

IT 09-1

Tax Type: Income 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 |) | Docket No. | 07-IT-0000 |
| OF THE STATE OF ILLINOIS |) | FEIN | 00-0000000 |
| v. |) | IBT No. | 0000-0000 |
| JOHN & JANE DOE, as |) | NPL Nos. | 0000-000-00-0 |
| responsible officers / employees of |) | | 0000-000-00-0 |
| ABC, Inc., |) | John White, | |
| Taxpayers |) | Administrative Law Judge | |

RECOMMENDATION FOR DISPOSITION

Appearances: John Doe appeared, *pro se*; George Foster, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose when John and Jane Doe (the Does or Taxpayers) protested the Notice of Deficiency (NOD) the Illinois Department of Revenue (Department) issued to each of them as responsible officers/employees of **ABC, Inc. (ABC)**. Each NOD assessed a penalty equal to the amount of Illinois income tax that **ABC** had withheld from the wages of its employees during the second through fourth quarters of 2006, and which amounts were not paid over to Illinois. The penalty assessed against each Taxpayer is a personal liability penalty, and is authorized by § 1002(d) of the Illinois Income Tax Act (IITA), and § 3-7 of Illinois' Uniform Penalty and Interest Act (UPIA).

John Doe (Doe) testified at hearing. I have reviewed the evidence, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the Director finalize the NODs as issued.

Findings of Fact:

1. During the second through the fourth quarters of 2006, and prior thereto, Doe was the president of **ABC**. Department Group Ex. 1, pp. 5-16 (copies of annual reports filed by **ABC** with the Illinois Secretary of State's Office). Jane Doe was **ABC**'s secretary. *Id.*
2. In February 2007, the Department conducted a withholding tax audit of **ABC**, and determined that **ABC** had not filed withholding returns regarding the second through fourth quarters of 2006. Department Group Ex. 1, pp. 3 (copy of Department completed form number IL-1904, Results of Withholding Tax Audit, dated February 13, 2007), 17 (copy of email communication from Department employee James Barborka to Department counsel).
3. Because **ABC** had not filed returns for those quarters, the Department's auditor estimated **ABC**'s withholdings using amounts that **ABC** had previously reported during 2005. Department Group Ex. 1, pp. 3, 17.
4. As a result of the withholding tax audit, the Department issued a withholding tax NOD to **ABC** on March 13, 2007. Department Group Ex. 1, pp. 3, 17.
5. In May 2007, the Department received from **ABC** a completed form IL-W-3, Annual Withholding Income Tax Return, dated January 31, 2007, and bearing Doe's signature. Department Group Ex. 1, pp. 4 (copy of completed and signed form), 17.
6. **ABC** paid the withholding tax due for the first quarter of 2006 on October 19, 2006. Department Group Ex. 1, p. 4. It paid the withholding tax due for the fourth quarter of 2006 on June 4, 2007. *Id.*, pp. 4, 17. Since **ABC** paid the withholding tax for the fourth quarter of 2006 late, the Department determined that **ABC** still owes penalty and interest regarding that quarter. Department Group Ex. 1, pp. 1-2 (copies of

NODs), 17.

7. Each NOD set forth the following amounts due:

| Period | Tax | Penalty | Interest | Total Liability |
|------------------------|-------------|------------|----------|-----------------|
| 2006/2 | \$12,475.00 | \$1,597.00 | \$659.31 | \$14,731.31 |
| 2006/3 | \$12,475.00 | \$1,597.00 | \$488.76 | \$14,560.76 |
| 2006/4 | 0.00 | \$343.21 | \$45.06 | \$388.27 |
| Sum of total liability | | | | \$29,680.34 |

Department Ex. 1, pp. 1-2.

Conclusions of Law:

When the Department introduced the NODs into evidence under the certificate of the Director, it presented prima facie proof that Taxpayers were personally responsible for ABC’s unpaid tax liabilities. 35 ILCS 735/3-7; Branson v. Department of Revenue, 168 Ill. 2d 247, 260, 659 N.E.2d 961, 968 (1995) (“by operation of the statute, proof of the correctness of such penalty, including the willfulness element, is established by the Department’s penalty assessment and certified record relating thereto.”). The Department’s prima facie case is a rebuttable presumption. Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968. 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. *Id.*

Article 7 of the IITA requires Illinois employers that withhold federal income tax from the compensation (i.e., wages) they pay to employees in Illinois or to Illinois residents, to also withhold Illinois income tax from the wages of such employees. 35 ILCS 5/701. Section 704 requires such employers to file Illinois returns to report, and to pay over to the Department, the amounts of Illinois income tax withheld from such employees. 35 ILCS 5/704. Section 705 provides that any income tax withheld by an

employer from its employees is a trust tax, and becomes the tax liability of the employer itself. 35 ILCS 5/705 (“Any amount of tax actually deducted and withheld under this Act shall be held to be a special fund in trust for the Department.”).

Article 10 of the IITA authorizes the Department to impose interest and/or penalties when required returns are not timely filed, or when taxes are not paid when due. 35 ILCS 5/1001-5/1008. Section 1002(d) of the IITA provides for a personal liability penalty to be imposed on an individual, under certain circumstances, when an employer has failed to pay over the amount of income tax it withheld from the wages of its employees:

(d) 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 UPIA provides that a personal liability penalty liability may be imposed upon:

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).

The first issue is whether Taxpayers were required to collect, truthfully account for, and pay over the Illinois income tax that **ABC** withheld from its employees. Since Doe was the only Taxpayer to appear at hearing, I begin with him.

Doe was **ABC**'s president prior to and during the period at issue. Department Group Ex. 1, pp. 5-16. At hearing, Doe testified that he "was in complete agreement with all the records" the Department offered into evidence. Hearing Transcript (Tr.) p. 6. Doe said that he never intended to not pay **ABC**'s taxes. Tr. pp. 7-9. He testified that he entered into an installment agreement with the Department to pay **ABC**'s 2006 withholding taxes over time. Tr. p. 7. While the evidence shows that Doe made some overdue withholding tax payments for **ABC** (Department Group Ex. 1, pp. 4, 17), he testified that he could not complete such payments because the business ceased to operate due to the recession and to the increase in fuel prices. Tr. p. 7. Finally, Doe testified that he has no personal assets to pay the corporate liability. Tr. pp. 7-9. In sum, the evidence does not rebut, and only supports, the Department's presumptively correct determinations that Doe was a person who was required to collect, truthfully account for, and pay over the tax imposed on **ABC** by the IITA (35 ILCS 5/1002(d)), and that he had the control, supervision or responsibility over filing **ABC**'s withholding tax returns, and for paying those taxes. Department Group Ex. 1, pp. 3, 17.

The next issue is willfulness. The Department's prima facie case presumes willfulness. Branson, 168 Ill. 2d at 262, 659 N.E.2d at 968. 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.* Whether a responsible officer acts willfully is a mixed question of law and fact. Branson, 168 Ill. 2d at 265, 659 N.E.2d at 970. A

responsible officer cannot prove his lack of willfulness simply by denying conscious awareness of a tax deficiency that could have been easily investigated by an inspection of corporate records. *Id.* at 267, 659 N.E.2d at 971.

There is no dispute that **ABC** had withheld Illinois income tax from its employees' wages during the period at issue. Department Group Ex 1, pp. 4; Tr. pp. 6-7. Further, and notwithstanding the fact that **ABC** filed an annual withholding tax return for 2006, the amount of tax it withheld during 2005 and 2006 required it to file separate, quarterly returns for 2006, and also required it to make quarter-monthly payments of such withheld tax amounts. 35 **ILCS** 5/704; 86 Ill. Admin. Code § 100.7300(a); 86 Ill. Admin. Code § 100.7310(a); 86 Ill. Admin. Code § 100.7320(d). The evidence shows that **ABC** did not file quarterly returns regarding the pertinent quarters of 2006, and it did not make the required quarter-monthly payments of the taxes it withheld. *See* Department Group Ex. 1, pp. 3-4, 17. Since the tax originally assessed against **ABC** was based on the corporation's failure to file returns, and on its failure to pay the taxes required to be shown due on such returns (Department Group Ex. 1, pp. 3, 17), the penalty proposed here is very much like the penalty assessed against the taxpayer in Branson. Branson, 168 Ill. 2d at 250, 659 N.E.2d at 963 ("The corporation had collected the taxes from its customers but failed to remit the collected taxes to the State.").

As **ABC**'s president, and as the person admittedly responsible for filing **ABC**'s withholding tax returns and paying its withholding tax liabilities, Doe knew that **ABC** did not file quarterly returns regarding the three latter quarters of 2006. *See* Department Group Ex. 1, pp. 3, 17; Tr. pp. 6-7. Further, Doe must have known that **ABC** was not making quarter-monthly, or even quarterly, withholding tax payments for the last three

quarters of 2006. More specifically, when **ABC**'s second quarterly return was due, in July 2006, Doe knew that **ABC** had already withheld tax from its employees for that quarter. But instead of actually paying such monies over to the Department, Doe knew that **ABC** was using those monies for other corporate expenses, the most obvious example of which was **ABC**'s continued payment of wages to its employees during the remaining quarters of 2006. *See* Department Group. Ex. 1, pp. 3-4, 17.

Illinois courts have long concluded that preferring other creditors over the Department constitutes a willful failure to pay a tax liability. Branson, 168 Ill. 2d at 259, 659 N.E.2d at 967 (“Under Illinois law, if a responsible officer uses collected ... taxes to pay other creditors of the corporation, while knowing that he or she was obligated to file the returns and remit the taxes, the willful element ... is satisfied.”). As the Illinois Supreme Court noted, first in Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568, 369 N.E.2d 1279 (1977), and more recently in Branson, “The reason for passing on the tax liability to the responsible officers is obvious. The corporate officers could employ the funds collected for the State to pay corporate obligations as well as salaries and bonuses to employees, and thus make recovery of the funds from a defunct corporation an impossibility.” Branson, 168 Ill. 2d at 258, 659 N.E.2d at 967; Joseph Bublick & Sons, Inc., 68 Ill. 2d at 575-76, 369 N.E.2d at 1283. That is exactly what occurred here. *See* Department Group. Ex. 1, pp. 3-4, 17.

I conclude that Doe has not rebutted the Department's prima facie correct determination that he was personally liable for **ABC**'s unpaid withholding tax liability. Department Group. Ex. 1, p. 1; 35 **ILCS** 735/3-7; Branson, 168 Ill. 2d at 260, 659 N.E.2d at 968.

This matter also involves the Department's proposal to assess a § 1002(d) penalty against Jane Doe. Department Group Ex. 1, p. 2. During the pertinent period, Jane Doe was ABC's corporate secretary. Department Group Ex. 1, pp. 5-16. The evidence provides no other information regarding Jane Doe's authority over ABC's operations during 2006, nor does the evidence provide any information of her actions regarding ABC during that time. But again, the lack of evidence regarding Jane Doe's actions does not help Taxpayers here, because they bear the burden of production and persuasion. *See Branson*, 168 Ill. 2d at 261, 659 N.E.2d at 968 ("After the Department presents a prima facie claim for tax penalty liability, our construction of section 13½ places the burden on the taxpayer to establish that one or more of the elements of the penalty are lacking.").

The Illinois Supreme Court's construction of the statutory presumption included within former § 13½ of the Retailers' Occupation Tax Act (ROTA), in *Branson*, applies equally as well to the statutory presumption included within UPIA § 3-7. That is because the operative text within each of those statutory sections is virtually identical. *Compare 35 ILCS 735/3-7(a) with Branson*, 168 Ill. 2d at 256, 659 N.E.2d at 966 (*quoting* former § 13½ of the ROTA, Ill. Rev. Stat. ch. 120, par. 452½ (1991)).¹ Moreover, UPIA § 3-7 was intended to take the place of the different personal liability penalties previously

¹ In both sections, the Illinois General Assembly provided that:
*** 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 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. ***
35 ILCS 735/3-7(a); Ill. Rev. Stat. ch. 120, par. 452½ (1991).

authorized by various Illinois tax acts. *See, e.g.*, 35 **ILCS** 735/3-1A.

When construing the effect of the identical statutory presumption in Branson, the Illinois Supreme Court held that, “If [at hearing] the taxpayer offers no countervailing evidence, the Department’s prima facie case stands un rebutted and becomes conclusive.” Branson, 168 Ill. 2d at 260, 659 N.E.2d at 968. Here, Doe offered no evidence to show that Jane was not a responsible officer of **ABC**, or that she had no power, supervision, or control over **ABC**’s obligations to collect, truthfully account for, or to pay over the tax imposed by the IITA. Nor does the evidence that Doe did offer, about his own actions regarding **ABC**, establish that Jane was not a responsible officer of **ABC**, or that she could not have acted willfully. Finally, the plain text of UPIA § 3-7 provides that there can be more than one responsible officer in a corporation. 35 **ILCS** 735/3-7(a) (“Any officer or employee of any taxpayer ... 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”) (emphasis added); *accord Williams v. United States*, 931 F.2d 805, 810 n.7 (11th Cir. 1991) (“A company may have more than one responsible person”); Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366, 734 N.E.2d 945 (1st Dist. 2000) (three individuals held liable for unpaid corporate taxes).

I conclude that Taxpayers have not rebutted the Department’s prima facie correct determination that Jane Doe was personally liable for **ABC**’s unpaid withholding tax liability. Department Group. Ex. 1, p. 2; 35 **ILCS** 735/3-7(a); Branson, 168 Ill. 2d at 260, 659 N.E.2d at 968.

Conclusion:

I recommend that the Director finalize NOD numbers 0000-000-00-0 and 0000-000-0-0 as issued.

January 13, 2009

Date

John White, Administrative Law Judge