

ST 09-6
Tax Type: Sales Tax
Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
ILLINOIS DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE, as
Responsible Officer of
ABC ENTERPRISES, INC.,
TAXPAYER**

**No. 08-ST-0000
IBT No. 0000-0000
NPL No. 0000000
SSN: 000-00-0000**

**Kenneth J. Galvin
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Anthony Pinelli appearing on behalf of Mr. John Doe; Mr. George Foster, Special Assistant Attorney General, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to John Doe’s (hereinafter “Mr. Doe”) protest of Notice of Penalty Liability (hereinafter the “NPL”) No. 0000000, as responsible officer of ABC Enterprises, Inc. (hereinafter “ABC”). The NPL represents a penalty liability for Retailers’ Occupation Tax of ABC due to the Department for the months of January through September, 2006. A hearing was held on this matter on March 12, 2009, with Mr. Doe providing oral testimony. Following submission of all evidence and a review of the record, it is recommended that the NPL 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 NPL No. 0000000, dated January 14, 2008, which shows a penalty for unpaid sales tax liability of ABC Enterprises, Inc., of \$49,577.86 for January through September, 2006. Tr. pp. 6-7; Dept. Ex. No. 1.
2. ABC Enterprises owned and operated an Italian restaurant at Anywhere in Chicago, under the name "Doe's Restaurant." When Mr. Doe first became involved with ABC, he purchased 25% of the stock. When Joe Blow retired in 1997, Mr. Doe bought him out, becoming 100% owner of the shares and changing the name of the restaurant to "Doe's Italian Restaurant." Tr. pp. 8-11, 16-17, 21.
3. In 2005, Smith Jones became a corporate officer and manager of the restaurant with the duties of hiring and firing, purchasing, paying bills including rent, selecting purveyors, and paying taxes. Mr. Smith Jones became a 25% shareholder in ABC, with Mr. Doe retaining 75% of the shares. Tr. pp. 14-15, 35-36.
4. Mr. Doe testified that in September, 2006, he went to the restaurant on a Sunday, when the restaurant was normally closed, and found the restaurant in disarray. Mr. Doe could not find Smith Jones. Mr. Doe testified that he found "a couple of cardboard boxes with a lot of unopened envelopes in them, bank statements, envelopes from the IRS, State of Illinois, purveyors." Some of the envelopes were up to a year old. Mr. Doe turned the boxes over to ABC's accounting firm, "Kolnicki, Peterson Wirth, LLC." Tr. pp. 20-21, 28-31.
5. The lease for the restaurant was up in September, 2006. Mr. Doe opted not to renew the lease and closed the restaurant. Tr. pp. 21-22.

6. The ST-15, “Business Information Update (Sales and Use Tax)” for Doe’s Italian Restaurant lists “John Doe” as being responsible for filing tax returns and paying taxes. The signature of “John Doe” appears under the sentence “[I] accept personal responsibility for the filing of returns and the payment of taxes due.” The social security number listed next to the signature is Mr. Doe’s. The ST-15 is dated September 1, 2003. Tr. pp. 36-38; Dept. Ex. No. 2.
7. Mr. Doe was an authorized check signer for the restaurant during the period covered by the NPL. Tr. pp. 39-40.

Conclusions of Law:

The sole issue to be decided in this case is whether Mr. Doe should be held personally liable for the unpaid Retailers’ Occupation Tax of ABC Enterprises, Inc. 35 ILCS 120/1 *et seq.* The statutory basis upon which any personal liability is premised is 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 NPL establishes the Department’s *prima facie* case with regard to both the fact that Mr. 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 (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 Mr. Doe was a responsible officer of ABC. During the period covered by the NPL, Mr. Doe was a 75% shareholder in ABC. Tr. p. 49. Mr. Doe testified that he believed he was President of ABC in 2006 and Smith Jones was Secretary and Treasurer. Tr. p. 36. The ST-15, “Business Information Update (Sales and Use Tax)” for Doe’s Italian Restaurant, shows its “owning entity,” as “ABC Enterprises, Inc.,” and lists “John Doe” as being responsible for filing tax returns and paying taxes. The signature of “John Doe” appears under the sentence “[I] accept personal responsibility for the filing of returns and the payment of taxes due.” Mr. Doe testified that the signature is not his. The social security number listed next to the signature is Mr. Doe’s. The ST-15 is dated September 1,

2003. Tr. pp. 36-38; Dept. Ex. No. 2. No sample of Mr. Doe's writing was offered into evidence at the hearing. No handwriting expert was called as a witness by Mr. Doe. There was no testimony or documentary evidence admitted at the hearing showing that Mr. Doe had filed suit against any person for falsely signing his name to the ST-15. I am unable to conclude, based on Mr. Doe's testimony alone, that the signature on the ST-15 is not his.

Mr. Doe's testimony attempted to minimize his responsibilities and involvement at the restaurant. He testified that his role was "merely to try and stimulate business for the restaurant." Tr. p. 15. According to his testimony, Mr. Doe did not order supplies for the restaurant, did not pay vendors, did not pay taxes, and he did not have any role in the licensing of the restaurant. Tr. pp. 15-16. Mr. Doe testified that he did not inspect the restaurant's books and records. Tr. p. 42. However, other testimony indicated that Mr. Doe was more involved in the restaurant than he indicated. Mr. Doe testified that he would go to the restaurant "once a week for lunch, maybe twice a week for dinner, have clients meet me there..." Tr. p. 40. Mr. Doe apparently had a key to the restaurant because he met friends at the restaurant on Sundays when the restaurant was closed. Tr. p. 19. Mr. Doe testified that he made the decision to retain the restaurant's accounting firm, "Kolnicki, Peterson, Wirth, LLC." The firm had been retained by Mr. Doe for nine years. Tr. pp. 47-48. Mr. Doe is an attorney, licensed in Illinois since 1964. Tr. pp. 8-9. He testified that he was involved in the ownership of ABC for "about 12 years." Tr. pp. 9-10.

Mr. Doe testified that Smith Jones, as manager of the restaurant, was responsible for filing tax returns and issuing checks for the amount of taxes owed. Tr. p. 17. The manager's responsibilities were to "hire and fire, to purchase the product, file tax returns, pay purveyors." Tr. p. 13. Smith Jones was not subpoenaed for the evidentiary hearing. Mr. Doe testified that he

heard that Smith Jones had moved to Texas. “I don’t know what part of Texas, it’s a big state.” Tr. p. 33.

Mr. Doe was President and 75% shareholder in ABC during the period covered by the NPL. As President and shareholder, Mr. Doe could have inspected the books and records at any time. Mr. Doe could have called the accounting firm, which was retained by Mr. Doe, and asked if taxes were being paid. If Mr. Doe chose not to exercise his authority over Mr. Smith Jones or chose to share his authority with Mr. Smith Jones, this does not make Mr. Doe less of a responsible officer or indicate that he was not a responsible officer. The statute does not confine liability to only one person or to the person most responsible. All responsible persons owe a fiduciary obligation to care properly for the funds that are entrusted to them. “A fiduciary cannot absolve himself merely by disregarding his duty and leaving it to someone else to discharge.” Hornsby v. Internal Revenue Service, 558 F. 2d 952 (5th Cir. 1979). One does not cease to be a responsible person merely by delegating that responsibility to others. Gustin v. United States, 876 F.2d 485 (5th Cir. 1989).

Mr. Doe hired Mr. Smith Jones as manager. Tr. pp. 13-14. As the Department’s counsel stated so succinctly in his closing argument: “I mean, if [Mr. Doe] couldn’t fire Mr. Smith Jones, who could fire Mr. Smith Jones?” Mr. Doe could have inquired of Mr. Smith Jones, his employee, as to whether sales taxes were being paid. Mr. Doe could have inquired of the accounting firm, which he retained for nine years, as to whether sales taxes were being paid. Responsibility is a matter of status, duty and authority, not necessarily knowledge. Mazo v. United States, 591 F.2d 1151 (5th Cir. 1979). With the status of President and 75% shareholder, and the authority to hire and fire the manager and retain accountants, Mr. Doe was a responsible officer.

The NPL at issue in this case covers the months of January through September, 2006. Mr. Doe testified that he was an authorized check signer for the restaurant during the period covered by

the NPL. Tr. pp. 39-40. He signed checks “sporadically.” “It may have been a payroll check to an employee who didn’t get paid or needed an advance, and maybe [the manager] wasn’t around to do it so I would sign ...” Tr. pp. 39- 40. No copies of cancelled checks were admitted into evidence at the hearing.

Mr. Doe admitted at the hearing that he had the ability to sign corporate checks. 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). Individuals who hold corporate office and who have authority to make disbursements are presumptively responsible persons for purposes of 26 USC § 6672, the federal responsible officer statute. Hildebrand v. United States, 563 F. Supp. 1259 (D.C. N.J. 1983). As President with the ability to sign corporate checks, Mr. Doe could have written a check to the State of Illinois for unpaid sales tax.

The evidence shows then that Mr. Doe was in a responsible position with ABC in which he knew or should have known whether returns were filed and taxes paid. In order to overcome the Department’s *prima facie* case, evidence must be presented which is consistent, probable and identified with the corporation’s books and records. Central Furniture Mart, Inc. v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). When the Department established its *prima facie* case, the burden shifted to Mr. Doe to overcome the presumption of responsibility through sufficient evidence. Branson, supra. The only document caused to be admitted by Mr. Doe at the hearing was a letter from the accounting firm retained by Mr. Doe, addressed to Mr. Smith Jones, instructing Mr. Smith Jones on telefiling procedures for Illinois sales tax returns. This document is insufficient to show that Mr. Doe was not a responsible officer of ABC or that he was less responsible than Mr. Smith

Jones. Mr. Doe hired not only Mr. Smith Jones, but also the accounting firm, and could have easily determined if telefiling procedures for sales tax returns were being followed. Without any documentary evidence to support his case, I must conclude that Mr. Doe has failed to rebut the Department's presumption that he was a responsible party under the statute.

The second and remaining element which must be met in order to impose personal liability is the willful failure to pay the taxes due. The Department presents a *prima facie* case for willfulness with the introduction of the NPL into evidence. Branson v. Dept. of Revenue, 168 Ill. 2d 247 (1995). The burden, then, is on the responsible party to rebut the presumption of willfulness. 35 ILCS 735/3-7 fails to define what constitutes a willful failure to pay or file taxes. In attempting to clarify what constitutes a willful failure to file or pay taxes, the courts have adopted a broad interpretation of the words "willfully fails." Department of Revenue ex rel. People v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989). Under this broad interpretation, responsible officers are liable if they fail to inspect corporate records or otherwise fail to keep informed of the status of the Retailers' Occupation Tax returns and payments. Branson, *supra*. Willfulness also includes "failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government." Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). "Willfulness" as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970) *cert. denied* 400 U.S. 821 (1970).

Mr. Doe's conduct was willful under each of the above benchmarks. As President, 75% shareholder, employer of Mr. Smith Jones, with authority to retain the restaurant's accountants, Mr. Doe was certainly in a position to inspect corporate records and keep informed of the status of the tax returns and payments. Mr. Doe's failure to do so constitutes willfulness under the statute. If

Mr. Doe delegated his responsibilities to Mr. Smith Jones, his conduct was still willful. Responsible officers are liable if they delegate bookkeeping duties to third parties and fail to inspect corporate records or otherwise fail to keep informed of the status of the tax returns and payments. Branson, *supra* at 267. If the taxes were not paid by an employee that Mr. Doe hired and supervised, then I must conclude that they were not paid with Mr. Doe's approval, which satisfies the willful requirement under the statute. In light of Mr. Doe's background as an attorney, and 12 years experience with restaurants, it is inconceivable that he never once questioned Mr. Smith Jones or the accounting firm as to whether sales taxes were being paid. A responsible person cannot escape his obligation to ensure that taxes are paid simply by delegating the responsibility to others. Wright v. United States, 809 F.2d 425 (7th Cir. 1987).

Mr. Doe testified that "[T]here had been losses the entire time that I owned the restaurant. I never took any money out of it as a shareholder or as an employee." Mr. Doe testified that he never received a paycheck. Tr. p. 23. Mr. Doe was asked if the restaurant ever had cash flow problems "in terms of having trouble paying day-to-day bills." He responded: "Oh sure, like every business has that, we were no different." When asked specifically about cash flow problems in 2006, the period covered by the NPL, Mr. Doe responded that he "never got any complaints about anything but, you know, you get purveyors that then put you on COD because you are not paying your bills in a timely fashion..." Mr. Doe testified that purveyors, putting the restaurant on COD status, was "the normal course of business." Tr. pp. 44-45.

Mr. Doe's testimony, above, also demonstrates willfulness. A restaurant that constantly loses money and that has purveyors putting the business on COD status should be an indication to a responsible officer that investigation is warranted as to whether taxes are being paid and remitted. Failure to investigate or to correct mismanagement after having knowledge of cash-flow problems

demonstrates willfulness. “Willfulness” as used in the statute may indicate a reckless disregard for obvious or known risks. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970) *cert. denied* 400 U.S. 821 (1970). Mr. Doe’s failure to investigate and correct mismanagement, after having knowledge of the restaurant’s losses and cash flow problems, indicates a “reckless disregard” for the risk that taxes were not being paid and remitted to the State of Illinois. There was no testimony or documentary evidence showing any positive steps that Mr. Doe took to pay the taxes. Mr. Doe was a responsible person in a position to easily discover the nonpayment of ABC’s taxes. He clearly ought to have known of the grave risk of nonpayment, but he did nothing. Under these circumstances, a finding of willfulness is justified. Estate of Young v. Department of Revenue, 316 Ill. App. 3d 366 (1st Dist. 2000). Mr. Doe’s failure to take action in light of the restaurant’s losses and cash flow problems is sufficient to find willfulness under the statute and I conclude that he has failed to rebut the Department’s presumption that he willfully failed to pay ABC’s sales taxes.¹

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Penalty Liability No. 0000000 issued against Mr. John Doe should be finalized as issued.

ENTER:

Kenneth J. Galvin
Administrative Law Judge

April 24, 2009

¹ In his closing argument, counsel for Mr. Doe cited Department of Revenue v. Corrosion Systems, Inc., 185 Ill. App. 3d 580 (4th Dist. 1989), where, according to counsel, “the Court specifically held the state was required to show that the corporate officer knew that the taxes were due and voluntarily consented to the failure to pay the taxes.” Tr. p. 65. In Corrosion Systems, the principal financial officer argued that the record did not show that the taxes were ever collected by Corrosion Systems because the transactions were believed to be tax-exempt. “Since the moneys were never collected, were never available to the corporation, and were not spent on other corporate obligations, [the officer] argues the Department cannot show, as a matter of law, that he willfully failed to pay the tax.” Corrosion Systems at 583. In the instant case, Mr. Doe never argued that any of the transactions generating ABC’s sales tax liability were tax exempt or that the unpaid taxes were not collected by the restaurant.