

ST 05-20

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.

**JOHN DOE,
Taxpayer**

**No. 04-ST-0000
IBT #: 0000-0000
NPL # 0000
Tax pds. 4/01-12/01, 1/02, 2/02,
7/02, 8/02, 9/02
NOD # 0000
Tax pds. 1/Q/02, 3/Q/02
Charles E. McClellan
Administrative Law Judge**

RECOMMENDATION FOR DECISION

Appearances: George Foster, Special Assistant Attorney General, for the Illinois Department of Revenue; Jeffrey A. Peters of Farwell, Farwell & Peters, P.C., for John Doe.

Synopsis:

This matter arose from a protest filed by John Doe (“Doe”) to a Notice of Penalty Liability (“NPL”), dated April 20, 2004, and a Notice of Deficiency (“NOD”), dated April 21, 2004, issued to him by the Department. The NPL and the Nod were issued to Doe as an officer or employee of *ABC, Inc.* and *XYZ, Inc.* who was responsible for paying taxes incurred by those two entities during the periods asserted in each case. *ABC, Inc.* and *XYZ, Inc.*¹ were combined restaurants and bars in Arlington Heights, Illinois. The

¹ Doe testified about his work at *XYZ, Inc.* for 13 years prior to when he started working at *ABC, Inc.* Tr. p. 11. He did not state exactly when he resigned from *XYZ, Inc.*, and there is no other testimony in the record about his involvement with that entity.

NPL involved various periods from April 2001 through September 2002. The NOD involved withholding tax for the first and third quarters of 2002. The issue is whether Doe is liable, as a responsible person, for the penalty assessed him under § 735/3-7 of the Uniform Penalty and Interest Act². An evidentiary hearing was held on July 20, 2005 at which Mr. Doe was the only witness that testified. Doe offered no documents for admission into evidence.

I recommend that the Notices of Penalty Liability and Deficiency be made final.

Findings of Fact:

1. The Department issued a NPL to Doe on April 20, 2004. Dept. Ex. No. 1.
2. The NPL was issued to Doe as a responsible officer or employee of *ABC, Inc.* and *XYZ, Inc.* for various months from April 2001 through September 2002. *Id.*
3. The NOD was issued to Doe as a responsible officer or employee of *ABC, Inc.* for the first and third quarters of 2002. *Id.*

Conclusions of Law:

A pre-trial order was entered into the record for this case on April 22, 2005, in which the issues to be resolved at the hearing were set forth as follows:

1. Whether Doe was a responsible officer or employee of *XYZ, Inc.* and *ABC, Inc.* during the periods at issue.
2. Whether Doe willfully failed to file returns or pay taxes to the Department for the periods at issue.

² Unless otherwise noted, all statutory references are to 35 ILCS 735/1, *et seq.*, the Uniform Penalty and Interest Act (“UPIA”), or to the Retailers’ Occupation Tax Act (ROTA), 35 ILCS 120/1 *et seq.*, sometimes referred to as the *sales tax*.

Before addressing the issues in this matter there is a preliminary matter to be addressed. On the afternoon prior to the hearing, Doe filed an *EMERGENCY MOTION FOR CONTINUANCE OF EVIDENTIARY HEARING*. The motion was denied at the hearing for failure to assert sufficient justification for designating the motion as an emergency motion and for failure to file it on a timely basis as required by the administrative regulations. 86 IL. Admin. Code § 200.160(e).

As to the issues involved in this matter, the statute that imposes personal liability for paying to the state unpaid corporate Retailers' Occupation Tax, Use Tax and Withholding Tax obligations 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 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. 35 ILCS 735/3-7(a).

This section of the statute sets forth two tests for determining whether a person has personal liability for unpaid sales and withholding taxes incurred by a corporation. First, the person must be responsible for accounting for and paying the tax due. Second, the individual must willfully have failed to file for and/or pay the corporate taxes due.

The statute does not define the concept of willful failure. However, in applying the penalty tax, the Illinois courts look to federal cases involving § 6672 of the Internal Revenue Code³ which contains language similar to the Illinois statute. *Branson v. Dept. of Revenue*, 168 Ill. 2d 247, 254, 659 N.E.2d 961, 965, *Dept of Revenue v. Joseph*

³ 26 U.S.C. § 6672.

Bublick & Sons, 68 Ill. 2d 568 (1977). The key to liability under IRC § 6672 is control of finances within the employer corporation including the power to control the allocation of funds to other creditors in preference to the withholding tax obligations. *Haffa v. U.S.*, 516 F.2d 931 (7th Cir. 1975).

“Willful failure to pay taxes has generally been defined as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks.” *Branson*, 168 Ill. 2d at 255. The Department’s establishment of its *prima facie* case operates as a rebuttable presumption of willfulness that the party defending against the penalty can only overcome by producing evidence to disprove willfulness. *Branson*, 168 Ill. 2d at 262. This is fair because it is the taxpayer and not the Department that has access to the information regarding the reason the tax returns were not filed and/or the taxes not paid. *Id.*

Doe testified as follows: He began working for *XYZ, Inc.* part-time as a busboy and dishwasher. After he went to college, the owners hired him on a full time basis as manager to oversee the operations of the business. In that capacity he ordered inventory sometimes, seated customers and ran the bar. He never wrote any checks or paid any bills or had any other administrative duties in connection with the business operations. Tr. pp. 10-14.

Doe testified that after he worked at *XYZ, Inc.* for 13 years, Joe Blow (“Blow”) contacted him and offered him a 25% interest in *ABC, Inc.* for an investment of \$10,000. He accepted the offer and began working for *ABC, Inc.* in October of 1999. Tr. pp. 14-16. Doe was the secretary of *ABC, Inc.* and Blow, who owned the other 75% of the business, was the president and treasurer. *Id.* Doe worked for *ABC, Inc.* until April 2002. Tr. p. 27.

Doe testified that he ran the bar and restaurant and Blow handled all of the administrative matters including paying vendors, filing tax returns and paying taxes. Blow wrote most of the checks. Tr. p. 19. However, Doe could sign checks drawn on the business checking account, but Blow maintained control of the checkbook by taking it home with him every night and bringing it back in the morning. He kept it in a drawer in the establishment when it was there. Sometimes, when he was going out of town, he would leave deposit slips and some checks for Doe to use in paying vendors. Tr. pp. 18, 19, 24. Occasionally, he and Blow would sit at the bar and discuss things. Tr. p. 37.

Doe testified that Blow prepared and signed the sales tax returns except on one or two occasions when Doe signed them because Blow was out of town or had failed to sign them. Tr. p. 25.

Doe testified that he first became aware of the financial difficulties of *ABC, Inc.* when he stopped receiving paychecks in January of 2002. Tr. pp. 27-28. However, this conflicts somewhat with a letter he sent to Michael O. Sprincz of the Department dated March 22, 2004 in which he referred to knowledge he had prior to the time in 1991 that some *ABC, Inc.* checks had been returned for insufficient funds that the gas and electric services to the establishment had been turned off by the utilities for non-payment. Tr. pp. 45-49, Dept Ex. No. 2. He testified that Blow took care of those matters. *Id.*

Another problem with Doe's testimony arises from the manner in which his attorney elicited his direct testimony. His attorney persisted in asking leading questions on direct examination. These questions were pregnant with answers regarding Doe's involvement with *ABC, Inc.* Although the Department objected four times to the leading questions and was sustained in each instance (Tr. pp. 31, 35, 39, 52), Doe's attorney

persisted in asking leading questions. Because the essence of the testimony was framed by the attorney's leading questions rather than by the witness's own testimony, the credibility of the testimony is suspect.

With regard to the issues, the courts have held that,

“Corporate office does not, per se, impose the duty to collect, account for and pay over the withheld taxes. On the other hand, an officer may have such a duty even though he is not the disbursing officer. [citations omitted] The existence of the same duty and concomitant liability in another official likewise has no effect on the taxpayer's responsibility. [citations omitted] Liability attaches to those with power and responsibility within the corporate structure for seeing that the taxes withheld from various sources are remitted to the Government. [citations omitted] This duty is generally found in high corporate officials charged with general control over corporate business affairs who participate in decisions concerning payment of creditors and disbursement of funds.” *U. S. v. Monday*, 421 F.2d 1210 (7th Cir. 1970).

The record suggests that *ABC, Inc.* was a small two-man operation with a few employees. Doe testified that he was the secretary of *ABC, Inc.* and that he owned 25% of the company. The corporate by-laws were not offered into evidence, so the record does not establish the formal assignment of administrative duties such as deciding what creditors will be paid, tax return preparation and filing and check signing responsibility. Doe testified that Blow handled all of the administrative aspects of the business while he managed the bar and restaurant. However, he was the corporate secretary, and a 25% owner with check signing authority and on occasion he did sign sales tax returns and checks. In any case, responsibility for making certain that tax returns are timely filed and that tax obligations are timely paid cannot be avoided by compartmentalizing the responsibility for compliance. *Wright v. U.S.*, 809 F.2d 425 (7th Cir. 1997).

Doe testified that he did not become aware of the unpaid taxes until he received the Notice of Tax Liability and the Notice of Deficiency from the Department in April of 2004. However, in the letter he signed dated March 22, 2004 (Dept. Ex. No. 2), he stated that he was aware of utilities having been shut off for failure to pay the bills. The letter does not state when the utilities were shut off, but it indicates that he was aware of financial problems with the business earlier than April of 2004. In his position as a 25% shareholder and secretary of the company as well as the manager of day-to-day operations, and considering his testimony that he and Blow sometimes sat at the bar to discuss matters, it is reasonable to conclude that the financial status of the company came up in these discussions from time to time.

The issue of willfulness is concerned with the state of the responsible person's state of mind. *Sawyer v. U.S.*, 831 F.2d 755 (7th Cir. 1987) "Willful failure to pay taxes has generally been defined as involving intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks." *Branson*, 168 Ill. 2d at 255.

An officer may have that duty even though he does not have the treasury function. *U. S. v. Monday, supra*. He has the duty if he has general control over corporate business affairs and participates in decisions concerning payment of creditors. *Id.*

A responsible person is guilty of gross negligence and liable if he should have known that there was a significant risk that taxes were not being paid and he was in a position to find out that they were not being paid. *Wright v. U.S., supra*. Although Blow may have had primary responsibility for tax compliance, this was a small company with only two officer/shareholders. Because of the conversations Doe had with Blow, and because of his position with the company, he should have known that there was a risk

that taxes weren't being paid timely. Therefore, Doe had responsibility along with Blow to make sure that tax returns were timely filed and the taxes paid. Doe offered no evidence to overcome the presumption in the Department's *prima facie* case that he was a responsible party. His failure to do anything to make sure that the taxes at issue were paid was legally not excusable.

On this basis, I find that Doe's conduct in not making certain that the taxes at issue were being paid was the result of reckless disregard for obvious or known risks. That conduct coupled with the lack of any evidence offered to rebut the Department's *prima facie* case satisfies the test for willfulness.

Therefore, I recommend that the Notice of Penalty Liability and the Notice of Deficiency be made final.

Date: 10/26/2005

Charles E. McClellan
Administrative Law Judge