

**ILLINOIS INDEPENDENT
TAX TRIBUNAL**

MATTHEW S. MAY,)	
)	
Petitioner,)	
)	
v.)	14 TT 135
)	Judge Brian F. Barov
ILLINOIS DEPARTMENT)	
OF REVENUE,)	
)	
Respondent.)	

FINAL JUDGMENT ORDER

The Petitioner Matthew May (“May”) is challenging the Illinois Department of Revenue’s Notice of Penalty Liability seeking to hold him personally liable for unpaid Illinois income withholding taxes of Kelly & May Dirtworks, Inc., an S corporation (“the company”). The Notice covers the calendar quarters ending June 30, 2011, September 30, 2011, December 31, 2011 and March 31, 2012. A hearing was held on October 7, 2015, at which May testified and the Department offered documentary evidence. After considering all of the evidence, I find that the May is not subject to responsible officer liability for unpaid withholding taxes for the last three quarters of 2011, but is subject to responsible officer liability for unpaid withholding taxes for the first quarter of 2012.

Background

The company was in engaged in commercial construction. It excavated foundations and installed sewer and water lines. It was incorporated on November 25, 2008 by Daniel Kelly, May’s brother-in-law. Kelly was the initial registered agent and president. Kelly listed his wife, Kathryn Kelly, as secretary and

treasurer, and listed May as a vice president on the Department's business registration form.

On this same business registration form, Kelly listed himself and May as responsible persons for paying Illinois withholding taxes. On the company's 2010 annual report, May was listed as a director, but not an officer. On the 2011 annual report, May was listed as a vice president and a director.

According to May, he was unaware that Kelly had named him as a corporate officer or of how a corporation operates, and he never attended any shareholder meetings. In the spring of 2009, May became aware that he was made an officer and was listed as a 25% shareholder of the company. May never received stock. Instead, he was named an officer of the company in order to obtain an owner-operator's card from his union. The company was a union shop and holding an owner-operator's card allowed him to "operate on" union jobs. Tr. 16 at 12-13. May testified the company was involved with "primarily all union" jobs. *Id.* at 17.

Kelly generated the company's business through relationships he had developed with other contractors from a previous landscaping business. The company was run out of Kelly's home, and Kelly handled the administrative and financial tasks such as bidding for jobs, generating payroll and paying expenses, including taxes. May visited the Kelly home for social occasions but never saw, nor requested to see, any of the company's financial records.

May's role in the company was to "help run and manage jobs." Tr. 12 at 12-13. He maintained and ran the heavy equipment and supervised the work crews. May prepared a daily report of hours worked for payroll purposes, and had check writing authority so that he could buy and pay for supplies while in the field.

Generally, Kelly prepared the paychecks and gave them to May to pass out to the crew. May observed that his paycheck, and the paychecks for the crew, reflected that taxes had been withheld. May occasionally filled out and signed paychecks for

the crew at Kelly's direction. On those occasions, May would receive a pay stub at a later date reflecting his taxes were withheld, but he did not see the pay stubs for the crew and did not know whether their taxes were also withheld.

May's state and federal tax returns for 2009 through 2012 show state and federal income tax withheld. May received federal income tax refunds for the 2009-2012 tax years. He received Illinois income tax refunds for the 2010, 2011, and 2012 tax years.

May acknowledged that the company had financial problems from the "get go." Tr. 39 at 6-7. Although, his income increased substantially from 2009 to 2010, it began to decline in 2011 and this decline accelerated in 2012. According to the Department's "customer relationship log," on November 30, 2010, its collections division contacted May and informed him that the company had an outstanding withholding tax balance, and that liability could be transferred to him personally. Dep't Ex. 8 at 110. May did not recall this event.

May recalled that checks bounced "sporadically" every year, Tr. 38 at 22 - 39 at 3, but by the end of 2012, "checks were bouncing all over the place," Tr. 20 at 2-7. The Department introduced into evidence 85 cancelled checks signed by May, dated during the last three quarters of 2011 and the first quarter of 2012. Of these checks, 12 were written between April and November 2011, and none of those were returned for insufficient funds. The remaining 73 checks were dated during the first quarter of 2012, and 9 were returned for insufficient funds, including paychecks to May dated January 17 and March 8, 2012. Dep't Ex. 7. According to May, he confronted Kelly about the returned paychecks, and Kelly told him that he felt the employees should be paid on time, even if there was no money in the bank. May told Kelly "[t]hat's not a way to operate a business." Tr. 32 at 7.

Analysis

The Illinois Income Tax Act requires Illinois employers to withhold and remit to the State Illinois withholding income tax on compensation paid to employees. *See* 35 ILCS 5/701-706. Under the Uniform Penalty and Interest Act (“Act”), a corporation that incurs a tax liability, but fails to remit those funds, subjects its responsible officers or employees to personal liability, including interest and penalties for the unpaid amounts. *See Cerone v. State*, 2012 IL App (1st) 110214, ¶ 14.

Section 3-7(a) of that Act states:

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). Section 3-7(a) liability is “derivative in nature” arising only where the corporation has incurred a tax liability that it does not pay. *McLean v. Dep’t of Revenue*, 326 Ill. App. 3d 667, 673-74 (1st Dist. 2001). Personal liability survives a corporate dissolution, and “may be imposed . . . upon corporate officers or employees who are responsible for the filing of . . . tax returns and payment of taxes due, and who have ‘willfully’ failed to file such returns or remit such taxes.” *Id.* at 674.

The Department’s certified record of the Notice of Penalty Liability serves as its prima facie case of responsible officer liability. *See Branson v. Dep’t of Revenue*, 168 Ill. 2d 247, 262-63 (1995); *McClean*, 326 Ill. App. 3d at 674. The prima facie case creates a presumption that the person named is a responsible person and willfully failed to pay the amount of the taxes due. *Branson*, 168 Ill. 2d at 262. The prima facie case is rebuttable where the taxpayer provides “sufficient evidence

to disprove willful failure to file returns and pay taxes.” *Id.* at 262; *Cerone*, 2012 IL App (1st) 110214, at ¶ 15.¹

A. May as a Responsible Person

Responsible person status extends to corporate officers beyond those who directly participate in preparing and filing tax returns. *Cerone*, 2012 IL App (1st) 110214, at ¶ 19. The exercise of “significant control and authority” over a firm’s business, regardless of whether that authority involves paying taxes, may make the corporate official a responsible person under the Act. *Id.* Thus, an investor or absentee owner may not have the degree of control and authority to be considered a responsible person, *see, e.g., McClean*, 326 Ill. App. 3d at 674-75 (holding that majority shareholder and company chairman was not a responsible party for that portion of the tax period in question where he was uninvolved in day-to-day business decisions, seldom visited the corporate offices and signed only two checks), whereas a corporate officer who is regularly involved in and actively exercises authority over a business may qualify as a responsible person, *see, e.g., Cerone*, 2012 IL App (1st) 110214, at ¶ 19 (taxpayer was responsible officer where he had controlling interest in restaurant, visited it frequently and spoke with the manager about business affairs and was involved in key business decisions); *McClean*, 326

¹ The Department argues briefly that May “was required to ‘present evidence, consistent, probable, and closely identified with [Kelly & May’s] books and records,’” to rebut the Department’s prima facie case, and his failure to do so dooms his case. Dep’t Post Trial Br. at 3 (quoting *Cent. Furniture Mart, Inc. v. Johnson*, 157 Ill. App. 3d 907, 911 (1st Dist. 1987)). *Central Furniture* involved a challenge to a sales tax deficiency assessment made after an audit, and restates the burden generally imposed on taxpayers necessary to rebut the accuracy of such an assessment. But neither the *Branson* court, nor other Illinois courts, have adopted the “closely identified with books and records” standard for evaluating responsible officer liability. *Branson*, 168 Ill. 2d at 262. Rather, Illinois courts use the term of “sufficient evidence,” *id.*, and have considered testimony alone or together with documentary evidence in determining whether the Department’s prima facie case has been rebutted, *see id;* *see also Cerone*, 2012 IL App (1st) 110214, at 18-19; *McClean*, 326 Ill. App. 3d at 674-75. But whether or how the *Central Furniture Mart* standard applies does not have to be decided directly, as May’s testimony, at least where it cuts in his favor, was consistent and closely identified with the documentary evidence submitted by the Department.

Ill. App. 3d at 675 (majority shareholder became a responsible person during that portion of the tax period when he became significantly involved in day-to-day business operations and knew of corporation's financial troubles).

Here, May testified credibly that he was unsophisticated in business matters and generally unfamiliar with corporate formalities or business administration. He was not involved in bidding out jobs, preparing payroll or paying bills, and trusted Kelly to handle all of these financial matters. May never saw financial documents or corporate books and records. He became aware that Kelly listed him as an officer and as a responsible party for taxes after the fact.

Yet, May never objected to being named a corporate officer or to being listed as a responsible person for paying taxes on the Department's business registration form, and for good reason. According to May, in order for him to "operate on" union excavating jobs, he had to have an "owner/operators" card, *see* Tr. 16 at 5-13, and the "easiest way" to obtain an "owner/operators" card was to be listed as an owner on corporate records, *id.*, 34 at 14-16. May's position as a corporate officer permitted him to be an owner-operator and to operate on union construction jobs, which were the primary source of the company's business.

Further, May was "the boss" on the job site every day. Tr. 36, at 12-14. In this role, May supervised the crews, tracked the employee hours and provided a daily report for payroll purposes. He wrote checks for needed supplies, and signed payroll checks for employees and for himself. Further, he acknowledged awareness of the company's general financial problems from the "get go," *id.*, 39 at 6-7, and in 2012 was aware that checks were being returned, including his own paycheck.

The record was not clear as to whether May had authority to actually address the company's financial problems or pay taxes. May held a minority interest in the company and trusted Kelly to handle these matters. The company was run out of Kelly's house. Corporate books were kept there and May never saw them. But he never asked to see the company's books and records and did not establish that he was denied access to them.

In the absence of proof that May could not exercise authority over the company's finances, the evidence of his acquiescence in being included as a responsible person on the business registration form, the importance of his owner-operator status in running the business, his day-to-day supervisory role, and the exercise of check writing authority outweighs his lack of involvement with the company's financial affairs in establishing responsible person status. May had at least a minimally sufficient involvement in the company's business to render him a responsible person under the Act. *See Cerone*, 2012 IL App (1st) 110214, at ¶ 19; *McClellan*, 326 Ill. App. 3d at 676.

B. May's Willful Failure to Pay Taxes

In order to impose personal liability, however, May's failure to insure that withholding taxes were paid must be willful. Willfulness does not require a showing of fraud, bad intent, or even actual knowledge of nonpayment. *See Branson*, 168 Ill. 2d at 255; *McClellan*, 326 Ill. App. 3d at 675-76. Rather, a responsible person acts willfully when he is "in a position to easily discover nonpayment [and] clearly ought to have known of a grave risk of nonpayment but does nothing." *Estate of Young*, 316 Ill. App. 3d 366, 375 (1st Dist. 2000). This standard has been described as "reckless disregard for obvious or known risks." *Branson*, 168 Ill. 2d at at 255 (internal punctuation omitted).

Branson illustrates the standard's application. The taxpayer owned a restaurant in a college town and was charged with failure to pay sales tax on his food sales from June 1986 to January 1987. 168 Ill. 2d at 250, 252. He had hired a bookkeeper to handle the restaurant's finances, including the payment of taxes. *Id.* at 251-52. During the summer of 1986, the taxpayer was aware that the restaurant had cash flow problems, but the situation seemed to improve in the fall, when the students returned to the campus. *Id.* at 252. In December 1986, when the bookkeeper went on vacation, the taxpayer took over the restaurant's finances and discovered that despite a positive ledger balance, accounts were overdrawn and bills had gone unpaid for months. *Id.*

The *Branson* court found that the taxpayer had not willfully failed to pay sales taxes before taking over the bookkeeping duties in early December. *See id.* at 264, 267. But once he took over those duties, and became aware of unpaid bills and returned checks, it became his responsibility to account for state taxes and his failure to do so was willful, subjecting him to personal liability. *See id.* at 267-69.

Here, as in *Branson*, May acted willfully for part, but not all, of the tax periods in question. During the last three quarters of 2011, May had no particular reason to suspect that taxes or bills were going unpaid. The Department's evidence shows that for this period he signed 12 checks and none were returned for insufficient funds. Further, there was affirmative evidence that withholding taxes were being paid. May testified that he saw that tax was withheld from his and the other employees' paychecks and this testimony is consistent with his 2009 through 2011 federal and Illinois income tax returns, all of which show that income taxes were withheld from his pay. In fact, for 2011, May was significantly over withheld and received a substantial federal refund, as well as a state refund.

The Department contends that May must be willful because on November 30, 2010, it informed him, in a telephone call, of a withholding tax deficiency and warned him that tax liability could be transferred to him personally. *See Dep't Post-Trial Br.* at 6 (citing *Dep't Ex. 8* at 110). The scope of the Department's argument is not entirely clear. To the extent the Department is arguing that the November 30, 2010 telephone call imputed a continuing willfulness to May as a matter of law, it cites no authority for such a broad application of the willfulness standard. If the Department is contending that the November 30, 2010 telephone call is factual support for the conclusion that May acted willfully in later tax periods, the argument is unpersuasive. The record does not show that back taxes have been sought against May or the company for the last quarter for 2010, or that there was any failure to pay withholding taxes or for the first quarter of 2011. As with the taxpayer in *Branson*, it would have been reasonable for May to assume

that any problems with paying withholding taxes occurring at the end of 2010 tax had been cured by early 2011. *See* 155 Ill. 2d at 252, 267.

As far as May knew, or could have known, things did not change until the first quarter of 2012, when numerous checks were returned for insufficient funds including May's paycheck, first in January and then again in March of 2012. By March 2012, May was certainly aware of the company's specific financial problems, and it was incumbent upon him to make inquiries into the financial stability of the company and to take reasonable steps to insure that taxes were being paid. *See Branson*, 155 Ill. 2d at 264, 267; *McClellan*, 326 Ill. App. 3d at 676. May's one-time admonishment of his brother-in-law's business practices is not sufficient. *Cf. Cerone*, 2012 IL App (1st) 110214, ¶ 23 (finding responsible officer personally liable for unpaid taxes where he did not take positive action to pay taxes after he was aware the corporation was not paying bills). May's failure to take action in the face of actual specific knowledge of the company's financial distress was a willful failure to pay the company's withholding taxes. *See Branson*, 155 Ill. 2d at 267-68; *McClellan*, 326 Ill. App. 3d at 676; *Cerone*, 2012 IL App (1st) 110214, ¶ 25.

This case is distinct from *Estate of Young*, the Department's primary authority. There, the taxpayer, like May, was not involved in his business's financial affairs, *See* 316 Ill. App. 3d at 370, but unlike May, the taxpayer was aware that during the tax period in question bills were going unpaid, the company was on a cash only basis with vendors, and the corporation's accounting was "screwed up" and not getting any better, *id.* at 377. Here, as far as May knew, or could have known, in 2011, checks were clearing, bills were being paid, and income taxes were being withheld.

It is only during the first quarter of 2012, when May knew of definite financial problems, that he had a duty to make sure that the company's Illinois withholding taxes were paid. *See Branson*, 155 Ill. 2d at 267-69. And it is only for this period that his failure to insure the proper payment of withholding taxes can be deemed willful, subjecting him to personal liability under the Act. *See id.*

Conclusion

The May 23, 2014 Notice of Penalty Liability is reversed in part and affirmed in part. For the periods ending June 30, 2011, September 30, 2011, December 31, 2011, the assessment of penalty liability is dismissed. For the period ending and March 31, 2012, the Notice of Penalty Liability is upheld.

This is a final order subject to review under section 3-113 of the Administrative Review Law, and service by email is service under section 3-113(a). The Illinois Independent Tax Tribunal is a necessary party to any appeal.

s/ *Brian Barov*
BRIAN F. BAROV
Administrative Law Judge

Date: December 28, 2015