

ST 97-30

Tax Type: SALES TAX

Issue: Responsible Corp. Officer - Failure to File or Pay Tax

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

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|---------------------------|---|--------------------------|
| THE DEPARTMENT OF REVENUE |) | |
| OF THE STATE OF ILLINOIS |) | No. |
| |) | IBT # |
| v. |) | Tax Pd. 07/81-02/92 |
| |) | NPL # |
| TAXPAYER, |) | |
| TAXPAYER |) | Charles E. McClellan |
| |) | Administrative Law Judge |

RECOMMENDATION FOR DISPOSITION

Synopsis:

This matter came on for evidentiary hearing on August 27, 1996, following the filing of a timely protest to a Notice of Penalty Liability ("NPL") issued by the Department of Revenue ("Department") on December 13, 1994, to TAXPAYER ("TAXPAYER"). The NPL, in the amount of \$24,696.17, was issued to TAXPAYER as a responsible officer of CORPORATION Inc. ("CORPORATION"), a corporation located at Chicago, Illinois. The issue is whether TAXPAYER is liable, as a responsible person, for the penalty assessed him under section 13 1/2 of the Retailers' Occupation Tax Act, now § 3-7 of the Uniform Penalty and Interest Act. 35 ILCS 735/3-7.

Following the submission of all evidence and a review of the record, I recommend that the Department's NPL be made final.

Findings of Fact:

1. CORPORATION was incorporated circa 1980 by TAXPAYER and PARTNER ("PARTNER"). Tr. p. 21.

2. TAXPAYER and PARTNER each contributed \$1,000 for a 50% ownership share in the corporation. Tr. pp. 15, 22.

3. CORPORATION was located at 1814 ADDRESS, Chicago, Illinois. Tr. p. 35.

4. TAXPAYER, whose address is 1960 ADDRESS, Chicago, Illinois, served as president of CORPORATION at all relevant times starting with its incorporation. Tr. pp. 21, 27.

5. TAXPAYER took profit out of the business on some occasions. Tr. pp. 17, 22.

6. PARTNER was vice president, secretary and treasurer of the corporation from the time the business started until she died of lung cancer on December 24, 1994. Tr. pp. 19, 27, 33.

7. CORPORATION was in the business of buying and reselling promotional specialty items, such as T-shirts, tote bags, and pins. Tr. pp. 22, 23, 24, 35.

8. The business became inactive in 1992. Tr. p. 17.

9. PARTNER ran CORPORATION on a day-to-day basis, doing the purchasing and selling and keeping the books and records. Tr. pp. 17, 23, 24, 27, 36, 47.

10. PARTNER maintained control of the corporate business records and was responsible for determining the order of debt payment. Tr. pp. 17, 18.

11. Both TAXPAYER and PARTNER were authorized signers on CORPORATION's checking account, but PARTNER signed most of the checks. Tr. pp. 15, 28, 29.

12. TAXPAYER signed a few checks from time to time. Tr. pp. 15, 28, 29.

13. During all relevant times, TAXPAYER's primary business was operating restaurants. Tr. pp. 14, 20, 30.

14. CORPORATION did not file sales and use tax returns for periods prior to 1993. Tr. pp. 9, 10, 11; Dept. Ex. No. 1.

15. TAXPAYER signed an Illinois Business Registration form (Form NUC-1) which was filed with the Department on September 28, 1992, to register under the Retailers Occupation Tax Act. Tr. pp. 20, 33; Dept. Ex. 3.

16. TAXPAYER signed and filed sales and use tax returns for the months of January through September of 1993, all of which showed no tax liability. Dept. Ex. No. 2.

17. A certified public accountant, CPA ("CPA"), was retained by CORPORATION for all of the years relevant to this matter. Tr. pp. 35, 40, 44.

18. CORPORATION had no employees so CPA did not prepare withholding tax returns. Tr. p. 42.

19. CPA was not hired to prepare sales tax returns for CORPORATION. Tr. p. 39.

20. CPA was responsible for preparing the corporate income tax returns for CORPORATION at the end of each year from 1981 through 1992. Tr. pp. 35, 40, 41, 44.

21. If CPA had questions regarding CORPORATION's business he contacted PARTNER. Tr. p. 35.

22. CPA prepared CORPORATION's income tax returns from recaps provided by PARTNER but did not examine the company's books. Tr. p. 38.

23. At the end of each year CPA would get together with TAXPAYER and PARTNER and discuss what happened during the year and what the tax returns showed. Tr. p. 37.

24. PARTNER was also involved in TAXPAYER's restaurant businesses. Tr. pp. 41, 42.

25. CPA did the accounting work and prepared the income tax returns for TAXPAYER's restaurant businesses. Tr. pp. 36, 42, 43.

26. At the year end meetings with TAXPAYER and PARTNER, CPA also discussed the income tax returns for TAXPAYER's restaurant businesses. Tr. p. 47.

27. At these year end meetings, CPA would ask PARTNER and TAXPAYER why they kept CORPORATION in business since it was doing so poorly and he encouraged them to discontinue the business because they were not making any money. Tr. p. 45.

Conclusions of Law:

The issue in this case is whether TAXPAYER is a responsible person who willfully failed to file and pay retailers' occupation taxes for CORPORATION as required by statute, and is, therefore, personally liable for the penalty imposed by section 13½ of the Retailers Occupation Tax Act ("Act")¹ now that CORPORATION is defunct and CORPORATION's retailers' occupation taxes remain unpaid.

Once the Department introduced into evidence the NPL under the Director's certificate (Dept. Ex. No. 1), its *prima facie* case was made. Branson v. Dept. of Revenue, 168 Ill.2d 247 (1995) By operation of the statute, proof of the correctness of the penalty, including the willfulness element of the statute was established. *Id* at p. 260. At that point in the proceedings, TAXPAYER had the burden of proving that the penalty did not apply to him. *Id.* at p. 261. The record shows that he failed to do so.

Taking into account the evidence and testimony of record, for the reasons set forth below, I conclude that TAXPAYER failed to overcome the Department's *prima facie* case that he is liable for the penalty assessed by the Department.

Section 13 ½ (now 35 ILCS 735/3-7), in relevant part, provides as follows:

(a) 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 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 proceedings 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.

Whether TAXPAYER is liable for the tax depends in the first instance on whether he is a responsible person under the statute. In applying the penalty

¹ Ill. Rev. Stat. 1991, ch. 120, ¶ 452½, repealed effective January 1, 1994; replacement provision enacted as § 3-7 of the Uniform Penalty and Interest Act, 35 ILCS 735/7.

tax, the Illinois courts look to federal cases involving § 6672 of the Internal Revenue Code² which contains language similar to the Illinois statute. The fact that a person was an officer of a corporation does not, *per se*, mean that he was the person who had the duty to collect, account for and pay over the tax. Monday v. U.S., 421 F.2d 1210, (7th Cir. 1970), cert. den. 400 U.S. 821. However, the fact that another person may have had that responsibility does not mean that the officer was not also responsible. *Id.* The liability attaches to those who have the power and responsibility within the corporation for seeing that tax owed is paid and that responsibility is generally found in high corporate officials charged with general control over corporate business. *Id.* Responsibility is not a matter of knowledge, but rather a matter of status and authority. Mazo v. U.S., 591 F.2d 1151 (5th Cir. 1979)

In the instant case, TAXPAYER was president and 50% owner of CORPORATION from its inception until it became inactive. He had check signing authority during this time which he did exercise on occasion. There was only one other officer, PARTNER, and no employees. CORPORATION's by-laws are not in evidence, so the record does not show what duties and responsibilities they vested in the president of the corporation. However, the president of a corporation is customarily charged with overall responsibility for management of the corporation, and there is no reason to assume that not to be the situation in this case. Thus, even though PARTNER may have handled the day to day business of the corporation, TAXPAYER had a duty to make sure the retailers' occupation taxes were paid as required. Therefore, TAXPAYER's position as president and 50% owner of CORPORATION gave him the status and authority that made him a responsible person under the statute.

Finding that TAXPAYER was a responsible person, the next question is whether he willfully failed to pay over the retailers' occupation tax within the meaning of the statute. The concept of willfulness is not defined in the statute. The court in Monday, *supra*, noted that the concept, when used in criminal statutes,

². 26 U.S.C. § 6672.

requires "bad purpose or the absence of justifiable excuse. *Id.* at p. 1215. The court then distinguished the meaning the term when used in civil actions by saying, "[R]ather, willful conduct denotes intentional, knowing and voluntary acts. It may also indicate a reckless disregard for obvious or known risks." *Id.*; Dept. of Revenue v. Joseph Publick & Sons, Inc., 68 Ill.2d 568 (1977).

The willfulness requirement "is satisfied if the responsible person acts with reckless disregard of a known risk that the trust funds may not be remitted to the Government. . . ." Garsky v. U.S., 600 F.2d 86 (7th Cir. 1979) A high degree of recklessness is not required because if it were required, the purpose of the statute could be frustrated simply by delegating responsibilities within a business and adopting a "hear no evil -- see no evil" policy. Wright v. U.S., 809 F.2d 425 (7th Cir. 1987) A "responsible person is liable if he (1) clearly ought to have known that (2) there was a grave risk that withholding taxes were not being paid and if (3) he was in a position to find out for certain very easily." *Id.* at p. 427. Willfulness can be established by showing gross negligence as in a situation in which a responsible party ought to have known of a grave risk of nonpayment and who is in a position to easily find out, but does nothing. Branson, supra.

In this case, TAXPAYER was in the business of operating one or two restaurants at all times relevant to this matter. It is inconceivable that a person who is in the business of operating two restaurants over a period of years would not be aware of the obligation to file and pay retailers' occupation tax to the state. PARTNER worked with TAXPAYER in his restaurant businesses. He and PARTNER met with their CPA, CPA, at the end of each year to discuss the tax returns of CORPORATION and the restaurants. CPA testified that he encouraged them to discontinue CORPORATION's business because it continued to lose money. Although the testimony was that the retailers' occupation tax problem was never discussed, that testimony is incredulous.

Because the company was in a money losing pattern, it is not reasonable to believe that the liabilities of CORPORATION to the state and to other creditors

would not have been discussed at some time during one or more of these meetings. TAXPAYER testified that he never discussed the retailers' occupation tax filing obligation with PARTNER (Tr. p. 28), that he had no involvement with the business (Tr. p. 25), and was not aware of the retailers' occupation tax problem until 1992 when PARTNER was diagnosed with cancer. (Tr. p. 19). However, he was the president of the company, a 50% owner of the company, and he took out profits from time to time. TAXPAYER's testimony that he never discussed CORPORATION's business with PARTNER at some time during the 11 or 12 year period of CORPORATION's existence is also incredulous.

However, taking his testimony at face value, his failure to discuss the business with PARTNER and to make himself aware of its financial and tax problems constituted gross negligence. TAXPAYER was a responsible person who knew or should have known that the taxes were not being paid. The company was in a money losing situation. He was an experienced business man. The discussions with CPA over the years should have alerted him to the fact that the taxes might be going unpaid. He was in a position to find out easily if there was a problem or not, yet he did nothing, according to his testimony. These factors establish willfulness within the context of the statute and make him liable for the penalty assessed.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's Notice of Denial should be made final.

Date: _____
June 23, 1999

Charles E. McClellan
Administrative Law Judge