ST 03-16
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	)	Docket No.	02-ST-0000
OF THE STATE OF ILLINOIS	)	IBT No.	0000-0000
v.	)	NPL No.	0000
SAM DOE, as responsible officer of	)		
ABC Food & Liquor, Inc.,	)	John E. White,	
Taxpayer.	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Akram Zanayad, appeared for John Doe; Marc Muchin, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose when John Doe ("taxpayer" or "Doe") protested a Notice of Penalty Liability the Illinois Department of Revenue ("Department") issued to him as a responsible officer of ABC Food & Liquor, Inc. ("ABC"). Notice of Penalty Liability ("NPL") number 0000 assessed a penalty equal to ABC's unpaid Retailers' Occupation Tax ("ROT") liability regarding the months of January 1997 through and including March 31, 1999. The penalty was a personal liability penalty, issued pursuant to § 3-7 of Illinois' Uniform Penalty and Interest Act ("UPIA").

At hearing, the parties introduced evidence via stipulation and otherwise. I have reviewed that evidence, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the penalty be assessed as issued.

Findings of Fact:

1. ABC is a corporation that conducts business in Illinois as a retailer of food and

liquor. Department Ex. 3 (transcript of Doe's deposition testimony),[1] p. 6.

2. Doe owned ABC during all times pertinent to this matter. Department Ex. 3, p. 6. During the same period, Doe was ABC's sole officer and director. Department Ex. 7 (copies of ABC's annual reports to the Illinois Secretary of State for 1995 – 2000).

3. Doe kept ABC's books and records. Department Ex. 3, p. 9.

4. Doe was the sole signatory for ABC's checking account during the audit period. Department Ex. 3, p. 11.

5. Doe kept copies of ABC's cash register tapes and gave them to a bookkeeping service that prepared ABC's Illinois sales and use tax returns. Department Ex. 3, pp. 8-9, 29. Doe signed the prepared returns, and also signed the checks drawn to pay the tax shown due on those returns. *Id.*, p. 9.

6. Doe signed page four of ABC's application for an Illinois business license with the Department. Department Ex. 3, pp. 9-10; Department Ex. 6 (copy of application form). Doe signed under the following statement, "Under penalties of perjury, I state that I have examined this application and, to the best of my knowledge, it is true, correct, and complete." Department Ex. 6, p. 4. The application also includes Doe's name on page 2 of the form, where a person is required to sign as accepting personal responsibility for signing a licensee's Illinois tax returns and for paying the licensee's Illinois taxes. *Id.* p. 2. At hearing, Doe denied signing that section, and the signature on that page of the application does not appear to be the same signature as the one on another page of

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[1] Counsel for the parties stipulated to the admission of Doe's deposition testimony as a substitute for his testimony at hearing. Hearing Transcript ("Tr."), pp. 5-7.

the application, which Doe identified as his. Department Ex. 3, pp. 9-10.

7. On or about July 28, 1997, ABC entered into an employment agreement with Joe Blow ("Blow"). Attachment to Department Ex. 2 (copy of Doe's responses to the Department's interrogatories) (hereinafter, "Department Ex. 2, Blow Contract"), p. 1 ¶ 1.

8. Doe entered into the Blow Contract, on behalf of ABC, because he was interested in selling the business ABC conducted. Department Ex. 3, p. 21; Department Ex. 2, Blow Contract, p. 4 (Doe signed for ABC).

9. One of the Blow Contract provisos stated, "Employee [Blow] desires to be employed by said Employer [ABC] and Employer desires to employ employee to operate the business located at 3950 W. GRAND (Hereinafter sometimes referred to as 'premises' …." Department Ex. 2, Blow Contract, p. 1.

10. The substantive provisions of the Blow Contract are as follows:

> 1) The term of the employment agreement shall be for twelve months if not sooner terminated beginning July 28, 1997 and continuing until July 28, 1998. The term may be extended for an additional period upon the written consent of the parties. Either party shall have the right to terminate this agreement by giving the other party 30 days written notice of termination. This agreement shall terminate 30 days after notice is given. This right is in addition to the right to terminate under paragraph 6 below.
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> 2) Upon the execution of this agreement, Employee shall pay Employer for all inventory (valued at cost) located on the premises and receive a bill of sale for all inventory. During the term of this agreement, all inventory located on the premises shall be the sole property of Employee. Employee shall purchase goods as needed and be solely responsible for the payment to all vendors. Upon the termination of this agreement by lapse of time, early termination or otherwise, Employer shall pay Employee for all inventory located on the premises valued at cost. Until

such time as Employer makes the payment to Employee for the inventory, all inventory shall belong exclusively to Employee. Upon receiving payment, Employee shall execute a bill of sale returning all inventory to Employer.

2)[*sic*] Employee agrees to use his best efforts to promote future Employer earnings in a manner consistent with its past performance.

3) Employee agrees to work a minimum of 70 hours a week. Employee agrees that it is his responsibility to maintain store hours on a consistent basis. Employee shall keep accurate books and records of all sales and purchases of the Employer and shall make available said records to Employer upon demand.

4) Provided this agreement is in effect, employee shall receive as his compensation an amount equal to all remaining funds, if any, of the business after paying rent and all expenses of the business after July 28, 1997 whether for taxes, creditors, suppliers, utilities, repairs, capital improvements, maintenance or any other item requiring an outlay of monetary consideration during the time Employee is employed. Employee acknowledges that so long as this agreement is not terminated, he shall not receive any compensation other than what is provided for in this section. Employer shall be responsible for all expenses for the period before July 29, 1997, the day Employee assumed control of the business. Employee understands and agrees that he is not entitled to any beneficial interest in the business or business profits, either directly or indirectly and that all decisions regarding the business are subject to approval by Employer who shall at all times remain as the sole management authority.

5) Employee shall be in default if he commits any of the following:

A) Fails to work his allotted hours as stated in this agreement.

B) Materially violates any law of the State of Illinois or City of Chicago regarding the operation of the business.

C) Fails to pay all expenses of the Employer when they come due.

D) Fails to keep accurate books and records of the business sales and purchases or provide said books to

Employer upon demand.

Before, Employer may declare Employee in default, Employer must provide Employee with a written notice of default and a minimum of 5 days to cure the default, if possible.

6) If Employee is in default and has not or could not cure the default as listed above, he shall not be entitled to any new compensation and Employer shall be entitled to immediately terminate this agreement and eject Employee. In said event, employee will be entitled to immediate payment for his inventory as stated in Paragraph 1.

7) If Employer defaults, then in addition to the remedies described in this agreement, employee shall have all rights available at law or equity.

8) Employee shall be personally liable for all amount [*sic*] due under the terms of this agreement. The Employer assumes complete responsibilities for all risk of physical loss or damage to the equipment from any cause. Loss due to fire, storm, or other cause, which renders the premises unsuitable for use as intended shall at the option of either party result in complete discharge of employee duty to perform and render the remaining term of this Employment Agreement null and void.

9) Any notice to be given under this agreement shall be mailed to the party to be notified at the address set forth below, by registered or certified mail with postage prepaid and be deemed given when so mailed.

10) This agreement shall be binding on and shall inure to the benefit of all parties hereto and their respective successors and assigns.

11) This agreement constitutes the entire agreement between the parties and all parties acknowledge that no other agreements exist regarding said agreement.

12) This agreement shall be construed in accordance with the laws of the State of Illinois.

13) Employee acknowledges that he shall be responsible for the repair, replacement, and maintenance of the equipment listed on exhibit A. Employee shall return

> said equipment in the same condition, ordinary wear and tear excepted upon the expiration of the agreement.
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> 14) In the event the business is destroyed by fire or otherwise, Employee shall be entitled to all insurance proceeds for the inventory and Employer shall be entitled to all proceeds for the fixtures, equipment, loss or income or any proceeds for any other reason.
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> 15) If Employee purchases the business through his corporation as contemplated in the agreement to sell assets, Employee shall pay an additional amount of $50,000.00 at closing over and above all amounts listed in this agreement and/or the agreement to sell assets dated July 28, 1997.

Department Ex. 2, Blow Contract.

11. During the time the Blow Contract was executory, Doe continued to sign ABC's Illinois sales and use tax returns, and he continued to sign checks drawn to pay the tax shown due on those returns. Department Ex. 3, pp. 9, 22, 24-26. Doe also remained the sole officer of ABC. Department Ex. 3, pp. 24-25; Department Ex. 7.

12. When Blow was unable to obtain a liquor license, Doe terminated the Blow Contract. Department Ex. 3, p. 23.

13. Pursuant to a Department project,[2] the Department conducted both a criminal investigation and an audit of ABC for the period beginning on January 1, 1997 through and including March 31, 1999. Department Ex. 4 (Department report, dated 11/29/99, by Bureau of Criminal Investigation ("BCI") agent Michael Hoff), pp. 2, 12.

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[2] The project was called the Hi/Lo Project, and it consisted of teams of auditors and BCI agents who conducted inspections at businesses that registered with the Department as liquor stores, but that reported high amounts of sales of foods and/or drugs, which are taxed at a lower rate. Department Ex. 4, p. 2.

14. During the criminal investigation, BCI agents subpoenaed books and records from the beer and liquor distributors from whom ABC purchased beer and liquor for resale, to ascertain ABC's monthly purchases of such goods. *See* Department Ex. 4, pp. 6-7.

15. After receiving responses to the subpoenas from seven different distributors, the BCI agent totaled ABC's monthly purchases of beer and liquor. Department Ex. 4, pp. 6-7.

16. On its monthly returns, ABC reported the gross receipts that it said it realized from selling goods taxed at the rate of 6.25% (applicable to, inter alia, sales of beer and liquor), and the gross receipts that it said it realized from selling goods taxed at the lower rate of 1% (applicable to, inter alia, sales of food for consumption off the premises and from its sales of drugs). Department Ex. 4, pp. 5-6; 35 **ILCS** 120/2-10 (rate of tax).

17. During the Department's investigation of ABC, the BCI agent compared the information from ABC's monthly sales and use tax returns filed during the audit period with ABC's monthly beer and liquor purchases. Department Ex. 4, pp. 8-11. The agent's comparison established that, for 1997, ABC purchased $283,757 worth of beer and liquor, and reported that it received $82,466 from selling goods taxed at the rate of 6.25% on its monthly tax returns. Department Ex. 4, pp. 8-9. For 1998, ABC purchased $270,696 worth of beer and liquor, and reported gross receipts of $105,135 from selling goods taxable at the higher tax rate. *Id*. For January through March of 1998, ABC purchased $59,465 worth of beer and liquor, and reported that it sold $24,094 worth of goods at the high rate. *Id*.

18. As a result of the audit, the Department issued an NTL to ABC. *See* Department Ex. 1 (copy of the NPL issued to Doe).

19. After the NTL remained unpaid, the Department issued an NPL to Doe. Department Ex. 1.

20. As a result of the Department's investigation of ABC, both ABC and Doe were charged, via indictment, for felony offenses of filing fraudulent Illinois sales and use tax returns regarding the months of January 1997 through March 1999. Department Ex. 3, p. 13.

21. On December 19, 2000, and as part of a plea agreement, Doe pled guilty to a misdemeanor charge of attempt to file a fraudulent Illinois sales and use tax return for the month of January 1997. Department Ex. 5, p. 1 (copy of order of conditional discharge for Doe); Department Ex. 3, pp. 13-14. ABC pled guilty to a felony charge of filing a fraudulent Illinois sales and use tax return on the same day. *Id*., p. 2 (copy of order of conditional discharge for ABC). Doe signed the sentencing orders for both himself and for ABC. *Id*., pp. 1-2.

22. As part of the plea agreement, ABC and Doe paid $35,195 restitution to the Department. Department Ex. 5. The Department took that restitution into account prior to issuing the NPL at issue here. Tr. pp. 13-14 (colloquy between counsel and administrative law judge at hearing).

Conclusions of Law:

When the Department introduced the NPL into evidence under the certificate of the Director, it presented prima facie proof that Doe was personally responsible for ABC's unpaid tax liabilities. 35 **ILCS** 735/3-7; Branson v. Department of Revenue, 68

Ill. 2d 247, 260, 659 N.E.2d 961, 968 (1995) ("by operation of the statute, proof of the correctness of such penalty, including the willfulness element, is established by the Department's penalty assessment and certified record relating thereto."). The Department's prima facie case is a rebuttable presumption. Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968. After the Department introduces its prima facie case, the burden shifts to the taxpayer to establish that one or more of the elements of the penalty are lacking. *Id*.

Section 3-7 of the UPIA provides that a personal liability penalty liability may be imposed upon:

> (1) Any officer or employee of any corporation … who has the control, supervision or responsibility of filing returns and making payment of … the tax[es] … imposed … **and** who willfully:
> (2) fails to file such return **or**
> (3) [fails] to make such payments to the Department **or**
> (4) … attempts … in any other manner to evade or defeat the tax ….

35 **ILCS** 735/3-7.

Doe contends that while he was a responsible officer of ABC, he did not willfully fail to pay any of the tax at issue. That is because, he argues, the Blow Contract was not an employment contract, but was instead a contract for the sale of the business from him to Blow. Tr. p. 18 (closing argument). He asserts that, since he was not operating the retail business when Blow owned it, i.e., from August 1997 through September 1998, he could not have known of any liability that existed for that period of time, and could not have willfully failed to pay that liability. And when Doe repurchased the business from Blow approximately one year later, Doe's argument continues, he was not informed of any liability, and thus, could not have willfully failed to pay such a tax liability.

The documents and other evidence admitted at hearing, however, contradict the facts upon which Doe's arguments are premised. First, while Doe asserts that he sold the business to Blow, the Blow Contract is not one pursuant to which ABC sold its business to Blow. *See* Department Ex. 2, Blow Contract, *passim*. Similarly, during his deposition, Doe stated that Blow would manage the business during his employment. Department Ex. 3, p. 22. But the express terms of ¶ 4 of the Blow Contract provide that, "***Employee understands and agrees that*** he is not entitled to any beneficial interest in the business or business profits, either directly or indirectly and that ***all decisions regarding the business are subject to approval by Employer who shall at all times remain as the sole management authority***." Department Ex. 2, Blow Contract, p. 2 (emphasis added). And while it may be that ABC and Blow contemplated a sale of all of ABC's assets to Blow (*see* Department Ex. 3, pp. 22-23),[3] it is also clear that no such sale ever took place, because Blow was unable to acquire a liquor license. Department Ex. 3, pp. 22-23.

The evidence similarly contradicts Doe's argument that he did not act willfully because he could not have known anything about what ABC's liability actually was during the period when Blow was running the day-to-day affairs of ABC's retail business. Again, the terms of the agreement provide that ABC — not Blow — would retain all management authority over the business. Department Ex. 2, Blow Contract, ¶ 4. In other words, ABC never assigned to Blow its responsibility to supervise or control all of ABC's business activities (*see id.*, ¶ 3 (ABC maintained the ability to review ABC's books and records during Blow's employment)), and Doe, as ABC's sole officer, director and shareholder, retained sole management authority over ABC's corporate obligations.

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3 As opposed to just its inventory.

Id., ¶ 4. Similarly, ABC's employment of Blow did not obviate ABC's statutory obligation, as a retailer, to file true and accurate sales and use tax returns. Branson, 68 Ill. 2d at 258, 659 N.E.2d at 966-67 ("… we do not intend to imply that a corporate officer who is responsible for filing retailers' occupation tax returns and remitting the collected taxes may avoid personal liability … merely by delegating bookkeeping duties to third parties and failing to inspect corporate records or otherwise failing to keep informed of the status of the retailers' occupation tax returns and payments").

Doe's argument that he could not have known what ABC's sales were during the time Blow was running the store is similarly inconsistent with the documentary evidence of record. During the entire audit period, Doe was ABC's sole officer, director and its sole shareholder. Department Ex. 7. Having that status made him the only person with the authority to act on the corporation's behalf. True, Doe had the authority to hire employees for ABC, and he clearly did hire Blow. *See* Department Ex. 2, Blow Contract. But hiring employees and designating duties to those employees does not render the sole corporate officer any less responsible for the corporation's affairs. *See* Branson, 68 Ill. 2d at 258, 659 N.E.2d at 966-67. The statutory inquiry is whether Doe was responsible for filing ABC's tax returns and paying its taxes. 35 **ILCS** 735/3-7. Here, there is no question that Doe was responsible for both acts. Department Ex. 3, pp. 24-25.

Notwithstanding Doe's admission that he signed and filed ABC's sales and use tax returns throughout the audit period (Department Ex. 3, pp.24-25), Doe also testified that he did not know what the returns he signed said, and he just signed them in the place his bookkeeper told him to. Department Ex. 3, pp. 17-18. Such testimony, however, does

not help a person claiming a lack of willfulness.[4] If Doe truly did not know what the returns he signed during the audit period said, he should not have signed them and, thereby, sworn that the statements contained therein were true. 86 Ill. Admin. Code § 130.560.

Further, if Doe signed ABC's returns without knowing whether the statements on the returns were true, he acted with reckless disregard for the truth — and swore falsely to boot. As the Illinois Supreme Court acknowledged in Branson, a responsible officer may not claim ignorance of a corporation's nonpayment to avoid personal liability, where a cursory examination of the corporation's records would reveal the facts. Branson, 68 Ill. 2d at 258, 659 N.E.2d at 966-67. Here, an inspection of ABC's books and records — to which the evidence shows Doe had access — would have revealed here that ABC purchased $22,795 worth of beer and liquor during January 1997, and that, for the same month, he signed a return on which he swore that ABC received only $4,305 from selling goods taxed at the higher tax rate of 6.25%. Department Ex. 4, p. 8.

In the end, I do not believe Doe's testimony when he said that he did not know what was on the returns he signed as ABC's president. That is because Doe plead guilt to the criminal offense of attempt regarding the first month in the audit period. Department Ex. 3, p. 13. Attempt is a specific intent crime. People v. Gilman, 113 Ill. App. 3d 73, 76,

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[4] The Illinois General Assembly requires a corporate official to sign a corporation's tax return. 35 **ILCS** 120/3. The reason a corporate official must sign a corporation's monthly ROT returns — or any corporate tax return — is to make sure that someone with actual personal knowledge of the corporation's activities review the return and then attest, under penalty of perjury, that the information included on the return is true and correct. 86 Ill. Admin. Code § 130.560 ("Each return or notice required to be filed under this Act shall contain or be verified by a written declaration that it is made under the penalties of perjury."); *see also* the forms directory on the Department's web site, http://www.revenue.state.il.us/ (the signature line on Illinois' tax forms provides, "Under penalties of perjury, I state that I have examined this return, and to the best of my knowledge, it is true, correct, and complete.").

446 N.E.2d 595, 597 (4th Dist. 1983) ("To sustain a charge of attempt it must be shown that a defendant formed the specific intent to commit a crime"). The specific crime Doe pleaded guilty of attempting to commit was the offense of filing a fraudulent tax return. Department Ex. 3, pp. 13-14; Department Ex. 5, p. 1. The Illinois General Assembly has defined the term "intent" to mean a mental state in which a person acts with a "… conscious objective or purpose … to accomplish that result or engage in that conduct." 735 **ILCS** 5/4-4 (definition of "intent"); *see also* Gilman, 113 Ill. App. 3d at 76, 446 N.E.2d at 597 ("The committee comments to section 4-3 [now § 4-4 of the Criminal Code] reveal that the use of the word 'intent' in the Code is limited to conscious objective or purpose to accomplish a described result."). In order to form intent, one must first be aware of the surrounding circumstances and then intend to commit a specific unlawful act. Gilman, 113 Ill. App. 3d at 77, 446 N.E.2d at 597. Since intent requires an awareness of the facts and surrounding circumstances necessary to commit a specific wrongful act, I cannot and do not believe that Doe was ignorant of what was on the monthly returns he signed during the audit period. His guilty plea proves otherwise.

The Department's introduction of proof of Doe's and ABC's convictions and sentences in the related criminal matters (Department Ex. 5, pp. 1-2) constitute evidence of Doe's statements that are contrary to the position Doe took at hearing, i.e., that he did not act willfully regarding the corporation's failure to pay taxes. When the sole officer, director and shareholder of a corporation admits that he intended to file a fraudulent tax return, that is compelling substantive evidence that he has also willfully failed to pay all of the corporate tax due. Spircoff v. Stranski, 301 Ill. App. 3d 10, 15-16, 703 N.E.2d 431, 435 (1st Dist. 1998) (noting modern trend to give proof of a party's conviction a

conclusive effect, where the criminal and subsequent matters are closely correlated); In re Cook County Treasurer, 166 Ill. App. 3d 373, 379, 519 N.E.2d 1010, 1014 (1st Dist. 1988) *aff'd* 131 Ill. 2d 541 (1989) (contradictory statements of a party constitute substantive evidence against the party of facts stated). Similarly, it is evidence that he has willfully attempted to defeat or evade the collection of the tax that should have been paid by the corporation. The evidence offered at hearing does not support Doe's assertion that he did not act willfully.

Conclusion:

I recommend that NPL No. 0000 be finalized as issued, with interest to accrue pursuant to statute.

Date: 10/28/2003

John E. White
Administrative Law Judge