ST 97-31
TAX TYPE: SALES TAX
Issue: Responsible Corp. Officer - Failure to File or Pay Tax

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

THE DEPARTMENT OF REVENUE	**)**	
OF THE STATE OF ILLINOIS	**)**	
	)	**Docket #**
v.	**)**	
	)	
TAXPAYER A and	**)**	**NPL #**
TAXPAYER B	**)**	**NPL #**
Responsible Officers,	**)**	
CORPORATION	**)**	**IBT #**

RECOMMENDATION FOR DISPOSITION

Appearances: Holten D. Summers, of Webber and Thies, P.C. for TAXPAYER B and TAXPAYER A.

Synopsis:

This matter comes on for hearing pursuant to TAXPAYER A's protest to Notice of Penalty Liability No. XXXX and TAXPAYER B's protest to Notice of Penalty Liability No. XXXX. The Notices of Penalty Liability (hereinafter referred to as the "NPLs") were issued by the Illinois Department of Revenue, (hereinafter referred to as the "Department") against TAXPAYER A and TAXPAYER B (hereinafter referred to as the "Taxpayers") as officers of CORPORATION a/k/a CORPORATION, CORPORATION, a/k/a CORPORATION. The NPLs represent a penalty liability for Retailers' Occupation Tax and related taxes admitted by the corporation as due to the Department for the periods of December,

1989, through August, 1990, but were unpaid. A hearing in this matter was held on March 6, 1997. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the taxpayers.

Findings of Fact:

1. The *prima facie* case of the Department, consisting of two Notices of Penalty Liability, was established by the admission into evidence of Department's Exhibit No. 2.

2. On April 17, 1991, the Department issued Notice of Penalty Liability No. XXXX to TAXPAYER A as a responsible officer for CORPORATION, in the amount of $16,302.24 for assessment periods of December 1989, through August 1990. (Dept. Ex. No. 2)

3. On April 17, 1991, the Department issued Notice of Penalty Liability No. XXXX to TAXPAYER B as a responsible officer for CORPORATION, in the amount of $16,302.24 for assessment periods of December 1989, through August 1990. (Dept. Ex. No. 2)

4. The Notices of Penalty Liability were based upon sales and use tax returns for the aforementioned periods filed by CORPORATION, CORPORATION, with the Department. (Dept. Ex. No. 3; Taxpayer's Ex. No. 10)

5. In 1987, TAXPAYER B and TAXPAYER A, as sole shareholders, formed a business named CORPORATION, for the purpose of opening a golf store in Champaign, Illinois. By December 1989, there were two locations, one in Champaign and one in Danville. (Tr. pp. 9-11)

6. On November 30, 1989, CORPORATION, d/b/a CORPORATION, CORPORATION, and CORPORATION, drew up a document entitled "General

Partnership Agreement", ostensibly to form a partnership under the name of CORPORATION Partnership. The document was not executed. (Taxpayer Ex. No. 1; Tr. p. 13)

7. On January 1, 1990, CORPORATION, d/b/a CORPORATION, CORPORATION and CORPORATION d/b/a CORPORATION executed a document entitled "Joint Venture Agreement" to establish "CORPORATION Joint Venture." CORPORATION stands for CORPORATION. The purpose of the joint venture was to combine the respective business operations of the two entities and operate retail locations in Decatur, Danville, and Champaign, Illinois. (Taxpayer's Ex. No. 8; Tr. p. 11)

8. Mr. TAXPAYER B vaguely remembered that the reason that the partnership agreement was not executed and the joint venture agreement was substituted, was due to tax ramifications that the attorney who drew up the documents explained to the parties. (Tr. p. 16)

9. Paragraph 9 of the joint venture agreement, entitled "dissolution", details that "[I]f either member of the Joint Venture becomes insolvent or become[s] subject to bankruptcy proceedings, the Joint Venture shall automatically be dissolved." The paragraph also describes the disbursements of CORPORATION Joint Venture in the event of a dissolution. The assets and liabilities of CORPORATION, included a note at Busey Bank, an SBA loan at Busey Bank, and a note at First Midwest Bank. The assets and liabilities of CORPORATION, included a promissory note due to Marine Bank and an obligation to XXXXX. (Taxpayer's Ex. No. 8)

10. Pursuant to the joint venture agreement, CORPORATION had two votes and CORPORATION, had one vote with respect to the actions of the joint venture. A majority of the votes was required to approve

actions of the joint venture. The principal office of the joint venture was 1741 Kirby, Champaign, Illinois. (Taxpayer's Ex. No. 8)

11. CORPORATION operated golf stores in Champaign and Decatur, Illinois and was a competitor of CORPORATION, CORPORATION, in Champaign. When the two stores merged, CORPORATION moved their inventory to the location, formerly operated by CORPORATION, d/b/a CORPORATION, CORPORATION, at, Champaign, Illinois. (Tr. pp. 11-12)

12. PRESIDENT, personally and as President of CORPORATION, executed a promissory note on December 1, 1989, in the amount of $50,000.00 to CORPORATION The note stated that it was for 10 payments of $5,700.00, due in January, May, June, July, and August of 1990 and 1991. No payments were ever received by the taxpayers regarding the note. (Taxpayer's Ex. No. 2; Tr. pp. 21-23)

13. It was the understanding of Mr. TAXPAYER B that CORPORATION was sold to PRESIDENT on December 1, 1989 and that PRESIDENT would be responsible for the management of the business while Mr. TAXPAYER A obtained his graduate degree and Mr. TAXPAYER B became employed by First of America Bank. (Tr. pp. 12, 18-20)

14. On January 8, 1990, TAXPAYER B became employed by First of America Bank and is currently a branch manager for the bank in Champaign, Illinois. (Taxpayer Ex. No. 9; Tr. pp. 9, 12)

15. TAXPAYER A was employed by CORPORATION, , Champaign, Illinois, for a period of months during 1990. From the entity, he earned state wages and tips in the amount of $1,969.85. (Taxpayer's Ex. No. 5; Tr. p. 36)

16. TAXPAYER A was available to help out on a part-time basis for a short time in early 1990 as an employee of CORPORATION. When it

became obvious that the income from the promissory note would not be forthcoming, he went to Eastern Illinois University as a full time graduate student. (Tr. pp. 36-37; 46-47)

17. TAXPAYER A signed the sales and use tax returns for CORPORATION, CORPORATION/CORPORATION that were submitted to the Department for the periods of December 1989, January 1990, and February 1990. TAXPAYER A also endorsed a check on a Busey Bank account for CORPORATION, CORPORATION, an CORPORATION Co., in the amount of $2,607.60 to the Department on December 26, 1989. The check was for sales tax liabilities for CORPORATION, for November 1989. (Dept. Ex. Nos. 3 and 4; Taxpayer's Ex. No. 10; Tr. p. 55)

18. PRESIDENT signed the sales and use tax returns for CORPORATION, CORPORATION/CORPORATION, that were submitted to the Department for the periods of April 1990, through August 1990. The return submitted to the Department for March 1990, is unsigned. (Taxpayer's Ex. No. 10)

19. It was the understanding of TAXPAYER A that a new taxpayer number was necessary, and until such time as one was issued, the [tax] forms had to be sent in under the name of CORPORATION (Tr. p. 45)

20. The taxpayers were notified that PRESIDENT filed for bankruptcy in October 1990. (Tr. pp. 23; 38)

21. As a consequence, the taxpayers personally filed bankruptcy. They attempted to salvage the business but the debts incurred were substantial. The taxpayers were obligated on the lease for the building that CORPORATION, had rented. (Tr. p. 24-25)

22. TAXPAYER A accompanied Busey Bank loan officers to the site of the building in October/November 1990, to gather inventory. (Tr. p. 38)

23. During the inspection of the premises, Mr. TAXPAYER A searched a desk in the business. In the desk were checks issued by CORPORATION on a Marine Bank account to various employees. The checks, dated June 29, 1990, were unsigned. (Taxpayer's Ex. No. 4; Tr. pp. 40-42)

24. Busey Bank took the inventory of the joint venture and sold it at a "fire sale" in Indianapolis. (Tr. p. 34)

25. PRESIDENT, as general partner of CORPORATION, was sent various notices by the Internal Revenue Service that his tax returns were overdue for the tax periods of March 31, 1990, and June 30, 1990. The Internal Revenue Service sent further correspondence to PRESIDENT, as general partner of CORPORATION, at, Savoy, Illinois, regarding the liabilities. The correspondence and notices were also found by Mr. TAXPAYER A in the search of the desk at the building. (Taxpayer's Ex. No. 3; Tr. pp. 39-40)

26. PRESIDENT, as general partner of CORPORATION, received a notice dated March 15, 1990, of a new employer identification number assignment for CORPORATION from the Internal Revenue Service. (Taxpayer Ex. No. 11)

Conclusions of Law:

The Retailers' Occupation Tax Act imposes a personal liability upon corporate officers that have the control, supervision or responsibility of filing returns and making payments of the taxes of

the business. The statutory language, found at Ill. Rev. Stat. Ch. 120, Para. 452.5[1] states:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount herein imposed ... and who willfully fails to file such return or make such 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 corporation, including interest and penalties thereon ....

The Notice of Penalty Liability is *prima facie* correct and the burden is on the taxpayer to rebut this presumption. Branson v. Department of Revenue, 168 Ill.2d 247 (1995)

The Department submitted the Notices of Penalty Liability to the record, thereby establishing the *prima facie* case of the Department. Thus,

> the Department's establishment of a *prima facie* case for a tax penalty operates, in effect, as a rebuttable presumption of willfulness. In addition to establishing the amount of penalty due and the person responsible for paying the taxes, the Department's *prima facie* case for a tax penalty presumes willfulness. To rebut the presumption, the person defending against the penalty must adduce sufficient evidence to disprove willful failure to file returns and pay taxes. *id.* at 262

For a notice of penalty liability to be viable, it must: 1) be issued to an officer or employee of a corporation subject to the tax act who has the control, supervision or responsibility for filing returns and making payment of the tax therein; and 2) be issued to an officer or employee of a corporation who willfully fails to file such return or make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax.

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[1]. The section is currently found at 35 **ILCS** 735/3-7(a) *et seq*.

The assertion of the taxpayers is that they conveyed CORPORATION to PRESIDENT, as the general manager of CORPORATION, and at that time relinquished control of the business and also relinquished any responsibility for the taxes.

In support of this argument, they offered into evidence a promissory note that had been signed by Mr. PRESIDENT, both in his individual capacity and as president of CORPORATION, which obligated him to pay $50,000.00 to CORPORATION The note was executed on December 1, 1989, the date Mr. TAXPAYER B stated is the date he felt that CORPORATION, was conveyed to Mr. PRESIDENT.

The note states that for "value received" PRESIDENT d/b/a CORPORATION promises to pay the sum of $50,000.00. The note does not specify what value was received for that sum of money. However, the Joint Venture Agreement, the correspondence between Mr. PRESIDENT and the Internal Revenue Service, the unexecuted checks found in the desk at the address drawn on the account of CORPORATION, the sales tax returns signed by Mr. PRESIDENT for the periods of March through August 1990, and the issuance of the new federal tax identification number, support the assertion by both Mr. TAXPAYER A and Mr. TAXPAYER B that they thought that the business had been sold to Mr. PRESIDENT.

In regards to the control, supervision, or responsibility for filing returns and making payments of the corporation's taxes, in Department of Revenue v. R. S. Dombrowski Enterprises, Inc., 202 Ill.App.3d 1050 (1st Dist. 1990; Rehearing denied, May 1, 1990) the Appellate Court found that Dombrowski was a responsible officer in that he had a substantial role in the preparation and filing of the corporate returns and in the payment of the taxes. The court relied

on the facts that he prepared preliminary ledgers which were used by his accountant to prepare the returns, he signed the checks remitting the tax payments, and appeared to have personally mailed the payments. *Id.* at 1055

The same court found that a president and principal shareholder of a corporation who had the control, supervision or responsibility of filing returns and making payment of the amount of tax due, satisfied the requirement of control, supervision and responsibility as well. People ex. rel. Dept. of Revenue v. National Liquors Empire, Inc., 157 Ill.App.3d 434 (4th Dist. 1987) However, the court went on to say that does not necessarily establish that the defendant willfully underreported the tax obligations of the corporations, and remanded the case for a determination of that question. *Id.* at 438

Regarding the NPLs at issue, TAXPAYER B was not employed by the business of CORPORATION, a/k/a CORPORATION, CORPORATION, a/k/a CORPORATION, after the eighth of January 1990. TAXPAYER A was certainly more closely affiliated with the business from December 1989 through March 1990, but testified credibly that he was not involved with the book and record keeping activities. Both of the gentlemen testified that when they were the sole shareholders of CORPORATION, during the years prior to the time period covered by the NPLs, that CORPORATION, paid the taxes owed before all other obligations were paid. That testimony was not questioned by the Department, nor was there any evidence offered, that prior to the periods covered by the NPLs, that CORPORATION, was ever in arrears with the Department.

Furthermore, the testimony of the two gentlemen, that after the first part of 1990, they were no longer responsible for the

bookkeeping of the business, is supported by the checks found in the desk of the business as well as the correspondence with the Internal Revenue Service. PRESIDENT had to have corresponded with the Internal Revenue Service prior to March 1990, in order to have that entity send the Notice of New Employer Identification Assignment, assigning a new employer identification number for CORPORATION, to him as the general partner, on March 15, 1990.

In interpreting the word willful in the statute, the courts have used such words as "consciously", "voluntarily", "intentionally", "knowingly" and "recklessly" in an attempt to define what is a willful attempt or failure to evade or defeat the tax due. *See* Branson, *supra*, at 255; Department of Revenue v. Joseph Bublick & Sons, 68 Ill.2d 568 (1977)

In Department of Revenue v. Heartland Investments, Inc., 106 Ill.2d 19 (1985), the Court found the officer personally responsible for the corporate liability based upon a willful failure to pay the taxes due because the funds collected were diverted to pay other creditors of the business. In Department of Revenue v. Corrosion Systems, 185 Ill.App.3d 580 (4th Dist. 1989), the Appellate Court found that a trial was necessary to establish whether the corporate officer knew or should have known that the use taxes were due in order to impose the penalty upon him. And in Department of Revenue v. Joseph Bublick & Sons, 68 Ill.2d 568 (1977), the Supreme Court found that the penalty was appropriately imposed against a taxpayer who instructed the bookkeeper to report only 50% of the corporate gross receipts to the Department, based upon the taxpayer's judgement that the balance of the sales were nontaxable resales.

There are also a number of cases where the court has found that the penalty does not apply. For instance, in Department of Revenue v. Marion Sopko, Inc., 84 Ill.App.3d 953 (1980), the Appellate Court found that a president of a corporation, even though he was in complete control of the operations of the corporation, was not willful in his disregard of the taxes due because he relied upon an accountant. The accountant had assured the president that he would take care of the matter. The accountant failed to do so.

In Branson, *supra* at 263-268, the Supreme Court found that a taxpayer was liable for the taxes during the time that he was responsible for the bookkeeping of the corporation. The court declined to disturb the Appellate Court's ruling, on the sufficiency of that court's determination of penalty liability for the period that the bookkeeper was responsible for the payment of the corporation's debts, finding that the taxpayer was not liable for that period.

In interpreting the above cases, it seems apparent that the taxpayer must have knowledge of the liability, be responsible for and have access to the corporate funds, in order to be "willfully" liable for the corporate debt. The Department argues that voting rights in the joint venture agreement established the right of the taxpayers to control CORPORATION and that put both TAXPAYER B and TAXPAYER A in a position so as to be responsible for the filing of the necessary returns and the remittance of the collected sales tax. The Department relies upon the decision rendered in Branson as support of this position. The Department then argues that because the taxpayers did not produce signature cards for the account utilized by the joint venture to show their inability to write checks on the joint account,

that the taxpayer has not sustained its burden of overcoming the Department's *prima facie* case. (*See* Memorandum of the Department of Revenue, pp. 4-6)

The taxpayer argues that it is not the control of the business, but rather the control, supervision or responsibility of filing returns and making payments that creates the liability. The taxpayer asserts that once they established that they thought that the business was sold, and therefore the taxpayers were no longer involved in the control of the business, the burden then shifts to the Department to show that the taxpayers willfully failed to pay the taxes due. The taxpayer also asserts that the Department has not established that the taxpayers had the requisite control, supervision or responsibility of filing returns and making payments as required by a portion of the time at issue in Branson and the other cases where the taxpayers rely on another individual to prepare and pay the tax liabilities. (*See* Taxpayer's Memorandum of Law and Brief, pp. 9-15)

I find that the fact scenario before me is closely aligned with the cases in which a taxpayer relied upon another individual or accountant to prepare and pay the tax liability. I find that the testimony of both TAXPAYER B and TAXPAYER A was extremely credible. I also find that there was no willful attempt to avoid the payment of the liability on their parts during the time period in question. I find that the taxpayer did not have access to and control over the funds of the business entity that incurred the liability in question. In this case, PRESIDENT acted as the taxpayer's bookkeeper or general manager and he is the individual who willfully failed to pay the taxes

due, not the persons who received the Notices of Penalty Liability that are before me.

I therefore recommend that Notice of Penalty Liability No. XXXX and Notice of Penalty Liability No. XXXX be dismissed.

Respectfully Submitted

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Barbara S. Rowe
Administrative Law Judge

September 15, 1997