13, 2015) and Ex. 11 (Answer to Second Amended Complaint at Law submitted in The ABC Business, Inc. v. ABC Business Jr. Inc., Docket number 2011 CH 39815 filed July 24, 2013).² The principal court document tendered by the Taxpayer in support of his claim not to be a responsible officer is Taxpayer's Ex. 5, indicated above. The Taxpayer seeks to rely upon narrative statements and conclusions contained in this document made by unidentified persons that were not sworn in as witnesses, did not testify and were not made available for cross examination at the hearing in this case. Inadmissible hearsay consists of precisely this type of evidence.

² Taxpayer's Exhibit 11 entitled "Answer to Second Amended Complaint at Law" contains little more than unsubstantiated and unproven allegations of wrongful conduct by the Taxpayer. I find that this document provides no information that is useful in deciding the issues presented in this case.

In Illinois, hearsay has been determined to constitute out of court statements made by an out of court declarant offered for the truth of the matter asserted. People v. Carpenter, 28 Ill. 2d 116 (1963). The purpose of the rule excluding hearsay evidence is to exclude evidence that cannot be subject to cross-examination. *Id.* Accordingly, the principal objective of the rule is to exclude evidence where the author of the statement or writing is not available to be cross-examined or questioned concerning the accuracy of what was said or written. People v. Ramos, 112 Ill. App. 2d 330 (2d Dist. 1969). Clearly the hearsay dangers identified by the Illinois courts are present in Taxpayer's Exhibit 5 the witness seeks to rely upon.

The Administrative Procedures Act, pursuant to which Department hearings are conducted, provides that, "[t]he rules of evidence and privilege as applied in civil cases in the circuit courts of this State shall be followed. Evidence not admissible under these rules of evidence, may be admitted, however, (except where precluded by statute) if it is of a type commonly relied upon by reasonably prudent men in the conduct of their affairs." 5 ILCS 100/10-40(a).

In the instant case, I find that there is simply no way to conclude that the hearsay contained in the aforementioned document that is cited by the Taxpayer constitutes evidence that can be "relied upon by reasonably prudent men in the conduct of their affairs." *Id.* I reach this conclusion because there is simply no way to test the accuracy of the statements contained in this document without identifying and cross examining the persons who made them. Accordingly, in the exercise of discretion to determine the weight to be given this type of evidence accorded to me as the finder of fact in this administrative proceeding (see Jackson v. Department of Labor, 105 Ill. 2d 501, 508-509 (1985)), I have accorded absolutely no weight to the hearsay evidence the Taxpayer seeks to rely upon contained in Taxpayer's Exhibit 5.

The record in this case also contains an investigative police report on a criminal complaint filed by the Taxpayer's parents, as owners of ABC Business, alleging that the Taxpayer used his position as manager of the company to steal some of its assets. Taxpayer's Ex. 1. The Taxpayer cites various statements contained in this report in support of his claim that he was not a responsible officer. While business records shown to be kept in the ordinary course of business and meeting other requirements are admissible in court and administrative proceedings pursuant to Illinois Rules of Evidence ("Ill. R. Evid.") 803(6), investigative police reports do not constitute business records of a police department. 725 ILCS 5/115-5(c)(2); People v. Tsombanidis, 235 Ill. App. 3d 823, 835 (1st Dist. 1992); see also M. Graham, Handbook of Illinois Evidence § 803.10 (Business Records) p. 728, § 803.13 (Police Reports) pp. 745-47.

As was true of the Taxpayer's exhibit 5 discussed above, the hearsay dangers are readily apparent in the police report the Taxpayer has included, without objection, in the record. Like Taxpayer's Exhibit 5, Taxpayer's Exhibit 1 consists of narrative statements and conclusions made by unidentified persons that were not made available for cross examination at the hearing in this case. There is simply no way to test the accuracy of the statements contained within the police report upon which the Taxpayer relies without cross-examining the officer who made the report, and the persons whose statements were relied upon in determining the information contained in it. I find no reason to conclude that reasonably prudent men would (or should) rely on the veracity of such information contained in this police report. Therefore, I give no weight to the narrative contained in Taxpayer's Exhibit 1 in reaching my recommendation in this case.

ANALYSIS OF THE STATUS OF THE TAXPAYER AS A RESPONSIBLE OFFICER

As previously noted, in the present case, the Department's *prima facie* case with respect to the Taxpayer's status as a responsible officer was established when the Department's certified records relating to the penalty liabilities at issue were admitted into evidence. Branson, supra. In response, the Taxpayer presented no documentary proof that he did not have any control over ABC Business's finances or over the payment of ABC Business's tax liabilities.

Unfortunately, the Taxpayer, 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 the Taxpayer's books, records or other documents showing that the Taxpayer did not have control over the payment of taxes.

The only non-testimonial evidence given any weight in this matter that has any bearing on the Taxpayer's responsibilities at ABC Business is an Agreed Order entered in the DuPage County Circuit Court in divorce proceedings involving Mary Green and Gene Green. Taxpayer's Ex. 7 (Agreed Order entered in In Re: The Marriage of Mary Green, Petitioner, and Gene Green, Respondent, No. 11 D 129 dated January 31, 2011). This Agreed Order enjoined Mary Green and Gene Green from paying the company's bills, and expressly authorized the Taxpayer to perform this function. This documentation, along with testimony elicited during the hearing (at tr. p. 50) clearly shows that John Doe was authorized to sign checks drawn on the company's bank account.

The ability to sign corporate checks is a significant factor in determining whether a person is a responsible officer 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. 1981). 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 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 resources paying other bills while neglecting its tax obligations is indicia of significant control over a corporation's finances. Thomas v. United States, 41 F. 3d 1109 (7th Cir. 1994). For this reason, I conclude that the Taxpayer had significant control over the corporation's financial matters under criteria for making this determination enumerated in the federal case law. *Id.*

The Taxpayer urges this tribunal to ignore the Court's Agreed Order claiming that he was not aware of it, and that it did not affect the duties he performed as the company's manager. Tr. pp. 49, 50. To accept the Taxpayer's claim, one would have to assume that no one was paying the company's bills while the court's Agreed Order enjoining Mary Green and Gene Green from doing so, was in effect. It would defy logic to conclude that a company that continued to operate after the court's injunction did so without anyone performing any bill paying function.

Disregarding documentary evidence this tribunal has determined to be incompetent for reasons noted above, the only other evidence supporting the Taxpayer's claim that he was not a responsible officer is the Taxpayer's own testimony. This testimonial evidence alone is insufficient to overcome the Department's *prima facie* case. Jefferson Ice 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 corporate minutes enumerating a job description for

the position “manager” or the Taxpayer’s employment agreement, delineating the duties and responsibilities vested in him as the company’s manager. 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.

WHETHER THE TAXPAYER WILLFULLY FAILED TO FILE RETURNS AND/OR PAY TAXES

As previously noted, by Illinois statute, personal liability will be imposed upon a person who: (1) has control or supervision over, or responsibility for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make tax payments. UPIA 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 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 corporate records. *Id.* at 267.

In McClellan v. Department of Revenue, 326 Ill. App. 3d 667 (1st Dist. 2001), the appellate court provided a further, concise description of Illinois law regarding willful conduct by a responsible officer:

Under Illinois law, if a responsible officer uses collected retailers’ occupation taxes to pay other creditors of the corporation, while knowing that he or she was obligated to file the returns and remit the taxes, the “willful” [element] ... is satisfied. (Citations omitted) “A finding of willfulness ... does not require a showing of actual knowledge of nonpayment. Reckless disregard for obvious or known risks will suffice. . .[.]” (Quoting Estate of Young, 316 Ill. App. 3d 366, 375 (1st Dist. 2000).
McClellan at 675-76.

The record in this case indicates that the Taxpayer was well aware that ABC Business's taxes were overdue. This is evident from the Taxpayer's testimony concerning the financial condition of the company, wherein he states as follows.

Even going back to the date of 2010, December 2010, Gene Green, my father, which had gone into a coma just prior, was not able to work ...[.] ... Gene Green did handle [the books] ... and pretty much a good reason why the business was caput was because he was mishandling the funds of the corporation ...[.]

Because of the tit-for-tat they were having, initially Mary Green had Gene Green restricted from the business because he was basically taking all the money and was sending it to a mistress in Kentucky, not paying the property taxes, the building was getting taken away each month. We had no idea when. Payroll taxes were all unpaid. The company was very highly in debt. Tr. pp. 18, 29 (Emphasis added)

In spite of having knowledge that the company's taxes were delinquent and unpaid, the Taxpayer routinely authorized checks to pay corporate bills. Tr. p. 50. In authorizing the payment of other creditors while knowing that the company's taxes remained delinquent, the Taxpayer made a voluntary, conscious and intentional decision to prefer these creditors over the State. His actions in doing so constituted a willful failure to pay Illinois taxes in violation of UPIA section 3-7. Joseph Bulbick & Sons, Inc., supra at 577 ("a voluntary, conscious and intentional failure to pay taxes satisfies the requirements of "willfully fail" as those words are used in [UPIA section 3-7].").³

The Department's notice of section 1002(d) penalty issued for failure to pay Illinois payroll withholding tax for the period ending 12/31/10 covers the period concerning which the taxpayer admitted that payroll withholding taxes were not paid. Tr. pp. 18, 19, 29. Accordingly,

³ While the Court in Joseph Bulbick & Sons, supra was addressing section 452 ½ of the Retailers' Occupation Tax, 120 SHA ¶452 ½, which preceded section 3-7 of the UPIA, a comparison of these provisions reveals that they are almost identical, and all enumerate corporate officer and employee 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).

I find that the taxpayer is liable for the entire section 1002(d) penalty that has been assessed in this case.

WHETHER THE TAXPAYER WAS LIABLE FOR TAXES DUE FROM THE CORPORATION FOR THE PERIOD JUNE 2011 THROUGH JULY 2012

The Taxpayer contends that he cannot be held liable for the period covered by the NPL issued in this case (June 2011 through July 2012) because he left ABC Business to start a new company, ABC Business Jr. which commenced operations in July 2011. The principal evidence upon which the Taxpayer seeks to rely to support this contention has been determined to be incompetent evidence and has been given no weight for reasons noted earlier. However, the record in this case contains other credible documentary evidence that supports the Taxpayer's claim that he left to form a new company. Specifically, the record contains a 2011 Business License issued by the village of Anywhere Illinois effective July 6, 2011 authorizing a business identified as "ABC Business Jr." to conduct business. Taxpayer's Ex. 2. The record also contains checks issued to the Illinois Department of Revenue by ABC Business Jr. in payment of sales taxes due from this company commencing in July 2011. Taxpayer's Ex. 3. The tax payment for that month, in the amount of \$XXXX, is evidence that a significant amount of business activity was conducted by that company during July 2011.

The Taxpayer's contention is further supported by information concerning ABC Business Jr. at <http://www.ilsos.gov/corporatellcController>, the Illinois Secretary of State's website, of which I take judicial notice pursuant to Ill. R. Evid. 201. This document identifies John Doe as the President of this company.

The foregoing documentation supports the Taxpayer's testimony that he left ABC Business to form ABC Business Jr. prior to the due dates for returns for the period covered by

the Department's NPL. Based upon this evidence I find that, after June 2011, John Doe no longer had any status, duty or authority at ABC Business.

The NPL assesses taxes due from ABC Business for the months of June 2011 through July 2012. Sales tax returns for those months would have been due on the 20th day following the end of each of these months. 35 ILCS 120/3 (retailers' returns due on the 20th day of the month following the month in which receipts were received). Since the aforementioned documentation supports the Taxpayer's contention that he was not any kind of officer or employee of ABC Business at that time, he cannot have been responsible for filing ABC Business's returns for those months. Thus, I recommend that the Director find that John Doe was not a responsible officer of ABC Business during the period covered by the Department's NPL.

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

Ted Sherrod
Administrative Law Judge

Date: August 17, 2015