

ST 05-11

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, as responsible
officer of ABC Corporation,

Taxpayer

No. 03-ST-0000
IBT No. 0000-0000
NPL # 0000
NOD # 0000

Kenneth J. Galvin
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Timothy E. Cronin, Timothy E. Cronin, P. C., appearing on behalf of *John Doe*; Mr. George Foster, Special Assistant Attorney General, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to *John Doe*' protest of Notice of Penalty Liability No. 0000 (hereinafter "NPL") and Notice of Deficiency No. 0000 (hereinafter "NOD"), as responsible officer of ABC Corporation. The NPL represents a penalty liability for retailers' occupation tax of ABC Corporation due to the Department for various months beginning August, 2001, through March, 2002. The NOD represents a penalty liability for withholding taxes for the fourth quarter of 1999 and the first quarter of 2002. A hearing was held on this matter on March 3, 2005, with Mr. Doe testifying. Following submission of all evidence and a review of the record, it

is recommended that the NPL be finalized through the January, 2002, assessment and that the NOD be finalized as issued. 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. 0000, dated January 9, 2003, which shows a penalty for sales tax liability of ABC Corporation of \$82,747.21 for various months beginning August, 2001 through March, 2002 and NOD No. 0000 dated January 10, 2003, which shows a total liability due and owing for unpaid withholding tax of \$6,196.90 for the fourth quarter of 1999 and the first quarter of 2002. Tr. pp. 12-13; Dept. Ex. No. 1.
2. Mr. Doe was vice-president of ABC Corporation until 1984, at which time he was elected president. Beginning in 1984, Mr. Doe was the sole member of the Board of Directors and was never less than an 80% shareholder of ABC Corporation. Mr. Doe testified that he was the sole person with authority to make determinations as to the payments or nonpayment of expenses and bills of the corporation including state and federal taxes. Tr. pp. 15-16.

Conclusions of Law:

There are two types of taxes at issue here. The Department seeks to impose personal liability on Mr. Doe pursuant to Section 1002(d) of the Illinois Income Tax Act for the failure to pay withholding taxes. 35 ILCS 5/1002(d). In addition, the Department seeks to impose personal liability on Mr. Doe for failure to remit retailers’ occupation tax. 35 ILCS 120 *et seq.* The personal liability penalty for both taxes is imposed by 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 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 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 and NOD establishes the Department’s *prima facie* case with regard to both the fact that Mr. Doe 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 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the case. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

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 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). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

At the evidentiary hearing, Mr. Doe admitted that he was a responsible officer of ABC Corporation and that he willfully failed to file and remit tax payments. Mr. Doe was vice-president of ABC Corporation beginning in 1974. In 1984, Mr. Doe became president, sole member of the

Board of Directors and was never less than an 80% shareholder. Tr. pp. 15-16. Mr. Doe testified that beginning in 1984, he was the sole person with authority to make determinations as to the payment or nonpayment of expenses and bills of the corporation including state and federal taxes. Tr. p. 16. Mr. Doe admitted that, while he was president of ABC Corporation, he was in charge of seeing to it that the taxes were paid. Tr. pp. 20-21. Mr. Doe' counsel stated in opening argument that Mr. Doe "was a responsible party and there was that willful failure to file tax returns or remit payments." Tr. pp. 7-8. Based on Mr. Doe' own admissions and his counsel's statements, I conclude that Mr. Doe had the power and responsibility for seeing that taxes were remitted to the government and that he was a responsible officer of ABC Corporation.

Mr. Doe testified that on January 14, 2002, he executed an assignment for the benefit of creditors in favor of a company known as "Mr. Smith and Associates, Inc." Tr. p. 17. According to Mr. Doe, on January 14, 2002, he relinquished the "running and ongoing business of ABC Corporation as it existed." Tr. p. 16. At the time Mr. Doe made the assignment, he testified that he turned over to the assignee all of the taxing records, the payroll accounts, vendors, "anybody that we owed money to and so on." He also testified that he turned over to the assignee all physical assets, bank account records and keys to the building. Tr. pp. 19-20. ABC Corporation's balance sheet, dated January 14, 2002, shows total assets of \$221,000 and total liabilities of \$719,000. The total liabilities include \$45,000 in "state tax liability." According to Mr. Doe' counsel, "[F]rom January 14, 2002, on, [Mr. Doe] had no authority over the company, no control over any of its assets, and none of the decision making power; all of that having been taken over by the assignee." Tr. p. 8.

It must be noted that if Mr. Doe had no control over ABC Corporation's assets and "none of the decision making power" as of January 14, 2002, this was his choice and it didn't relieve him of the responsibility for the payment of ABC Corporation's liabilities to the State. Mr. Doe offered

into evidence a “Joint Written Consent by the Board of Directors and Shareholders” of ABC Corporation to the assignment, the “Assignment Agreement,” and the “Acceptance” of the assignment by Mr. Smith & Associates. Taxpayer’s Ex. No. 1. None of these documents are signed by either directors, shareholders or officers of ABC Corporation, Mr. Doe or Mr. Smith. None of the blank spaces on the documents are filled in and the documents are not dated. The only explanation offered at the evidentiary hearing for this was that the completed and signed documents were given to Mr. Smith. Tr. pp. 17-18. The only evidence admitted at the hearing showing that there was an actual assignment is a “Notice of Assignment for the Benefit of Creditors” from “Mr. Smith & Associates, Inc” signed by “Mr. Smith” stating that ABC Corporation had executed an assignment on January 14, 2002. Taxpayer’s Ex. No. 2. Mr. Smith did not testify at the evidentiary hearing.

This “Notice of Assignment” states that a public auction on the premises of ABC Corporation was scheduled for February 28, 2002. Taxpayer’s Ex. No. 2. Mr. Doe testified that “[W]e had an auction and everything was seized, disconnected, organized by the auctioneers, and they had an auction on the premises shortly after we signed.” Tr. pp. 24-25. According to Mr. Doe, there was no business conducted by ABC Corporation during February or March of 2002. Tr. p. 25. Counsel for the Department did not cross-examine Mr. Doe. Mr. Doe’ knowledge of what happened with ABC Corporation after January 14, 2002, indicates that he was more involved with the Corporation after that time than he has admitted to.

NPL No. 0000 includes unpaid retailers’ occupation tax of ABC Corporation for the months of August, 2001, through March, 2002. Mr. Doe’ admission of responsibility and willfulness for ABC Corporation through January 14, 2002 means that the only unpaid retailers’ occupation assessments at issue are the assessment for December, 2001, which according to Mr. Doe was payable on January 15, 2002, the day after the assignment, and the assessments for January,

February and March, 2002, payable on the 15th of the month following the assessment. NOD No. 0000 includes unpaid withholding tax for the fourth quarter of 1999 and the first quarter of 2002. Mr. Doe' admission of responsibility for ABC Corporation through January 14, 2002 covers the unpaid withholding tax for the fourth quarter of 1999, leaving only the withholding tax assessment for the first quarter of 2002 at issue.¹

Mr. Doe testified that on January 14, 2002, when he "relinquished control of the corporation and turned over all assets of the company," he provided Mr. Smith with "specific information as to amounts that were owed to the State of Illinois for sales tax." Tr. p. 23. According to Mr. Doe, the December, 2001, assessment for retailers' occupation tax was payable on January 15, 2002, the date after the assignment, and retailers' occupation tax on sales made prior to January 14, 2002 would have been payable on February 15, 2002. Tr. pp. 20-22. Mr. Doe also testified that on January 14, 2002, when he relinquished control, there was more than \$8,800 in ABC Corporation's bank account. Tr. p. 23. The balance sheet for ABC Corporation as of January 14, 2002, shows Cash of \$10,000 and Accounts Receivable, Vehicles and Equipment of \$211,000. Taxpayer's Ex. No. 2.

I am unable to conclude that Mr. Doe' responsibility for payment of taxes ended on January 14, 2002. The assignment for the benefit of creditors was obviously a voluntary undertaking on the part of ABC Corporation and did not relieve the Corporation or its President of the responsibility for paying the State for taxes owed. An executed copy of the Assignment was not admitted into evidence and it seems likely that the decision to make the assignment could have

¹ The unpaid withholding taxes for the fourth quarter of 1999 were assessed in the amount of \$4,586.06. Mr. Doe argued at the hearing that this assessment had been paid. He offered into evidence a "Notice of Trustee's Final Report" in his personal bankruptcy case, dated January 6, 2004. The Report states at Paragraph 6 that the "Illinois Department of Revenue filed two priority tax claims in the total amount of \$75,933.75 and will be paid 43% of their claims or \$32,464.30." Taxpayer's Ex. No. 5. On or about March 8, 2004, after the issuance of NOD No. 0000,

been done unilaterally by Mr. Doe, as President, sole member of the Board of Directors and 80% shareholder of ABC Corporation. My research does not indicate and counsel for Mr. Doe did not refer me to any case that holds that an admittedly responsible officer would cease to be responsible by making a unilateral voluntary assignment of the assets of the corporation. The December and January sales tax assessments which were due according to Mr. Doe, on January 15 and February 15, 2002, respectively, plus the withholding tax for the first quarter of 2002 totaled \$11,500. At the time that Mr. Doe turned over the assets of ABC Corporation, ABC Corporation had \$10,000 in “Cash,” which would just about have covered these three assessments.

No documentary evidence was offered to show that Mr. Doe made any effort to retain the \$10,000 in the bank, by court order if necessary, to cover the sales tax and withholding tax liabilities. No documentary evidence was presented to show that Mr. Doe attempted to safeguard any of the other \$211,000 in existing assets of ABC Corporation as of January 14, 2002, by court order if necessary, for the payment of the sales tax and withholding tax liabilities. There were funds available to pay these assessments when ABC Corporation voluntarily made an assignment for the benefit of creditors, and as the responsible officer of ABC Corporation, Mr. Doe should have taken steps to ensure that these payments were made. “A fiduciary cannot absolve himself merely by disregarding his duty and leaving it to someone else to discharge.” Hornsby v. Internal Revenue Service, 558 F. 2d 952 (5th Cir. 1979). By not taking steps to ensure that funds were retained to pay the State, Mr. Doe allowed the available funds to be used to pay other creditors thereby exhibiting willfulness under the Statute. 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). I conclude that Mr. Doe was responsible for the December and January sales tax assessments payable January 15, 2002 and February 15, 2002, respectively and for the first

\$2,282.90 was received by the Department and was applied toward the withholding tax assessment

quarter withholding tax liability and that by his inaction, he willfully failed to remit these tax payments.

The February and March 2002 assessments for ABC Corporation, included in NPL 0000, appear to be estimates by the Department. The February assessment is coded as an “estimate.” Dept. Ex. No. 1. Mr. Doe testified that no business was conducted by ABC Corporation in February and March, 2002, and that “everything” was seized, disconnected and auctioned shortly after ABC Corporation executed the Assignment with Mr. Smith. Tr. pp. 24-25. The Notice of Assignment states that a public auction is scheduled for February 28, 2002. The Department’s counsel did not cross-examine Mr. Doe. In light of Mr. Doe’ testimony in this matter and the documentary evidence, I recommend that the assessments for February and March, 2002, be cancelled.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. 0000 be finalized as issued through assessment 00 00000000000000 (01-2002) and that the 02/2002 and 03/2002 assessments be cancelled and that Notice of Deficiency No. 0000 be finalized as issued.

Date: May 20, 2005

Kenneth J. Galvin
Administrative Law Judge