

ST 99-17

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.

THEODORE CLEAVER", as responsible
officer of "XYZ Corp.", d/b/a "Greasy Spoon
Restaurant",

Taxpayer.

No. 98-ST-0000

NPL 0000

John E. White,
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances:

Mr. Gust Dickett of the firm of Romanoff & Dickett, on behalf of the taxpayer; Alan Osheff, Special Assistant Attorney General on behalf of the Illinois Department of Revenue.

Synopsis:

This matter arose after "Theodore Cleaver" ("Cleaver" or "taxpayer") protested a Notice of Penalty Liability the Illinois Department of Revenue ("Department") issued to him. Notice of Penalty Liability ("NPL") no. 0000 assessed a penalty equal to the unpaid retailers' occupation tax ("ROT") liability of "XYZ Corporation", ("XYZ" or "the corporation"), a corporation doing business as the "Greasy Spoon Restaurant", regarding gross receipts from the corporation's transactions during the period from January 1984 through December 1993.

At hearing, taxpayer offered into evidence certain books and records, including,

inter alia: copies of the returns "XYZ" filed during some of the period at issue; copies of "XYZ" checks submitted to pay the tax shown due on those returns; and documents regarding the Department's audit of "XYZ. Taxpayer and "XYZ's" accountant also appeared as witnesses. I am including in this recommendation findings of fact and conclusions of law. I recommend that the penalty assessed be cancelled.

Findings of Fact:

1. "XYZ" was a corporation that conducted business as a restaurant and banquet hall. *See* Taxpayer Ex. 3 (copies of two of "XYZ's" standard banquet sales contracts).
2. The greatest portion of "XYZ's" unpaid corporate liability arose from a final tax assessment, issued on January 9, 1996, regarding gross receipts from sales during the period from January 1984 through December 1992. Taxpayer Ex. 2, p. 2 (exhibit 2 includes a copy of a final assessment, and copies of Department audit schedules and reports).
3. That final assessment was for \$81,006, and \$73,988 of it arose from deductions "XYZ" had taken on its monthly Illinois sales and use tax returns, but which were disallowed following audit. Taxpayer Ex. 2, pp. 2-3.
4. The unpaid corporate tax liabilities assessed against "XYZ" regarding the periods from January 1993 through December 1993 were also premised upon deductions "XYZ" claimed on its returns, but which were disallowed following audit. Taxpayer Ex. 2, pp. 4-6.
5. The Department's audit of "XYZ's" business took place in 1994 or 1995, after "XYZ" ceased doing business. *See* Taxpayer Ex. 2; Hearing Transcript ("Tr.") p. 20 ("Clever").

6. The NPL was issued on September 23, 1996. Department Ex. 1.
7. "Eddie Haskell" ("Haskell") performed accounting services for "XYZ". Tr. p. 8 ("Haskell"). He prepared and signed (as the preparer) all of "XYZ's" sales tax returns, state and federal income tax returns, state and federal payroll tax returns, and he also prepared the compliance standards for preparing those returns. Tr. p. 8 ("Haskell"); *see also* Taxpayer Ex. 1 ("XYZ's" Illinois sales and use tax returns for the period from January 1991 through December 1992).
8. "Haskell" set up a simplified cash receipts system "XYZ" used to record its income, using the corporation's banquet deposit tickets and bank statements. Tr. p. 17 ("Haskell").
9. On each of the Illinois sales and use tax returns he prepared for "XYZ", "Haskell" took a deduction for the amount of tax "XYZ" claimed it charged and collected from its customers. Taxpayer Ex. 1 (page 2, line 1 of each of the returns included in the exhibit); Tr. p. 10 ("Haskell"). "Haskell" also took a deduction, as non-taxable sales of service, for the amounts "XYZ" claimed it charged for renting banquet rooms and for the amount of gratuities "XYZ" claimed it charged and paid to the persons who worked at the banquets booked at the restaurant. Taxpayer Ex. 1 (page 2, line 9 of each of the returns); Tr. pp. 10-13 ("Haskell").
10. After "Haskell" prepared "XYZ's" sales tax returns, he gave them to "Sancho Panza" ("Panza"), who was the "Greasy Spoon's" business manager. *See* Tr. p. 9 ("Haskell").
11. "Panza" signed "XYZ's" sales tax returns. Taxpayer Ex. 1; Tr. p. 9 ("Haskell"). None of the returns "Haskell" prepared were ever signed by taxpayer. Tr. p. 9

- ("Haskell"); *see also* Taxpayer Ex. 1.
12. "Panza" also signed the "XYZ" checks drawn to pay "XYZ's" monthly ROT liabilities. Taxpayer Ex. 4 (exhibit 4 includes copies of "XYZ's" cancelled checks, drawn to the order of the Department, regarding the period from January 1991 through December 1993); Tr. p. 15 ("Haskell").
 13. "Panza" hired, fired and managed "XYZ's" employees, and he also dealt with the corporation's major suppliers. Tr. p. 16 ("Haskell"). "Panza" also signed the banquet sales contracts "XYZ" used when booking banquets and parties at the restaurant. Taxpayer Ex. 3.
 14. "XYZ's" standard contracts provided, "PRICES SHOWN ARE PER PERSON WITH TAX AND GRATUITIES INCLUDED". Taxpayer Ex. 3. Those contracts also indicated whether a banquet room rental charge was included in the contract price. *Id.* The contracts, however, did not separately state the specific amounts of tax, room rental and gratuities that were being included as part of the contract price. *Id.*; *see also* Taxpayer Ex. 2, pp. 3-6.
 15. "Haskell" never involved "Cleaver" in the preparation, filing or payment of "XYZ's" Illinois sales and use tax returns. Tr. p. 19 ("Haskell").
 16. "Theodore Cleaver" was president of "XYZ". Tr. p. 19 ("Cleaver").
 17. "Cleaver" did not hire or fire any of "XYZ's" employees. Tr. pp. 16 ("Haskell"), 19-20 ("Cleaver"). "Cleaver" knew that "Sancho Panza" managed "XYZ's" business. Tr. pp. 19-20 ("Cleaver"). He also knew that "Haskell" prepared and filed "XYZ's" returns in a timely manner, and that the taxes were timely paid. Tr. p. 20 ("Cleaver").

18. "XYZ" went out of business in 1993, and "Clever" learned that the corporation had unpaid taxes in late 1994, or in 1995. Tr. p. 20 ("Clever").

Conclusions of Law:

Under former section 13½ of the Retailers' Occupation Tax Act ("ROTA") and current section 3-7 of the Uniform Penalty and Interest Act ("UPIA"), a responsible officer 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 to in any other manner to evade or defeat the tax

35 ILCS 120/13.5; 35 ILCS 735/3-7. When the Department introduced the NPL into evidence under the certificate of the Director, it presented *prima facie* proof that "Theodore Cleaver" was personally responsible for "XYZ's unpaid tax liabilities. 35 ILCS 120/13.5 (in effect until 12/31/93); 35 ILCS 735/3-7 (effective 1/1/94); Branson v. Department of Revenue, 168 Ill. 2d 247, 260 (1995). The Department's *prima facie* case is a rebuttable presumption. Branson, 168 Ill. 2d at 262.

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. Branson, 168 Ill.2d at 248. A taxpayer cannot overcome the Department's *prima facie* case merely by denying the accuracy of its assessments. Instead, evidence must be presented which is consistent, probable, and identified with its books and records. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1st Dist. 1988); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296-97 (1st Dist. 1981).

To establish that he never acted willfully, "Cleaver" initially introduced the testimony of "XYZ's accountant, "Eddie Haskell". "Haskell" testified that the liability assessed against "XYZ" was based on the Department's determination that certain deductions claimed on "XYZ's" returns should be disallowed. Tr. pp. 10-13. Specifically, he testified that the Department disallowed the amounts of tax "XYZ" reported that it charged and collected from its customers, because its banquet sales contracts did not separately state the amounts of tax charged per each contract. *Id.* "Haskell" also testified that the Department determined that the amounts he claimed as deductions for "XYZ's" sales of service (*see* Taxpayer Ex. 1 (page 2 of each return)), should be disallowed, for the same reason. Tr. pp. 10-13. The Department made those determinations during an audit that was initiated in 1994, after "XYZ" ceased operations. *See* Taxpayer Ex. 2; Tr. p. 11.

"Haskell" further testified that "XYZ" had signs at each of the "Greasy Spoon's" bars, which informed customers that tax was included in the price of drinks sold. Tr. pp. 13-14. "Haskell" pointed out that "XYZ's" standard banquet sales contracts also notified customers that the contract price for banquets included tax and gratuities. Tr. pp. 13-14; *see also* Taxpayer Ex. 3. Those contracts also indicated whether the contract price included a banquet room rental charge. Taxpayer Ex. 3. "Haskell" testified that he believed that those notices and statements were sufficient proof for him to claim the tax and service deductions on the returns he prepared for "XYZ". Tr. p. 13. Finally, "Haskell" testified that "XYZ's" business manager signed the returns "Haskell" prepared, and he also signed the checks drawn to pay the tax on those returns. Taxpayer Exs. 1, 4; Tr. p. 16. "Cleaver", "Haskell" said, was never involved in the process of preparing,

reviewing or paying "XYZ's" tax returns. Tr. pp. 18-19.

Taxpayer then testified. He said that while he was president of "XYZ", he had no real responsibilities with the corporation. Tr. p. 19. He knew that "Panza" ran the business, and he relied on "Haskell" to prepare "XYZ's" tax returns. Tr. p. 20. To the best of his knowledge, the returns were always filed and paid on time. *Id.* He said that "XYZ" ceased business in 1993, and that he first learned that the Department was seeking to collect unpaid taxes from the corporation in late 1994 or early 1995. Tr. p. 20.

The testimony taxpayer offered was not unworthy of belief, and it was also corroborated by the books and records offered at hearing. Those books and records show that "Cleaver" did not sign "XYZ's" returns or the checks drawn to pay the liability shown thereon. Taxpayer Exs. 1, 4. Instead, "Haskell" signed the returns as the preparer, and "Panza" signed the returns and checks on behalf of "XYZ". "Panza" also signed the banquet sales contracts which, because they did not separately state the amounts of the different services charges and taxes claimed to have charged and collected from "XYZ's" customers, form the basis of "XYZ's" underlying tax liability. *See* Taxpayer Exs. 2-3; Tr. pp. 10-13, 18 ("Haskell"). The returns themselves appear to have been always timely filed, and the amounts of tax shown due on those returns timely paid. Taxpayer Exs. 1, 4; Tr. pp. 15 ("Haskell"), 20 ("Cleaver"). Those documents also provide some objective support for "Haskell's" testimony that "Cleaver" was never involved in the preparation, filing or payment of "XYZ's" sales tax returns. Tr. pp. 18-19. Thus, the books and records taxpayer introduced corroborate taxpayer's claim that he was not an officer of "XYZ" with the control, supervision or responsibility over filing "XYZ's" tax returns and making payment of "XYZ's" taxes.

I also conclude that the documents taxpayer offered tend to show that he did not willfully fail to file "XYZ's" returns, fail to pay its taxes when due, or willfully attempt to evade or defeat the collection of "XYZ's" subsequently determined unpaid tax liability. "Clever" testified that he first learned of the liability in late 1994 or 1995, after the business had been closed for about a year. Tr. p. 20. That testimony is corroborated by the Department's audit schedule that was prepared regarding the period from 1984 through 1992, and by the final assessment regarding the same period, which was issued by the Department in 1996. Taxpayer Ex. 2, pp. 2-3; *see also id.*, pp. 4-5 (taxpayer's counsel signed two auditor-prepared returns on behalf of "XYZ", regarding the period from January 1993 through December 1993, in December 1995).

In Branson, the Illinois Supreme Court recently wrote:

... 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 under section 13½ 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.

... Although plaintiff claims he did not actually know or become consciously aware of the tax deficiency until after the business was closed in late January 1987, *lack of willfulness is not proved simply by denying conscious awareness of a tax deficiency that could have been easily investigated by an inspection of corporate records.*

168 Ill. 2d at 267 (emphasis added).

Here, however, taxpayer introduced sufficient competent evidence to show that he was *not* an officer who was responsible for filing the corporation's returns or paying the taxes due. This case, moreover, does not involve a situation similar to the one in Branson. There, the officer could have easily discovered that the corporation was not

filing returns or paying its ROT liabilities, merely by reviewing the company's books and records. Branson, 168 Ill. 2d at 264. I cannot conclude that "Clever's" inspection of "XYZ's" books and records would have revealed any such patent tax deficiencies or delinquencies. Therefore, I conclude that "Clever" has rebutted the Department's *prima facie* case.

After a taxpayer introduces evidence sufficient to rebut the Department's *prima facie* case, the burden shifts to the Department to prove its case by a preponderance of competent evidence. Goldfarb v. Department of Revenue, 411 Ill. 573, 580 (1952). Here, after taxpayer rested, the Department introduced no evidence that "Clever" ever assumed personal responsibility for filing "XYZ's" ROT returns, or for paying its tax liabilities. Nor did it introduce any evidence that "Clever" ever willfully attempted to evade or defeat the collection of the taxes the Department determined were due after "XYZ" ceased operations.

The Department had the opportunity to test "Clever's" testimony via cross-examination, but chose not to do so. Tr. p. 21. In its opening argument, the Department asserted that taxpayer willfully ignored tax regulations (Tr. p. 4), but it never offered any competent evidence to support that contention. After considering all of the evidence, I conclude that the Department has not established that taxpayer is liable for the penalty authorized by former § 13½ of the ROTA, or by current § 3-7 of the UPIA.

Conclusion:

I recommend that the Director cancel the NPL previously issued to "Theodore Cleaver".

Date: 8/13/99

John White
Administrative Law Judge