

ST 02-13

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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|---------------------------|---|-----------------------|
| THE DEPARTMENT OF REVENUE |) | |
| OF THE STATE OF ILLINOIS |) | |
| |) | Docket No. 01-ST-0000 |
| v. |) | IBT # 0000-0000 |
| |) | NPL # 0000 |
| JOHN DOE |) | |
| |) | |
| Respondent |) | |

RECOMMENDATION FOR DISPOSITION

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Francis J. Giganti of Stratton, Giganti, Stone & Kopec for John Doe.

Synopsis:

The Department of Revenue (“Department”) issued a Notice of Penalty Liability (“NPL”) to John Doe (“respondent”) pursuant to section 3-7 of the Uniform Penalty and Interest Act (“UPIA”) (35 ILCS 735/3-7). The NPL alleges that the respondent was an officer or employee of R2D2, Inc. (“corporation”) who was responsible for wilfully failing to pay the corporation's retailers' occupation taxes (“ROT”). The respondent timely protested the NPL, and an evidentiary hearing was held. After reviewing the record, it is recommended that the liability be affirmed.

Findings of Fact:

1. The corporation was incorporated in Illinois on January 5, 1994 and was formed for the purpose of purchasing a liquor store known as ABC, Inc.,. During the summer of 1994, a second liquor store was purchased. (Dept. Group Ex. #3, p. 8, Tr. pp. 15-17)

2. The corporation originally had four shareholders: the respondent, his brother Ron Doe, Smith, and Jones. (Tr. pp. 15-16; Dept. Group Ex. #3)

3. When the corporation was formed, Smith was the president, Ron Doe was the vice-president, the respondent was the secretary, and Jones was the treasurer. (Dept. Group Ex. #3, p. 2)

4. In 1995, Jones ceased his involvement as a shareholder, officer, and director of the corporation. (Tr. p. 17)

5. On April 1, 1996, Smith resigned as a director and president of the corporation. He also surrendered all of his stock to the corporation. (Dept. Ex. #3, pp. 6-9)

6. On April 1, 1996, the respondent became the president of the corporation. Ron Doe became the secretary/treasurer. The respondent and his brother were the sole officers/shareholders of the corporation until the business stopped operating in February 1999. (Tr. p. 18; Dept. Ex. #3, pp. 6-7)

7. The corporation leased the premises from which it operated its business and was ordered to vacate the premises by May 21, 1999. (Tr. p. 47; Respondent's Ex. #2)

8. Ron Doe worked full-time as the manager of ABC, Inc.,. He did not work anywhere else while the corporation operated its stores. The corporation had approximately six employees in addition to the officers of the corporation. (Tr. pp. 18-19, 32)

9. Since 1971, the respondent has worked full-time as a guidance dean administrator for Anywhere High School. He also worked part-time at the corporation's

stores during the entire time that the corporation operated the stores. The respondent usually worked at the stores two or three days a week and at least one day on the weekends. During the summers he worked additional hours. (Tr. pp. 14, 31, 34)

10. The respondent saw reports from the accountant. The unaudited reports were initially received on a monthly basis. After Smith left the corporation, the respondent saw the reports less frequently. (Tr. pp. 36, 38)

11. The respondent was aware that in March of 1998, the corporation was not timely paying some of its vendors. The respondent spoke to one of the vendors who told the respondent that some of the invoices to the corporation were in arrears. (Tr. p. 40)

12. The respondent fired one of the employees of the business. The respondent at one point told his brother that he could not hire employees. The respondent told his brother that he was not going to allow his brother to hire his friends. (Tr. p. 41)

13. On January 18, 2001, the Department issued an NPL to the respondent that proposed a total penalty liability of \$47,192.37, including tax, interest, and penalty, for failure to pay ROT for the following months: March 1998, April 1998, November 1998, January 1999, February 1999. The NPL was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1).

Conclusions of Law:

Section 3-7 of the Uniform Penalty and Interest Act provides in part 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 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;" (35 ILCS 735/3-7(a)).

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 ROT returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

Under section 3-7, the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due.¹ (See 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 (1st Dist. 1988). The person must present evidence that is consistent, probable, and identified with the respondent's books and records to support the claim. Id.

In the present case, the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence. In response, the respondent first contends that he did not have control over the filing of the returns and the payment of the taxes, and therefore cannot be found to be a responsible party.

For guidance in determining whether a person is responsible under section 3-7, the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal

¹ The relevant portion of section 3-7 provides as follows: "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. Proof of that determination by the Department shall be made at any hearing before it or in 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(a).

Revenue Code (26 U.S.C. §6672)². See Branson at 254-56; Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19, 29-30 (1985). These cases state that the critical factor in determining responsibility is whether the person had significant control over the corporation's finances. See Purdy Co. of Illinois v. United States, 814 F.2d 1183, 1186 (7th Cir. 1987). Responsibility is generally found in high corporate officials who have control over the corporation's business affairs and who participate in decisions concerning the payment of creditors and the dispersal of funds. Monday v. United States, 421 F.2d 1210, 1214-1215 (7th Cir. 1970), cert. den. 400 U.S. 821.

Some of the factors that courts have considered in determining responsibility include whether the person: (1) is an officer or member of the board of directors; (2) owns shares or possesses an entrepreneurial stake in the company; (3) is active in the management of day-to-day affairs of the company; (4) has the ability to hire and fire employees; (5) makes decisions regarding which, when and in what order outstanding debts or taxes will be paid; (6) exercises control over daily bank accounts and disbursement records; and (7) has check-signing authority. Fiataruolo v. United States, 8 F.3d 930, 939 (2nd Cir. 1993).

In determining whether the respondent was a responsible officer, it is important to first note the type of evidence that was submitted by the respondent in this case. He offered his own testimony, a copy of his Chapter 7 Individual Bankruptcy Petition, and a copy of the Order to Vacate the premises that the corporation had leased. As the Department's counsel noted, the respondent's testimony is self-serving. It has been well-established in tax cases that in order to overcome the Department's *prima facie* case, it is incumbent upon the respondent to present more than his own testimony denying the Department's determination. (See A. R. Barnes & Co. at 833-34; Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203, 217 (1st Dist. 1991).) Without

² This section imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

corroborating evidence in support of the respondent's position, the Department's determination cannot be dismissed. The bankruptcy petition and the Order to Vacate do not aid in the determination of whether the respondent had the control, supervision or responsibility for filing the returns. The Department offered into evidence some of the corporation's Sales and Use Tax Returns, which were signed by the respondent's brother. This was the only documentation that supports the respondent's arguments. The respondent testified that the corporation's records "disappeared" and that he attempted to get a copy of them from the corporation's accountant. (Tr. p. 51) There is no indication, however, that he attempted to get the documents through a subpoena. Although the respondent argues that it is difficult to "prove a negative" (Tr. p. 62), it can be done with corroborating testimony and documents such as tax returns, cancelled checks, or a signature card from the bank.

Despite the lack of corroborating evidence, the respondent's testimony supports a finding that he is a responsible party. He has always been an officer and shareholder of the corporation and was president from April 1, 1996 until the corporation ceased its operations. Although he testified that his brother had the responsibility of taking care of everything (Tr. p. 33), the respondent participated in the daily activities of the business. (Tr. pp. 31, 34) The respondent testified that he constantly told his brother that he needed to make an agenda and a budget, and he kept trying to give his brother advice and tell him what he had to do. (Tr. pp. 22, 28) The respondent also gave testimony indicating that he had authority to hire and fire employees because he said that he actually fired one of the employees and he took away his brother's authority to hire employees. (Tr. p. 41) Furthermore, the respondent admitted that he initially had looked at reports from the accountant. (Tr. p. 36) This evidence indicates that he had access to the corporation's financial information, or at least was in a position to access the information, to ensure that the trust taxes were being paid.

The evidence also supports a finding that the respondent's failure to pay the taxes was wilfull. Case law defines "wilfull" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson at 254-56; Heartland at 29-30. Wilfull 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 (7th Cir. 1987). Furthermore, whether the person in question wilfully 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 Bublick & Sons, Inc., 68 Ill.2d 568, 577 (1977). Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes wilfull behavior. See Heartland at 29-30.

The respondent admitted that in the spring of 1998 he became aware that the corporation was not paying its taxes because he participated in a meeting with his brother and representatives of the Department at the Department's facilities in Springfield. (Tr. pp. 20-21). Although the respondent stated that he was not aware that in March of 1998 the corporation's bills were not being paid, he stated that he knew that the corporation was not timely paying its bills. One of the corporation's vendors told him that some of its invoices to the corporation were in arrears. (Tr. p. 40) The respondent then told his brother that he had to pay for the invoices. (Tr. p. 41) The respondent stated that he had "some idea" that there were problems because when he would ask questions to some of the employees, he said, "nobody wanted to tell me anything." (Tr. p. 41) In Branson, the court noted that an officer who is responsible for filing the returns and remitting the taxes may not avoid personal liability merely by delegating bookkeeping duties to third parties, failing to inspect corporate records, or otherwise failing to keep informed of the status of the tax payments. (Branson at 267.) The respondent in this case was aware of the

corporation's financial difficulties and was aware that some of the taxes had not been paid. He clearly should have known that there was a grave risk that the trust taxes that the corporation held were not being remitted to the Department, and he was in a position to determine whether they had been paid. These facts support a finding that the respondent should be held personally liability for the taxes.

Recommendation

It is therefore recommended that the Notice of Penalty Liability be upheld.

Linda Olivero
Administrative Law Judge

Enter: April 8, 2002