

ST 11-08
Tax Type: Sales Tax
Issue: Gross ReceiptsAB

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

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

ABC BUSINESS,
Taxpayer

No.
Account ID
Letter ID
Period

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Shepard Smith on behalf of the Illinois Department of Revenue; Thomas Benno, Esq. of Law Office of Thomas Benno, on behalf of ABC Business

Synopsis:

This matter arose from a protest filed by the taxpayer on April 22, 2010 to a Notice of Tax Liability issued to ABC Business ("taxpayer"), by the Department of Revenue ("Department") on March 31, 2010 for taxes assessed under the Retailers' Occupation Tax Act, 35 **ILCS** 120/1, *et seq.*, and related taxes. The issue is whether the taxpayer reported the correct amount of gross receipts from its sales and paid the proper amount of tax incurred on these sales. An evidentiary hearing was held on March 30, 2011 regarding this matter. After reviewing the transcript of the hearing and documents

presented at hearing, I recommend that the Notice of Tax Liability at issue in this case be made final.

Findings of Fact:

1. The taxpayer is a subchapter S corporation doing business in Illinois. Department Group Exhibit (“Ex.”) 1. The Department conducted an audit of the taxpayer's records for period January 1, 2006 through December 31, 2008. *Id.*
2. At the conclusion of the audit, the Department determined that the taxpayer’s actual sales were over 250% higher than its reported sales, and that the taxpayer had underreported sales by over six hundred thousand dollars, which is 80% of gross sales. *Id.* Based upon this determination, the auditor imposed a 50% civil fraud penalty pursuant to 35 ILCS 735/3-6 for the audit period at issue. *Id.*
3. On March 31, 2010, the Department issued a Notice of Tax Liability to the taxpayer assessing tax due in the amount of \$89,664.63 including penalties and interest. *Id.*

Conclusions of Law:

This is a case in which the taxpayer has produced no books, records or other documentary evidence and has presented no testimony in support of its claim that the Department's assessment of liability for unpaid Retailers’ Occupation and related taxes for the period January 1, 2006 through December 31, 2008 is erroneous. Section 4 of the Retailers’ Occupation Tax Act provides that the Department's correction of the taxpayer's returns constitutes *prima facie* proof that tax is due as determined by the Department. 35 ILCS 120/4. In this case, the Department established its *prima facie* case when it

introduced Department Group Exhibit 1 including its Notice of Tax Liability for the tax period in controversy under the Certificate of the Director of the Department. This exhibit, without more, constitutes *prima facie* proof that the taxpayer owes tax in the amount determined by Department. 35 ILCS 120/4. The Department's *prima facie* case is overcome, and the burden shifts to the Department to prove its case, only after the taxpayer presents evidence that is consistent, probable and closely identified with books and records, to show that the Department's determination was not correct. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); A.R. Barnes and Company v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276 (1943). Accordingly, it is well settled that a Notice of Tax Liability as prepared by the Department is a *prima facie* conclusive determination absent documentary evidence to the contrary. Copilevitz, supra; DuPage Liquor Store, supra; Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978); 60 Ill. App. 3d 11 (1st Dist. 1978); Howard Worthington, Inc. v. Department of Revenue, 96 Ill. App. 3d 1132 (2nd Dist. 1981).

At the hearing, the Department established its *prima facie* case by introducing its Notice of Tax Liability and related documents into evidence. The burden thus shifted to the taxpayer to overcome the presumed correctness of the Department's determination. Masini, supra; Anderson v. Department of Revenue, 370 Ill. 225 (1938). However, the taxpayer, by its own admission, has offered no evidence to overcome the Department's *prima facie* case and has conceded that the Department's determination of its tax liability is correct. Tr. pp. 7, 10-12. Therefore, pursuant to the aforementioned case law

authority, I find that the taxpayer has presented insufficient evidence to overcome the *prima facie* correctness of the Department's Notice of Tax Liability at issue in this case.

While the taxpayer (at Tr. p. 7) concedes that the Department's determination of tax liability and related failure to file penalties determined to be due and owing is correct, it specifically objects to the imposition of the fraud penalty pursuant to 35 ILCS 735/3-6 in this case. *Id.* The Department's Notice of Tax Liability does not create a presumption that the Department's fraud penalty is correct, and the burden of proving fraud is upon the Department. Brown Specialty Co. v. Allphin, 75 Ill. App. 3d 845 (3d Dist. 1979). The standard for determining whether a fraud penalty is appropriate is clear and convincing evidence. Puelo v. Department of Revenue, 117 Ill. App. 3d 260, 268 (4th Dist. 1983). Moreover, where civil fraud is alleged, the Department must show intent. Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213 (3d Dist. 1983). However, clear and convincing evidence of an intent to defraud can be circumstantial in nature. Vitale, supra.

The taxpayer maintains that there is no evidence that it deliberately attempted to deceive the Department by keeping deceptive or fraudulent books and records or that amounts reported on its returns were deliberately fabricated. Tr. pp. 10-12. However, under Illinois case law it is not necessary to find overt conduct of the kind the taxpayer claims it did not engage in, showing a deliberate attempt to deceive or mislead the auditor or the Department, to support an inference of fraudulent intent. Admissions that such actions were taken, which would be tantamount to a confession of one's true mental state, are rare. Accordingly, the courts have found the requisite intent from circumstantial evidence of declarations, acts or conduct from which it may fairly be inferred that the

accused acted intentionally. Puelo, supra; People v. L&M Liquors, Inc., 37 Ill. App. 3d 117, 122 (1st Dist. 1976) (“Of course ... [intent]...may be shown by circumstantial evidence”).

In Vitale, supra, the court found the necessary intent from a number of facts having nothing to do with any overt deceptive conduct by the taxpayer. Evidence found sufficient to support a finding of fraud in that case included the court’s finding that the taxpayer purchases significantly exceeded sales and that the taxpayer failed to maintain business records. Vitale, supra at 213. In Puelo, supra, the court, as in Vitale, found circumstantial evidence sufficient to support the fraud penalty where the taxpayer’s purchases exceeded sales during the tax period in controversy and its books and records were inadequate.

In this case there are a number of factors that support a finding of fraudulent intent. The Department’s audit division, in documents included in the record, cites three factual bases for the fraud penalty assessment: (1) despite the fact that the Department previously determined that the taxpayer was noncompliant and imposed a fraud penalty, the taxpayer made no effort to maintain books and records as instructed by the Department or to otherwise improve any of its compliance procedures; (2) the taxpayer’s actual purchases based on information provided by its suppliers substantially exceeded its reported sales; and (3) the taxpayer’s actual sales were over 250% higher than its reported sales, and the taxpayer failed to report 80% of its actual sales (reported sales of \$230,903 versus actual sales of \$835,628). During the hearing, the taxpayer did not contest any of these audit findings. Tr. p. 7.

The factors the audit division has identified constitute the type of clear and convincing evidence of intent to commit fraud recognized by Illinois case law. Specifically, this evidence parallels evidence cited by the court in Vitale, *supra*, where the assessment of a fraud penalty was upheld based upon evidence that the taxpayer's actual sales exceeded reported sales by more than 200%, that the business' purchases exceeded its sales by 46%, and that the business wholly failed to maintain business records as instructed by the Department. Vitale, *supra* at 213. In sum, as in Vitale, *supra*, the huge disparity between gross receipts as reported to the Department by the taxpayer and gross receipts determined by the Department, coupled with the taxpayer's failure to maintain books and records is sufficient indicia of the taxpayer's intent to defraud to sustain the imposition of a fraud penalty in this case. Therefore, the Department's assessment of a fraud penalty must be sustained.

Wherefore, for the reasons stated above, it is my recommendation that the Notice of Tax Liability at issue in this case, including the fraud penalty indicated therein, be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: April 21, 2011