

ST 04-16

Tax Type: Sales 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. 03-ST-0000
IBT# 0000-0000
NPL# 0000**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General George Foster on behalf of the Illinois Department of Revenue; Lester A. Ottenheimer, III of Ottenheimer, Teplinsky, Rosenbloom, on behalf of John Doe.

Synopsis:

This matter comes on for hearing pursuant to John Doe's ("taxpayer[s]") protest to Notice of Penalty Liability ("NPL") number XXXX issued by the Department of Revenue against the taxpayer as an officer of ABC Inc. d/b/a XYZ Restaurant. The NPL represents a penalty liability for Retailers' Occupation Tax and related taxes, penalties and interest finally determined to be due from the corporation to the Department for the periods August, 2000 through January, 2001, August, 2001 and October, 2001 through January, 2002 which were not paid. A hearing in this matter was held on August 11,

2004. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the taxpayer.

Findings of Fact:

1. On October 10, 2003, the Department of Revenue issued to the taxpayer, John Doe, a Notice of Penalty Liability (“NPL”) for Retailers’ Occupation Tax and related taxes which assessed \$67,930.95 in tax, penalties and interest due for the periods August, 2000 through January, 2001, August, 2001 and October, 2001 through January, 2002. The notice states that the taxpayer is liable individually as an “officer, partner or employee” of ABC Inc. d/b/a XYZ Restaurant under section 3-7 of the Uniform Penalty and Interest Act, 35 ILCS 735/3-7. Dept. Ex. 1.
2. ABC, Inc. operated a restaurant called XYZ Restaurant located in Anywhere, Illinois. Dept. Ex. 2. ABC, Inc. (“ABC”) was registered with the Illinois Department of Revenue effective November 15, 1999, for the purpose of operating XYZ Restaurant. *Id.* The taxpayer was a 25% shareholder in the corporation. Two other individuals owned the remaining 75% of the shares, including XYZ who owned 25%, and Mr. Smith, the majority shareholder, who owned 50% of the corporation’s stock. Tr. p. 11. The taxpayer was president of the corporation (Tr. p. 12), XYZ was Treasurer and Mr. Smith was secretary. Dept. Ex. 2.
3. The taxpayer was also the general manager of XYZ Restaurant from 1999 until August 15, 2001. Tr. p. 11. As general manager, the taxpayer was responsible for the day to day operations of the restaurant. Tr. p. 12. His duties in this capacity included supervision of the restaurant’s staff, overseeing inventory orders and paying creditors. Tr. pp. 12, 13, 25, 26.

4. During the period of his employment at the restaurant, the taxpayer usually signed the sales tax returns filed by the corporation. Tr. pp. 12, 26. The sales tax returns were prepared by Free Enterprises, a bookkeeping company retained by ABC. Tr. p. 12. The taxpayer also had check signing authority, and ordinarily signed checks for payment of sales taxes during his tenure as general manager. Tr. pp. 12, 26, 27.
5. On August 24, 1999, the taxpayer signed a standard form NUC-1 Illinois Business Registration on behalf of ABC accepting personal responsibility for the filing of returns and the payment of taxes due from the corporation. Tr. pp. 24, 25; Dept. Ex. 2.
6. Retailers' Occupation and/or Use Taxes, penalties and interest were not paid for the following periods covered by the NPL: August, 2001 and October, 2001 through January, 2002. Retailers' Occupation and/or Use Taxes, but not penalties and interest assessed, were paid for the following period covered by the NPL: August, 2000 through January, 2001. Dept. Ex. 1. Retailers' Occupation and/or Use Tax was not paid, or timely paid during these periods because of the corporation's financial difficulties. Tr. p. 13. Such difficulties also caused the taxpayer to refrain from paying sales tax in favor of paying other bills during his tenure as general manager, in order to allow the restaurant to continue operating. Tr. p. 27.
7. Taxpayer's involvement in the day to day affairs of the restaurant ceased as of August 15, 2001. Tr. pp. 7, 16. The taxpayer also ceased to be an officer of ABC on or about this date. Taxpayer's Ex. 2. The taxpayer's departure from the restaurant was caused by the restaurant's financial difficulties, the fact that bills were becoming delinquent due to poor cash flow (Tr. p. 13) and difficulties in keeping the restaurant bill

payments up to date. Tr. p. 17. On July 20, 2001, the taxpayer met with Mr. Smith and XYZ, the owners of 75% of the corporation's stock, and advised them that he was resigning. *Id.*; Taxpayer's Ex. 1.

8. For the sales tax period August, 2000 through January, 2001, ABC failed to timely pay sales taxes due and owing. Tr. pp. 13, 14; Dept. Ex. 1. However, upon being made aware of this situation, Mr. Smith, majority stockholder of ABC, made a check for the full amount of taxes that were due for this period, which was given to the taxpayer and forwarded by the taxpayer to the Illinois Department of Revenue. Tr. p. 14. While the check given to the taxpayer did not cover penalty and interest, at the time the tax liability was paid, a payment plan was worked out with the Illinois Department of Revenue's Chicago office to pay back penalties and interest assessed for this tax period at the rate of \$1,000 per month. Tr. pp. 14, 15. The taxpayer made all payments required pursuant to this payment plan prior to his termination in August, 2001. Tr. p. 19.
9. At the time the taxpayer was terminated from his employment as general manager of XYZ Restaurant, he was required to turn all of the restaurant's books, records, and inventory and bank account information over to Mr. Joe Blow, his successor as general manager of the restaurant. Tr. p. 18. The taxpayer was told that after August 15, 2001 his involvement with the restaurant would cease and he was instructed not to return to the restaurant. Moreover, after his termination, the locks were changed on the restaurant doors denying him any access to the restaurant premises. ABC's bank account was also changed. Tr. pp. 19, 20, 22.

10. Subsequent to his termination as general manager of XYZ Restaurant in August, 2001, the taxpayer was sent various notices by the Department regarding unpaid penalties and interest liabilities of ABC. Tr. p. 22. In response to these notices, the taxpayer sent a letter to the Department advising it that the taxpayer was no longer the general manager or an officer of ABC and instructing it to forward notices of tax deficiencies to ABC's majority shareholder, Mr. Smith. Tr. pp. 20, 21; Taxpayer's Ex. 2.

Conclusions of Law:

The Department seeks to impose personal liability on the taxpayer, John Doe, as indicated in NPL number XXXX pursuant to section 3-7 of the Uniform Penalty and Interest Act ("UPIA"), which 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 wilfully fails to file the return or make the payment to the Department or wilfully 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 its 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

It is clear under the foregoing 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. Moreover, pursuant to this section, the Department's certified copy of the NPL at issue constitutes *prima*

facie proof of the correctness of the penalty due. See also Branson v. Department of Revenue, 168 Ill. 2d 247, 260 (1995). Once the Department has presented its *prima facie* case, the burden shifts to the respondent to establish that one or more of the elements of the penalty are lacking, i.e. that the person charged was not the responsible corporate officer or employee, or that the person's actions were not willful. *Id.* 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 books and records to support its claim. *Id.*

The months covered by NPL number XXXX can be divided into two distinct time periods. During the period of August, 2001 through January, 2002, it appears from the record that Mr. Doe was not a responsible officer for purposes of section 3-7(a) of the UPIA. For the earlier period covered by the NPL, August, 2000 through January, 2001, the taxpayer concedes that he was a responsible officer, but argues that he did not act willfully in failing to remit the pertinent taxes. Tr. pp. 34 – 36. Therefore, he argues, personal liability cannot attach to him. *Id.*

Section 3-7 of the UPIA does not define “responsible” person or “wilfull” conduct. However, the Illinois Supreme Court, in cases wherein it has considered personal liability, has referred to Federal court interpretations of similar language in Section 6672 of the Internal Revenue Code (26 USCA §6672). Department of Revenue v. Heartland Investments, 106 Ill. 2d 19, 29 (1985). Section 6672 imposes personal

liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

In determining whether an individual is a responsible person, the federal 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 disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), cert. denied 400 U.S. 821 (1970). The courts have considered specific facts in determining whether individuals were "responsible" for the payment of taxes, to wit: 1) the duties of the officer as outlined in the corporate by-laws; 2) the ability of the individual to sign checks of the corporation; 3) the identity of the officers, directors and shareholders of the corporation; 4) the identify of the individuals who hired and fired employees and 5) the identity of individuals in control of the financial affairs of the corporation. Id.; Gephart v. United States, 818 F. 2d 469 (6th Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. Id.

With regard to Mr. Doe, his testimony and evidence admitted at the evidentiary hearing clearly shows that he was not a responsible party under the statute for the period August, 2001 through January, 2002 which the NPL covers. While Mr. Doe was the President of ABC, and acted as general manager responsible for hiring and firing personnel and paying bills, Mr. Doe resigned from these positions, effective August 15, 2001. Tr. pp. 16, 17; Taxpayer's Ex. 1, 2. The record shows that, after his resignation,

Mr. Doe was excluded from the corporation and was not allowed to assume any responsibilities with respect to it whatsoever. Tr. pp. 19, 20, 22.

Mr. Doe's liability is derivative from the corporate liability of ABC. Department of Revenue v. Dombrowski Enterprises, 202 Ill. App. 3d 1050 (1st Dist. 1990); Heartland Investments, *supra* at 32 ("The liability imposed upon an individual defendant ... is derivative in nature."); 86 Ill. Admin. Code, ch. I, sec. 521.105(h)(1). Mr. Doe's alleged derivative liability for the period August, 2001 through January, 2002, arising from ABC's failure to pay taxes due for that period relates to taxes that were due after the effective date of Mr. Doe's resignation.

The presentation of evidence that Mr. Doe resigned from ABC and was no longer involved in the financial or other affairs of this company after August, 2001 rebutted the Department's *prima facie* showing that Mr. Doe was a responsible officer for that period. Accordingly, it was incumbent upon the Department to present evidence that the taxpayer had sufficient authority and control over the affairs of ABC to be considered a responsible officer under the case law noted above after his resignation took place. Novicki v. Department of Revenue, 373 Ill. 342, 346 (1940). The Department has failed to do so. Consequently, I find that the taxpayer was not a responsible officer of ABC after August 15, 2001 and therefore was not responsible for the unpaid taxes of this corporation for the period August, 2001 (due September 20, 2001 pursuant to 35 ILCS 120/3 and 86 Ill. Admin. Code, ch. I, § 130.501(a)) through January, 2002. Indeed, the Department has tacitly conceded that the taxpayer was not a responsible person upon which liability for taxes included in the NPL for the period August, 2001 through January, 2002 can be levied, having only argued during the evidentiary hearing

proceedings that the taxpayer is liable for unpaid penalty and interest for the period August, 2000 through January, 2001, which preceded the taxpayer's resignation from the company. Tr. pp. 31 – 33.

With respect to the period August, 2000 through January, 2001 covered by the NPL, during which the taxpayer was the president and general manager of ABC, the taxpayer admits that he was a responsible officer of the company during that time. Tr. p. 34. Indeed, the record shows that virtually all of the indicia of a “responsible officer” identified in case law delineating this status are present here. Compare Monday, *supra* with Tr. pp. 25 - 27.

While the taxpayer does not contest the Department's finding that the taxpayer was a responsible officer of ABC for the period August, 2000 though January, 2001 covered by the NPL, he does contest the Department's finding that he acted willfully in failing to remit the penalties and interest due for that period. Tr. pp. 34 – 36. 35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay taxes. However, as previously noted, the Illinois Supreme Court has accepted, as indicia of willfulness, a showing of “reckless disregard for obvious or known risks” as set forth in cases dealing with section 6672 of the Internal Revenue Code. Heartland Investments, *supra* at 29. In the case of Wright v. United States, 809 F. 2d 425, 427 (7th Cir. 1987), the Seventh Circuit Court of Appeals held that a “responsible person” acts willfully and 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 also includes a “failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government.”

Peterson, *supra* at 1217. A person acts willfully “when or after he or she gains actual knowledge that the taxes are delinquent, liquid funds are available from which the taxes can be paid and he or she, having the ability to pay the taxes, fails to do so.” *Id.* at 1216. Moreover, a person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Heartland Investments, *supra*; Calderone v. United States, 799 F. 2d 254 (6th Cir. 1986).

The taxpayer seeks to rebut the presumption of willfulness by testifying that he paid all taxes due and owing while a responsible officer, and made arrangements for the payment of interest and penalties due on delinquent tax payments during his tenure prior to his resignation from office. Tr. pp. 35, 36. The record shows that the taxpayer reached an agreement with the Department to pay all penalties and interest for the period prior to the taxpayer’s departure. Tr. pp. 14 – 16. While a copy of this agreement was not introduced into the record, testimony regarding it was credible and was not contested. Moreover, the existence of an agreement to cover unpaid penalties and interest is consistent with ABC’s otherwise flawless record of compliance prior to Mr. Doe’s departure and the fact that, upon his departure, tax compliance essentially ceased. See Dept. Ex. 1.

The agreement entered into required the taxpayer to pay \$1,000 per month beginning in 2001 to abrogate the liability of ABC d/b/a XYZ Restaurant for unpaid interest and penalties. The record also indicates that the taxpayer made all payments in accordance with this agreement prior to his resignation from the company. Tr. p. 19. Further, it reveals that the taxpayer advised Mr. Smith, the principal stockholder of ABC, and his successor as general manager, of this agreement. These successors assumed

responsibility for payments required in accordance with this agreement after his departure from the company. Tr. pp. 18, 19. Obviously, however, the taxpayer had no authority to compel them to do so, and no way of assuring that payments were being made.

A review of the cases previously cited herein, *supra* at pages 6 – 9, indicates that there are many Illinois and Federal court judicial precedents holding that the responsible officer penalty was properly imposed. However, there are also a number of cases where the court has found that the penalty does not apply. In Department of Revenue v. Marion Sopko, Inc., 84 Ill. App. 3d 953 (2d Dist. 1980), the Appellate Court found that a president of a corporation was not willful in his disregard of taxes even though he was in complete control of the corporation. The record in this case indicates that the corporation's president relied upon his accountant who assured the president that he would take care of tax matters. However, the accountant failed to do so.

In Branson, *supra* at 263-268, the Supreme Court found that a taxpayer was liable for taxes during the time that he was responsible for the bookkeeping of the corporation. The court declined, however, to disturb the Appellate Court's ruling affirming the lower court's finding that the corporation's bookkeeper rather than the taxpayer was responsible for the payment of the corporation's debts for part of the period at issue, and that the taxpayer was not liable for that period.

I find the fact scenario presented in the instant case analogous to cases in which the taxpayer relied upon another individual to pay the tax liability due. The record shows that the taxpayer was excluded from the company after his resignation and therefore had no control or supervision over the handling of tax payments, including payments due pursuant to the corporation's agreement to pay penalty and interest on delinquent taxes as

agreed to by the taxpayer prior to his resignation.¹ Accordingly, the taxpayer was required to rely upon his successors to carry out these responsibilities. Indeed, it would have been impossible for him to even discover that these commitments had been neglected since the taxpayer was deliberately divorced from the corporation's affairs by his successors.

In sum, I find that there was no willful attempt to avoid payment of liability for penalties and interest resulting from delinquent payments during the period August, 2000 through January, 2001. The taxpayer paid all taxes due for these periods and made arrangements for the payment of unpaid interest and penalties prior to his resignation as President of ABC. After his resignation, the taxpayer did not have control over or access to funds of the business entity incurring these liabilities to assure payments agreed to by the taxpayer, and of necessity had to rely upon continuing management to do so. In this case it is the taxpayer's successors who took responsibility for making these payments and failed to do so. It is these persons that willfully failed to pay the penalties and interest due pursuant to the taxpayer's agreement with the Department, not the taxpayer.

¹While the record shows that the taxpayer remained a 25% stockholder in ABC after his separation from the company, (Tr. p. 21; Dept. Ex. 2), his voting rights as a minority stockholder would have been insufficient to control or even influence the filing of returns and payment of taxes. Gidwitz v. Lanzit Corrugated Box Co., 20 Ill. 2d 208, 215 (1960); Elward v. Peabody Coal Co., 121 Ill. App. 2d 298, 308 (1st Dist. 1970); Polikoff v. Dole & Clark Building Corporation, 37 Ill. App. 2d 29, 35 (1st Dist. 1962) ("Every one [holding] stock in a corporation impliedly agrees that he will be bound by the acts and proceedings done or sanctioned by a majority of the shareholders, or by agents of the corporation duly chosen by such majority, within the scope of the powers conferred by the charter."). See also DiStasio v. U.S., 66 AFTR

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's NPL number XXXX be cancelled.

Ted Sherrod
Administrative Law Judge

Date: September 30, 2004

2d 90-5904 (Cl. Ct. 1990) holding that a minority shareholder having no other corporate status lacks sufficient authority or control over the corporation to be considered a "responsible officer."