

IT 12-02

Tax Type: **Income Tax**

Issue: **Responsible Corporate Officer – Failure To File Or Pay Tax**

Illinois Department of Revenue
OFFICE OF ADMINISTRATIVE HEARINGS
James R. Thompson Center
100 West Randolph Street, Level 7-900
Chicago, Illinois 60601
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**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

JOHN DOE,
As Responsible Officer of
ABC Company,
TAXPAYER

No. XXXXXX
Letter ID: XXXXXX
Account ID: XXXXXX
1002D ID: XXXXXX

Kenneth J. Galvin
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Jonathan Decatorsmith, Chicago-Kent College of Law Low Income Taxpayer Clinic, on behalf of John Doe; Ms. Mehpara Suleman, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to John Doe' protest of Notice of Deficiency No. 360148 (hereinafter "NOD"), as responsible officer of ABC Company (hereinafter "ABC COMPANY"). The NOD was issued for unpaid Illinois withholding tax and covers the fourth quarter of 2007 and four quarters of 2008. A hearing was held in this matter on June 20, 2011, with oral testimony from Jane Doe, Human Resources Manager at ABC COMPANY, and John Doe. Following submission of all evidence and a review of the record, it is recommended that NOD No. 360148 issued against John Doe be finalized as issued. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of NOD No. 360148, dated December 7, 2009, issued against John Doe, showing a withholding tax liability for ABC COMPANY, in the amount of \$57,625.18 for the fourth quarter of 2007 and four quarters of 2008. Tr. pp. 16-17; Dept. Ex. A.
2. XYZ Company, founded in 1984, provided outsourced logistics services, including warehousing and transportation, to corporations, including General Electric, Hewlett Packard and Siemens Medical. XYZ BUSINESS ceased doing business in April of 2009 and it was assigned to Perfect Business, for the benefit of the creditors, in September or October, 2009. John Doe was the sole owner of XYZ BUSINESS and its President and CEO. Tr. pp. 76-77, 91, 130-131, 139-140.
3. Jack Jones was the CFO and General Manager of XYZ BUSINESS starting from the end of 2007 until XYZ BUSINESS went out of business. Jack Jones reported directly to John Doe. Tr. pp. 93-94, 157.
4. XYZ BUSINESS's payroll had always been processed by an outside payroll processing company. ABC COMPANY was formed to process XYZ BUSINESS's payroll internally. John Doe was ABC COMPANY's sole owner. ABC COMPANY did not have a Board of Directors or officers. Tr. pp. 97-98, 142-143, 145.
5. ABC COMPANY was incorporated under the Illinois Limited Liability Company Act on May 14, 2007 with "management vested" in John Doe. ABC COMPANY was dissolved by the Secretary of State on November 14, 2008 for failure to file a 2008 Annual Report. Tr. pp. 16-18, 143-144; Dept. Ex. E and F.

6. ABC COMPANY maintained bank accounts at Red Bank. John Doe had signature authority over the accounts. There was no dollar limit on the checks that John Doe could sign. Tr. pp. 99-100, 156-157.

Conclusions of Law:

The sole issue to be decided in this case is whether John Doe should be held personally liable for the unpaid withholding tax of ABC COMPANY. The personal liability penalty is imposed by Section 3-7 of the Uniform Penalty and Interest Act, which provides 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 willfully fails to file the return or to 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.

35 ILCS 735/3-7.

It is clear under the statute that personal liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NOD establishes the Department’s *prima facie* case with regard to both the fact that John Doe was a “responsible” officer and the fact that he “willfully” failed to file and or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995). Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the case. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

In determining whether an individual is a responsible person, the courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

I conclude, based on the testimony and evidence admitted at the evidentiary hearing, that John Doe was a responsible party of ABC COMPANY under the statute. John Doe testified that XYZ BUSINESS's payroll was historically processed by an outside payroll processing company. ABC COMPANY was formed to process XYZ BUSINESS's payroll internally. Tr. pp. 97-98, 142-143. John Doe testified that in 2007, he got a call from "Frank Blue" saying that "we can save a ton of money if we process our own payroll internally." Frank Blue needed John Doe's permission to form ABC COMPANY. Tr. pp. 144-145. Throughout the evidentiary hearing, John Doe attempted to deflect all responsibility for the unpaid withholding taxes onto others. He testified that he had "no idea" why XYZ BUSINESS employees were paid from an ABC COMPANY bank account. ABC COMPANY was "set up by the CFO." "They were my financial experts." "I had a high school education. I listened to – I hired trusted people and I followed what they said." Tr. p. 123.

ABC COMPANY was formed as a limited liability company. ABC COMPANY's Articles of Incorporation state that management is "vested" in "John Doe." Dept. Ex. E. ABC COMPANY's registration with the Secretary of State lists "John Doe" as the only "LLC Member." Dept. Ex. C. John Doe also testified that he was "the only member of the LLC." Tr. p. 142. ABC COMPANY had no Board of Directors or officers. Tr. p. 145. John Doe "believes"

that he was the sole member of ABC COMPANY throughout the liability period at issue. Tr. p. 142. By his own admission, he retained his position with ABC COMPANY throughout the entire period covered by the NOD.

ABC COMPANY maintained bank accounts at Red Bank. John Doe testified that he had signature authority over ABC COMPANY's accounts. There was no dollar limit on the checks that John Doe could sign. Tr. pp. 99-100, 156-157. The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose which creditors are paid. Gold v. United States, 506 F. Supp. 473, (E.D.N.Y. 1981), aff'd, 671 F. 2d 492 (2d Cir. 1982). At any time during the period at issue covered by the NOD, John Doe could have written a check to the Illinois Department of Revenue to cover ABC COMPANY's unpaid withholding taxes.

John Doe testified that he never wrote an ABC COMPANY check. Tr. pp. 99-100. He also testified that Jack Jones had the authority to "authorize checks to go out" for ABC COMPANY but he did not have the authority to sign the checks. John Doe "believes" that Jack Jones had "Joe Blow" sign all checks. Tr. pp. 155-156. This testimony is not supported by any documentary evidence. It is unclear from the record who did sign ABC COMPANY's checks. No ABC COMPANY check registers for the period at issue were admitted into evidence and no explanation was offered for their absence. No bank signatory cards or check approval authorizations were admitted into evidence for any quarter included in the NOD. Without the check registers, bank signatory cards, or check approval authorizations, I am unable to verify that John Doe did not sign a check for ABC COMPANY during the period at issue.

However, even if some other person at ABC COMPANY could also have authorized and written a check to the Department, this does not relieve John Doe of responsibility. In any

corporation, there may be more than one responsible officer. Monday v. United States, *supra*. The statute does not confine liability to only one person in the corporation or to the person most responsible. 35 ILCS 735/3-7. John Doe was the sole member of the LLC. Management was “vested” in him. He had unlimited check writing authority. At any time during the liability period, he could have written a check to the State for unpaid withholding taxes.

According to John Doe’ testimony, Jack Jones was hired to be chief financial officer and general manager. “His responsibility was to run, to control all the assets and money of the company, pay all the bills, decide who got paid, who didn’t get paid.” Jack Jones “managed things from a financial standpoint.” John Doe had a verbal agreement with Mr. Jack Jones. “But there was no written contract. I didn’t believe in them.” “My employees that worked for me work on a trust basis.” Jack Jones was “responsible, 100%” for payroll and for preparing both state and federal tax returns.” Tr. pp. 93-96. John Doe offered no documentary evidence regarding the corporate structure such as an organization chart, delegations of authority or corporate by-laws. John Doe testified that he was getting “false information” on the status of XYZ BUSINESS from Mr. Jack Jones. Jack Jones prepared financial statements in which, according to John Doe, receivables were overstated by up to \$1 million and “payables didn’t include any taxes.” Tr. pp. 115-116.

There are several problems with this testimony. First, the financial statements admitted into evidence are for “XYZ BUSINESS-USA.” It is unclear from the record if these financial statements consolidate ABC COMPANY. The financial statements are not audited and do not contain notes. Taxpayer’s Ex. No. 10. No financial statements for ABC COMPANY were offered into evidence. John Doe testified that he never saw any financial statements for ABC COMPANY. Tr. p. 123. I cannot conclude from this record that Jack Jones prepared false

financial statements for ABC COMPANY. John Doe testified that “people” have told him to “press criminal charges” against Jack Jones for what he did. “But what I’m trying to do now is get through one thing first and then certainly consider that as an option.” Tr. p. 135.

Secondly, Jack Jones was not called to testify at the evidentiary hearing and I am not aware of a subpoena being issued for his appearance at the hearing. Apparently, John Doe chose not to subpoena the one person who could corroborate his testimony that John Doe had no responsibility for payroll or the payment of withholding taxes. If John Doe was not involved in ABC COMPANY’s financial affairs, this was his choice. As sole member of the LLC, he could have inspected ABC COMPANY’s corporate books at any time and become directly and personally involved in the financial affairs, if he desired.

John Doe’ testimony about his total lack of involvement with ABC COMPANY’s financial affairs is self-serving, not backed up by any documentary evidence and not credible. He testified that he was “typically a seven-day-a-week, eight to fourteen hours a day worker.” He “worked every weekend” and he would come in when nobody was there. Tr. pp. 96-97. At one point, XYZ BUSINESS had 300 employees and \$25 million in sales. Tr. p. 91. XYZ BUSINESS’s customers included General Electric, Hewlett Packard, and Siemens Medical. Tr. p. 76. “We did every Target store in the country.” Tr. p. 88. It is difficult to believe that John Doe, the sole owner of the company, in the office seven days a week, managing a business of this magnitude, could be so uninvolved with the financial affairs of his company. No documents supporting John Doe’ testimony as to his lack of involvement in ABC COMPANY were offered into evidence. The testimony at the hearing forces me to conclude that John Doe, as sole owner of ABC COMPANY and with the authority to sign checks, had significant control over the financial affairs of ABC COMPANY during the period covered by the NOD. He may have

chosen not to exercise his control during this period but that was his choice. Accordingly, John Doe has failed to rebut the Department's *prima facie* case, that he was a responsible person under the statute.

The second element which must be met in order to impose personal liability is the willful failure to pay taxes. The Department presents a *prima facie* case for willfulness with the introduction of the NOD into evidence. Branson, *supra*. The burden then is on the responsible parties to rebut the presumption of willfulness.

35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay taxes. The Illinois Supreme Court accepts as indicia of willfulness, a showing of “reckless disregard for obvious or known risks” as set forth in cases dealing with section 6672 of the Internal Revenue Code. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19, 29 (1985). In the case of Wright v. United States, 809 F. 2d 425, 427 (7th Cir. 1987), the Seventh Circuit Court of Appeals held that 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. Willfulness also includes a “failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the government.” Peterson V. United States, 785 F. Supp. 1209, 1217 (N.D. Ill. 1990). A person acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Department of Revenue v. Heartland Investments, 106 Ill. 2d 19 (1985). John Doe's conduct was willful under each of the above.

XYZ BUSINESS was apparently having financial problems as early as late 2007. The “Illinois Quarterly Withholding Income Tax Return” for ABC COMPANY for the first quarter of 2008 was signed by Jane Doe. Tr. pp. 35-36; Taxpayer's Ex. No. 3. Jane Doe testified that in

November or December of 2007, she received a notice from Illinois that the third quarter withholding return had not been filed. She mailed it in. She later received a notice that payment had not been made for the third quarter. She also learned that her predecessor had not sent payments to the State and that federal withholding had not been paid. She testified further that in the first quarter of 2008, Jack Jones would not let Jane Doe send in tax payments saying that they had to wait until more money came in. Jack Jones held checks in his office. When he allowed Jane Doe to send in late payments, it was only for federal tax. Tr. pp. 39-40, 67-69.

According to Jane Doe, problems with timely filing and payments continued. On September 30, 2008, Jack Jones sent Jane Doe an e-mail stating that a representative from the Illinois Department of Revenue “stopped by and said that no IL 941’s were filed for 12/31/07 or 6/30/08.” Jane Doe e-mailed the “IL reports” to Jack Jones and asked him to send them to the State. Tr. pp. 41-43, 68-69; Taxpayer’s Ex. No. 5. On October 7, 2008, Jane Doe e-mailed Jack Jones asking if she could pay third and fourth quarter federal withholding. Tr. pp. 44-45, 65-67; Taxpayer’s Ex. No. 6.

John Doe testified that Jack Jones would prepare XYZ BUSINESS’s financial statements once a month for the bank. “We would discuss the current assets and liabilities every month.” But Jack Jones “never talked to me about [ABC COMPANY] ever.” Tr. pp. 149-151. XYZ BUSINESS’s Income Statement for February 29, 2008, shows a “Net Loss Before Income Tax Provision” of \$117,393. This Net Loss should have put John Doe on notice that investigation of the financial position of XYZ BUSINESS and ABC COMPANY was warranted. He ought to have known at that time that there was a grave risk that taxes were not being paid.

John Doe testified that he made personal loans to XYZ BUSINESS and ABC COMPANY. He was unsure if during the period covered by the NOD, he was repaid for the

loans. If he was not repaid, this should have provided him with further notice that investigation of the financial position of XYZ BUSINESS and ABC COMPANY was warranted. If he was not repaid, he ought to have known at that time that there was a grave risk that taxes were also not being paid. On the other hand, if he was repaid the loan, it shows that companies that he controlled and managed preferred other creditors, rather than paying the State for withholding taxes.

John Doe testified that he got a tax notice from Anywhere, USA “in the latter part of 2008,” during the period covered by the NOD. According to the testimony, he brought the notice to Jack Jones who said that he would check it out. “Called me back the same day immediately, he said they made a mistake.” “It’s corrected.” Tr. pp. 126-127. John Doe was in a position to find out for certain very easily whether the taxes had been paid. No testimony or evidence was presented to show any steps taken by John Doe to ensure that the taxes were paid to Anywhere, USA and other states. No evidence was presented at the hearing to show what steps John Doe took to correct what he now argues was Mr. Jack Jones’s mismanagement. By doing nothing, John Doe failed to correct ABC COMPANY’s mismanagement after being on notice that taxes may not have been remitted, indicating willfulness under the statute. Peterson, *supra*. By not going to the bank where he had access to XYZ BUSINESS’s and ABC COMPANY’s records, John Doe demonstrated a reckless disregard for obvious or known risks, further indicating willfulness under the statute. Monday, *supra*.

Finally, John Doe was asked if he would have paid the back taxes if Jack Jones would have told him about the arrearage. “I would have stopped the presses right there and made sure it got paid.” John Doe testified that in October, 2008, during the period covered by the NOD, he “spent \$400,000 in cash for a company – to get out of a lease on a building that I wasn’t

personally liable for.” “All that money should have been used to pay back taxes that we owed.” Tr. pp. 184-185. This testimony is disingenuous. By October, 2008, John Doe had ample opportunity to have known about the unpaid taxes and, equally important, ample opportunity to investigate the financial position of ABC COMPANY and XYZ BUSINESS. John Doe was in a position to find out for certain if the taxes were being paid by simply calling the Department of Revenue or by checking with the banks to see if checks payable to the Department of Revenue had been negotiated. In October, 2008, John Doe could have written a check to the State for withholding taxes. Woods’ failure to investigate whether taxes were being remitted constitutes willfulness. Furthermore, in paying the \$400,000 to get out of a lease during the period covered by the NOD, John Doe preferred other creditors to the State, further exhibiting willfulness. Accordingly, John Doe has failed to rebut the Department’s presumption of willfulness.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Deficiency No. 360148 be finalized as issued.

February 1, 2012

Kenneth J. Galvin
Administrative Law Judge