

ST 11-10

Tax Type: Sales Tax

Issue: Gross Receipts

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

THE DEPARTMENT OF REVENUE)	Docket No.
OF THE SZZTE OF ILLINOIS)	Reg. No.
)	NTL Nos.
v.)	
)	
ABC BUSINESS,)	John E. White,
Taxpayer)	Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances:

Jenny Johnson, Matthew Hinderman and Ziemowit Smulkowski, Katten Muchin Rosenman, LLP, appeared for ABC Business; Jessica Arong O'Brien and Mehpara Suleman, Special AssisZZnt Attorneys General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose after the Illinois Department of Revenue (Department) issued four Notices of Tax Liability (NTLs) to ABC Business (Taxpayer), following an audit. The NTLs assessed retailers' occupation Tax (ROT), penalties, and interest, as measured by the gross receipts the Department determined Taxpayer received from selling Tangible personal property at retail during the months of January 2002 through and including December 2006 (hereafter, the audit period). Taxpayer protested those NTLs, and asked for a hearing. In a pre-hearing order, the parties identified the issues to be resolved as whether Taxpayer's gross and net sales were properly determined by the Department for the audit period, and whether the negligence penalty was properly assessed.

At hearing, Taxpayer offered into evidence books and records, as well as the testimony of several witnesses, including the Department's auditor. I have considered the evidence adduced at hearing, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the Director reconsider and revise the Tax, penalties and interest assessed in the NTLs.

Findings of Fact:

1. Taxpayer operates a restaurant in Illinois. Department Ex. 12 (copies of audit reports prepared by the Department's auditor), p. 9 (copy of Auditor's Comments report).
2. Taxpayer is an S corporation, and its two shareholders are John Doe and Jane Doe. Department Exs. 5-7 (copies of, respectively, Taxpayer's 2002 through 2004 federal and Illinois income Tax returns). John Doe owns 23.9% of Taxpayer, and Jane Doe owns 76.1 %. Department Exs. 5-7. Jimmy Doe (Doe), the Doe's son, also considered himself an owner of Taxpayer. Hearing Transcript (Tr.), p. 54 (Doe); *but see* Department Exs. 5-7.
3. The Department conducted an audit of Taxpayer's business for the audit period. Department Ex. 12. Timothy Beavers (Beavers) conducted the audit for the Department. Department Ex. 12, pp. 9-12; Tr. p. 11 (Beavers).
4. Between the date the audit began and the date it was completed, the scope of the audit period, that is, the length of time encompassed by it, increased. Tr. pp. 46-47 (Beavers). At the initiation of the audit, Taxpayer did not have copies of cash register receipts, commonly called z-Tapes, for that part of the audit period prior to July 1, 2004. *See* Department Ex. 12, pp. 9-12. Because Taxpayer did not have such z-Tapes, Beavers could not confirm whether the amounts Taxpayer reported on line 1

of its monthly returns were correct. *Id.*; *see also* 35 ILCS 120/7; 86 Ill. Admin. Code § 130.805. As a result, Beavers estimated Taxpayer's monthly receipts. Department Ex. 12, pp. 9-12.

5. Beavers used a mark-up method to estimate Taxpayer's monthly receipts, which took into account: Taxpayer's purchases of tortillas from its vendor during a six month test period; the number, types, and relative proportion of such tortilla purchases; Taxpayer's cost for such tortillas; the number of tortillas used in different popular menu items; and Taxpayer's selling prices for such menu items. Department Ex. 12, pp. 9-12; Taxpayer Exs. 1-7 (copies of schedules Beavers prepared during the audit); Tr. pp. 13-14 (Beavers).
6. Beavers began the audit by reviewing Taxpayer's purchase invoices for a test period, which consisted of the months of January through June of 2004. Department Ex. 12, p. 10. After that review, Beavers made a schedule of the number of each of the different types of tortillas Taxpayer purchased from XYZ Business, Inc. (ZZ), the vendor from whom Taxpayer purchased tortillas. *Id.*; Taxpayer Exs. 1-2; Tr. pp. 13, 48 (Beavers).
7. One of the reasons Beavers chose the mark-up method using Taxpayer's tortilla purchases is that "it appeared that all of the invoices were on hand for the tortillas that were purchased for the above time period." Department Ex. 12, p. 10.
8. Beavers identified Taxpayer Exhibit 1 as a copy of the schedule he prepared to document Taxpayer's purchases of tortillas for the test period. Taxpayer Ex. 1; Tr. pp. 11, 13 (Beavers).
9. The first two pages of Taxpayer Exhibit 1 set forth what Beavers intended to be an

accurate count of the numbers of cases of the different types of tortillas Taxpayer purchased from ZZ during the test period, as reflected on the purchase invoices. Taxpayer Ex. 1, pp. 1-2; Tr. pp. 17-18 (Beavers). The remaining two pages set forth what Beavers intended to be an accurate schedule of Taxpayer's cost prices for the different types of tortillas it purchased from ZZ on each invoice. Taxpayer Ex. 1, pp. 3-4; Tr. p. 18 (Beavers).

10. Beavers also reviewed the checks Taxpayer wrote and made payable to ZZ during the test period, and beyond. Tr. pp. 11, 14 (Beavers). After that review, he prepared a schedule, a copy of which he identified as Taxpayer Exhibit 2, on which he listed, by date, number, and by their respective amounts, the checks Taxpayer wrote and issued to ZZ for 2002 and 2003, for the last six months of 2004, and for the first half of 2005. Taxpayer Ex. 2; Tr. p. 14 (Beavers).
11. Several of the column entries on the first two pages of the schedule admitted as Taxpayer Exhibit 1 do not accurately identify the number of cases of the different tortillas Taxpayer purchased from ZZ during the test period. *Compare* Taxpayer Ex. 1, pp. 1-2 *with id.* pp. 3-4; Tr. pp. 18-28 (Beavers).
12. The column of Beavers' schedule designated to identify Taxpayer's purchases of number 8 burrito tortillas reflects that Taxpayer purchased a total of 52 such cases. Taxpayer Ex. 1, pp. 1-2. That total consists of the sum of entries where Beavers indicated that Taxpayer purchased 10 cases on each of five separate dates, and entries where Beavers indicated that Taxpayer purchased $\frac{1}{2}$ of a case on each of four separate different dates. *Id.*
13. At hearing, however, and when asked to compare the entries on that column on the

first two pages of Taxpayer Exhibit 1 with the checks written regarding those particular purchase invoices, Beavers acknowledged that Taxpayer paid ZZ \$10 for the number 8 burrito tortillas purchased and documented within each of the invoices he reviewed regarding the first half of 2004. That is, Taxpayer paid ZZ \$10 for the number 8 burrito tortillas it purchased on each of the dates for which Beavers entered the number “10” in the column for number 8 burrito tortillas, and on each of the dates for which Beavers entered the number “.5” in the same column of that schedule. *Compare* Taxpayer Ex. 1, pp. 1-2 *with id.* pp. 3-4.

14. After being asked, at hearing, to compare the first two pages of his schedule (the quantities of different tortillas purchased) with the second two pages (the amounts paid for such tortilla purchases), Beavers agreed that it was more reasonable to conclude that $\frac{1}{2}$ of a case of number 8 burrito tortillas was equal to ten packages of such tortillas than it was to conclude that ZZ sold 10 cases of a product to Taxpayer for the same price that it sold $\frac{1}{2}$ of a case of the identical product to Taxpayer. Tr. pp. 19-20 (Beavers).
15. Beavers acknowledged, at hearing, that whenever he entered the number 10 in the column designated for number 8 burrito tortillas, each such entry should be understood to reflect that Taxpayer purchased 10 packages, and not 10 cases, of such items. Tr. pp. 19-20 (Beavers). Thus, while Taxpayer Exhibit 1 reflects that Taxpayer purchased 52 cases of number 8 burrito tortillas during the first half of 2004, that entry is not correct. Taxpayer Ex. 1, p. 2; Tr. pp. 19-20 (Beavers). Instead, Taxpayer actually purchased only 4.5 cases of such tortillas during that period. *See* Taxpayer Ex. 1, p. 2; Tr. pp. 19-20 (Beavers).

16. Beavers acknowledged that, if he had mistakenly scheduled that Taxpayer purchased 52 cases of number 8 burrito tortillas, when it had actually purchased only 4.5 cases of such items, such an error would substantially impact the results of his audit. *See* Tr. p. 20 (Beavers).
17. After reviewing Taxpayer Exhibit 1 further at hearing, and comparing the number of items purchased in the column designated for number 2 burrito tortillas with the amount Taxpayer paid for such items, Beavers agreed that, when he entered 8 in that column, regarding invoice number 115453 (dated April 8, 2004), that entry should be understood to reflect that Taxpayer purchased 8 packages of such burrito tortillas, and not 8 cases of such items. Tr. pp. 20-21 (Beavers). Thus, the schedule showing that Taxpayer purchased a total of 19 cases of number 2 burrito tortillas during the test period was not correct. *Id.*
18. After reviewing Taxpayer Exhibit 1 further at hearing, and comparing the number of items purchased in the column designated for number 1 burrito tortillas with the amount Taxpayer paid for such items, Beavers agreed that, when he entered 8 in that column, regarding invoice number 204603 (dated March 20, 2004), that entry should be understood to reflect that Taxpayer purchased 8 packages of such tortillas, and not 8 cases of such items. Tr. p. 22 (Beavers). Thus, although Taxpayer Exhibit 1 reflects that Taxpayer purchased 8 cases of number 1 burrito tortillas during the first half of 2004, Beavers agreed that entry was not correct. Taxpayer Ex. 1, pp. 1-2; Tr. pp. 21-22 (Beavers).
19. After comparing, at hearing, the number of items purchased in the column designated for 20 ounce flour tortillas [for enchiladas] with the amount Taxpayer paid for such

items, Beavers agreed that, regarding invoice numbers 408878 (dated March 2, 2004) and 114804 (dated April 9, 2004), when he entered, respectively, 7 and 10 in those columns, those entries should be understood to reflect that Taxpayer purchased 17 packages of such tortillas, and not 17 cases of such items. Tr. pp. 22 (Beavers). Thus, although Taxpayer Exhibit 1 reflects that Taxpayer purchased 20 cases of flour tortillas for enchiladas during the first half of 2004, Beavers agreed that that entry was not correct. Taxpayer Ex. 1, pp. 1-2; Tr. pp. 22-24 (Beavers).

20. Beavers acknowledged that, if he had mistakenly scheduled that Taxpayer purchased 20 cases of flour tortillas for enchiladas, when it had actually purchased only 4 cases and five packages of such items, such an error would substantially impact the results of his audit. *See* Tr. p. 20 (Beavers).

21. Taxpayer Exhibit 1 includes a column Beavers intended to reflect the number of cases of corn tortillas that Taxpayer purchased in the first half of 2004 for use in preparing tacos, and another column which Beavers intended to reflect the number of cases of a different type of corn tortilla that Taxpayer purchased, during the same period, to use to make taco chips. Taxpayer Ex. 1, pp. 1-2; Tr. pp. 22-28 (Beavers). The column designated for corn tortillas purchased and used to make tacos is headed by the words, "corn tortillas 1 dozen 10 oz pkg". Taxpayer Ex. 1. The column designated for corn tortillas purchased and used to make taco chips is headed by the words, "chips 20 lbs". Taxpayer Ex. 1. For ease, I will hereafter refer to those two respective columns as either the tacos column or the chips columns.

22. Beavers was aware that Taxpayer made its own taco chips using a certain type of corn tortilla. Tr. p. 26 (Beavers). He was also aware that the selling/purchase price for

such corn tortillas used to make chips was \$8.60 per case. Tr. p. 26 (Beavers).

23. On pages 3 and 4 of Taxpayer Exhibit 1 (the amounts paid for the different types of tortillas), the entries in the chips column are consistently in amounts that are either \$8.60 or multiples thereof. Taxpayer Ex. 1, pp. 3-4; Tr. pp. 24-26 (Beavers).
24. In contrast, the entries in the tacos column of Taxpayer Exhibit 1 include two different costs per case; either \$9 per case or \$8.60 per case, or multiples thereof. Taxpayer Ex. 1, pp. 3-4; Tr. pp. 24-28 (Beavers).
25. Beavers acknowledged that the purchase invoices he obtained from Taxpayer for the test period, and reviewed prior to preparing Taxpayer Exhibit 1, were completed by hand by the truck driver/deliverers when they stopped to deliver tortillas to Taxpayer at its restaurant. Tr. p. 26 (Beavers). He further acknowledged that the invoices were not completed consistently. *Id.*
26. While Beavers acknowledged that he lacked personal knowledge sufficient to conclude that, whenever Taxpayer purchased an item from ZZ that cost \$8.60 per case, it was purchasing corn tortillas for chips, he agreed that if his schedule reflecting that Taxpayer purchased 187 cases of taco tortillas was mistaken, and that Taxpayer had, in fact, purchased only 51 cases of such tortillas, that would substantially change the outcome of the audit. Tr. p. 28 (Beavers).
27. After completing the schedule of Taxpayer's tortilla purchases from ZZ during the test period, Beavers prepared separate schedules on which he estimated Taxpayer's monthly receipts for different periods within the audit period. Taxpayer Exs. 3-7 (respectively, copies of schedules titled, "Mark-up Analysis" for each of the following periods: 2002; 2003; the first six months of 2004; the last six months of

2004; and 2005); Tr. pp. 13-17 (Beavers). Those schedules took into account the data recorded on Taxpayer Exhibit 1, which Beavers then used to estimate the gross receipts from selling the different menu items that could be sold from the items Taxpayer purchased from ZZ. Taxpayer Exs. 3-7.

28. After preparing the estimates of Taxpayer's expected gross receipts for discrete parts of the entire audit period, Beavers compared the estimated gross receipts with the gross receipts Taxpayer reported on the monthly returns it filed for certain months in the audit period. Department Ex. 10 (copy of schedule of entries reported on the monthly returns Taxpayer filed regarding the audit period); Department Ex. 12, pp. 9-12. Beavers treated the difference between the estimated gross receipts and the reported gross receipts as under-reported gross receipts, and assessed tax on the difference. Taxpayer Exs. 3-7; Department Exs. 12, 15.

29. To estimate Taxpayer's gross receipts for 2006, Beavers took into account the percentage difference between the amounts Taxpayer reported as taxable receipts on the returns it filed during the first six months of 2005, and the amount of the gross receipts Beavers estimated that it had actually received during that period. Department Ex. 12, p. 11; Department Ex. 15 (Beavers' audit schedule titled, Exhibit I). He then projected that Taxpayer's under-reported receipts for 2006 would be consistent with that same percentage. Department Ex. 12, p. 11; Department Ex. 15.

30. In his mark-up schedules/estimates of Taxpayer's gross receipts, Beavers did not estimate that Taxpayer realized any gross receipts from selling the chips it made from a specific type of corn tortilla. Taxpayer Exs. 3-7.

31. After receiving and reviewing Beavers' audit schedules (Taxpayer Exs. 1, 3-7),

Taxpayer took into account what it considered to be flaws on the face of the schedule admitted as Taxpayer Exhibit 1, and caused to have schedules prepared showing how the Department's estimates would be affected if such flaws were corrected. Taxpayer Ex. 21 (copy of schedule titled as being a "Corrected" version of schedule admitted as Taxpayer Ex. 1); Taxpayer Exs. 22-26 (copies of, respectively, schedules titled as being "Corrected" versions of Beavers' schedules estimating Taxpayer's gross receipts for discrete parts of the audit period).

32. The corrected schedules Taxpayer caused to have prepared for this purpose were completed by Luis Garza (Garza), an accountant related by marriage to Taxpayer's shareholders. Tr. pp. 169-70, 172-84 (Garza). When preparing the schedules, Garza used the same methods Beavers used on his estimates of Taxpayer's gross receipts for different parts of the audit period. *Compare* Taxpayer Exs. 3-7 *with* Taxpayer Exs. 22-26; Tr. pp. 178 (Garza).
33. The schedules Garza prepared show that, once the Department's estimates of Taxpayer's gross receipts were revised to eliminate the overstatements of Taxpayer's purchases of different types of tortillas for resale, those estimates show that taxpayer would have realized less gross receipts than the amounts actually reported on the monthly returns Taxpayer filed regarding the audit period. *Compare* Taxpayer Exs. 3-7 *with* Taxpayer Exs. 22-26 *and* Department Ex. 10.
34. During the audit period, Taxpayer purchased, and by July 1, 2004, it began to use, a cash register system that printed daily sales totals in a variety of formats. Taxpayer Ex. 16. Taxpayer kept, and produced for Department review, copies of each of the daily cash register receipts that were produced by that system, for each of the days it

made taxable sales during the months of July 2004 through December 2006. *Id.*

35. At hearing, taxpayer offered copies of each of the daily cash register receipts that were produced by that cash register system, and kept by Taxpayer, for the days it made taxable sales during the months of July 2004 through and including December 2006. Taxpayer Ex. 16. Taxpayer also admitted, as a summary of those voluminous documents, a schedule of the monthly totals from its daily cash register receipts for July 2004 through and including December 2006. Taxpayer Ex. 15.

36. Taxpayer also admitted into evidence, as Taxpayer Exhibit 17, a schedule comparing the monthly totals of its daily z-tapes with the amounts of gross receipts reported on its returns as filed for the same period, which reflects as follows:.

2004	Total Receipts Reported on Sales Tax Returns Per Auditor's Worksheets	Total Receipts Recorded on Z Tapes	Difference Between Sales Tax Returns and Z Tapes
July	22,030	21,083.55	-946.45
August	37,989	38,009.42	20.42
September	22,929	22,935.66	6.66
October	22,274	22,271.09	-2.91
November	23,170	23,168.92	-1.08
December	21,287	21,285.88	-1.12
2004 Total	139,679	138,754.88	-924.48
2005			
January	18,886	18,885.36	-0.64
February	22,965	22,966.59	1.59
March	24,635	24,634.86	-0.14
April	24,973	24,975.46	2.46
May	25,890	25,889.41	-0.59
June	27,434	27,433.01	-0.99
July	30,000	20,634.89	-9,365.11
August	31,465	30,907.44	-548.56
September	27,441	27,186.82	-254.18
October	27,055	26,522.69	-532.31
November	25,686	25,951.48	265.48
December	22,590	24,872.88	2,282.88
2005 Total	309,011	300,860.89	-8,150.11

2006	Total Receipts Reported on Sales Tax Returns Per Auditor's Worksheets	Total Receipts Recorded on Z Tapes	Difference Between Sales Tax Returns and Z Tapes
January	28,775	28,774.47	-0.53
February	27,785	28,550.73	765.73
March	30,889	30,888.64	-0.36
April	28,248	25,319.44	-2,928.56
May	32,050	32,049.57	-0.43
June	31,198	28,064.12	-3,133.88
July	31,000	28,700.30	-2,299.70
August	30,212	29,312.58	-899.42
September	28,020	28,020.10	0.10
October	25,234	24,280.14	-953.86
November	24,876	24,876.05	0.05
December	21,060	23,250.46	2,190.46
2006 Total	339,347	332,086.60	-7,260.40

Taxpayer Ex. 17.

37. After ignoring amounts of less than \$1, the z-tapes Taxpayer admitted show that, for the months of August and September of 2004, February, April, November and December of 2005, and February and December of 2006, Taxpayer's monthly returns reported less gross receipts than are reflected on its monthly z-tape totals. Taxpayer Ex. 17; *see also* Taxpayer Ex. 16. The amount of gross receipts under-reported are as follows:

Month/Year	Difference Between Sales Tax Returns and Z Tapes as per Taxpayer Ex. 17
August/2004	20.42
September/2004	6.66
February/2005	1.59
April/2005	2.46
November/2005	265.48
December/2005	2,282.88
February/2006	765.73
December/2006	2,190.46
Total	\$5,535.68

Taxpayer Ex. 17.

38. Taxpayer produced to the auditor all of its bank statements for the audit period. Tr. pp. 36-37 (Beavers). Taxpayer also offered and had admitted as evidence at hearing, complete copies of its bank statements for the audit period. Taxpayer Ex. 20. Those bank statements included copies of the front of each check drawn on Taxpayer's checking account. *Id.*
39. Prior to hearing, and after the Department issued the NTLs, the Department conducted a re-audit of Taxpayer's books and records, including the daily z-tapes taxpayer made and kept for the period from July 2004 through December 2006. Department Ex. 9 (copies of schedules prepared by Beavers following re-audit); Tr. pp. 333-50 (colloquy during objection to discussion of re-audit results)
40. Following reaudit, an order was entered which provided, in pertinent part: "The Department has completed its re-audit in this matter; and ... has significantly reduced the liability at issue in this matter based on the additional documentation provided to the Department" Order, dated August 31, 2009.
41. After the conclusion of the re-audit, the Department issued a § 7 demand for documents to Taxpayer, through its counsel. Department Ex. 14 (copy of § 7 demand, dated January 26, 2010).
42. At hearing, for its prima facie case, the Department offered into evidence, under the Director's certificate of records, copies of the NTLs, without any re-audit revisions attached as reflecting a more correct, or proper estimate of the amount of tax due. Department Ex. 1; Tr. pp. 387 (Beavers), 475-76 (colloquy).
43. After Taxpayer rested, the Department offered into evidence a copy of schedules Beavers prepared regarding the re-audit. Department Exs. 9, 11.

44. When offering evidence regarding its re-audit results, Department counsel expressly and repeatedly denied that the re-audit schedules reflected any revision of, or correction to, the NTLs, and instead offered them as evidence to rebut the evidence Taxpayer offered during its case-in-chief. Tr. pp. 475-76 (colloquy).

Conclusions of Law:

The Department introduced a copy of the NTLs into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the Retailers' Occupation Tax Act (ROZZ), those documents constitute the Department's prima facie case in this matter. 35 ILCS 120/4, 7. The Department's prima facie case is a rebuttable presumption. 35 ILCS 120/7; Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). A Taxpayer cannot overcome the statutory presumption merely by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217, 577 N.E.2d 1278, 1287 (1st Dist. 1991).

Taxpayer's primary argument is that the audit did not meet a minimum standard of reasonableness. It also asserts that, while it did not have z-tapes for the initial part of the audit period, it kept, maintained and offered into evidence copies of such z-tapes for every

date on which it made retail sales during the period from July 1, 2004 through the end of the audit period. It contends that the amounts of gross receipts identified on those daily z-tapes are consistent with its bank deposits as recorded on its bank statements, which it kept and maintained for the entire audit period, and copies of which bank statements it offered into evidence at hearing. Taxpayer reasons that, since its bank deposits as documented on its bank statements are consistent with the amounts it reported as gross receipts during both the period for which it kept z-tapes, and for the period for which it did not retain daily z-tapes, those bank statements provide a better proxy for its gross receipts than the auditor's flawed estimates, upon which the Department premised its NTLs. Finally, taxpayer contends that no evidence exists to support the Department's assessment of a fraud penalty.

Taking Taxpayer's last argument first, during its rebuttal case, Department counsel advised that the Department was withdrawing the fraud penalty identified on, and assessed within, the NTLs. Tr. p. 259. Since the Department conceded this issue, the NTLs must, at a minimum, be revised to eliminate the fraud penalty assessed.

Taxpayer's primary argument is that the audit conducted here did not meet a minimal standard of reasonableness. On this point I first note that the Department's use of a mark-up method to estimate gross receipts has often been used to estimate what a given Taxpayer might expect to realize by selling the goods it purchases for resale at retail. *See, e.g. Mel-Park Drugs, Inc. v. Department of Revenue*, 218 Ill. App. 3d 203, 216, 577 N.E.2d 1278, 1286 (1st Dist. 1991) (citing cases in which the Department estimated a Taxpayer's gross receipts using a mark-up method). Generally, that audit method takes into account: the goods purchased by the retailer for later sale at retail to customers for use or consumption in Illinois; the Taxpayer's purchase price of such goods; and its mark-up of

such goods, using either the Taxpayer's selling price for such goods or the general mark-up percentage of similar goods. Here, Beavers used the selling prices identified on Taxpayer's menu, for different types of popular menu items, and the number of tortillas used in each such menu item. Taxpayer Exs. 3-7. This general method has long been used by the Department, and has been upheld when the audit method was reasonably applied. *See, e.g., Goldfarb v. Department of Revenue*, 411 Ill. 573, 104 N.E.2d 606 (1952). The question is whether the method was reasonably applied here.

Nature of the Evidence Admitted by Taxpayer

Taxpayer's case focused on its claim that the audit method actually used here was unreasonable because it was premised upon a schedule of Taxpayer's purchases in which the auditor grossly overstated the number of different types of tortillas Taxpayer purchased for resale, and sold at retail. The evidence Taxpayer offered on this point consists of the Department's own audit schedules, as well as Taxpayer's purchase invoice records, which the auditor reviewed when preparing the purchase schedule later admitted as Taxpayer Exhibit 1. Taxpayer Exs. 1, 3-7 (Beavers' schedules), 27 (copies of the purchase invoices Beavers reviewed when preparing the schedule admitted as Taxpayer Exhibit 1). Taxpayer also offered the Department auditor's sworn testimony, during which he acknowledged that his schedule of Taxpayer's tortilla purchases (Taxpayer Ex. 1) overstated Taxpayer's purchases of: number 8 burrito tortillas; number 2 burrito tortillas; number 1 burrito tortillas; and flour tortillas for enchiladas. Tr. pp. 19-24 (Beavers). He overstated Taxpayer's purchases on that schedule when he repeatedly counted Taxpayer's purchases of a given number of packages of different tortillas as though it had purchased the same given number of cases of such items. *Id.*

Taxpayer also asserts that Taxpayer Exhibit 1 contains another significant counting error that renders the Department's estimates of its gross receipts unreasonable. This error, Taxpayer contends, occurred when the Department lumped together two different types of tortillas in one column of Taxpayer Exhibit 1. Specifically, Taxpayer offered evidence to show that the Department's estimates grossly overstated Taxpayer's taxable receipts when Beavers counted some of Taxpayer's purchases of corn tortillas for chips as though they were purchases of corn tortillas for tacos. Beavers' estimates of Taxpayer's gross receipts did not project that Taxpayer realized any gross receipts from selling the chips he acknowledged that Taxpayer made from corn tortillas purchased from ZZ for that purpose. *See* Taxpayer Exs. 3-7; Tr. p. 26 (Beavers). The reason for this is that the Department accepted as true that the tortillas Taxpayer purchased to make chips were not sold, but were instead offered, without charge, to Taxpayer's customers when they sat down to order meals. *See* Taxpayer Exs. 3-7.

On this particular point, however, and while Beavers conceded that Taxpayer Exhibit 1 overstates how many number 8 tortillas, number 2 burrito tortillas, number 1 burrito tortillas, and flour tortillas for enchiladas Taxpayer purchased for resale, he also testified that he lacked personal knowledge sufficient to conclude that he also overstated the number of cases of tortillas that Taxpayer purchased to use to make Tacos. Tr. p. 28 (Beavers). To establish evidence of this particular counting error, therefore, Taxpayer offered the testimony of ZZ's owner, Munoz. But before Munoz took the stand, Beavers acknowledged that the prices ZZ charged for different types of tortillas remained consistent throughout the test period. Tr. pp. 24-26 (Beavers). He also acknowledged that, where a handwritten entry on an invoice clearly denoted a sale or purchase of chips,

the price for such tortillas was consistently \$8.60 per case, or some multiple thereof. *Id.*; Taxpayer Ex. 1. Further, he agreed that the Tacos column on Taxpayer Exhibit 1 is the only column within Taxpayer Exhibit 1 which consistently included two different case prices for what Beavers determined were the same products being purchased during the test period. Tr. p. 25 (Beavers).

Thereafter, Munoz testified that ZZ sold corn tortillas for chips for \$8.60 per case, whereas its selling price for corn tortillas for Tacos was \$9 per case. Tr. p. 147 (Munoz). He said that ZZ did not sell corn tortillas for Tacos at the price of \$8.60 per case. *Id.* Munoz described the differences between the two products, and why corn tortillas made to be deep fried — that is, those purchased to make tortilla chips — would not be suitable to use for Tacos. Tr. pp. 146-47, 155-56 (Munoz). He also explained that ZZ's drivers completed the partially pre-printed purchase orders/invoices by hand, and that, when doing so, the drivers occasionally misidentified the different types of corn tortillas being sold. Tr. pp. 146-49 (Munoz). As examples, Munoz identified invoices on which the driver wrote, by hand, a unit number (of cases) next to the pre-printed row designated for "Corn Tortillas (1 dz. 10 oz. Pkg.)", and then, in the same row, inserted ZZ's price for a corresponding number of cases of corn tortillas for chips. Tr. pp. 146-49 (Munoz); *see also, e.g.*, Taxpayer Ex 27, pp. 1 (invoice number A254403), 3 (invoice number A164633). After reviewing copies of different invoices that Taxpayer had produced to the Department for audit, Munoz identified the type of corn tortillas being sold on each such invoice by reference to the selling prices for such tortillas. Tr. pp. 148-49 (Munoz).

When considering the evidence offered on this issue, it helps to consider the reasoning of Occam's razor, which is basically a rule of logic that asks, "what is the

simplest explanation for this fact situation.” See In re Faith B, 349 Ill. App. 3d 930, 939-40, 812 N.E.2d 640, 648 (2d Dist. 2004). Here, when the Department was counting the number of corn tortillas for Tacos Taxpayer purchased and resold at retail, it determined that Taxpayer purchased the same exact item of property, from the same seller, for two different prices. Taxpayer Ex. 1; Tr. p. 25 (Beavers). To support its determination, the Department points to the invoices, and explains that it counted what the invoices reflected. See Tr. pp. 6 (during the Department’s opening statement, counsel advised that, “The auditor’s assumptions were based on ... what he thought was credible information given to him at the time of the audit”), 25-28 (Beavers). Taxpayer, in contrast, posits that the Tacos column of Taxpayer Exhibit 1 includes two different prices because the Department mistakenly included in that column some of the number of tortillas for chips Taxpayer purchased during the test period, which tortillas the Department agreed Taxpayer did not sell at retail. Tr. pp. 25-28 (Beavers). To explain its position, Taxpayer offered the testimony of Munoz, who owns the business that sold different types of tortillas to Taxpayer, and who described a situation in which hurried delivery drivers inserted, on a partially pre-printed invoice, a handwritten unit number in a row that is designated for one particular type of tortilla, but then wrote a unit price for a different type of tortilla later in the same row. In other words, the owner of the business that employs the different drivers testified, under oath, that some drivers made mistakes when entering the unit numbers and unit prices in the wrong rows on the business’ partially pre-printed invoices, and that the better way to identify the particular product being sold by ZZ on those invoices is by reference to the prices being charged.

Now, I accept that it is possible that the different drivers employed by ZZ were absolutely and perfectly unerring when making hand-written entries on the employer's invoices, and that ZZ's owner, thereafter, either lied or testified in error when he appeared as a witness at hearing and described the nature of ZZ's business practices, and the prices it charged for different items it sold to Taxpayer. But that is not the simplest explanation for the fact situation presented by this record, and I do not accept that possibility as being what actually occurred here. Munoz was a credible witness, and I perceived no bias or unwillingness to accurately narrate his personal knowledge of the facts at issue. Moreover, his testimony is corroborated by the invoices that Taxpayer kept during the audit period, produced for audit, and which invoices were offered and admitted at hearing, by both parties. Taxpayer Ex. 27; Department Ex. 8. His testimony is also consistent with the entries included within the chips column of Taxpayer Exhibit 1, under which Beavers identified the cost price of Taxpayer's purchases on invoices that correctly identified that tortillas for chips were being sold. Taxpayer Ex. 1, pp. 3-4. All such entries are multiples of \$8.60. *Id.*

It is not hard to understand why Beavers originally included, under the Tacos column of Taxpayer Exhibit 1, the number of cases of the particular product described on a particular invoice. But now, when considering the correctness of the Department's determination of how many cases of a particular type of tortilla Taxpayer purchased from ZZ during the test period and actually resold at retail, it would be unreasonable to ignore the credible, competent and unbiased testimony of a witness having personal knowledge of ZZ's business practices, and of the prices at which it actually sold the different types of tortillas to Taxpayer. The Department's statutory duty, when correcting a Taxpayer's

returns, is to use its best judgment and information. 35 ILCS 120/4; Du Page Liquor Store, 383 Ill. at 280, 48 N.E.2d at 927 (“The statute directs that the Department shall ‘correct such return according to its best judgment and information.’”). The competent, credible evidence shows that the audit determination to count some of Taxpayer’s purchases of tortillas for chips as though they were purchases of tortillas for Tacos was incorrect. *See* Taxpayer Exs. 3-7; Tr. pp. 26-28 (Beavers), 146-50 (Munoz).

To the extent that Taxpayer Exhibit 1 — and the Department’s estimates of gross receipts that were based on that schedule — should be considered reliable at all, the admitted and other counting errors included thereon must be corrected by taking into account the best information available to the Department. 35 ILCS 120/4; Du Page Liquor Store, 383 Ill. at 280, 48 N.E.2d at 927. The best information currently available to the Department includes the competent and credible evidence admitted at hearing, which is corroborated by Taxpayer’s purchase invoices that were used to create Taxpayer Exhibit 1. Taxpayer Ex. 27. Taxpayer offered, and had admitted into evidence, schedules prepared by Garza which do just that. Taxpayer Exs. 21-26.

During Taxpayer’s offer of those exhibits, Garza described how he prepared them, and the differences between his schedules and Beavers’ schedules. The first such schedule was admitted as Taxpayer Exhibit 21. Taxpayer Ex. 21. Garza testified that the only two differences between Taxpayer Exhibit 21 and Taxpayer Exhibit 1 is that: (1) Garza’s schedule of Taxpayer’s tortilla purchases corrects Beavers’ admitted overstatements of the number of cases of different tortillas purchased from ZZ during the test period; and (2) Garza’s schedule corrects the error of counting some of Taxpayer’s purchases of tortillas for chips as though they were purchases of tortillas for Tacos.

Taxpayer Ex. 21; Tr. pp. 171-75 (Garza). The remaining schedules, admitted as Taxpayer Exhibits 22-26, correspond to Beavers' estimates of Taxpayer's gross receipts, which were admitted as Taxpayer Exhibits 3-7. *Compare* Taxpayer Exs. 3-7 with Taxpayer Exs. 22-26. Garza testified that, when preparing Taxpayer Exhibits 22-26, he used the exact same procedures and methods that Beavers used when Beavers prepared the schedules admitted as Taxpayer Exhibits 3-7, with the only difference being that Garza's exhibits use Taxpayer's actual purchases during the test period. Tr. pp. 179-84 (Garza).

After being given copies of Garza's schedules for review and comparison with his own schedules, Beavers acknowledged that he could identify no calculation errors on Garza's schedules, other than his disagreement with Garza's elimination of many of the purchases that Beavers had included in the Tacos column of Taxpayer Exhibit 1. Tr. pp. 442-45 (Beavers); *compare also* Taxpayer Ex. 1 with Taxpayer Ex. 21. And Beavers agreed, once again, that his own schedule, Taxpayer Exhibit 1, was flawed and incorrect when it counted purchases of packages of different types of tortillas as case purchases. Tr. p. 444 (Beavers). Garza's schedules reflect that, when the fundamental counting errors included within Taxpayer Exhibit 1 are corrected, and those corrections are then taken into account within the different schedules on which Beavers estimated and projected Taxpayer's gross receipts for the audit period, the resulting estimates of gross receipts are less than the gross receipts reported on Taxpayer's monthly returns. *Compare* Taxpayer Ex. 1 with Taxpayer Ex. 21; *compare also* Taxpayer Exs. 3-7 with Taxpayer Exs. 22-26. This significant reduction in the amount of gross receipts estimated to have been realized by Taxpayer during the audit period cannot come as a surprise to the

Department, given Beavers' acknowledgment that the schedule admitted as Taxpayer Exhibit 1 contained errors that would substantially affect the audit. Tr. pp. 19-24, 28 (Beavers); *see also* Tr. pp. 180-182 (colloquy, during which Department counsel conceded that Taxpayer attached a copy of the schedule admitted as Taxpayer Exhibit 21 to its protest).

At the end of its case, Taxpayer offered into evidence voluminous copies of books and records. The first set of records consists of a copy of a z-tape it made, kept, and previously produced to the Department for review, for every day it made sales at retail, beginning July 1, 2004 through the end of the audit period. Taxpayer Ex. 16. From those voluminous records, Taxpayer caused to have prepared, and offered into evidence, a summary of the entries recorded on the daily z-tapes, in which it totaled the daily gross receipts by month, for every month in audit period from July 2004 through December 2006. Taxpayer Ex. 15. It also offered into evidence copies of all of its bank statements for the audit period. Taxpayer Ex. 26. Finally, it offered into evidence all of the purchase invoices it kept and produced to the auditor, regarding its purchases from ZZ during the test period. Taxpayer Ex. 27.

Did the Evidence Taxpayer Offered Rebut the Department's Prima Facie Case?

The evidence Taxpayer admitted at hearing includes both documentary evidence and competent, credible testimony that was closely identified with Taxpayer's books and records. Thus, this Taxpayer is not like the Taxpayer in Du Page Liquor Store, who kept and produced no books and records for audit, and attempted to rebut the Department's prima facie case using only testimony, and documentary evidence that was not closely related to its books and records. Du Page Liquor Store, 383 Ill. at 278, 48 N.E.2d at 927.

And while Taxpayer concedes that it did not have available z-Tapes for the beginning part of the audit period, it did make, keep, and produce for audit, z-Tapes for every day it was open and made sales after July 1, 2004 through the end of the audit period. Taxpayer Ex. 16. The Department's audit estimates, moreover, were made from Taxpayer's copies of the purchase invoices it received and kept regarding its purchases from ZZ during the test period. Taxpayer offered copies of those purchase invoices into evidence at hearing, and those records conform with the checks Taxpayer wrote to ZZ regarding those purchases. *Compare* Taxpayer Exs. 1-2 *with* Taxpayer Ex. 26. In other words, while Taxpayer agrees that it did not have a complete set of books and records, it retained records sufficient for the Department to conduct its audit, and it offered into evidence the books and records the Department relied upon when conducting that audit, as well as other records. In sum, the documentary and other credible evidence admitted establishes that the Department's audit estimates of Taxpayer's gross receipts were grossly incorrect because of obvious and other counting errors included within the purchase schedule on which those estimates were based.

Regarding Garza's schedules in particular, I cannot agree with the Department's argument that Taxpayer's offer of such schedules constituted an attempt to use or propose an alternate audit method, without any documentary support. Tr. pp. 254-56 (colloquy during the Department's continued objection to admission of Taxpayer's Exhibits 21-26, *citing* Mel-Park Drugs). Since the legislature has granted presumptive correctness to the Department's determinations of tax due, a Taxpayer bears the burden to identify when there has been *any* type of error when making such determinations. 35 ILCS 120/4; Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist.

1981). But pointing out the tax collector's math or counting errors is not an audit method. I presume that accurate counting is an intended component of any audit method, whether used by the Department or anyone else. Garza's schedules merely corrected the errors — many of them acknowledged (Tr. pp. 18-28, 442-45 (Beavers)) — that Taxpayer proved were made when the Department calculated its estimates of Taxpayer's gross receipts for the audit period. Taxpayer Exs. 21-26. Those schedules were based on the same books and records the Department used when making its estimates of Taxpayer's gross receipts, which documents were admitted as evidence at hearing. Taxpayer Ex. 26; Department Ex. 8. Garza also used the same methods the Department used when making its estimates, and Beavers acknowledged that he could discern no errors in his (Garza's) calculations. Tr. pp. 442-44 (Beavers). Thus, Taxpayer established that, once the errors were corrected, the Department's own audit estimates reflected that no additional tax was owed — again, at least based on the Department's estimates.

I conclude that the evidence Taxpayer admitted at hearing rebuts the presumptive correctness of the Department's prima facie case, in one critical respect. *See Young v. Hulman*, 39 Ill. 2d 219, 222, 234 N.E.2d 797, 799 (1968) (holding that the evidence was not sufficient to “disregard the audit in its entirety as the Taxpayer urges.”). At the heart of the Department's prima facie case lie two separate determinations — that Taxpayer under-reported the amount of its gross receipts during the audit period, and the amount of that under-reporting. *See* Department Exs. 1, 12. Taxpayer has offered competent, credible evidence showing that the Department's audit estimate of the amount of the under-reporting was not correct — in fact, it was admittedly incorrect. On the other hand, the evidence also shows that, during certain months during the second half of the audit

period, Taxpayer had more gross receipts than it reported on the returns it filed for such months. Specifically, Taxpayer Exhibit 17 constitutes an admission that for the months of August and September of 2004, February, April, November and December of 2005, and February and December of 2006, Taxpayer's monthly returns reported less gross receipts than are reflected on its monthly z-tape totals. Taxpayer Ex. 17; In re Cook County Treasurer, 166 Ill. App. 3d 373, 379, 519 N.E.2d 1010, 1014 (1st Dist. 1988) (contradictory statements of a party constitute substantive evidence against the party of facts stated). Rounding to the nearest dollar, Taxpayer's own books and records reflect that, for the period for which it made and kept cash register Tapes, it under-reported its gross receipts by the amount of \$5,536. Taxpayer Ex. 17.¹ At a minimum, tax, penalties, and interest are due on that amount. 35 ILCS 120/4; 35 ILCS 735/3-3; 35 ILCS 735/3-5.

But that only accounts for half of the audit period. Regarding the first half, Taxpayer did not have cash register receipts available for review. Taxpayer has argued that, in the absence of such documentation, its bank statements constitute books and records that corroborate Doe's testimony that Taxpayer's true and correct gross receipts were always reported on the returns Taxpayer filed regarding the first half of the audit period. Tr. pp. 507-08, 515-17 (closing argument). On this point, however, while the bank statements constitute competent evidence of the amounts Taxpayer deposited into particular accounts at a particular bank, those bank statements are not sufficient to identify Taxpayer's gross receipts for the first half of the audit period. *See* Taxpayer Exs.

¹ I make no conclusions regarding Taxpayer's records, or Taxpayer Exhibit 17, showing that, during other months from July 2004 through December 2006, it reported on some monthly returns more gross receipts than its cash register receipts showed that it had. That is because this matter does not involve any amended returns that Taxpayer timely filed regarding such months, to claim a credit or refund of such amounts. *See* 35 ILCS 120/6; American Airlines, Inc. v. Department of Revenue, 402 Ill. App. 3d 579, 931 N.E.2d 666, 678-84 (1st Dist. 2009).

18-19 (comparing bank deposits with gross receipts reported on filed returns). For the first half of the audit period, therefore, it remains necessary to estimate such amounts, using the best information available.

Based on the competent and credible evidence offered at hearing, I cannot recommend that the estimate be based on the Department's original audit method. Nor, as discussed more fully *infra*, do I recommend that Taxpayer's receipts be estimated using the approach taken during the re-audit the Department conducted, prior to hearing, but which it then rejected as not reflecting a more correct estimate of Taxpayer's gross receipts. *See* Tr. pp. 387, 456 (Beavers), 475-76 (colloquy). Instead, I recommend that Taxpayer's gross receipts for the first half of the audit period be estimated by reference to Taxpayer's demonstrated level of under-reporting during the second half of the audit period. This estimate is particularly easy in this case, since the period for which Taxpayer kept cash register Tapes is exactly half of the audit period.

The best available documentary evidence shows that Taxpayer under-reported gross receipts by the amount of \$5,536 during the second half of the audit period. Taxpayer Ex. 17. Based on that evidence, and the corresponding absence of books and records that document its daily gross sales, it is not unreasonable to estimate that Taxpayer had a similar level of under-reporting for the first half of the audit period. Therefore, I recommend that, for the entire audit period, Taxpayer be found to have under-reported gross receipts in the amount of \$11,072 ($5,536 \times 2$), and that tax, penalties and interest be assessed on that amount of under-reported receipts. To be sure, this estimate is rough, but it is rough because of the combination of Taxpayer's failure to document its daily sales for half of the audit period, and the basic counting errors

Taxpayer proved the Department made when estimating Taxpayer's gross receipts for the entire audit period using the mark-up method.

As a final note regarding penalties, § 3-5 of the Uniform Penalty and Interest Act (UPIA) provides:

§ 3-5. Penalty for negligence. (a) If any return or amended return is prepared negligently, but without intent to defraud, and filed, in addition to any penalty imposed under Section 3-3 of this Act, [FN1] a penalty shall be imposed in an amount equal to 10% of any resulting deficiency.

(b) Negligence includes any failure to make a reasonable attempt to comply with the provisions of any Tax Act and includes careless, reckless, or intentional disregard of the law or rules.

(c) Penalty for negligence shall not apply where an assessment results from a reasonable difference of opinion as to taxability.

35 ILCS 735/3-5. While the legislature has authorized the abatement of certain penalties for reasonable cause, the negligence penalty is not one of them. 35 ILCS 735/3-8.

A Taxpayer bears the burden to show that it is not liable for tax penalties. *E.g.*, PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 18-19, 765 N.E.2d 34, 36-37 (1st Dist. 2002). Here, Taxpayer offered no evidence to explain why, during the second half of the audit period, it reported less receipts on some of its monthly returns than were reflected on its cash register Tapes regarding those months. Taxpayer Ex. 17; 35 ILCS 735/3-5(a). Further, even assuming the truth of Taxpayer's claim that it made and kept z-Tapes for the first half of the audit period, but that they were lost in a flood, the fact that the loss occurred means that Taxpayer neglected to maintain and secure critical business records the law required it to keep. 35 ILCS 735/3-5(b); 86 Ill. Admin.

Code § 700.320(b). I agree that the evidence supports the imposition of the negligence penalty on the gross receipts determined to have been under-reported. 35 ILCS 735/3-5.

After Taxpayer Rebutted the Department's Prima Facie Case, Did the Department Show, By a Preponderance of the Competent Evidence, that Its Determinations of tax Due Were Correct?

After a Taxpayer has offered evidence sufficient to rebut the Department's prima facie case, the burden shifts back to the Department to prove its case by a preponderance of the competent evidence. *See Novicki v. Department of Finance*, 373 Ill. 342, 345-46, 26 N.E.2d 130, 132 (1940). During the Department's rebuttal, it first called Doe as an adverse witness. Tr. pp. 260-89 (Doe). Thereafter, the Department offered into evidence a demand for books and records authorized by § 7 of the ROZZ, which it served to Taxpayer following re-audit. Tr. pp. 298-310. That demand letter was offered by the Department to show that its audit methods were applied reasonably. Tr. p. 309; *but see* 35 ILCS 120/7. It next called Beavers, through whom it offered into evidence, under the certificate of the Director, several schedules he prepared during the original audit (Department Exs. 10, 12, 15), and others he prepared regarding the re-audit. Department Exs. 9, 11, 13. During his rebuttal testimony, Beavers explained in detail the methods he used during the audit, including the steps he used to estimate what he determined was Taxpayer's under-reporting of gross receipts. He also explained the nature of the Department's re-audit, during which he reviewed the z-Tapes Taxpayer produced to the Department for review. Although the Department offered several schedules Beavers prepared during the course of the re-audit, the Department expressly and repeatedly denied that such schedules constituted any correction to, or revision of, the original corrections of returns and NTLs that constituted its prima facie case. Tr. pp. 336-37, 340,

475-76 (colloquy). Instead, the re-audit schedules were offered to rebut the credibility of the z-Tapes offered into evidence by Taxpayer. Tr. pp. 344-45, 475-76.

I first address the Department's arguments regarding the effect of its § 7 demand letter, Department Exhibit 14. Section 7 of the ROZZ provides, in pertinent part:

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable. In the course of any audit or investigation or hearing by the Department with reference to a given Taxpayer, if the Department finds that the Taxpayer lacks documentary evidence needed to support the Taxpayer's claim to exemption from tax hereunder, the Department is authorized to notify the Taxpayer in writing to produce such evidence, and the Taxpayer shall have 60 days subject to the right in the Department to extend this period either on request for good cause shown or on its own motion from the date when such notice is sent to the Taxpayer by certified or registered mail (or delivered to the Taxpayer if the notice is served personally) in which to obtain and produce such evidence for the Department's inspection, failing which the matter shall be closed, and the transaction shall be conclusively presumed to be taxable hereunder.

35 ILCS 120/7.

The Department's § 7 letter was initially referred to during its objection to Taxpayer's identification of Garza's schedules, which were admitted as Taxpayer Exhibits 22-26. Tr. pp. 180-82. Later, the Department explained that its letter was being offered to show that the audit method it applied was reasonable. Tr. pp. 308-09. Either way, the Department's argument seems to misapprehend the function of § 7. First, Garza's schedules are not Taxpayer's books and records. Rather, they are math calculations that Garza personally prepared, and which Taxpayer offered as evidence to show how correcting the errors included within the Department's original audit schedules

would significantly affect the Department's estimates of Taxpayer's gross receipts. *See* Tr. pp. 18-28 (Beavers), 170-80 (Garza). Further, § 7 says nothing about having the conclusive presumption described therein apply to prevent a Taxpayer from offering evidence showing that the Department, in a particular case, committed fundamental counting errors when conducting an audit. 35 ILCS 120/7. Thus, I cannot agree that § 7, or the Department's demand for documents (Department Ex. 14), operates to render any determination the Department made here conclusively correct.

Moving on to the other aspects of the Department's rebuttal, the re-audit schedules do not constitute competent evidence that Taxpayer actually realized the receipts that the Department estimated that it did. First, while the Department's regularly kept books and records can be admitted at any hearing held under the ROTA, when offered under the Director's certificate of records (35 ILCS 120/8), the Illinois General has also specifically identified the types of agency determinations to which it has granted a statutory presumption of correctness. *E.g.* 35 ILCS 120/4 (Department's correction of returns and NTL are prima facie correct), 6b (Department's Notice of Tentative Determination of Claim is prima facie correct). The Department chose not to adopt Beavers' re-audit determinations as its prima facie case, or as a revised, corrected, or better statement of the amount of tax determined to be due. Tr. pp. 336-37, 340, 475-76. Thus, the Department's re-audit estimates of Taxpayer's gross receipts were never cloaked with the statutory presumption of correctness that attaches to the Department's prima facie case. 35 ILCS 120/4. Nor did those schedules acquire that statutory presumption merely because they were admitted into evidence under the certificate of the Director. *Compare* 35 ILCS 120/4 *and* 35 ILCS 120/6b *with* 35 ILCS 120/8.

The NTLs the Department offered as its prima facie case were based on the auditor's original audit schedules, and were presumptively correct when offered under the certificate of the Director. 35 ILCS 120/3. But that presumption vanished after being rebutted by the documentary and other evidence Taxpayer offered to show: (1) how the original audit was fundamentally flawed due to basic counting errors; and (2) when the Department's original estimates of Taxpayer's gross receipts were corrected to eliminate the demonstrated errors, the Department's own audit method shows that Taxpayer did not under-report its receipts in the amount determined by the Department. Taxpayer Exs. 21-26; Franciscan Sisters Health Care Corp. v. Dean, 95 Ill. 2d 452, 462, 448 N.E.2d 872, 877 (1983) ("The prevailing theory regarding presumptions that Illinois follows ... is [the] bursting-bubble hypothesis: once evidence is introduced contrary to the presumption, the bubble bursts and the presumption vanishes."); Goldfarb, 411 Ill. at 580, 104 N.E.2d a 608 ("The rule ... is that the corrected return is prima facie correct but when the prima facie presumption is overcome the Department has the burden of proving its case by a preponderance of competent evidence.").

When the burden shifts back to the Department to prove its determination that tax is owed by a preponderance of the competent evidence, its audit estimates no longer constitute competent evidence of a Taxpayer's receipts. The Department's auditor has no personal knowledge of Taxpayer's actual gross receipts for the months during the audit period. Without such personal knowledge, his written mathematical estimates of what they might have been, based on his personal review of Taxpayer's z-Tapes and other data, are just surmise, even though the written estimates, themselves, are admissible as

evidence under the certificate of the Director. *See Goldfarb*, 411 Ill. at 580, 104 N.E.2d at 608; *Novicki*, 373 Ill. at 345-46, 26 N.E.2d at 132.

Finally, the fundamental position taken during the re-audit was that the daily z-Tapes produced by Taxpayer for review did not satisfy the ROT regulation which describes the type of books and records that are required to show daily gross sales. The applicable regulation is found at 86 Ill. Admin. Code § 130.805(a), and provides, in pertinent part:

Section 130.805 What Records Constitute Minimum Requirement

a) In General. A Taxpayer shall maintain all records that are necessary to a determination of the correct tax liability under the Act. All required records must be made available on request by the Department. Where a Taxpayer's business consists exclusively of the sale of tangible personal property at retail, the following records will be deemed by the Department to constitute a minimum for the purposes of the Act:

- 1) Cash register Tapes and other data which will provide a daily record of the gross amount of sales.
- 2) A record of the amount of merchandise purchased. To fulfill this requirement, copies of all vendors' invoices and Taxpayers' copies of purchase orders must be retained serially and in sequence as to date.
- 3) A true and complete inventory of the value of stock on hand taken at least once each year.

86 Ill. Admin. Code § 130.805(a). During the re-audit, the Department determined that the daily z-Tapes Taxpayer produced were not reliable (Tr. pp. 374-79, 447-56 (Beavers)), and it argued at hearing that they did not satisfy the first type of records the regulation requires a retailer to keep, that is, cash register Tapes and other data which will provide a daily record of the gross amount of sales. Tr. pp. 509-12 (closing argument).

This argument has been made before. *E.g.*, *Goldfarb*, 411 Ill. at 580, 104 N.E.2d at 608. In certain respects the argument conflates the different requirements regarding

records necessary to document daily gross sales and those necessary to document particular transactions claimed as being exempt from, or not subject to, Tax. The latter requirements are described in 86 Ill. Admin. Code § 130.810, which provides, in pertinent part:

Section 130.810 Records Required to Support Deductions

b) To support deductions made on the Tax return form, as authorized under the Act, on account of receipts from isolated or occasional sales of tangible personal property, on account of receipts from sales of Tangible personal property for resale, on account of receipts from sales of Tangible personal property made within the protection of the Commerce Clause of the Constitution of the United States, on account of receipts received by the seller from sales made to any corporation, society, association, foundation or institution organized and operated exclusively for charitable, religious or educational purposes, on account of receipts received by the seller from sales made on or after March 21, 1963, to any governmental body or on any other ground, entries in any books, records or other pertinent papers or documents of the Taxpayer in relation thereto shall be in detail sufficient to show the name and address of the Taxpayer's customer in each such transaction, the character of every such transaction (whether it is a sale for resale, a sale made within the protection of the Commerce Clause of the Constitution of the United States, an isolated or occasional sale, etc.), the date of every such transaction, the amount of receipts realized from every such transaction and such other information as may be necessary to establish the nonTaxable character of such transaction under the Act

86 Ill. Admin. Code § 130.810(b).

Again, the distinction apparent between the two different regulations is that more documentation is needed to show that specific transactions or gross receipts are exempt from Tax, than is needed to show the amount of the Taxpayer's daily gross sales. During re-audit, Beavers rejected the z-Tapes' statements of Taxpayer's daily gross sales receipts because they were not accompanied by each and every guest check written by Taxpayer's wait staff, to identify the receipts from each and every sale of food or drink at retail during that particular day. *See* Tr. pp. 374-84, 447-56 (Beavers), 509-12 (closing

argument). Instead, Taxpayer kept, and produced for re-audit, only those guest checks for which a customer paid via credit card. *See* Tr. pp. 374-84 (Beavers).

Here, the Department's argument why it did not consider reliable the daily z-Tapes Taxpayer produced for re-audit, and offered into evidence at hearing (Taxpayer Ex. 16), is similar to the Department's argument in Goldfarb. There, the Department argued that the Taxpayer's records of daily sales were not reliable, in part, because Taxpayer did not retain receipts showing that it sold items of clothing to customers for less than the list prices Taxpayer gave the Department, after being asked to identify its selling prices for commonly sold clothing items. Goldfarb, 411 Ill. at 578, 104 N.E.2d at 608. Here, the Department argues that Taxpayer's records of its daily gross sales are not reliable because Taxpayer did not retain each and every guest check its wait staff wrote regarding that period. Tr. pp. 374-84 (Beavers), 509-11 (closing argument). Thus, in both Goldfarb and in this case, the Department sought to dismiss a Taxpayer's documented record of daily sales because the Taxpayer did not also have additional documentation regarding each and every sale it made. And again, this documentation is not demanded as being necessary to support the Taxpayer's claim that a particular transaction was exempt from Tax; it is documentation that the Department asserts is necessary before it will consider reliable the Taxpayer's documented daily gross sales.

After considering the z-Tapes Taxpayer admitted at hearing, I cannot agree that they fail to "provide a daily record of the gross amount of [Taxpayer's] sales." 86 Ill. Admin. Code § 130.805(a)(1). Especially where the Department has expressly refused to adopt the particular re-audit schedules admitted here as its prima facie case (Tr. pp. 387, 456 (Beavers), 475-76 (colloquy)), I cannot recommend that the Director consider those

re-audit schedules as being more competent or reliable evidence of Taxpayer's gross receipts than Taxpayer's own documented record of its daily sales. *Compare* 35 ILCS 120/4, 6b *with* 35 ILCS 120/8. And since Taxpayer has proven that, once corrected, the audit method the Department used to measure the Tax shown due on the NTLs shows that Taxpayer did *not* under-report its gross receipts to the extent the Department estimated it did (Taxpayer Exs. 21-26), Taxpayer's z-Tapes remain the only competent, documentary evidence which supports the Department's fundamental determination that Taxpayer did, in fact, realize more receipts than it reported on its monthly returns. Taxpayer Ex. 17.

I conclude that the Department has not proven, by a preponderance of the competent evidence, that Taxpayer owes the amount of Tax, penalties and interest identified in the NTLs. Goldfarb, 411 Ill. at 580, 104 N.E.2d at 608.

Conclusion:

I recommend that the Director revise the NTLs to eliminate all Tax, penalties and interest but for the amounts of Tax, penalties and interest due on the \$11,072 of under-reported receipts shown, by this record, to have occurred. I recommend that the NTLs be finalized as so revised, with late payment and negligence penalties, plus statutory interest, imposed on such under-reported receipts.

January 21, 2011

John E. White

Administrative Law Judge