

IT 06-10

Tax Type: Income 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.

JANE DOE,

Taxpayer

**No. 05-IT-0000
SSN 000-00-0000
Period 4/Q/00 – 3/Q/03**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Jessica O’Brien on behalf of the Illinois Department of Revenue; Tony Mankus, Esq. of Mankus & Marchan, Ltd., on behalf of Jane Doe.

Synopsis:

This matter comes on for hearing pursuant to the taxpayer’s timely protest of Notice of Deficiency (1002D) number 2004-364-06-D issued by the Department on December 30, 2004 for withholding tax liability. Such Notice of Deficiency was issued to Jane Doe (hereinafter “taxpayer”) as a responsible officer of ABC Corp. pursuant to section 1002(d) of the Illinois Income Tax Act, 35 ILCS 5/1002(d). The issues to be resolved are 1) whether the taxpayer was a responsible officer of the corporation and thereby required to collect, account for and pay over withholding taxes, and 2) whether the taxpayer willfully failed to collect, truthfully account for and pay over such taxes for the fourth quarter of 2000 through the third quarter of 2003, (hereinafter the “tax

period”). A hearing was held on February 27, 2006. Upon consideration of all of the evidence presented at the hearing, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The Department’s *prima facie* case was established by the admission into evidence of the Notice of Deficiency, dated December 30, 2004, showing a total liability due and owing in the amount of \$89,610.41 for the period 4/Q/00-3/Q/03. Department Exhibit (“Ex.”) 1.
2. ABC Corp. (“ABC”), a Delaware corporation formed in 1991 (Tr. pp. 147, 173), having its principal place of business in Anywhere, Illinois (Tr. pp. 64, 65) and subsequently during the tax period in controversy, in Everywhere, Illinois (Tr. pp. 81, 82), is engaged in the business of temporary staffing and employee leasing (Tr. p. 8).
3. From its formation until “the early ‘90s” ABC was engaged in the business of providing engineering staff and temporary employees. Tr. p. 87. Subsequently, ABC purchased a business engaged in providing temporary staff and employees for trucking and transportation companies from an in-law relative of the taxpayer. Tr. pp. 87, 88. ABC was engaged in this activity during the tax periods in controversy. Tr. p. 83. Prior to obtaining this new business, the taxpayer assisted her husband in determining whether this business could successfully be operated. Tr. p. 88. While most of ABC’s business activities were conducted in Illinois, the company also provided temporary employees that worked in Michigan, New York, Ohio, Missouri and Indiana. Tr. pp. 78, 132, 133.

4. ABC employed permanent staff that operated the business, and temporarily employed individuals that were leased to or temporarily hired by third parties. Tr. pp. 66, 67, 187, 188. ABC had an average of 75–80 temporary employees per week. Tr. pp. 188, 189. The taxpayer was employed by ABC in 1999 and ceased to be a full time employee of the corporation in April 2002. Tr. pp. 312, 343.
5. From the inception of the company, and during the tax period in controversy, the taxpayer was the President of ABC (Tr. p. 46; Department Ex. 2-4, 7), and owned 100% of the corporation's stock (Tr. pp. 45, 139, 140, 176; Department Ex. 4). The taxpayer signed, as President, the corporation's NUC-1, Illinois Business Registration with the Illinois Department of Revenue dated September 6, 1991. Department Ex. 2.
6. The taxpayer's husband, John Doe, was ABC's Vice President (Tr. pp. 240, 313; Taxpayer Group Ex. 1, 2), and a director and employee of the corporation (Department Ex. 3, 4, 8), but did not own any of the corporation's outstanding stock (Tr. pp. 47, 176; Department Ex. 3, 4, 8). The other officers of the company were Mr. Smith (the taxpayer's father), Secretary, and Mrs. Smith (the taxpayer's mother), Treasurer. Tr. p. 47. The taxpayer's son, stepdaughter, and Mr. Jones, a friend of the taxpayer's son, were also employees of the company. Tr. pp. 66, 185, 186.
7. Prior to becoming the President of ABC, the taxpayer occupied various executive level positions at the U.S. Post Office. Tr. pp. 21-38. Her responsibilities while at the post office included reviewing legal documents, interpreting tax provisions of contracts and other documents, and making recommendations regarding the acquisition and lease of real estate. Tr. pp. 27-31, 34-37.

- 8.** Prior to becoming the Vice President of ABC, beginning in 1973 or 1974 until 1989, John Doe was employed by CDI Corporation, a company engaged in interviewing, qualifying and hiring temporary engineers, and was promoted to Vice President in charge of operations for the Midwestern region in 1984. Tr. pp. 255-257.
- 9.** ABC's initial capitalization was provided by the taxpayer from cashing in bonds she owned, and the taxpayer continued to fund the corporation using proceeds from the sale of her personal bonds, retirement funds and other savings throughout the tax period in controversy when the company experienced cash flow problems. Tr. pp. 119, 144, 161, 181, 195, 216, 220, 239, 240, 366.
- 10.** John Doe, who served as Vice President (Tr. p. 240, 313; Taxpayer Group Ex. 1, 2), and as the company's manager (Department Ex. 7), was primarily responsible for sales, customer service and business operations (Tr. pp. 149-151, 207). This included oversight of the corporation's financial affairs. Tr. pp. 162, 202, 208-210.
- 11.** The company's principal office was located in the basement of the taxpayer's residences throughout the tax period in controversy. Tr. pp., 64, 374.
- 12.** John Doe's responsibilities at ABC required him to be away from the company's offices to make calls on clients approximately 80% of the time during the tax period in controversy. Tr. p. 194. In his absence, the taxpayer assumed responsibility for issuing company checks to employees, creditors of employees having claims on their compensation and other company creditors. Tr. pp. 89-115, 122. The taxpayer wrote at least 1200 checks, 212 of which were payroll checks, immediately preceding and during the tax period in controversy. Tr. pp. 110, 156, 270. These included checks she signed that were issued to herself and her husband. Tr. pp. 90, 108, 122.

- 13.** The taxpayer participated in the process of determining who would be hired by ABC as temporary employees. Tr. pp. 73-78, 147, 148, 192, 210, 211, 226.
- 14.** During the tax period in controversy, ABC operated using two accounts, a payroll account, used exclusively to make payroll payments and a general account, used to cover other expenses of the corporation. Tr. pp. 48, 49. Taxpayer had check signing authority with respect to both of these accounts and could write checks without prior approval from her husband or anyone else at the company. Tr. p. 89; Department Ex. 7.
- 15.** John Doe was primarily responsible for the preparation of tax returns and the remission of tax payments. Tr. pp. 152, 154, 155, 161, 260-266, 271, 272. However, the taxpayer also exercised some of these responsibilities from time to time. Tr. pp. 94, 139, 143, 144, 221; Department Ex. 5.
- 16.** ABC employed the accounting firm of Smith & Associates to assist in the preparation of its tax returns during the tax period in controversy. Tr. pp. 265, 294, 295, 297, 326; Department Ex. 5, 6.
- 17.** Prior to the tax period in controversy, from 1991-1996, ABC employed a payroll service company selected by John Doe to handle the processing and payment of its payroll. Tr. pp. 49, 145, 187. In 1996, the corporation ceased to retain the services of the payroll company and began preparing its payroll in house. Tr. p. 187.
- 18.** During the tax period in controversy, the taxpayer handled payroll related responsibilities previously performed by ABC's payroll company including calculating the number of hours each employee worked, the amount owed to each employee and determining the amount to be invoiced to each of the company's

clients. Tr. pp. 84, 85, 152, 153, 155, 156, 360. The taxpayer was also responsible for indexing and filing cancelled payroll checks, and was aware that some of the payroll checks ABC issued were returned due to “insufficient funds.” Tr. pp. 117, 118.

- 19.** ABC’s books and records were kept at the taxpayer’s home. Tr. pp. 64, 65. Taxpayer had access to these books and records but chose not to review them or discuss financial matters with her husband. Tr. pp. 195, 196, 205, 222-224, 227, 313, 358-360, 364, 367-369.
- 20.** Taxpayer had access to the company’s checkbooks, and the company’s correspondence, including correspondence concerning financial matters, during the tax period in controversy. Tr. pp. 67, 68, 122, 123, 135, 193, 205, 227, 228.
- 21.** During the tax period at issue, ABC held corporate meetings, which the taxpayer attended. During these meetings, the financial affairs of the corporation were discussed. Tr. pp. 88, 89, 367, 368, 372.
- 22.** The taxpayer was aware that the corporation had experienced a reduction in cash flow after 9/11/01, and that some of the corporation’s customers had ceased to pay invoices in a timely manner as a result of a slow down in the transportation industry after that date. Tr. pp. 83, 84, 370, 371.
- 23.** The taxpayer had access to the corporation’s payroll related withholding documents. Tr. p. 148. She was aware that taxes were being withheld from employee checks and that the company was required to remit withheld taxes to the state and federal governments. *Id.*

24. The taxpayer's initial salary as President of ABC was \$82,000 a year, and she received wages in the amount of \$88,000 from ABC in 2000. Tr. pp. 146, 206, 312; Department Ex. 9. The taxpayer ceased to receive any income from the corporation after 2000, and was aware that ABC was unable to pay her salary due to the cash flow problems the company faced, and its financial condition. Tr. pp. 62, 63, 146, 147, 205, 206, 220, 223, 224, 351, 352; Department Ex. 12.
25. ABC failed to file payroll tax returns and/or make payroll tax payments of amounts withheld from employees' payroll during the periods 4/Q/00 through 3/Q/03. Tr. p. 7; Department Ex. 1. As a consequence, the Department assessed ABC for such taxes and, upon its failure to pay them, assessed the taxpayer and her husband, John Doe, as responsible officers of the corporation pursuant to section 1002(d) of the Illinois Income Tax Act, 35 ILCS 5/1002(d). Tr. pp. 278, 279; Department Ex. 1.
26. The taxpayer became aware of the corporation's tax delinquencies to the federal government in 2003. Tr. p. 353.
27. ABC filed for bankruptcy and ceased its business operations in September 2003. Tr. pp. 220, 221.

Conclusions of Law:

The Department seeks to impose personal liability on the taxpayer pursuant to Section 1002(d) of the Illinois Income Tax Act ("IITA"), which provides:

Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for the penalty imposed by Section 3-7 of the Uniform Penalty and Interest Act.
35 ILCS 5/1002(d)

Section 735/3-7 of the Uniform Penalty and Interest Act (“UPIA”) 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 make 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 the tax unpaid by the taxpayer including interest and penalties thereon.

35 ILCS 735/3-7

Section 1002(d) of the IITA is modeled after Section 6672 of the Internal Revenue Code, which imposes liability upon those individual persons actually responsible for an employer’s failure to withhold and pay over the taxes. Allen v. United States, 547 F. Supp. 357 (N.D. Ill. 1982).

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 the corporation and whether he or she participates in the decisions regarding the payment of creditors and disbursement of funds. See, e.g., 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 withholding taxes are remitted to the government. Id. Thus, the statute does not confine liability to the single most responsible person. Howard v. United States, 711 F. 2d 729 (5th Cir. 1983).

Although title alone is insufficient to constitute a finding of responsibility (Monday, supra), it is clear from both testimony and documentary evidence that the taxpayer had significant authority with respect to the corporation’s affairs. The taxpayer

was President and the sole shareholder of ABC, a Delaware corporation.¹ Tr. pp. 45, 46, 139, 140, 147, 173, 176; Department Ex. 2-4, 7. As the company’s sole shareholder, the taxpayer had ultimate authority to control the corporation’s affairs by virtue of her legal right to determine the company’s directors responsible for hiring, retaining and firing the corporation’s officers. See 8 Del. C. § 142(b) (“Officers shall be chosen in such manner and shall hold their offices for such terms as ... determined by the board of directors ... [.]”) and 8 Del. C. § 141(k) (“Any director or the entire board of directors may be removed with or without cause, by the holders of a majority of the shares ... [.]”). These statutory provisions conferred upon the taxpayer the ultimate authority to control ABC’s business affairs and participate in decisions concerning the allocation of corporate funds. Such authority over corporate matters is an indicia of “responsible officer” status. Monday, *supra*.

The taxpayer was also a signatory on all of the corporation’s bank accounts and was authorized to sign checks without prior approval from her husband or anyone else in the company. Tr. p. 89; Department Ex. 7. Such authority is also indicative of “responsible officer” status. Gephart v. United States, 818 F. 2d 469, 473 (6th Cir. 1987) (“It is well established that the test for determining the responsibility of a person under § 6672 is essentially a functional one, focusing on the degree of influence and control which the person exercised over the financial affairs of the corporation and, specifically, disbursements of funds ... [.]”) (emphasis added). Moreover, she exercised this

¹ All of ABC’s initial capital consisted of funds provided by the taxpayer. Tr. p. 181.

authority in signing at least 1200 of the corporation's checks immediately preceding and during the tax period in controversy. Tr. pp. 89-115, 156, 270.

The taxpayer seeks to negate the inferences that logically follow from her status as the corporation's President and sole shareholder, and from her unfettered authority to sign corporate checks, by contending that her husband exerted ultimate control over the transfer of corporate funds, and made all decisions regarding the payment of corporate bills. Specifically, she testified that she needed her husband's permission before paying bills and did not exercise any authority over the execution and issuance of corporate checks without his prior approval. Tr. pp. 122, 154, 155. However, the taxpayer has offered no evidence, other than testimony, to corroborate these claims. The Department established its *prima facie* case of personal liability against the taxpayer through the introduction of its Notice of Deficiency ("NOD"). Vitale v. Illinois Department of Revenue, 118 Ill. App. 3d 210 (1983). Once the Department presents its *prima facie* case, the burden shifts to the respondent taxpayer to rebut it. In order to overcome the Department's *prima facie* case, the alleged 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 (1st Dist. 1988). Rather, that person must present evidence that is consistent, probable and supported by books and records to rebut the Department's finding. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). Oral testimony without corroborating books and records is insufficient to overcome the Department's *prima facie* case. Mel-Park Drugs v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991). In the absence of documentary evidence, such as corporate by-

laws, resolutions or similar documents, or employment contracts and agreements spelling out limitations on the taxpayer's authority, or bank documentation restricting the taxpayer's authority over the corporation's accounts, I find that the taxpayer's mere testimony fails to rebut the Department's NOD. Mel-Park Drugs, *supra*.

Indeed, the documentary evidence in the record tends to contradict rather than corroborate the taxpayer's contentions. As previously noted, documents in the record indicate that the taxpayer had the unfettered right to access and utilize the corporation's bank accounts. Tr. p. 89; Department Ex. 7. Her exercise of this authority did not require the approval of her husband or anyone else in the company. *Id.* Moreover, she was the sole signatory on the corporation's NUC-1, Illinois Business Registration filed at the inception of the corporation, a section of which provides as follows: "I accept personal responsibility for the filing of returns and the payment of taxes due." Department Ex. 2.

Testimony in the record is also at odds with the taxpayer's claim that she failed to exercise any authority over the corporation's financial affairs. The taxpayer claims that her husband exercised all authority over the corporation's tax and financial affairs. Tr. pp. 152, 154, 155, 161, 162. However, the taxpayer admits that she was responsible for paying corporate bills and other obligations during her husband's absences from the company's headquarters. Tr. pp. 89-115, 122. The taxpayer describes these absences as periodic rather than routine. Tr. p. 134. However, her husband testified that he was absent from the corporation's home office providing on-site services to ABC clients over 80 percent of the time during the tax period in controversy. Tr. p. 194. Given her husband's frequent, rather than occasional, absences from the company's headquarters,

Ms. Larsen, of necessity, would have routinely exercised control over the payment of corporate bills and obligations in order to avoid late payment of the company's payroll and other obligations. Tr. p. 155. The record also indicates that the taxpayer was primarily responsible for such critical corporate functions as invoicing corporate clients and determining the amount of compensation due each of the company's temporary employees. Tr. pp. 84, 85, 152, 153, 155, 156, 360.

Inherent in the taxpayer's control over a substantial part of the corporation's check disbursement function, and her unfettered ability to write checks drawn on the corporation's accounts, is power over the allocation of corporate funds. Such authority is the type of control that establishes the taxpayer as a responsible person under section 1002(d) of the Illinois Income Tax Act because it indicates that she had the power and authority within the corporation to see to it that state tax compliance and payment responsibilities are not compromised by the company's financial position. Gephart, *supra*. The fact that she failed to exercise this authority or that her husband also had control over the corporation's financial matters does not exonerate the taxpayer from liability as a responsible officer. *Id.* In sum, the taxpayer failed to rebut the Department's *prima facie* finding that she was a "responsible officer." Indeed, there is ample evidence in the record to establish that the taxpayer wielded significant control over the corporation's finances and, therefore, was a responsible person as required under the section 1002(d) of the Illinois Income Tax Act.

In order to establish the taxpayer's statutory liability as a "responsible officer" under section 1002(d), it must also be determined whether the taxpayer willfully failed to remit withholding taxes to the Department. Willfulness in regards to section 1002(d) is

not merely limited to “intentional, knowing and voluntary acts”. Monday, 421 F. 2d at 1215. Willful as applied in Section 6672, and hence in section 1002(d), encompasses a reckless disregard for obvious or known risks.² In the present case, there is evidence in the record showing that the taxpayer acted “willfully” as this term is construed for purposes of applying section 1002(d).

The record shows that the taxpayer clearly knew that ABC was having serious financial difficulties. Specifically, she knew that some of the checks that were drawn on the company’s accounts were dishonored due to insufficient funds. Tr. pp. 117, 118. Moreover, the taxpayer ceased to receive any income from the company after 2000, and was informed by her husband that the company’s financial condition made such payments impossible. Tr. pp. 62, 63, 146, 147, 205, 206, 220, 223, 224, 351, 352; Department Ex. 12. The taxpayer also admitted that she was aware of the company’s loss of business and revenue due to the effects of the World Trade Center bombing on 9/11/01 on the transportation industry. Tr. pp. 83, 84, 370, 371. Given the taxpayer’s knowledge of the company’s inability to pay its bills, her position in the company required that she investigate whether or not the corporation had also fallen behind in the payment of its taxes. The taxpayer could have easily confirmed payment since, as the corporation’s sole shareholder, she had the legal authority to control the corporation’s affairs. 8 Del. C. §§ 141, 142. Moreover, she had almost daily contact with corporate information. She initially received most of this information through the mail before forwarding it to her

² The Illinois Supreme Court in Department of Revenue v. Heartland Investments, 106 Ill. 2d 19, 29 (1985), accepted that cases arising under section 6672 of the IRC provide guidance in determining the meaning of the “willful failure” requirement of Chapter 120 par. 452 ½ (13 ½). While the court was addressing the Retailers’ Occupation Tax Act (“ROT”), its holding applies equally in this case because the underlying policies of the ROT section construed in Heartland and section 1002(d) are similar. Moreover, the language of both sections encompasses both responsibility and willfulness.

husband. Tr. pp. 67, 68, 135, 193, 205, 227, 228. Indeed, the taxpayer admits that she could have seen the corporation's financial records that indicated its financial condition but insists that she "did not choose to look ... [.]” Tr. p. 359. The fact that the taxpayer adopted a “hear no evil – see no evil” policy does not relieve her of liability. Wright v. United States, 809 F. 2d 425 (7th Cir. 1987), accord, Calderone v. United States, 799 F. 2d 254, 260 (6th Cir. 1986) (rejecting the proposition that “a responsible officer may immunize himself from the consequences of his actions by wearing blinders which will shut out all knowledge of the liability for and the nonpayment of [the corporation's] withholding taxes.”).

Furthermore, the taxpayer has failed to submit sufficient evidence of her lack of willfulness, as this concept is construed for purposes of applying section 1002(d), to rebut the Department's *prima facie* case. The taxpayer testified that she had no actual knowledge of the corporation's failure to pay its taxes until 2003, immediately preceding the corporation's bankruptcy filing. Tr. p. 353. However, a finding of willfulness does not require a showing of actual knowledge of nonpayment of taxes. Reckless disregard for obvious or known risks that taxes were not being paid is sufficient to find willfulness under section 1002(d). Branson v. Department of Revenue, 168 Ill. 2d 247 (1995). The taxpayer was well aware that the corporation lacked sufficient cash flow to satisfy all of its obligations. Indeed, the taxpayer received no salary from the corporation after 2000, and was aware that the reason for this was the corporation's inability to pay its debts. In spite of clear indications that the corporation was unable to pay its bills, the taxpayer disregarded the obvious risk that Illinois taxes were among the company's financial obligations that were not being met.

The record indicates no testimony or documentary evidence showing any positive steps taken by the taxpayer to inspect the corporate books, which, as the company's sole shareholder, she had a clear legal right to do. 8 Del. C. § 220. Moreover, there is no testimony that she ever inquired into the status of the unpaid taxes or tried in any way to avoid the company's failure to comply with the state's tax laws. If a responsible person does nothing, despite being in a position to easily discover nonpayment and being clearly on notice of a grave risk of nonpayment, a finding of willfulness is justified. Branson, *supra*. Based on the evidence presented, I conclude that the taxpayer has failed to rebut the Department's presumption that the taxpayer willfully failed to pay the withholding taxes at issue in this case.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Deficiency (1002D) number 0000-000-00-0 issued against Jane Doe be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: May 23, 2006