

ST 08-18

Tax Type: Sales Tax

Issue: Reasonable Cause nOn Application Of Penalties

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

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

v.

**ABC BUILDING PRODUCTS, LLC,
TAXPAYER.**

) **No.: 07-ST-0000**
) **IBT No.: 0000-0000**
) **NTL Nos.: 00 00000000000000**
) **00 00000000000000**
) **00 00000000000000**
) **00 00000000000000**
) **Julie-April Montgomery**
) **Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: M. Scott Wilson of Collins & Scanlon, LLP, on behalf of ABC Building Products, LLC, Shepard K. Smith, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

The Illinois Department of Revenue (“Department”) issued four Notices of Tax Liability (“NTLs”) to ABC Building Products, LLC (“Taxpayer”) on December 21, 2006 covering the audit period January 1, 2002, through August 31, 2005, which assessed retailers’ occupation tax (“ROT”) for tax collected but not reported as well as tax due for unwarranted resale transactions. Taxpayer protested all four NTLs and requested a hearing in the matter. The parties stated that the issues relative to a determination of Taxpayer’s alleged liability to be whether: 1) Taxpayer is liable for unreported ROT/UT receipts in the tax amount of \$789 plus statutory interest; 2) Taxpayer is entitled to a deduction for sales for resale so as to not owe tax of \$38,883 plus statutory interest; 3)

Taxpayer can demonstrate “reasonable cause” to warrant relief from the late filing and late payment penalties assessed; 4) it is appropriate to have the interest and penalty assessed for the amnesty period of January 1, 2002 through June 30, 2002 doubled; 5) the Department followed appropriate procedures in the conduct of the audit of Taxpayer; and 6) Taxpayer had unauthorized personnel assisting in the conduct of the audit. December 20, 2007 Order. Taxpayer presented documentary evidence as well as the testimony of John Doe, the CFO of Doe Companies, LLC, which is a professional consulting firm that engages in crisis management for troubled companies. Tr. pp. 10, 11. Following a review of the testimony and the evidence, it is recommended that the NTLs be finalized as issued. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the four NTLs, issued December 21, 2006 reflecting unpaid retailers’ occupation tax, penalties and interest, covering the audit period January 1, 2002, through August 31, 2005. Dept. Ex. No. 1; Tr. p. 9.
2. Taxpayer, through its Controller and Accounting Manager, XXXX, agreed to and insisted upon projection of a randomly selected two month block sample for a determination of Taxpayer’s taxable sales because of “poor record keeping in prior years and the fact that the customers really did not change.” Dept. Ex. No. 2, p. 5 (Audit Comments, Sales Exam), p. 29 (Agreement Authorizing Test Check/Statistical Sampling Audit); Tr. pp. 42, 49-51, 69, 70.
3. Taxpayer, through its Account Manager and Officer, XXXXX, agreed to a projection of a randomly selected three month block sample to determine Taxpayer’s consumable supplies.

Dept. Ex. No. 2, pp. 5, 6 (Audit Comments, Purchase Exam), p. 30 (Agreement Authorizing Test Check/Statistical Sampling Audit); Tr. pp. 40, 41, 44, 45, 47.

4. Transactions where Taxpayer lacked both valid registration/resale certificates and certifications that the sales were sales for resale were not allowed the resale exemption. Dept. Ex. No. 2, p. 5 (Audit Comments, Sales Exam), pp. 23-28 (Global Taxable Exceptions); Tr. pp. 67-69.

Conclusions of Law:

Section 4 of the Retailers' Occupation Tax Act, (35 ILCS 120/1 *et seq.*), provides that the NTL issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due. *Id.* at 120/4. Once the Department has established its *prima facie* case by submitting the NTL into evidence, the burden shifts to the taxpayer to overcome the presumption of validity attached to the established *prima facie* case. Clark Oil & Refining v. Johnson, 154 Ill. App. 3d 773 (1st Dist. 1987).

In order to overcome the presumption of validity attached to the NTL, the taxpayer must produce competent evidence, identified with its book and records showing that the NTL is incorrect. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991). Documentary proof is required to prevail against an assessment of tax by the Department. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990).

At hearing, the Department introduced copies of the four NTLs under the certificate of the Director. These four NTLs assessed ROT for two reasons. The first reason for Taxpayer's ROT assessment was the collection of \$789 in tax that was not reported. The second reason for the NTLs was erroneously claimed resale transactions that amounted to \$38,883 in tax.

Taxpayer failed to offer evidence, documentary or testimonial, to rebut the Department's *prima facie* case regarding the Department's assessment of \$789 in unreported tax. Hence, Taxpayer has not satisfied its legal burden of overcoming the presumption of validity that this \$789 in unreported tax due is incorrect.

Section 1 of the Retailers' Occupation Tax Act ("ROTA") defines "sale at retail" as including "any transfer, made for or without a valuable consideration, for resale in any form as tangible personal property unless made in compliance with Section 2c of this Act." 35 ILCS 120/1. Section 2c requires that a purchaser who claims to be a reseller must apply for a resale number which will be issued by the Department after it receives sufficient information from the purchaser about its resale operations. 35 ILCS 120/2c. Section 2c also states that no sale shall be made tax-free on the ground of being a sale for resale unless the "purchaser has an active registration number or resale number from the Department and furnishes that number to the seller in connection with certifying to the seller that any sale to such purchaser is nontaxable because of being a sale for resale." *Id.* Section 2c further provides that "[f]ailure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller's sales are sale for resale, or that a particular sale is a sale or resale." *Id.* However the "other evidence" necessary to overcome the presumption that the transaction is taxable because it is a sale for resale must be documentary in nature. 86 Ill. Admin. Code Sec. 130.810(c). Oral testimony is insufficient. Jefferson Ice Co. v. Johnson, 139 Ill. App. 3d 626 (1st Dist. 1985).

The language of the statute is clear. The ROTA considers any transfer of personal property for resale to be a "sale at retail" unless that sale is made in compliance with Section 2c. Compliance with Section 2c requires that the purchaser have a registration/resale number with a certification

that the sale is a sale for resale or other documentary proof of a sale for resale. So the critical inquiry is whether Taxpayer supported its claim that the disputed resale transactions were in fact sales for resale. Such a claim is determined by the documentation Taxpayer presents to support the existence of resale transactions. At no time in the proceedings did Taxpayer produce, or claim to have, the statutorily required evidence of the disallowed purchasers' approved resale status. Section 2c creates an exemption to the ROTA's broad construction of "sale at retail" and such exemptions are to be strictly construed in favor of taxation. People ex rel. County Collector v. Hopedale Medical Foundation, 46 Ill. 2d 450 (1970). Once the Department established its *prima facie* case, the burden shifted to Taxpayer to show that the disallowed sales for resale were exempt. Taxpayer could only meet this burden by showing compliance with Section 2c and producing evidence of the registration/resale numbers along with the certification that the sale was a sale for resale or other documentary evidence. Dearborn Wholesale Grocers v. Whittler, 74 Ill. App. 3d 813 (1st Dist. 1979).

Taxpayer failed to offer documents that reflected compliance with Section 2c of the ROTA to rebut the Department's *prima facie* case as to the resale transactions that resulted in \$38,883 in tax being due. This lack of documentation makes clear that Taxpayer again failed to satisfy its legal burden of overcoming the presumption of validity attached to the \$38,883 assessed for unsubstantiated resale transactions. There having been no compliance with the ROTA statute, Taxpayer is not entitled to the benefit of the resale exemption.

Section 3 of the ROTA requires the filing of monthly returns and the accompanying payment of whatever tax is due not later than the twentieth day of the following calendar month for transactions that occurred in the preceding calendar month. 35 ILCS 120/3. Section 5 of the ROTA permits the Department to assess penalties in accordance with Illinois' Uniformity Penalty

and Interest Act, 35 ILCS 735/3-1 *et seq.* (“UPIA”). 35 ILCS 120/5. Section 3-3(a-10) of the UPIA authorizes the assessment of a 2% late filing penalty for failure to file a tax return on or before the prescribed due date. 35 ILCS 735/3(a-10). The UPIA also authorizes the assessment of late payment penalties for failure to remit tax on or before the prescribed due date. 35 ILCS 735/3(b-10)(1), (b-15), (b-20)(1). Section 3-8 of the UPIA also provides that these penalties “shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause.” 35 ILCS 735/3-8.

The Department has adopted a regulation regarding reasonable cause which provides that “[t]he determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.” 86 Ill. Admin. Code Sec. 700.400(b).

Taxpayer proffered no arguments or evidence, documentary or testimonial, as to the existence of any reasonable cause for abatement of the late filing and late payment penalties assessed. Moreover, Taxpayer presented no arguments or evidence of any good faith efforts exerted to determine its tax liability as well as timely file and pay the tax due. Hence, these penalties must be affirmed.

In 2003, the Tax Delinquency Amnesty Act (35 ILCS 745/1 *et seq.*) provided a taxpayer with the opportunity to pay any outstanding taxes, free of interest and penalties, for periods that ended after June 30, 1983 but before July 1, 2002. 35 ILCS 745/10. If a taxpayer failed to pay taxes eligible for amnesty during the period of October 1, 2003 through November 15, 2003, the

UPIA provides that such a taxpayer would be subject to double interest and penalties for taxes that would have qualified for amnesty. 35 ILCS 735/3-2(f), 3-3(i).

Taxpayer has been assessed tax for the period January 1, 2002 through August 31, 2005. The period January 1, 2002 through June 30, 2002 would have been subject to amnesty. There is no evidence to show that Taxpayer availed itself of the amnesty and paid the outstanding taxes due. Taxpayer's failure to partake of the amnesty, when it had outstanding taxes eligible for such a program, subject Taxpayer to the double interest and penalty provisions of the UPIA. In addition, Taxpayer made no arguments nor presented any evidence on this issue. Thus, the double interest and penalties associated with Taxpayer's tax liability for the period January 1, 2002 through June 30, 2002 should also be affirmed.

Taxpayer alleges the Department "followed inappropriate procedures" (December 20, 2007 Order) when it conducted the audit. Taxpayer's argument on this point appears to be only with respect to the resale transactions aspect of the audit because Taxpayer argues that the Department's two month block sampling methodology for sales was "not adequate" (tr. p. 8), and as such, Taxpayer's sales attributed to Illinois were "inflated" (*id.*) because resale transactions were not recognized as not subject to tax. Tr. pp. 8, 96, 97. As previously stated, Taxpayer failed to comply with the statutory requirements of the ROTA to overcome the Department's *prima facie* case on this issue.

Taxpayer's challenge of the audit sample with regard to sales for resale is to be rejected for various reasons. First, Taxpayer admitted it had poor records. Second, Taxpayer insisted and agreed to the sample. Third, the sample utilized Taxpayer's own books and records. Tr. pp. 54-56. Moreover, Taxpayer was unable to establish that the sample was not random as the evidence of the Department indicated. Furthermore, the testimony of the outside consultant was merely the

consultant's belief that a better method to perform the audit existed. The consultant's testimony failed to address if his beliefs considered, as did the auditor and Taxpayer during the course of the actual audit, Taxpayer's recordkeeping, available books and records, and customer base. Taxpayer's questioning of the Department's reasons for choice of audit months as well as Taxpayer's assertion that recognition of transactions with XYZ¹ as resales would have decreased the amount of tax due by 50% (tr. p.73) carries no weight because "[n]one of the hypothetical situations offered were identified with the taxpayer's records so as to demonstrate that the corrected returns of the Department were inaccurate." Vitale v. Illinois Department of Revenue, 118 Ill. App. 3d 210, 213 (3rd Dist. 1983). Taxpayer does not "overcome the Department's *prima facie* case merely by denying the Department's case or by suggesting hypothetical weaknesses. He must establish by documentary evidence that the hypothetical weaknesses are relevant to his business." *Id.*

Taxpayer questioned the audit methodology and choices made by the Department but was unable to refute evidence that Taxpayer had agreed to the audit methodology and sample months utilized to establish the liability at issue in these proceedings. Moreover, Taxpayer presented no evidence, in the form of documents or testimony associated with its books and records, in support of these allegations. Taxpayer's mere questioning of the Department's actions is legally insufficient to satisfy Taxpayer's legal burden to rebut the Department's *prima facie* case.

Taxpayer also alleged that the Department may not have worked with individuals either employed or authorized by it to assist with the audit. December 20, 2007 Order. Taxpayer produced no documentary evidence in support of this allegation. No employees or officers of Taxpayer testified on this issue. No evidence was introduced which contradicted the documentary

¹ XYZ is a particular customer of Taxpayer.

and testimonial evidence that the auditor was assisted by employees and representatives of Taxpayer. Again, Taxpayer failed to rebut the Department's *prima facie* case.

Conclusion:

WHEREFORE, for the reasons stated above, it is recommended that all four (4) NTLs be finalized as issued.

August 20, 2008

Julie-April Montgomery
Administrative Law Judge