Trust fund recovery penalties

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form of a 100 percent penalty, for unpaid trust fund taxes of the business if (1) the officer or employee is found to be "responsible" for the collection and payment of such taxes, and (2) the failure to remit the taxes to the Department is "willful." As to who is a responsible person, courts generally agree that responsibility is a matter of a person's "status, duty, and authority" within the organization of the business.[5] An individual's "status" within the business is commonly determined by reference to such things as title or position, as well as ownership, but the holding of a corporate office or ownership, by itself, is not sufficient reason to impose a 100 percent penalty on an officer.[6] A person's "duty" means his or her power to control business funds, and of particular relevance is whether the person has a duty to oversee, manage or administer the payment of creditors, including taxes.[7] A person's "authority" within the business may also be pertinent, especially when such person has authority to sign checks or otherwise control finances of the business.[8]

The Illinois Supreme Court has defined "willful" conduct as "intentional, knowing and voluntary acts or, alternatively, reckless disregard for obvious or known risks."[9] The conscious decision to favor a payment to other creditors over the State of Illinois generally constitutes willful conduct. Willfulness may also include evidence of gross negligence by an officer or employee in his or her duty to know or be aware of tax payments owed by the business.[10]

Accordingly, if an officer or employee of a business has the requisite status, duty or authority to control company funds, then the officer or employee should be particularly aware of any trust fund taxes that the business may owe to the State of Illinois. If the business were to default on the payment of its trust fund taxes, the Department could seek recovery of such taxes, plus penalties and interest, in the form of a 100 percent penalty directly from the responsible officer or employee. Thus, it is always good practice to remind clients and their relevant officers and employees of the potential for personal liability if trust fund taxes are not timely paid to the Department. ■

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1. Illinois defines a "trust tax" as "any tax for which an amount is collected or withheld by a taxpayer from another person, and any tax for which an amount is required to be collected or withheld by a taxpayer from another person, regardless of whether it is in fact collected or withheld." 35 ILCS 735/3-7(f).

2. As noted by the Illinois Supreme Court in *Department of Revenue v. Joseph Bublick & Sons, Inc.*, 68 Ill. 2d 568 (1977), "[t]he 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. There, of course, has to be some responsibility for the stewardship of the funds collected from the public for the State."

3. Prior to the effective date of the UPIA in 1994, the trust fund penalty provision for sales tax was found at 35 ILCS 120/13.5, which was repealed effective January 1, 1994 after the UPIA came into effect. The Use Tax Act expressly incorporates Section 3-7 of the UPIA at 35 ILCS 105/12.

4. 35 ILCS 735/3-7(a).

5. *Purcell v. United States*, 1 F.3d 932, 937 (9th Cir. 1993). Illinois cases have tendency to cite to federal cases arising under Internal Revenue Code Section 6672 (federal trust fund taxes) for guidance in determining Illinois cases on the same subject.

6. *Ghandour v. United States*, 36 Fed. Cl. 53 [78 AFTR 2d 96-5217, 96-5222] (1996).

7. *Godfrey v. United States*, 748 F.2d 1568 (Fed. Cir. 1984).

8. *Id.*

9. *Department of Revenue v. Heartland Inv., Inc.*, 106 Ill. 2d 19, 29, 476 N.E.2d 413, 418 (1985).

10. *Branson v. Department of Revenue*, 168 Ill. 2d 247, 659 N.E.2d 961 (1995).

Irwin Industrial Tool Co. v. IDOR

By Bill Seitz

On January 27, 2010, the Illinois Supreme Court accepted the petition for leave to appeal in *Irwin Industrial Tool Co. v. Department of Revenue*, 394 Ill. App.3d 1002, 915 N.E.2d 789 (1st Dist. 2009).

The Supreme Court will consider whether the appellate court erred in upholding a use tax imposed by the Illinois Department of Revenue on the full value of an aircraft even though it was hangared outside of the state.

The Appellate Court had found that the Department can impose the full use tax at the statutory rate without apportionment.

Background

Irwin had filed complaint in the Circuit Court of Cook County under the Protest Act seeking reimbursement of use tax, penalty and interest paid under protest on the purchase price of an airplane.

Judge White entered summary judgment for taxpayer in part and for Department of Revenue in part. Both parties appealed these findings, contending that summary judgment on both counts should have been made in their favor.

The Appellate Court held in the IDOR's favor on both counts that (1) taxpayer and aircraft had substantial nexus with Illinois as required under the Commerce Clause, and (2) use tax calculated based upon the entire value of the aircraft was externally consistent and thus fairly apportioned.

Substantial nexus

Irwin asserts that because the aircraft spent a nominal amount of time (less than 4 percent of its total ground time) in Illinois, there is no substantial nexus between the aircraft and Illinois so as to permit the Department to impose a use tax on it.

In support, Irwin cites the fact that Irwin's principal place of business is in Nebraska, and the aircraft it purchased was permanently based, hangared, and maintained in Nebraska, only making brief visits to Illinois to drop off or pick up passengers, while continually moving in interstate commerce.

Judge White found for the IDOR: a substantial nexus existed between the aircraft and Illinois so as to subject the Irwin, as the owner of the aircraft, and permit the Department to impose a use tax. This finding was affirmed by the Appellate Court.

Fair apportionment

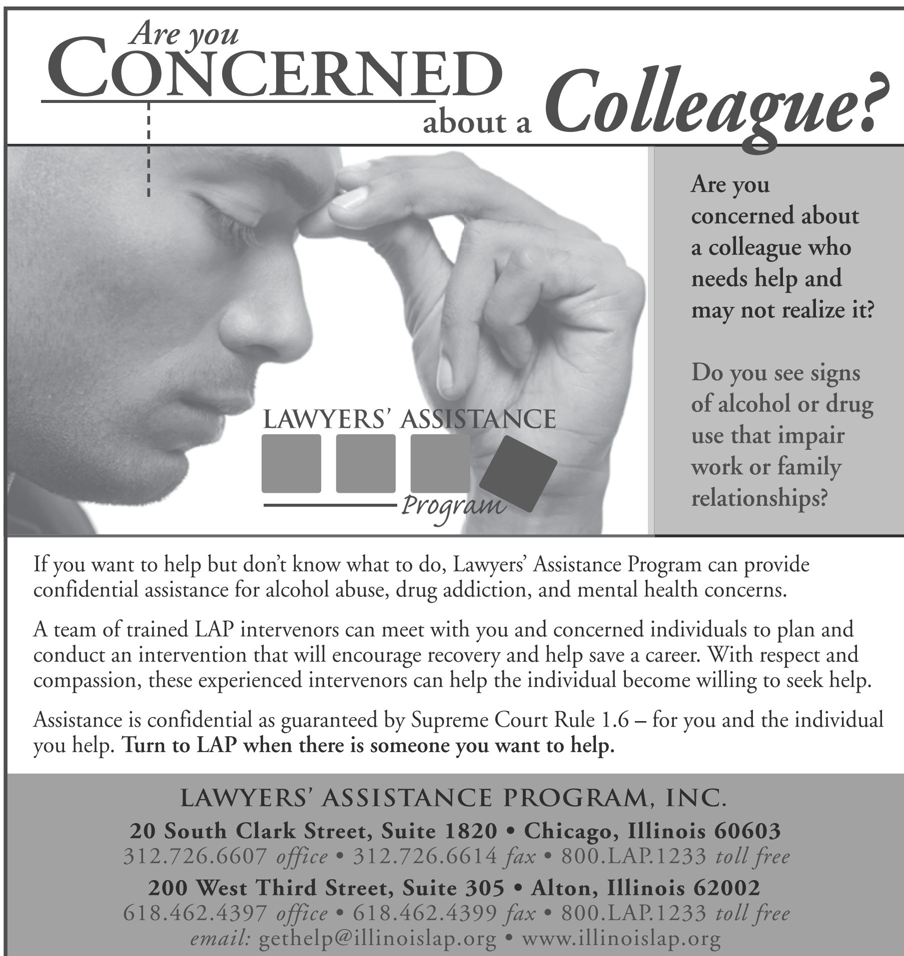
If there is sufficient nexus to impose a use tax, a major issue in the case is external consistency: the degree of relationship between the taxing state and the entity that it wants to tax, i.e., whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State.

In support, Irwin cited the fact that because the plane was permanently hangared and maintained in Nebraska, and traveled to more than 30 states and jurisdictions, spending less than 4 percent of its ground time in Illinois, a tax on the full value of the aircraft does not fairly reflect the in-state component of the activity being taxed.

Judge White found for Irwin on this issue: the Department could tax only 4 percent of the airplane's value based on the percentage of time that the airplane spent on the ground in Illinois.

The circuit court concluded that the amount of tax imposed on the plaintiff was erroneously ascertained because it had been based on the full purchase price of the aircraft. The circuit court held that because the fair apportionment prong of the commerce clause limits any tax the Department can impose to a value that reflects the amount of time the aircraft was actually in Illinois, the more equitable solution would be to tax only the percentage of actual use the aircraft was in Illinois, in this case approximately 4 percent.

This might end up being a case with national implications, as a decision on the Illinois Use Tax will need to look at constitutional limits, substantial nexus, and fair apportionment. (i.e., to survive constitutional scrutiny, a state tax on interstate commerce must be fairly apportioned). ■



Tax Trends

Published at least four times per year.

Annual subscription rate for ISBA members: $20.

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