

ST 00-29

Tax Type: Sales Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**DEPARTMENT OF REVENUE
STATE OF ILLINOIS
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

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

v.

JOHN DOE,
Taxpayer

No. 99-ST-0000
IBT# 0000-0000
NPL 0000
Periods: 4/92 – 12/93
4/94 – 12/95
1/97 – 2/97

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Attorney General Marc Muchin on behalf of the Illinois Department of Revenue; Gael Morris, Esq. of Lawrence & Morris, on behalf of John Doe.

Synopsis:

This matter comes on for hearing pursuant to a timely protest to Notice of Penalty Liability 0000 for the tax periods 4/92 – 12/93, 4/94 – 12/95 and 1/97 – 2/97. At issue is the question of whether John Doe is personally liable under Ill. Rev. Stat. 1991, ch. 120, par. 452 ½ and section 3-7 of the Uniform Penalty and Interest Act, 35 ILCS 735/3-7, effective January 1, 1994 as the “responsible” corporate officer who willfully failed to file returns and pay taxes owed by the corporate entity known as Encompassing ABC Resources, Inc., for the tax periods enumerated above. Following a hearing and

review of the evidence of record, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements is established by the admission into evidence of Notice of Penalty Liability ("NPL") 0000, issued against John Doe ("taxpayer") as the responsible officer of ABC Resources, Inc. ("ABC Resources") dated April 23, 1999 for the tax periods 4/92 – 12/93, 4/94 – 12/95 and 1/97 – 2/97. Dept. Ex. 1. ¹
2. The taxpayer was the sole owner/ shareholder, officer and employee of ABC Resources, and served as its President, Treasurer and Secretary during the period April, 1992 through December, 1993. Tr. pp. 12, 52, 53.
3. ABC Resources was engaged in the production and sale of tangible personal property consisting of graphics and artwork and the provision of art consulting and design services. Tr. pp. 13, 14, 32, 53, 54.
4. The taxpayer was responsible for paying all corporate bills. Tr. p. 56.
5. The taxpayer was the only authorized signatory on ABC Resources' corporate account. Tr. p. 64.
6. The taxpayer was paid a commission by ABC Resources during the tax periods April, 1992 through December, 1993. Tr. p. 53.
7. During the tax periods in controversy, the taxpayer authorized the use of corporate funds of ABC Resources to pay withholding taxes, insurance, employee wages and other expenses. Tr. p. 56.

¹ Unless otherwise noted, findings of fact apply to the tax periods.

- 8.** ABC Resources did not file Retailers' Occupation Tax returns prior to 1992, from April, 1992 through March, 1993, for the periods July, 1993 through September, 1993 and from January, 1994 through December, 1995. Tr. pp. 48, 50, 58, 110; Dept. Ex. 3.
- 9.** The taxpayer's return for the tax periods 10/93 – 12/93 was filed in 1997, after an audit by the Department covering this tax period had commenced. Tr. pp. 124, 125; Taxpayer's Ex. 3.
- 10.** ABC Resources' tax returns were prepared by the taxpayer's accountant based on information provided by the taxpayer. Tr. pp. 40, 45, 46, 47, 97, 98, 114.
- 11.** The taxpayer was responsible for reviewing, signing and filing ABC Resources' tax returns and paying taxes due during the tax periods April, 1992 through December, 1993. Tr. pp. 45, 46, 47, 64.
- 12.** The taxpayer did not collect tax from any of its customers on sales of artwork during the period April, 1992 through December, 1993. Tr. pp. 33, 90.
- 13.** The Department conducted an audit of ABC Resources covering the tax periods April, 1992 through December, 1993 in 1997. Tr. p. 33; Dept. Ex. 3.
- 14.** The taxpayer did not obtain resale certificates from all of its customers it believed to be purchasing for resale and did not have resale certificates from most of the customers to whom it purportedly made exempt sales for resale at the time the Department's audit was conducted. Tr. pp. 34, 35, 60, 61; Dept. Ex. 3.
- 15.** ABC Resources did not maintain a ledger or journals; these books and records were not available for review by the Department's auditor. Tr. pp. 79, 80.

16. The taxpayer has stipulated that he is liable for the tax assessed for the tax periods 4/94 – 12/95 and 1/97 – 2/97. Tr. pp. 5, 6.

Conclusions of Law:

The sole issue to be decided in this case is whether the taxpayer should be held personally liable for the unpaid Retailers' Occupation Tax of ABC Resources. The taxpayer protested the Department's assessment of penalty liability for the tax periods 4/92 – 12/93, 4/94 – 12/95 and 1/97 – 2/97. However, the taxpayer has stipulated that the penalty assessed for all of these tax periods except April, 1992 through December, 1993 is due and owing, and does not contest the Department's determination of liability. Tr. pp. 5, 6. Consequently, the only tax periods that are in controversy are the tax periods from April, 1992 through December, 1993.

The statutory basis upon which personal liability is premised for the tax periods in controversy is Ill. Rev. Stat. Ch. 120, Sec. 452 ½ (1987) which provides in relevant part:

Any officer or employee of any corporation subject to the provisions of this Act who has control, supervision and responsibility of filing returns and making payment of the amount of tax herein imposed in accordance with Section 3 of this Act and who wilfully fails to file such return or to make such 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 corporation, including interest and penalties thereon; The Department shall determine a penalty due under this Section according to its best judgment and information, and such determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section.

Ill. Rev. Stat., ch. 120, par. 452 ½ (1987).

It is clear under Section 452 ½ that personal liability will be imposed upon a person who: (1) is “responsible” for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file and/or pay such taxes.²

The admission into evidence of the NPL establishes the Department’s *prima facie* case with regard to both the fact that the taxpayer was a “responsible” officer and the fact that he “willfully” failed to file and pay tax. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995); Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366 (1st Dist. 2000). Once the Department establishes a *prima facie* case, the burden shifts to the taxpayer to show that the Department’s determination is incorrect. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978), Estate of Young v. Department of Revenue, *supra*.

The taxpayer does not contest that he was the responsible officer for ABC Resources (Tr. p. 130). Instead, the taxpayer’s defense to this action rests upon his contention that he did not act willfully as the responsible officer in failing to comply with the Retailers’ Occupation Tax Act. Accordingly, for purposes of this record, I conclude that the taxpayer was the responsible officer based upon the taxpayer’s admission.

Having established that the taxpayer was a “responsible officer” of ABC Resources, the remaining question to be determined is whether the taxpayer acted willfully in failing to file returns or pay taxes due from the corporation during the time period at issue. The record indicates that the taxpayer, as the responsible officer of ABC

² Prior to January 1, 1994, Section 452 ½ governed the assessment of personal tax penalties against responsible corporate officers and employees. Effective January 1, 1994, the penalty provision of Section 452 ½ was replaced by Section 3-7 of the Uniform Penalty and Interest Act (35 ILCS 735/3-7). Here, the taxes for the periods that remain in controversy as a result of the taxpayer’s stipulation of liability arose while Section 452 ½ was in effect. On the other hand, the Notice of Penalty Liability was not issued until 1999. Thus, a question arises as to whether Section 452 ½ or Section 3-7 controls the case at hand. In

Resources, failed to comply with record keeping, filing and other requirements of the Retailers' Occupation Tax Act. As a result, ABC Resources was assessed a tax liability which became final (Tr. pp. 19, 20) and is the liability underlying the NPL at issue. The taxpayer contends that he had a reasonable belief that no taxes were due and that scrupulous compliance with the Retailers' Occupation Tax Act was not required as he determined that his sales were exempt from the imposition of such tax. Tr. pp. 8, 9, 10. The taxpayer further contends that this belief was based upon advice given him by his accountant. Tr. pp. 10, 131.

The taxpayer avers that no personal liability can attach under the facts of this case due to his claimed ignorance that taxes were supposed to be collected. However, it is clear from Illinois case law that ignorance of the law is no excuse for compliance failure. Du Mont Ventilation Co. v. Department of Revenue, 99 Ill. App. 3rd 263 (3rd Dist. 1981). Tr. pp. 9, 10. This is particularly true where the laws that have not been complied with are clear and of long-standing duration as is the case with the compliance provisions ignored by the taxpayer. *Id.*

Citing the case Department of Revenue v. Corrosion Systems, 185 Ill. App. 3d 580 (4th Dist. 1989) (Tr. pp. 17, 133, 134), it is proffered that a principal component of willfulness is a showing that the responsible officer knew that tax was due. It therefore necessarily follows that in the absence of such a showing, no personal liability can be imposed.

While it is true that "willfulness" within the scope of Section 452 ½ has been defined as "intentional, knowing and voluntary acts" (Department of Revenue v. Joseph

Sweis v. Sweet, 269 Ill. App. 3rd 1, 12 (1st Dist. 1995), it was held that the penalty provision "in effect at the time the tax was incurred" should be applied. Accordingly, Section 452 ½ is controlling.

R. Bublick & Sons, Inc., 68 Ill. 2d 568, 576 (1977)), this standard has never been construed to allow corporate officials to hide behind a wall of self-created ignorance as an excuse for avoiding their compliance obligations and responsibilities. While the court in Department of Revenue v. Corrosion Systems did exonerate the corporate official held to be responsible, that case can be distinguished from the present facts. In Corrosion Systems, the principal officer was an officer of a corporation based outside of the state which voluntarily submitted itself to Illinois law. The record in that case established that the officer, who probably would not have been familiar with Illinois law, had no actual knowledge that taxes were due. Moreover, there was nothing in the decision in that case indicating the officer had any reason to believe that taxes were due. Here, the taxpayer's corporation was based in Illinois (Dept. Ex. 3) and the taxpayer applied for a Retailers' Occupation Tax license (Dept. Ex. 2); hence he knew, or should have known that the state imposed compliance obligations that were being ignored.

Moreover, other decisions have gone beyond the literal "intentional, knowing and voluntary" threshold applied in Corrosion Systems and have imposed personal liability where, alternatively, there has been a showing of a reckless disregard for obvious or known risks. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19, 29 (1985) ("A reading of such cases indicates that wilful failure to pay taxes has generally been defined as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks"); Carl E. Branson v. Department of Revenue, *supra*. The alternative standard is premised upon a finding of gross negligence, where an officer "clearly ought to have known of a 'grave risk of nonpayment' and...is in a position to easily find out, but does nothing". *Id* at 255; *see also* Estate of Young, *supra*.

Applying this standard to the facts presented, it must be determined whether the taxpayer was “grossly negligent” in failing to ascertain the tax compliance responsibilities of ABC Resources.

A review of the record indicates that the taxpayer made several compliance errors as a result of his belief that no taxes were due. These compliance omissions resulted in an assessment of ABC Resources (Dept. Ex. 3), which became final (Tr. pp. 19, 20) and is the basis for the NPL presently before this tribunal. The taxpayer admits that he failed to file tax returns for the period April, 1992 through March, 1993 (Tr.pp. 48, 50, 110).

With respect to the filing of returns, the Department’s regulatory provisions require that:

a) Except as provided in Section 130.502, 130.510 and 130.2045, on or before the twentieth day of each calendar month, every person engaged in the business of selling tangible personal property at retail in this State during the preceding calendar month shall file a return with the Department for such preceding month, stating the name of the seller; his residence address and the address of his principal place of business...from which he engaged in the business of selling tangible personal property at retail in this State... b) In addition, the return shall disclose the following...Total Receipts for the Month from Sales of Tangible Personal Property and Services...2) Deductions Allowed by Law...”

86 Ill. Admin. Code Ch. I, Sec. 130.501 (emphasis supplied).

It is obvious from the foregoing that Illinois retailers, of which ABC Resources was one, must file regular returns with the Department of Revenue and report total receipts from sales of tangible personal property. The law nowhere allows a retailer to skip the filing of returns and reporting of receipts on the belief that those receipts are not taxable. To the contrary, a retailer is required to report receipts on his non-taxable sales and take a deduction for them. 35 ILCS 120/3. Despite these clear legal requirements, the taxpayer, as the sole officer of ABC Resources, failed to file such returns and report

receipts on sales of tangible personal property for the period April, 1992 through March, 1993 and July through September, 1993.

The taxpayer contends that these compliance omissions were based upon a belief that filing was not required as a consequence of advice received from the taxpayer's accountant. Tr. pp. 10, 48, 131. However Ms. Smith, the accountant that was primarily responsible for the preparation of the taxpayer's returns, testified that she never advised the taxpayer that no returns were required to be filed. Tr. p. 110. Mr. Jones, the accountant that supervised Ms. Smith was unsure whether such advice was given with respect to the tax periods remaining in controversy. Tr. pp. 116, 117. While Mr. Jones later testified that such advice was given (Tr. p. 122), this testimony conflicts with his testimony that such advice may have covered a tax period other than April, 1992 through March, 1993. Consequently, I find this testimony to be contradictory, suspect and unreliable. Moreover, even if such advice was given, it was obviously rendered without any first hand knowledge or meaningful inquiry concerning how the taxpayer's business was conducted, as Mr. Jones states that his advice was based on "the way the business was described to me", Tr. p. 116.

The taxpayer also failed to consistently follow procedures for documenting sales for resale set forth at Regulation 130.1405 which provides:

- a) Except in the case of sales to totally exempt purchasers, when sales for resale are made, sellers should, for their protection, take a Certificate of Resale from the purchaser. Mere statements by sellers that property was sold for resale will not be accepted by the Department without corroborative evidence...
- d) Failure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale.

86 Ill. Admin. Code Ch. I, Sec. 130.1405.

In spite of the fact that the taxpayer had no background in tax or accounting (Tr. pp. 12, 13), and was a stranger to the world of taxation, there is no evidence that he ever sought advice from his accountant or the Department (5 ILCS 100/5-150; 2 Ill. Admin. Code 1200.110) regarding these procedures. Rather, the taxpayer relied upon his mistaken belief that such procedures did not have to be scrupulously adhered to because he decided his sales were exempt.

Finally, the taxpayer failed to maintain books and records for ABC Resources as required by 35 ILCS 120/7 which provides as follows:

Every person engaged in the business of selling tangible personal property at retail in this State shall keep records and books of all sales of tangible personal property, together with invoices, bills of lading, sales records, copies of bills of sale, inventories prepared as of December 31 of each year or otherwise annually as has been the custom in the specific trade and other pertinent papers and documents.
35 ILCS 120/7.

The keeping of business documentation is mandated by statute (35 ILCS 120/7) and taxpayer's duty to keep such books and records is mandatory. Smith v. Department of Revenue, 143 Ill. App. 3rd 607 (5th Dist. 1986). Ignorance of the law is no excuse for compliance failure. Du Mont Ventilation Co. v. Department of Revenue, *supra*.

Again, the record fails to indicate that the taxpayer made any effort to determine what books and records his company needed to maintain. While the taxpayer testified that he was never advised to maintain books and records (Tr. p. 83), there is no evidence that he ever sought advice from his accountant or anyone else concerning the company's record keeping requirements.

Even when sales were made that were not exempt, the taxpayer neglected his compliance responsibilities. The taxpayer testified that he was aware of non-exempt

sales during the latter part of 1993. Tr. p. 33. However, the taxpayer did not collect tax from such purchasers. Tr. pp. 9, 33, 90. Moreover, the taxpayer did not file returns covering the 4th quarter of 1993 until after the Department's audit commenced in 1997. Tr. pp. 33, 124, 125.

In the seminal case of Branson v. Department of Revenue, *supra*, the Illinois Supreme Court held that:

...lack of willfulness is not proved simply by denying conscious awareness of a tax deficiency that could have been easily investigated by an inspection of corporate records. *Id.* at 267.

Applying a similar analysis, it can be concluded that the absence of willfulness cannot be maintained through a plea of ignorance when no reasonable effort was expended to conclusively determine what the tax ramifications of the taxpayer's business might be. In this case, the taxpayer sought incomplete advice, possibly without clear disclosure of all pertinent facts at the taxpayer's disposal. The taxpayer's failure to seek adequate advice regarding the compliance obligations of ABC Resources, relying instead on partial information and his own unsophisticated beliefs concerning the company's responsibilities cannot be considered a responsible business act. This is especially true since taxpayer knew enough to apply for and obtain an Illinois business certificate, which he obviously realized he needed to conduct business.

In sum, attempts by the taxpayer to ascertain the tax obligations of his company through any reasonable investigation and inquiry are conspicuously absent from this record. His actions, or non actions, constitute a reckless disregard of what should have been obvious and known risks regarding the potential tax consequences of operating ABC Resources with no clear understanding of the company's tax compliance

obligations. As President, Secretary and Treasurer, the taxpayer was in the best position to ascertain through competent inquiry what tax compliance requirements would apply. The record shows that he did not and as a result, was grossly negligent in failing to do so.³

Since the taxpayer has stipulated that he is liable for the tax periods 4/94 – 12/95 and 1/97 – 2/97, I find that the taxpayer is personally liable for the unpaid taxes of ABC Resources for these tax periods. Moreover, I conclude from the record that the taxpayer acted willfully in failing to collect and pay over the taxes the Department’s auditor found to be due for the tax periods 4/92 – 12/93. This conclusion is founded upon the gross negligence displayed by the taxpayer in failing to responsibly and reasonably ascertain the tax compliance obligations of ABC Resources. At all times during these tax periods, the taxpayer knew or should have known that his ignorance of the tax laws created a grave risk that taxes were not being properly collected, exempt sales were being improperly documented and required records were not being maintained. In spite of this risk, the taxpayer took no steps to insure compliance with the law. Having found that the taxpayer acted willfully, I find that he is personally liable under the provisions of Ill. Rev. Stat. Ch. 120, Sec. 452 ½ for the unpaid taxes of ABC Resources for the tax periods 4/92 – 12/93. It is therefore recommended that the NPL at issue be finalized, as issued.

³ In Department of Revenue v. Marion Sopko, Inc., 84 Ill. App. 3d 953 (2nd Dist. 1980), the court found that a responsible officer’s reasonable reliance on the advice of his accountant in not paying tax negated a finding of willfulness. In this case, the court determined that the principal officer put in place compliance procedures and otherwise conscientiously attempted to comply with the law. In the instant case, the record shows that the taxpayer was not conscientious, did not collect tax even when he was aware tax collection was required, and otherwise ignored his compliance responsibilities. The decision in Marion Sopko, Inc. recognizes such a factual difference as affecting the outcome, distinguishing the facts in that case from Department of Revenue v. Joseph Bublick & Sons, Inc., *supra*, wherein the court ruled that a taxpayer could not plead ignorance if compliance failures resulted from ignoring procedures clearly set out in return forms. *Id* at 957. Moreover, in Marion Sopko the court only found that the taxpayer’s conduct did not constitute a “voluntary, conscious and intentional failure to pay tax” . *Id* at 956, 957. The court did not apply a “gross negligence” standard.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Penalty Liability No. 0000 be upheld in its entirety against the person of John Doe in accord therewith.

Ted Sherrod
Administrative Law Judge

Date: November 20, 2000