

ST 03-6

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
OF THE STATE OF ILLINOIS

v.

JOHN DOE, as
Responsible Officer of
ABC Group I,

TAXPAYER

No. 01-ST-0000
IBT No. 0000-0000
NPL No. 0000

Kenneth J. Galvin
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Gary I. Blackman appearing on behalf of John Doe, Mr. Sean Cullinan and Mr. Michael Abramovic, Special Assistant Attorneys General, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to John Doe’ (hereinafter “Doe”) protest of Notice of Penalty Liability No. 0000 (hereinafter the “NPL”) as a responsible party of ABC Group I (hereinafter “ABC”). The NPL represents a penalty liability for Retailers’ Occupation Tax and Metropolitan Pier and Exposition Authority Food and Beverage Tax of ABC due to the Department for various months beginning January, 2000, through August, 2000. A hearing was held on this matter on January 28 and 29, 2003, with Doe, and ABC attorney, Abraham XXXXX, providing oral testimony. Following the submission of all evidence and a review of the record, it is

recommended that NPL No. 0000 be finalized as issued. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NPL No. 0000, dated March 21, 2001, showing a personal penalty liability based upon the tax liability of ABC of \$172,583.70 for various months beginning January, 2000, through August, 2000. Tr. pp. 5-7; Dept. Ex. No. 1.
2. ABC, formed in April, 1999, and closed in December, 2000, operated exhibition theatres showing first run films. Tr. pp. 16, 276.
3. The “NUC-1, Illinois Business Registration” for ABC lists Doe as “President.” In question 14 of the NUC-1, Doe accepted “personal responsibility for the filing of returns and the payment of taxes due.” Tr. p. 8; Dept. Ex. No. 2.
4. The State of Illinois’ “Foreign Corporation Annual Report” for year 2000, filed July 24, 2000, lists Doe as “President/Treasurer” and “Director” and is signed by Doe. Tr. pp. 8-9, 109-111, 297-299; Dept. Ex. No. 3.
5. Joe Blow (hereinafter “Blow”) was ABC’s Vice-President of Operations. He oversaw the concession stands and box office, supervised employees, made sure the films were intact, and ran daily operations. Blow’ “Employment Agreement” was signed by Doe as “President” of ABC. Tr. pp. 24-28, 199-200; Taxpayer’s Ex. No. 1.
6. Jim Doe (hereinafter “Jim Doe”) was ABC’s controller. ABC’s “ST-1, Sales and Use Tax Returns” and “ST-4, Metropolitan Pier and Exposition Authority Food and Beverage Tax Returns” for the months included in the NPL were signed by Jim Doe. The ST-4 for August,

- 2000, the last month included in the NPL, was signed by Jim Doe on October 20, 2000. Tr. pp. 13-14, 31-38, 303-304; Dept. Ex. No. 17.
7. Jim Doe's "Offer of Employment" letter dated April 26, 1999, and signed by Doe, states that "[A]s the controller, [Jim Doe] will report directly to John Doe." Tr. pp. 39-41, 87, 99-100, 109; Taxpayer's Ex. No. 2.
 8. Blow, Jim Doe and Ron Doe (hereinafter "Ron Doe"), Operations Manager, were authorized signatories on ABC's operational account, number 0201168835 at Corus Bank. Tr. pp. 42-49; Taxpayer's Ex. No. 3.
 9. Blow and Ron Doe were authorized signatories on ABC's checking account, number 302-3195, at Mid Town Bank. Tr. pp. 49-53; Taxpayer's Ex. No. 4.
 10. A "Corporate Resolution of Board of Directors" of ABC, dated March 18, 1999, and signed by Doe as "President," authorizes the following signatories on two checking accounts, numbers 00000 and 00000000, at Northern Trust Bank: John Doe, Jane Doe (Donzell's wife), Blow and Ron Doe. The Resolution states that "two signatures are required on checks over \$5,000" and that only the "president" is "authorized to designate persons empowered to sign checks ... change or remove any or all of the persons so designated, or substitute the names of other persons or authorize additional persons as signatories." Account number 96229 remained open and showed activity from January , 2000, through January 2001. Tr. pp. 53-55, 131-139, 218-223; Taxpayer's Ex. No. 5; Dept. Ex. No. 10.
 11. Thirty checks drawn on ABC's bank account at Northern Trust Bank, number 30296229, dated between April 27, 1999 and August 21, 1999, payable to various creditors, were signed or co-signed by Doe. Tr. pp. 186-193, 261-262; Dept. Ex. No. 15.

12. On January 25, 2000, ABC borrowed \$2,500,000 from Bank of America in a note, signed by Doe as “President/CEO.” Tr. pp. 249-250, 327; Taxpayer’s Ex. No. 8.
13. On January 25, 2000, Doe as “President/CEO” signed a “Security Agreement” with Bank of America, in which ABC pledged and assigned to the Bank, *inter alia*, a security interest in “all accounts of the grantor,” and “any and all balances, credits, deposits (...) deposit accounts or monies of or now in the name of Grantor now or hereafter with the Lender” including but not limited to any bank account maintained in ABC’s name with any other bank or financial institution. Also pledged as security were leases for the theatres and personal property. Tr. pp. 250-257, 334-336; Taxpayer’s Ex. Nos. 9 and 10.
14. A January 27, 2000, letter from ABC signed by Doe as “President/CEO” to Bank of America states that “[W]e and our counsel have reviewed the Letters of Credit to be issued by Bank of America N.A. in the amounts of \$1,400,000.00 and \$36,292.00, respectively. We find the terms and conditions set forth in the Letters of Credit acceptable and hereby approve the Letters of Credit.” Tr. pp. 179-183, 327; Dept. Ex. No. 12.
15. ABC opened the following four bank accounts with Bank of America: number 12667 (operating account) opened February 1, 2000; number 12774 (payroll account) opened April 12, 2000; number 12773 (depository account) opened April 12, 2000; 12772 (payables account) opened April 12, 2000 and closed May 18, 2000. Jim Doe, Blow, Doe and Jane Doe were all signatories on the four accounts. Tr. pp. 158-170; Dept. Ex. No. 9.
16. On or before May 10, 2000, ABC defaulted on payments to Bank of America. On June 16, 2000, Doe, as “President,” signed a “Forbearance Agreement” with Bank of America. The Agreement states that “[T]he Bank is willing to forbear until December 31, 2000, from exercising any of its rights and remedies against [ABC] and its property...” but only pursuant

to and upon the terms of the Forbearance Agreement. One of the terms was that ABC maintain bank accounts only at Bank of America and Mid-Town Bank. As a condition of forbearance, ABC had to pay a minimum monthly payment of \$60,000, to be automatically debited from ABC's account. The Agreement would terminate if ABC "uses its ordinary income other than in the operation of its business..." Tr. pp. 171-186, 246, 268-272, 273-274, 279-285, 329-333, 340-348; Dept. Ex. No. 18.

17. Doe and members of the ABC Board of Directors were present at meetings with Bank of America during negotiations for the Forbearance Agreement. Tr. pp. 387-388.
18. In September, 2000, the City of Chicago shut down ABC for nonpayment of taxes. On September 29, 2000, ABC entered into a "Payment Agreement" with the City of Chicago's Department of Revenue for unpaid amusement taxes of \$283,770. Doe as "President" signed the Agreement on behalf of ABC and is listed as "individual guarantor." Doe personally paid the City \$150,000 for the amusement taxes and the theatres were reopened. Tr. pp. 145-152, 292-293; Dept. Ex. No. 6.
19. Between June and December, 2000, the leases that ABC held for its theatres were terminated by agreement or terminated for nonpayment of rent. Some landlords started eviction proceedings. When ABC went out of business in December, 2000, the assets were sold and the proceeds went to Bank of America. Tr. pp. 276-277, 347-348.
20. On January 4, 2001, Cook County filed a "Petition For Rule To Show Cause Why Defendant ABC Group, Inc. Should Not Be Held In Contempt Of Court," for an order entered November 20, 2000, which mandated that ABC make Cook County Amusement Tax Payments directly to the Cook County Department of Revenue. The Petition states that "[The] County of Cook has not received a cashier's check for collected Cook County Amusement Taxes collected since

December 7, 2000. Amended “Amusement Tax Returns” for ABC for the period May, 1999, through November, 2000, excluding June, 1999, were signed by Doe as “President” on December 7, 2000. Tr. pp. 139-146, 258-260; Dept. Ex. No. 5.

Conclusions of Law:

The sole issue to be decided here is whether Doe should be held personally liable for the unpaid Retailers Occupation Tax and Metropolitan Pier and Exposition Authority Food and Beverage Tax of ABC. The statutory basis upon which any personal liability is premised is Section 3-7 of the Uniform Penalty and Interest Act, which 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 to 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 shall be *prima facie* evidence of a penalty due under this Section. 35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon an officer or employee who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NPL establishes the Department’s *prima facie* case with regard to both the fact that Doe was a “responsible” officer and the fact that he “willfully” failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the

Department has established a *prima facie* case, the burden shifts to the taxpayer to rebut the *prima facie* correctness of the assessments. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

In determining whether an individual is a responsible party, 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 (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 taxes are remitted to the government. *Id.*

I conclude, based on the evidence and testimony admitted at the evidentiary hearing, that Doe was a responsible party under the statute. The “NUC-1, Illinois Business Registration” for ABC lists Doe as “President” and was signed by Doe on March 15, 1999, “under penalties of perjury.” In question 14 of the NUC-1, Doe accepted “personal responsibility for the filing of returns and the payment of taxes due.” Dept. Ex. No. 2. The taxes at issue in this case accrued from January through August, 2000. The State of Illinois “Foreign Corporation Annual Report” for year 2000, filed July 24, 2000, lists Doe as “President/Treasurer” and “Director” and was signed by Doe on July 21, 2000, “under penalty of perjury.” Dept. Ex. No. 3. Doe owned 33% of the shares of ABC. Taxpayer’s Ex. No. 6. On September 29, 2000, Doe, listing his title as “President,” signed a “Payment Agreement” with the City of Chicago for unpaid Chicago Amusement Tax. Dept. Ex. No. 6. Cook County Department of Revenue “Amusement Tax Returns” for ABC for the period May, 1999, through November, 2000, excluding June, 1999, were signed by Doe as “President” on December 7, 2000. Dept. Ex. No. 5.

Doe was asked on cross-examination whether he was “president and treasurer all throughout 2000...?” He responded: “There was, I believe there might have been an amendment changing it, I can’t remember, you know, throughout the year 2000.” Tr. p. 109. When questioned further about an amendment, Doe did not recall whether an amendment to the annual report had been filed. Tr. p. 299. No amendment was offered into evidence. Doe’s signature on the documents above, in which he listed himself as “President,” shows conclusively that he held the position of “President” at ABC during the entire period in which the taxes accrued. ABC’s bylaws and delegations of authority were not offered into evidence, and the record does not show what duties and responsibilities were vested in the office of president. However, the president of a corporation is usually charged with the responsibility for the management of the corporation, and without any evidence to the contrary, there is no reason to assume that this was not the case with ABC.

Throughout the evidentiary hearing, Doe testified repeatedly that he was not responsible for the filing and payment of taxes to the State. Doe described Vice-President of Operations, Joe Blow’s job as “to run the daily operations of the business. He was to oversee the filing and payment of taxes.” Tr. p. 24. According to Doe, Blow worked closely with Alan Jim Doe, ABC’s Controller. Doe testified that Jim Doe had “the responsibility of filling out the tax returns and filing them and paying the taxes.” Tr. p. 35. Doe also testified that as part of Mr. Jim Doe’s and Mr. Blow’s job responsibilities, they decided what creditors would be paid and when. Doe was asked in direct-examination: “So if Mr. Jim Doe or Mr. Blow decided that a particular creditor should be paid before or after something, before or after another creditor, that is something they didn’t need to consult with you about?” Doe responded “That’s right.” According to Doe, it was not part of his job responsibilities to decide “what creditors would be paid when.” Tr. p. 60.

Doe testified that he was not familiar with “sales and use tax returns that ABC needed to fill out and send in.” He never participated in the “filling out of these returns.” He never determined the “amount of the receipts that needed to be reflected, taxable receipts, on the returns.” Tr. p. 38. It was Jim Doe’s job “to write the check to the State when the amount of the taxes [was] determined to be owed.” Doe testified that in the eighteen months that ABC was in operation, he never wrote a check to the State for the taxes owed. Tr. p. 39. According to Doe, his responsibilities at ABC were twofold: “Basically, to raise finance or capital for the company and to make sure the films got to the movie houses.” Tr. p. 57. In Doe’ responses to the Department’s First Set of Interrogatories, he stated that “[M]y responsibilities and duties were in the area of corporate planning, including the raising of capital, rather than the day-to-day operation of the theatres.” Taxpayer’s Ex. No. 6.

Doe’ self-serving statements regarding his activities at ABC are contradicted by his own testimony and documentary evidence. Doe was neither an inexperienced businessman nor inexperienced in the theatre industry. Prior to working at ABC, Doe was an investment banker and traded government securities. In 1997, Doe and his wife Jane were officers of XYZ Entertainment, developers for XYZ Theatres. Tr. pp. 84-87. Although Doe testified that it was not part of his job responsibilities to determine which creditors were paid, thirty checks dated between April 27, 1999, and August 21, 1999, payable to various creditors, were signed or co-signed by Doe. Tr. p. 60; Dept. Ex. No. 15. These checks were written prior to the accrual of the taxes at issue in the case but they clearly negate Doe’ testimony that his duties were simply to raise capital and secure first-run movies. Blow’ employment began on April 2, 1999 and Jim Doe started with ABC on May 3, 1999. Taxpayer’s Ex. Nos. 1 and 2, respectively. The thirty checks signed by Doe

show that he participated in decisions regarding the payment of ABC's creditors after Blow and Jim Doe began employment with ABC.

No document was offered by Doe showing that Blow was responsible for the payment of taxes. Blow's duties, according to his "Employment Agreement," were to "devote his full working time and attention to [ABC's] business, [and] employ his best efforts in a competent, efficient and professional manner in the performance of his duties..." There is no mention of taxes in the Employment Agreement, which was signed by Doe. Taxpayer's Ex. No. 1. Jim Doe's specific duties, *inter alia*, according to his "Offer of Employment" were to "oversee accounts payable processing" and "insure that all payroll tax deposits are made and that all tax returns are filed." ABC's "ST-1, Sales and Use Tax Returns" and "ST-4, Metropolitan Pier and Exposition Authority Food and Beverage Tax Returns" for the months included in the NPL were signed by Jim Doe. The ST-4 for August, 2000, the last month included in the NPL, was signed by Jim Doe on October 20, 2000. Dept. Ex. No. 17. Jim Doe's Offer of Employment states specifically that "[A]s the Controller, [Jim Doe] will report directly to John Doe." The Offer of Employment was signed by Doe as "President/CEO." Taxpayer's Ex. No. 2.

It must be noted that in Question 14 of ABC's NUC-1, Doe accepted "personal responsibility for the filing of returns and the payment of taxes due." Dept. Ex. No. 2. No resolution terminating this responsibility was admitted into evidence. I cannot reasonably conclude that Blow was responsible for paying taxes, since it not mentioned in his Employment Agreement. The Agreement does not state who Blow reported to but it appears reasonable to conclude that, as Vice-President of Operations, he would report to the President of ABC, Doe. Accordingly, if Blow was responsible for the filing and payment of taxes, he either shared this responsibility with Doe or he did it under Doe's supervision. Jim Doe's Offer of Employment states specifically that Jim Doe

would report “directly” to Doe. Taxpayer’s Ex. No. 2. The last ST-4 signed by Jim Doe, for August, 2000, was signed on October 20, 2000. Dept. Ex. No. 17. Jim Doe evidently reported “directly” to Doe during the entire period that the taxes at issue accrued. Based on the documents admitted as evidence and the fact that no resolution was admitted terminating Doe’ responsibility for the payment of taxes, I must conclude that Jim Doe either shared responsibility for the payment of taxes with Doe or was supervised “directly” by Doe in this responsibility. Neither Blow nor Jim Doe was subpoenaed by Doe for the evidentiary hearing.

If Doe chose not to be involved in the day-to-day operations of ABC and allowed Blow and Jim Doe to make decisions as to when taxes were to be paid, this does not make him less of a “responsible” officer. 35 ILCS 735/3-7 does not confine liability for the payment of taxes to only one person or to the person most responsible. There can be more than one responsible person in a corporation. The statute certainly does not relieve a supervisor of responsibility for the payment of taxes when the payment function is “directly” under him. A responsible person, in this case the “President/CEO” of the company, cannot escape his obligation to ensure that taxes are paid by delegating responsibility to others. Wright v. United States, 809 F. 2d 425 (7th Cir. 1987). All responsible persons owe a fiduciary obligation to care properly for the funds that are entrusted to them. “A fiduciary cannot absolve himself merely by disregarding his duty and leaving it to someone else to discharge.” Hornsby v. Internal Revenue Service, 588 F. 2d 952 (5th Cir. 1979). As “President/CEO” of ABC, Doe had the power and responsibility for seeing that taxes were remitted to the State. He could not deflect this responsibility by “leaving it to someone else to discharge,” especially when, in this case, the “someone else” reported “directly” to him.

The ability to sign corporate checks is also a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors

are paid. Gold v. United States, 506 F. Supp. 473 (E.D.N.Y. 1981), aff'd, 671 F. 2d 492 (2d Cir. 1982). Doe also tried to deflect responsibility for the payment of taxes by testifying that he did not sign checks in the year 2000:

- Q. You weren't signing checks for these type of day-to-day expenses because people had been hired to do that?
- A. Yes.
- Q. And yet you haven't been given any checks by the State to look at as evidence to show that all through 2000, which is this tax period, you were writing those kind of checks?
- A. That's correct.
- Q. And even on those checks, and some of those checks, if it was over five thousand dollars you needed someone's else's approval?
- A. Yes.
- Q. You couldn't have written it yourself?
- A. I couldn't have written it myself.
- Tr. p. 262.

Doe' testimony here is self-serving and not credible. Blow, Jim Doe and Ron Doe, Operations Manager, were authorized signatories on ABC's account at Bank, number 0000000000. Taxpayer's Ex. No. 3. Blow and Ron Doe were authorized signatories on ABC's account at Mid Town Bank, number 000-0000. Taxpayer's Ex. No. 4. It seems reasonable to conclude that Blow, Vice-President of Operations, and Ron Doe, Operations Manager, reported to Doe. Jim Doe definitely reported "directly" to Doe, according to his Offer of Employment. Taxpayer's Ex. No. 2. Under these circumstances, Doe could have directed either Blow, Jim Doe or Ron Doe to write a check from the above accounts to the State of Illinois for unpaid taxes.

On March 18, 1999, Doe, as "President" signed a "Corporate Resolution of Board of Directors" of ABC authorizing the following signatories on two checking accounts, numbers 00000 and 00000000, at Northern Trust Bank: Doe, Jane Doe, Blow and Ron Doe. The Resolution states that "two signatures are required on checks over \$5,000." Only one signature was required for checks under \$5,000. The Resolution also states that only the "President" is "authorized to

designate persons empowered to sign checks ... change or remove any or all of the persons so designated, or substitute the names of other persons or authorize additional persons as signatories.” Taxpayer’s Ex. No. 5. Account number 00000 remained open and showed activity from January, 2000, through January 2001, which includes the period that unpaid taxes accrued. Dept. Ex. No. 10.

Doe’ testimony that he needed someone else’s “approval” to write a check for over \$5,000 is misleading. The three other signatories on the Northern Trust Bank accounts included Doe’ wife and two corporate officers, Blow and Ron Doe, who were likely reporting to Doe. There was no testimony or evidence that Doe attempted to remit a check to the State for over \$5,000 but was unable to attain another signature. Furthermore, the Board of Directors resolution stating that two signatures were required on checks over \$5,000 was signed by Doe and states that only the “President” was authorized to designate persons who could sign checks or substitute the names of other persons or authorize additional persons as signatories. If all of the other signatories had refused to sign a check to the State of Illinois for over \$5,000, Doe could have designated/substituted/authorized another signer. In addition, Doe, alone, could have executed multiple checks for under \$5,000 to pay the State of Illinois for unpaid taxes. No evidence was admitted showing that even one check for under \$5,000 was remitted to the State for taxes. Under these circumstances, I conclude that Doe was able to remit a check from the accounts at Northern Trust Bank to the State of Illinois for unpaid taxes, further indicating that he was a responsible party of ABC.

On January 25, 2000, ABC borrowed \$2,500,000 from Bank of America in a term note, signed by Doe as “President/CEO.” Tr. pp. 249-250, 327; Taxpayer’s Ex. No. 8. A January 27, 2000, letter to Bank of America from ABC signed by Doe as “President/CEO” acknowledges that

ABC had reviewed and found acceptable letters of credit to be issued by Bank of America totaling approximately \$1,436,000. Tr. pp. 179-183, 327; Dept. Ex. No. 12. On January 25, 2000, Doe as “President/CEO” signed a “Security Agreement” with Bank of America in which ABC pledged and assigned to the Bank a security interest in all accounts of ABC, including accounts then maintained in ABC’s name with any bank or financial institution. Tr. pp. 250-257, 334-336; Taxpayer’s Ex. Nos. 9 and 10. Doe’s signatures on the term note, the acknowledgment of the letters of credit, and the Security Agreement is clearly evidence that Doe had significant control over the business affairs of ABC. Monday, supra.

ABC then opened four bank accounts with Bank of America: number 00000 (operating account) opened February 1, 2000; number 00000 (payroll account) opened April 12, 2000; number 00000 (depository account) opened April 12, 2000; 00000 (payables account) opened April 12, 2000 and closed May 18, 2000. Doe, Jane Doe, Jim Doe and Blow were all signatories on the four accounts. Dept. Ex. No. 9. According to Doe’s testimony, these accounts were opened because ABC was then refinancing with Bank of America. Tr. p. 166. It seems reasonable to assume that the four accounts were opened up to secure Bank of America’s security interest in ABC. Doe was asked on cross-examination if his signature on the account authorization allowed him to “sign checks for the operating, payroll, depository and payables account at Bank of America?” He responded: “I’m not sure.” Tr. p. 160. Doe’s testimony here is obviously disingenuous. Doe had the authority, without needing a second signature, to write a check on any of the four accounts at Bank of America. Possessing check-writing authority is indicia of a responsible person. Thomas v. U.S., 41 F. 3d 1109 (7th Cir. 1994).

On or before May 10, 2000, ABC defaulted on payments to Bank of America and the Bank threatened to close the theatres. Tr. p. 340. Doe, as “President,” signed a “Forbearance Agreement”

with Bank of America. This Agreement stated that the Bank would forbear from exercising its rights against ABC until December 31, 2000. One of the terms of the Agreement was that ABC maintain bank accounts only at Bank of America and Mid-Town Bank. The Agreement would terminate if ABC “uses its ordinary income other than in the operation of its business...” [hereinafter “Clause 9(e)”]. Dept. Ex. No. 18. At the time the Agreement was entered into, taxes to the State were in arrears for approximately \$65,000. Doe’ testimony with regard to the Forbearance Agreement is contradictory and not credible. Doe was asked in cross-examination if there was “anything in the agreement that allowed the bank to take over the day-to-day operations of ABC?” Amazingly, he responded: “I haven’t read it, so I don’t know.” Tr. p. 173.

Despite having not “read” the Agreement, Doe testified that after the Forbearance Agreement was signed, ABC was unable to pay the State for the accumulated back taxes:

Q. ...Was it your understanding after the event of default and after the entry of the Forbearance Agreement that you did not have the authority to write a check to the State of Illinois for any past due taxes?

A. I did not have the authority...
Tr. p. 266.

There is no express provision in the Forbearance Agreement which specifically prevented ABC from paying the accumulated taxes. Mr. XXX, counsel for ABC at the time the Agreement was negotiated, testified that “[T]here was no express reference in the Forbearance Agreement to payments to the State of Illinois.” Tr. p. 371. The Agreement did not establish a tax escrow account for the payment of accumulated unpaid taxes. Tr. p. 381. Doe was asked whether a “mechanism” was in place after April of 2000 to make sure that past due tax payments were being made to the State. He responded: “Once the bank got involved, it was tough to do that.” Tr. p. 211. No evidence was presented showing that ABC implemented any tax payment plan for the accumulated unpaid taxes. The sale by ABC of each theatre ticket was subject to the imposition of

the Illinois taxes at issue in this case. ABC collected these taxes from each theatre patron. The taxes collected were not remitted to the State. To argue that ABC could not pay the collected taxes because the bank “got involved” ignores the obvious fact that the taxes had been used to pay other creditors long before any involvement by Bank of America.

Assuming, *arguendo*, that the Forbearance Agreement did prevent ABC from paying the accumulated back taxes, this would not be sufficient to relieve Doe of his responsibility for the unpaid taxes. XXXXX testified that Doe, *inter alia*, was present at “both meetings” where the Forbearance Agreement was negotiated with Bank of America. Tr. p. 387. According to XXXXX, the individuals that accompanied him to the meetings “made the final decision as to whether to enter into the Forbearance Agreement...” Tr. p. 388. Doe signed the Forbearance Agreement as “President,” obviously agreeing to the provisions of the Agreement, and again indicating his control over the business affairs of ABC. Monday, *supra*. Doe testified that ABC’s Board of Directors “sought out the Forbearance Agreement” although he was unable to provide a copy of a Board of Directors resolution authorizing the Agreement. Tr. p. 280. Doe’s signature on the Forbearance Agreement and his argument that it prevented him from paying accumulated taxes puts him in the untenable position of arguing that ABC could not pay the back taxes because he signed an Agreement with Bank of America which prevented their payment.

Although no provision was made for accumulated taxes in the Forbearance Agreement, both Doe and XXXXX testified that clause 9(e) allowed for the payment of future taxes to the State:

- Q. I believe that pursuant to [9(e)], you can use ordinary income in the course of, in the ordinary course of your business. What I am asking is are paying taxes in the ordinary course of your business?
- A. I don’t understand the question. Because ordinary is, was going forward, not anything going back.
- Q. I am just saying that either going forward or going back, is your ordinary business, does that include paying taxes?
- A. Going forward, paying taxes is part of going forward, yes.

- Q. Would your ordinary operation of business include also paying employees?
A. Going forward, yes.
Q. Would it also include paying vendors?
A. Going forward, yes. ...
Q. Subsequent to the agreement were employees paid?
A. Some employees.
Tr. pp. 283-285.

XXXXX was asked if it was his intent when the Agreement was drafted “that ABC was agreeing that it would not pay past due obligations and it would only pay out of ordinary income future obligations?” He responded: “Yes, the intent of the document was going forward only, operations of the business going forward.” Tr. pp. 344-345.

In spite of Doe’ and XXXXX’s testimony that the intent of the Agreement was “going forward,” the NPL shows that taxes continued unpaid through May, June July and August, 2000. Dept. Ex. No. 1. No evidence was presented showing that taxes accumulating after the date of the Forbearance Agreement were paid.

Responsibility is a matter of status, duty and authority. Mazo v. United States, 591 F. 2d 1151 (5th Cir. 1979). Doe’ signature as “President/CEO,” “Treasurer,” and “Director,” on the Forbearance Agreement and other corporate documents, including resolutions, term notes and security agreements, is evidence that he had significant control over ABC’s business affairs. Doe had check-writing authority on two checking accounts at Northern Trust Bank and four accounts at Bank of America and could have written a check to the State of Illinois from these accounts for unpaid taxes. Doe, in effect, had check-writing authority at Bank and Mid-Town Bank because employees who reported to Doe were authorized signatories on these accounts. Doe could have directed that these employees write a check to the State of Illinois for unpaid taxes.

Taxes collected from theatre patrons before the Forbearance Agreement was executed were not remitted to the State. No evidence was presented that Doe made any provision for the payment

of the past due taxes. No taxes were remitted after the Forbearance Agreement, although the Agreement allowed for the remittance of taxes “going forward.” As a corporate officer of record, Doe had the power and responsibility within ABC to see that the unpaid taxes were remitted to the State of Illinois. Monday, supra. I conclude that Doe has failed to rebut the Department’s *prima facie* case that he was a responsible party of ABC during the accrual of the unpaid taxes.

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson v. Dept. of Revenue, 168 Ill. 2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness.

35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay or file taxes. In attempting to clarify what constitutes a willful failure to file or pay taxes, the courts have adopted a broad interpretation of the words “willfully fails.” Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Under this broad interpretation, responsible officers are liable if they delegate bookkeeping duties to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of the retailers’ occupation tax returns and payments. Branson supra. Willfulness also includes “failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government.” Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). “Willfulness” as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970) *cert. denied* 400 U.S. 821 (1970). Also, a person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985).

Doe' conduct was willful under each of the above benchmarks. Unpaid taxes to the State began accumulating in January, 2000. Doe testified that he first became aware of the past due taxes in April or May of 2000. Tr. p. 66. At that time, he says he brought the delinquent tax liabilities to the attention of the Board of Directors. Tr. pp. 214-215. Doe testified that at approximately the same time, he learned that Jim Doe had not been paying the City of Chicago and other creditors, and was in default on ABC's loans from Bank of America. Tr. p. 245. When asked whether Jim Doe was performing the duties required in his Offer of Employment, such as filing tax returns and overseeing accounts payable processing, Doe replied that Jim Doe "did not come to me and say that he was not doing it." Tr. p. 102. Doe was then asked "[S]o other than him not reporting to you that he did not do it, you just assumed then that he had done these things?" Doe responded "[Y]es." Tr. p. 104.

Doe testified that he never saw the "ST-1's, Sales and Use Tax Returns." Tr. p. 306. In addition to not looking at the returns, Doe' testimony also shows that he failed to inspect corporate records to learn the status of the tax returns:

- Q. For 2000, was there anything in writing to show that the taxes were paid, the ROT taxes and the MPEA taxes?
- A. No, there was nothing in writing that this particular liability was not paid.
- Q. That you saw?
- A. Not that I saw. I mean what you have on a balance sheet it says liabilities, and that's where they are broken down. If it was anywhere, it would be in liabilities. It wouldn't be just taxes not paid. That's not the way financial statements are reported.
- Q. But on the balance sheet for liabilities, was there a column or an entry for taxes?
- A. I don't remember. I don't remember.
- Q. Did you make any inquiries of Mr. Jim Doe at anytime as to whether or not the taxes were being paid?
- A. April, May 2000.
Tr. pp. 106-107.

Doe testified that Jim Doe prepared quarterly financial statements and accounts payable reports and monthly budget reports. ABC had quarterly board meetings, attended by Doe, where the reports and statements were discussed. Tr. pp. 88-95.

ABC's "Payment Agreement" with the City of Chicago indicates that unpaid City Amusement Taxes began accumulating in April 1999. Dept. Ex. No. 6. It appears from the Cook County lawsuit filed against ABC that unpaid Cook County Amusement Taxes began accumulating in May of 1999. Dept. Ex. No. 5. In light of Doe's testimony about financial statements and meetings and the documentary evidence of the unpaid taxes to the City of Chicago and Cook County, it is difficult to believe that Doe first learned of the liability to the State of Illinois in April or May of 2000. Doe should have been on notice, since April or May of 1999, that Jim Doe was not remitting the taxes collected to the taxing bodies. Doe's testimony shows, at the very least, that he failed to keep informed of the status of the Illinois tax returns despite clear evidence that similar taxes were not being paid. As President of ABC, with Jim Doe reporting "directly" to him, Doe had the responsibility to inspect corporate books and ascertain the status of the unpaid taxes. As President of ABC, with Jim Doe reporting "directly" to him, Doe had the right to demand from him a detailed breakdown of "liabilities" on the balance sheet especially in light of the late tax payments to the other entities. His failure to keep informed and inspect the corporate books, particularly under the circumstances of this case, is evidence of willfulness.

It must be noted that the ST-4 for August, 2000, the last month included in the NPL, was signed by Jim Doe on October 20, 2000. Dept. Ex. No. 17. If Doe's testimony about Jim Doe is credible, Doe retained Jim Doe at ABC after the discovery of the unpaid taxes to the City of Chicago, Cook County and the State of Illinois and after defaults to creditors and Bank of America. Clearly this shows a failure to correct mismanagement by Doe after finding out that taxes were not

being paid. However, it also casts doubt on Doe's testimony in this case whereby he places blame for these unpaid taxes squarely on Jim Doe while claiming ignorance of the tax problem.

Doe exhibited a reckless disregard for the risk that accumulated taxes would not be paid by failing to provide for them in the Forbearance Agreement. No evidence of a tax payment plan or escrow agreement was admitted into evidence. Doe could not "recall" whether Bank of America ordered him not to pay the taxes to the State of Illinois. Doe could not "recall" whether he tendered "a check to the State of Illinois that Bank of America did not honor payment on." Tr. p. 297. There was no testimony or documentary evidence showing any positive steps taken by Doe to pay the late taxes to the State of Illinois. If a responsible person, such as Doe, does nothing, despite being on notice of a grave risk of nonpayment, a finding of willfulness is justified. Branson, *supra*.

The "Petition for Rule to Show Cause" filed by Cook County on January 4, 2001, for unpaid amusement tax states that Cook County had not received a "check for collected Cook County Amusement Taxes collected since Thursday, December 7, 2000." Dept. Ex. No. 5. As the unpaid taxes to the State were accumulating, ABC was apparently making payments to creditors other than the State of Illinois. In September, 2000, Doe testified that he paid the City of Chicago \$150,000 from his personal funds for accumulated City amusement taxes in order that the City allow the ABC theatres to reopen. Tr. pp. 145-152. The taxes owed to the City were ABC's debt. In using his personal funds to pay corporate debts, Doe took direct and specific action that allowed ABC to prefer creditors over the State, further evidencing his own willfulness in failing to cause ABC to pay its taxes owed to the State.

Doe testified that some employees were paid after the Forbearance Agreement was executed. He also testified that some vendors were paid "going forward" after the Agreement. Tr. pp. 283-285. In signing and approving the Forbearance Agreement, Doe made Bank of America a

secured creditor over the State of Illinois. Mr. XXXXX testified that the Forbearance Agreement called for all money deposited in ABC's accounts to go first to Bank of America. Tr. p. 381. Doe's own counsel stated "the bank is a secured creditor... they do have preference over the State." Tr. p. 382. Doe testified that "[W]hen ABC went down, when ABC went out of business, I believe the equipment in [the] some of the theatres were sold and the bank took them." Tr. p. 71. When ABC went out of business, the State of Illinois was not paid for the unpaid taxes. Doe's signature on the Forbearance Agreement allowed Bank of America to get preferential treatment over the State, further showing willfulness. Based on the evidence presented, I conclude that Doe has failed to rebut the Department's presumption that he willfully failed to pay the taxes due to the State of Illinois.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. 0000 issued against John Doe be finalized as issued.

Kenneth J. Galvin
Administrative Law Judge

April 30, 2003