

**ST 01-20**

**Tax Type: Sales Tax**

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

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

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<b>THE DEPARTMENT OF REVENUE</b>	)	
<b>OF THE STATE OF ILLINOIS</b>	)	<b>Docket #</b>
	)	<b>IBT #</b>
<b>v.</b>	)	<b>NPL #</b>
	)	
<b>JOHN SMITH</b>	)	<b>Barbara S. Rowe</b>
<b>Respondent</b>	)	<b>Administrative Law Judge</b>

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Mr. John Schwartz, of Giffin, Winning, Cohen, and Bodewes, P.C. for JOHN SMITH; Mr. Charles Hickman, Special Assistant Attorney General, for the Illinois Department of Revenue; Mr. Bruce Thiemann, for JOHN DOE.

**Synopsis:**

The Illinois Department of Revenue (hereinafter referred to as the "Department") issued Notice of Penalty Liability No. XXXX to JOHN SMITH (hereinafter referred to as "SMITH" or the "Respondent") on July 31, 1997. The notice was issued against SMITH as a responsible officer of SMITH-DOE Company, Inc. (hereinafter referred to as "SMITH-DOE" or the "Company"). The notice stated on its face that SMITH was responsible for sales tax assessments under the Uniform Penalty and Interest Act for the periods of September 1994 through November 1994, and February 1995. The issues to be resolved are 1) whether the respondent was a responsible officer of SMITH-DOE, and 2) whether the respondent's failure to pay the sales tax due was willful. Upon consideration of the evidence and a careful review of the record, it is recommended that the liability in question be upheld. In support thereof, I make the

following findings and conclusions in accordance with the requirements of Section 100/10-50 of the Administrative Procedure Act (5 ILCS 100/10-50)

**Findings of Fact:**

1. The *prima facie* case of the Department was established by the admission into evidence of Notice of Penalty Liability No. XXXX issued on July 31, 1997, for the periods of September 1994 through November 1994, and February 1995. The notice established liabilities for sales taxes, penalties, and interest due in the amount of \$89,806.78. (Dept. Ex. No. 1; Tr. p. 6)

2. SMITH was treasurer of SMITH-DOE. He signed the ST-1 Sales and Use Tax returns submitted to the Department for September 1994, October 1994, November 1994, and February 1995. SMITH admitted that they were filed without remittance. (Dept. Ex. No. 8; Tr. p. 81)

3. SMITH signed the ST-1 Sales and Use Tax Return for January 1995 submitted to the Department on February 21, 1995. It was remitted with a cashier's check for the full amount of the tax liability. (Dept. Ex. No. 2; Tr. p. 80)

4. SMITH had signatory authority and signed checks drawn on all of the corporate accounts of SMITH-DOE. (Dept. Ex. No. 2; Tr. pp. 80-81)

5. SMITH-DOE had problems paying its tax liabilities. On July 21, 1992, the company was assigned to a collection officer with the Department. Regarding the taxes due, the officer dealt exclusively with SMITH from July 21, 1993 through May 2, 1994. The collection officer would contact SMITH by telephone or in person. For the subsequent period, another collection officer was assigned to the company. That officer also discussed the debt owed to the Department with SMITH. SMITH was introduced as the controller of SMITH-DOE. (Dept. Ex. No. 3; Tr. pp. 7-20, 25-26, 29-30, 36-43, 94)

6. On March 12, 1992, SMITH, as treasurer executed an installment contract with the Department for liabilities incurred for SMITH-DOE in the amount of \$58,301.11. He submitted a down payment of \$9,653.36. (DOE Ex. No. 1; Tr. pp. 27-28)

7. The respondent, on behalf of SMITH-DOE, executed another installment contract with the Department on January 14, 1994. The contract stated that SMITH submitted a down payment for the company in the amount of \$20,050.00 and agreed to make weekly payments toward the liability of \$92,448.00. SMITH negotiated and executed the contract, but insisted that JOHN DOE, (hereinafter referred to as "DOE") president of SMITH-DOE, would be the responsible corporate officer for the debt. DOE's name and address are listed at the top of the contract. (Dept. Ex. No. 5; Tr. pp. 14-15, 20-21, 26-27)

8. On February 7, 1994, the Department sent a letter to DOE, acknowledging the payment agreement with the Department. (Dept. Ex. No. 6; Tr. pp. 30-31)

9. SMITH admits that the scope of his responsibilities with SMITH-DOE included the preparation and payments of sales tax obligations and dealing with the Department regarding unpaid sales tax obligations. He understood the amounts and periods of the obligations. (Tr. pp. 82-83)

10. The financial statement of the company at the end of 1993 reflects liabilities owed to the Department of about \$97,000.00<sup>1</sup>. SMITH, on behalf of SMITH-DOE, was making payments pursuant to the installment contract in 1994. (SMITH Ex. Nos. 1 & 2; Tr. pp. 94-96)

11. The Department issued a ten-day Notice of Intent to Seize Assets, dated December 15, 1994, to the company. DOE as president of SMITH-DOE acknowledged receipt of the notice on December 16, 1994. The notice showed an amount due of \$63,551.00 for Retailers' Occupation Taxes and Income Tax withholding liabilities. Both SMITH and DOE were present when the notice was served. This was the first time the collection officer met DOE. (Dept. Ex. No. 4; Tr. pp. 11-14, 17, 31)

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<sup>1</sup> The transcript states the amount due is \$94,000.00. (Tr. p. 94). The account summary submitted by the respondent shows a receivable beginning balance for January 17, 1994 in the amount of \$94,347.10. (SMITH Ex. No. 2)

12. The Department attempted to seize the assets of SMITH-DOE. On March 15, 1995, at 9:30 a.m. the warrant was executed. The warrant was served on personnel of the company. Both DOE and SMITH were present. At that time, the Department was notified of an assignment for the benefit of creditors that had been executed by DOE on March 10, 1995. SMITH was aware of the assignment and agreed it should be done due to the dire straits of the company. The Department notified the Attorney General's Office and was instructed to retract the warrant and allow SMITH-DOE to proceed with the assignment. (Dept. Ex. No. 7; Tr. pp. 32-35, 101-103)

13. DOE was the president of SMITH-DOE. During the last six months of 1994 and the first six months of 1995, he was the only director and shareholder. (Tr. pp. 65-66)

14. SMITH oversaw the financial aspects of SMITH-DOE. (Tr. p. 66)

15. SMITH had check signing authority and signed the bulk of the checks written on the company's bank accounts. (Tr. p. 66)

16. SMITH-DOE employed an outside CPA firm during the period in question. The financial reports of the CPA firm showed accrued sales tax liabilities. (Tr. pp. 68-75)

17. SMITH had influence in the hiring and firing decisions in the company. (Tr. pp. 61, 104)

18. SMITH was the secretary/treasurer and controller of SMITH-DOE. He was also a director at one time, but owned no stock in the company. (Tr. p. 79)

19. SMITH could have sent a payment for sales taxes without the knowledge of DOE. (Tr. p. 85)

20. Sufficient funds were available for SMITH-DOE to pay the Department's liability for September 1994 if other creditors had not been preferred. (Dept. Ex. Nos. 9 & 16; Tr. pp. 85-87)

21. Sufficient funds were available for SMITH-DOE to pay the taxes due for October 1994 if other creditors had not been preferred. (Dept. Ex. Nos. 10 & 17; Tr. pp. 87-88)

22. Sufficient funds were available for SMITH-DOE to pay the liability due to the Department for November 1994 if other creditors had not been preferred. (Dept. Ex. Nos. 11 & 14; Tr. pp. 89-90)

23. There were sufficient funds available in February 1995 for SMITH-DOE to pay the taxes due to the Department if other creditors had not been preferred. (Dept. Ex. Nos. 12 & 15; Tr. pp. 90-91)

24. Each of the bank statements of SMITH-DOE for the months in question shows negative amounts as the ending balance. (Dept. Ex. Nos. 14, 15, 16, & 17)

25. The hierarchy of payments made by SMITH-DOE was: 1) payroll; 2) withholding and FICA tax; 3) suppliers, the State of Illinois, or union obligations<sup>2</sup>. During all relevant periods, the bank statements show significant charges for overdrafts. The company was attempting to make payments to a number of different parties without sufficient funds to do so. At times DOE would direct SMITH to pay major suppliers or union obligations. (Tr. pp. 95-99, 104-107)

### **Conclusions of Law:**

The Department seeks to impose personal liability on SMITH pursuant to Section 3-7 of the Uniform Penalty and Interest Act, which reads, in pertinent part:

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. 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 be prima facie evidence of a penalty due under this section. \* \* \* 35 ILCS 735/3-7(a)

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<sup>2</sup> Union obligations included health and welfare benefits, pension. dues, and savings accounts.

An officer or employee of a corporation may therefore be personally liable for the corporation's taxes if (1) the individual had the control, supervision, or responsibility of filing the returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

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 (7<sup>th</sup> 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.*

The Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due.<sup>3</sup> Branson v. Department of Revenue, 168 Ill.2d 247, 260 (1995). Once the Department presents 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 (1<sup>st</sup> Dist. 1988). The person must present evidence that is consistent, probable, and identified with the taxpayer's books and records to support the claim. *Id.*

In this case the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence.

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<sup>3</sup> The relevant portion of §3-7 states:

Proof of that determination by the Department shall be made at any hearing before it or any legal proceeding by reproduced copy or computer printout of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. \* \* \* That certified reproduced copy or certified computer print-out shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax or penalty due. 35 ILCS 735/3-7.

In response the respondent alleges that he did not have the requisite control or supervision to be held responsible for the liability in question. SMITH relies on In re Stoecker, 202 B.R. 429 (Bkr. N.D. Ill. 1998) for the proposition that the requisite authority necessary includes factors such as the holding of an entrepreneurial stake in the company, the holding of corporate office, the authority to disburse funds on behalf of the company, the ability to take out loans on behalf of the company, and the ability to hire and fire employees.

What the respondent fails to address is that the statute states that the responsible officer must be an employee or officer who had the control, supervision, **or responsibility for filing the returns and paying the taxes**. SMITH admits that he filed the returns for the periods at issue in his capacity as treasurer and controller for the company. He admits that he filed the returns at issue without paying the liabilities due. He entered into installment contracts with the Department for past-due taxes. He made payments on those contracts. He had signature authority on the bank accounts of the company. The language of the statute is clear and SMITH admitted that he had the requisite responsibility for filing returns and paying the taxes.

Notwithstanding that he had that responsibility, SMITH also had the ability to recommend whether to hire and fire employees, held a corporate office, and had the authority to disburse funds on behalf of the company. Therefore, he met the majority of factors suggested in Stoecker. I therefore find that SMITH had control, supervision and the responsibility for filing returns for SMITH-DOE and making payment of the amount of any trust tax imposed in accordance with the Uniform Penalty and Interest Act.

The second component necessary is whether SMITH willfully failed to pay the taxes due. For guidance in determining the meaning of "willful" for personal penalty liability, the Illinois Supreme Court has referred to cases interpreting Section 6672 of the Internal Revenue Code (26 U.S.C. §6672).<sup>4</sup> Branson at 254-55; Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19, 29-30 (1985). These cases define willful as involving intentional, knowing, and

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<sup>4</sup> This section imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security or Federal income withholding taxes.

voluntary acts or alternately, reckless disregard for obvious known risks. *Id.* Willful conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. Willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F.2d 425, 427 (7<sup>th</sup> Cir. 1987). Furthermore, whether the person in question willfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at 30; Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill.2d 568, 577 (1977).

In the present case, SMITH did not provide sufficient evidence to indicate that the failure to pay the taxes was not willful. He certainly had access to the corporation's books and records, and he knew that the corporation was having financial difficulties. He filed the returns at issue without monetary remittance. He admits that he was aware of a tax liability owed to the Department, that he had access to the corporation's funds, and he made certain that liabilities to other suppliers were paid. Payroll was paid first, Federal taxes second, and whatever was most pressing was paid thereafter. He admitted that he could have made payments to the Department without DOE's knowledge or permission. Instead he made payroll and supplier payments first. The 1992 and 1993 financial statement<sup>5</sup> shows the amount of \$326,488.21 for salaries in 1993. That number is more than one-half of the operating expenses of the company. SMITH-DOE and SMITH chose to make those payments first. Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes willful behavior. Heartland at 29-30. SMITH has therefore failed to show that his actions were not willful.

For the foregoing reasons, it is recommended that the liability at issue be upheld in its entirety.

Respectfully Submitted:

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Barbara S. Rowe  
Administrative Law Judge

Date: September 5, 2001

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<sup>5</sup> SMITH Ex. No. 1