

IT 18- 02

Tax Type: Income Tax

Tax Issue: Penalty Under 1002(d)- Failure to File/Pay Withholding

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

THE DEPARTMENT OF REVENUE  
OF THE STATE OF ILLINOIS

v.

JOHN DOE and  
STEVE SMITH

Taxpayers

Docket # [REDACTED]  
Docket # [REDACTED]  
Letter ID # XXXXXXXXXXXX  
Letter ID # XXXXXXXXXXXX  
1002D ID # XXXXXXXXXXXX  
1002D ID # XXXXXXXXXXXX

RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; John Doe, *pro se*; Steve Smith, *pro se*

Synopsis:

The Department of Revenue ("Department") issued a Collection Action Assessment and Notice of Intent ("Notice") to John Doe and Steve Smith ("taxpayers") pursuant to section 1002(d) of the Income Tax Act (35 ILCS 5/1002(d)) and section 3-7 of the Uniform Penalty and Interest Act ("UPIA") (35 ILCS 735/3-7). The Notices allege that the taxpayers were responsible officers of ABC, Inc. ("corporation") who were responsible for filing and paying the corporation's withholding taxes and that they willfully failed to do so. The Notices assess penalties for the failure to pay the withholding taxes. The taxpayers timely protested the Notices, and a consolidated evidentiary hearing was held on both of the Notices. All of the parties agreed to the

consolidation of the hearings. During the hearing, the taxpayers argued that one of their employees was responsible for filing and paying the withholding taxes. After reviewing the testimony and documents submitted by the parties, it is recommended that the assessments be upheld.

Findings of Fact:

1. The corporation was in the business of pouring concrete. The corporation was organized on March 6, 2006. (Dept. Ex. #1B, pp. 4-6)
2. In January 2014 it became apparent to the taxpayers that the corporation could not financially sustain another long Illinois winter. The corporation was dissolved in February of 2014. (Dept. Ex. #1B, p. 5; Tr. p. 13)
3. The taxpayers, Steve Smith and John Doe, were each 50% shareholders of the corporation. Mr. Smith was the president and Mr. Doe was the secretary/treasurer. (Dept. Ex. #1B, p. 4)
4. The taxpayers both had check signing authority for the corporation account. (Dept. Ex. #1B, p. 4)
5. The taxpayers hired Jane Doe as the bookkeeper/office manager of the corporation. Her duties included paying the bills and filing and paying the corporation's withholding tax returns. (Dept. Ex. #1B, p. 4; Tr. pp. 28-29)
6. Mr. Smith gave Ms. Doe permission to sign his name to checks. (Tr. p. 28)
7. After the corporation was dissolved in February of 2014, the taxpayers discovered that Ms. Doe had embezzled money from the corporation. Ms. Doe pled guilty to theft and was ordered to pay restitution in the amount of \$XXXXXX. (Dept. Ex. #1B p. 20; Tr. p. 13)
8. The money that Ms. Doe is paying in restitution is being sent to a bank for debts that the corporation owes to the bank. (Tr. p. 33)
9. The corporation's withholding taxes were not paid for the fourth quarter of 2013 and the first quarter of 2014. (Dept. Ex. #1A, p. 3)

10. The taxpayers concede that they were responsible for paying the withholding taxes for the first quarter of 2014. (Tr. p. 15; Dept. Ex. #1B, p. 6)
11. On July 23, 2015, the Department issued a Collection Action Assessment and Notice of Intent to each taxpayer that proposed a total penalty liability of \$XXXX.XX including tax, interest, and penalty, for failing to pay the corporation's withholding taxes for the fourth quarter of 2013 and the first quarter of 2014. The Notices were admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1A, #1B).

Conclusions of Law:

Section 1002(d) of the Income Tax Act provides as follows:

Willful failure to collect and pay over tax. Any person required to collect, truthfully account for, and pay over the tax imposed by this Act who willfully fails to collect such tax or truthfully account for and pay over such tax or willfully attempts in any manner to evade or defeat the tax or the payment thereof, shall, in addition to other penalties provided by law, be liable for the penalty imposed by Section 3-7 of the Uniform Penalty and Interest Act. 35 ILCS 5/1002(d).

Section 3-7 of the Uniform Penalty and Interest Act provides in part 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 wilfully fails to file the return or make the payment to the Department or wilfully 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; 35 ILCS 735/3-7(a).

An officer or employee of a corporation may therefore be personally liable for the corporation's withholding taxes if (1) the individual had the control, supervision or responsibility of filing the withholding returns and paying the taxes, and (2) the individual willfully failed to perform these duties.

For guidance in determining whether a person is responsible under section 3-7 the Illinois Supreme Court has referred to cases interpreting section 6672 of the Internal

Revenue Code (26 U.S.C. §6672)<sup>1</sup>. See Branson v. Department of Revenue, 168 Ill. 2d 247, 254-56 (1995); Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19, 29-30 (1985). These cases state that the critical factor in determining responsibility is whether the person had significant control over the corporation's finances. See Purdy Co. of Illinois v. United States, 814 F. 2d 1183, 1186 (7th Cir. 1987) Responsibility is generally found in high corporate officials who have control over the corporation's business affairs and who participate in decisions concerning the payment of creditors and the dispersal of funds. Monday v. United States, 421 F. 2d 1210, 1214-1215 (7th Cir. 1970), cert. den. 400 U.S. 821.

In addition, these cases define "willful" as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious known risks. See Branson at 254-56; Heartland at 29-30. Willful conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. Willfulness may be established by showing that the responsible person (1) clearly ought to have known that (2) there was a grave risk that the taxes were not being paid and (3) the person was in a position to find out for certain very easily. Wright v. United States, 809 F. 2d 425, 427 (7th Cir. 1987). Furthermore, whether the person in question willfully failed to pay the taxes is an issue of fact to be determined on the basis of the evidence in each particular case. Heartland at 30; Department of Revenue v. Joseph Publick & Sons, Inc., 68 Ill. 2d 568, 577 (1977). Courts have found that giving preferential treatment to other creditors rather than paying the corporation's taxes constitutes willful behavior. See Heartland at 29-30.

Under section 3-7, the Department's certified record relating to the penalty liability constitutes *prima facie* proof of the correctness of the penalty due.<sup>2</sup> See Branson

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<sup>1</sup> This section imposes personal liability on any person who is required to collect, account for, and pay employees' withholding taxes and who willfully fails to do so.

<sup>2</sup> The relevant portion of section 3-7 provides as follows: "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

at 260. Once the Department presents its *prima facie* case, the burden shifts to the taxpayer to establish that one or more of the elements of the penalty are lacking, *i.e.*, that the person charged was not a responsible corporate officer or employee, or that the person's actions were not willful. *Id.* at 261. In order to overcome the Department's *prima facie* case, the allegedly responsible person must present more than his or her testimony denying the accuracy of the Department's assessment. A. R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1<sup>st</sup> Dist. 1988). The person must present evidence that is consistent, probable, and identified with the taxpayer's books and records to support the claim. *Id.*

In the present case, the Department's *prima facie* case was established when the Department's certified record relating to the penalty liability was admitted into evidence. In response, the taxpayers have conceded that they were responsible for paying the withholding taxes for the first quarter of 2014. (Tr. p. 15; Dept. Ex. #1B, p. 6) They contend, however, that they did not willfully fail to make the payment. They also contend that they were not responsible for paying the fourth quarter of 2013 withholding taxes.

With respect to responsibility for paying the fourth quarter of 2013 withholding taxes, the taxpayers did not provide any documents to overcome the Department's *prima facie* case, and the evidence supports a finding that they were responsible officers. As previously stated, the critical factor in determining responsibility is whether the person had significant control over the corporation's finances. More than one person may be found to be responsible, and "it is not necessary that the individual in question have the final word as to which creditors should be paid." Winter v. United States, 196 F. 3d 339,

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determination by the Department shall be made at any hearing before it or in any legal proceeding 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. ... That certified reproduced copy or certified computer print-out shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax or penalty due." 35 ILCS 735/3-7(a).

345 (2<sup>nd</sup> Cir. 1999), citing Fiataruolo v. United States, 8 F. 3d 930, 939 (2<sup>nd</sup> Cir. 1993). Personal responsibility for the taxes “encompasses all those individuals connected closely enough with the business to prevent the tax default from occurring.” *Id.*

In this case, both of the taxpayers were connected closely enough with the business to ensure the payment of the taxes. The corporation was a small business, and both of the taxpayers were officers and owners of the corporation. Although they claim that Ms. Doe was responsible for paying the taxes, both of the taxpayers were in a position to control the business affairs and participate in the decisions concerning the payment of creditors and dispersal of funds. In addition, the taxpayers were aware that the corporation was having financial problems in January 2014, which is the time period when the payment for the fourth quarter of 2013 withholding taxes would have been due. The taxpayers were in a position to determine whether the fourth quarter of 2013 payment was made and prevent the default from occurring.

With respect to the willful failure to pay the taxes, the taxpayers have again failed to present sufficient evidence to overcome the Department’s *prima facie* case. As previously stated, willful conduct does not require bad purpose or intent to defraud the government. Branson at 255; Heartland at 30. It also does not require a showing of actual knowledge of non-payment. Cerone v. Department of Revenue, 2012 IL App (1<sup>st</sup>) 110214, ¶ 22 (citing McClean, at 675). Giving preferential treatment to other creditors rather than paying the corporation’s taxes constitutes willful behavior. Heartland, *supra*.

The evidence presented supports a finding that the taxpayers gave preferential treatment to other creditors. The taxpayers admitted that Ms. Doe’s restitution payments have been going to a bank rather than the Department. The taxpayers also knew in January 2014 that the corporation was having financial problems. This was a time period when the fourth quarter of 2013 withholding payment would have been due, and it was well before the time when the first quarter of 2014 withholding payment was due. Because the taxpayers were aware that the corporation was having financial difficulties,

the taxpayers clearly ought to have known that there was a grave risk that the taxes were not being paid. They also were in a position to find out for certain.

Recommendation

It is therefore recommended that the Collection Actions, Assessments and Notices of Intent issued against John Doe and Steve Smith be finalized .

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Linda Olivero  
Administrative Law Judge

Enter: February 23, 2017