

**ST 15-04**

**Tax Type: Sales Tax**

**Tax Issue: Propriety of Penalty and Audit Methodologies and/or Other Computational Issues**

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

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<b>THE DEPARTMENT OF REVENUE</b>	)	Docket No.	XXXX
<b>OF THE STATE OF ILLINOIS</b>	)	Account No.	XXXX
<b>v.</b>	)	NTL Nos.	XXXX
<b>JOHN DOE, d/b/a</b>	)		XXXX
ABC Business,	)	Kenneth J. Galvin	
<b>Taxpayer</b>	)	Administrative Law Judge	

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**DIRECTOR'S DECISION**

**Appearances:** William P. Drew III, William P. Drew, Inc., appeared for John Doe; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

**Synopsis:**

This matter involves two Notices of Tax Liability (NTLs) the Illinois Department of Revenue (Department) issued to John Doe (Taxpayer), following an audit of Taxpayer's business for the periods from January 2008 through and including December 2010. A hearing was held at which Taxpayer, who operates ABC Business (ABC Business) as a sole proprietorship, testified. After considering the evidence admitted at hearing, the Administrative Law Judge (ALJ) submitted a Recommendation for Disposition (Recommendation), which includes findings of fact and conclusions of law. I accept part of the Recommendation, and reject part of it.

I accept and adopt the ALJ's findings of fact and legal conclusions that Taxpayer did not rebut the Department's prima facie determination that tax and late payment penalties were properly assessed. I reject, and do not adopt, the ALJ's conclusion that the record includes

insufficient evidence to support the fraud penalty assessed in the NTLs. My decision in this matter is based solely upon the evidence properly admitted at hearing, which has been carefully examined. As part of this final decision, I am incorporating the three findings of fact set forth in the Recommendation. I am also setting forth additional findings of fact regarding the Department's determination to assess the fraud penalty, together with citation to the record where evidence supporting the additional findings is contained.

**Adopted Findings of Fact, as Set Forth in the Recommendation:**

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the two NTL's, captioned above, both dated June 13, 2012. The first NTL covers the audit period January 1, 2008, to June 30, 2009, and includes a late payment penalty and fraud penalty, both penalties doubled because they were not paid during the amnesty period. The second NTL covers the audit period July 1, 2009, to December 31, 2010, and includes a late payment penalty, late filing penalty and a fraud penalty. Tr. pp. 9-10; Dept. Ex. No. 1.
2. ABC Business is located in Illinois. It opened May 1, 2001, and is a sole proprietorship. The restaurant is carry-out only. Mr. John Doe has two employees. His wife also works at the business taking orders over the phone and handling purchases. Tr. pp. 13-16; Dept. Ex. No. 2.
3. Taxpayer did not have available for audit all of the books and records that Illinois law requires a reseller to keep. In conducting the audit which led to the NTL's at issue, the Auditor used the "reseller method and not the markup method." "The reason being too many invoices of meat and seafood are missing." The Auditor took three months of invoices for June through August, 2010, and scheduled out all of the resellers. The

Auditor then took the average selling price of all the large and small rice orders. This resulted in unreported tax liability of \$XXXX for the audit period. A late filing penalty in the amount of \$XXXX and a late payment penalty in the amount of \$XXXX were assessed. A fraud penalty in the amount of \$XXXX was assessed “because the net tax reported percentage change is 555%.” Dept. Ex. No. 2.

**Additional Findings of Fact Supported by the Record:**

4. The two NTLs at issue in this case were issued following one audit, which was the second time the Department audited Taxpayer’s business. Department Ex. 2, p. 2; Tr. pp. 43-44 (Taxpayer).
5. In both the first and second audits, Taxpayer did not have available for review cash register tapes which showed ABC Business’s actual daily sales. Department Ex. 2, p. 2.
6. At or about the completion of the first audit, the Department provided Taxpayer and its accountant with written notice that reSue Bluelers were required to make and keep cash register tapes and other books and records. Department Ex. 2, p. 2.
7. For the first audit, the auditor was able to use a mark-up method to estimate ABC Business’s gross receipts, because the auditor determined that sufficient purchase records were available to estimate the amount of gross receipts that would have been realized if such purchases were later sold at reSue Bluel. Department Ex. 2, p. 2; Tr. pp. 43-44 (Taxpayer).
8. In the second audit, Taxpayer did not have available for review as many records showing ABC Business’s meat and seafood purchases as were made available for the prior audit, yet records showing purchases of other foods and items (for example, rice, sauces and carry-out conSue Blueners) remained relatively consistent with similar purchases during both audits.

Department Ex. 2, p. 1. The auditor determined that, for the second audit, Taxpayer was producing significantly less records showing meat and seafood purchased for resale. *Id.*

9. Prior to beginning the audit in this case, the auditor went to ABC Business on different occasions and purchased food, using a debit card to pay on one or some occasions, and using cash on others. Department Ex. 2, p. 2.
10. When the auditor paid for a meal purchased from ABC Business using a debit card, she received a receipt showing the total amount paid. Department Ex. 2, p. 2. However, when she paid using cash, no receipt was given to her. *Id.*
11. The auditor noted that Taxpayer stapled a guest check to the bag in which the food sold was given to customers, with text (that is, writing in areas commonly used to identify the food items ordered) written in a language other than English. Department Ex. 2, p. 2.
12. Taxpayer had guest checks available for the auditor to review during the second audit, but since such guest checks were not written in English, and were not kept numerically for any given month, the auditor determined that they would not constitute a reliable source for estimating gross receipts. Department Ex. 2, p. 2.
13. Even though the auditor determined that the guest checks available for review did not provide a reliable source for estimating Taxpayer's gross receipts for the second audit, when the auditor reviewed the numbers written on the guest checks Taxpayer produced for June 2010, she determined that such guest checks showed sales in the amount of \$XXXX, whereas the return Taxpayer filed for that period reported sales of \$XXXX. Department Ex. 2, p. 2.
14. The auditor did not use Taxpayer's bank deposits as the best information available to estimate Taxpayer's gross receipts during the second audit, because she determined that

Taxpayer used some of the cash realized from sales to pay for most of its inventory of food purchased for resale. Department Ex. 2, pp. 1-2.

15. Additionally, the auditor determined that Taxpayer used cash realized from sales to pay for United States (US) savings bonds and to make other personal investments, in amounts that greatly exceeded the amounts reported on its returns. Department Ex. 2, pp. 1-2. More specifically, she determined that Taxpayer used cash from sales to purchase US bonds in the amount of approximately \$XXXX annually, and that “when I add cash payouts yearly to the bank deposits the taxpayer[ ] ... has unreported receipts which totaled \$XXXX.” *Id.*

### **Conclusions of Law:**

I hereby accept and adopt the following conclusions of law, as set forth in the Recommendation, that Taxpayer did not rebut the Department’s determinations that tax and late payment penalties were due in the amounts assessed:

The ReSue Bluelers’ Occupation Tax Act requires that every person engaged in the business of selling tangible personal property at reSue Bluel in Illinois shall keep records and books of all sales of tangible personal property, together with invoices, sales records or copies of bills of sale. “The Department may adopt rules that establish requirements, including record forms and formats, for records required to be kept and mainSue Bluened by Taxpayers.” 35 ILCS 120/7. The Department has established cerSue Bluen “minimum” requirements for record keeping. 86 Ill. Adm. Code § 130.805(a), entitled “What Records Constitute Minimum Requirement,” states as follows:

In General. A Taxpayer shall mainSue Bluen 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. When a Taxpayer’s business consists exclusively of the sale of tangible personal property at reSue Bluel, 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.

The “Audit Narrative” in this case states that the Auditor requested, but did not receive, register tapes from Mr. John Doe. According to the Audit Narrative, Mr. John Doe’s “CPA,” Sue Blue, told the Auditor that Mr. John Doe and his wife did not know how to operate a cash register. The Audit Narrative notes that,

in a previous audit, Mr. John Doe and Ms. Sue Blue were “given a compliance letter for maintaining register tapes and books and records in the English language.” Dept. Ex. No. 2. Mr. John Doe testified that Ms. Sue Blue never told him to maintain register tapes. Additionally, according to Mr. John Doe, his cash register was stolen twice. He testified that he reported the first theft, but he failed to report the second theft to the Happyville Police Department. The dates of the thefts are not in the record. The audit period covers the year 2008, *inter alia*, and Mr. John Doe testified that in 2008, he did not use a cash register. It is a “small, home business, so use handwriting.” Tr. pp. 46-47. At the evidentiary hearing, Mr. John Doe did not offer register tapes into evidence.

If a taxpayer fails to maintain adequate records, and does not supply the Department with documentation to substantiate its gross receipts, the Department is justified in using other reasonable methods to estimate the taxpayer’s revenues. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1<sup>st</sup> Dist. 1978). In conducting the audit which lead to the instant case, the Auditor used the “container method and not the markup method.” “The reason being too many invoices of meat and seafood are missing.” The Auditor took three months of invoices for June through August, 2010, and scheduled out all of the containers. The Auditor then took the average selling price of all the large and small rice orders. This resulted in unreported tax liability of \$XXXX for the audit period. Dept. Ex. No. 2. I conclude that Mr. John Doe did not maintain adequate records and that the Auditor used a “reasonable” method to estimate Mr. John Doe’s revenues and the sales tax due on those revenues. The Auditor determined that Mr. John Doe owed additional tax of \$XXXX plus a late payment penalty and fraud penalty for the period January 1, 2008 through June 30, 2009 and additional tax of \$XXXX plus a late payment penalty, late filing penalty and fraud penalty for the period July 1, 2009 through December 31, 2010, as shown on the NTL’s. Dept. Ex. No. 1.

Sections 4 and 5 of the Retailers Occupation Tax Act provide that the admission into evidence of Department records under the certificate of the Director establishes the Department’s *prima facie* case and is *prima facie* evidence of the correctness of the amount of tax due. 35 ILCS 120/4 and 120/5; Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). Once the Department’s *prima facie* case is established, the burden of proof is shifted to the taxpayer to overcome the Department’s *prima facie* case. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773 (1<sup>st</sup> Dist. 1987). The Department’s *prima facie* case is a rebuttable presumption. Copilevitz, *supra*. In the instant case, the Department’s *prima facie* case was established by the admission into evidence of the NTL’s, under the Certificate of the Director, issued to Mr. John Doe on June 13, 2012. Dept. Ex. No. 1. The burden of proof then shifted to Mr. John Doe to overcome the Department’s *prima facie* case.

In order to overcome the presumption of validity attached to the Department’s determinations of tax due, the taxpayer must produce competent evidence, identified with its books and records showing that the determinations are incorrect. Copilevitz, *supra*. Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1<sup>st</sup> Dist. 1991). Documentary

proof is required to prevail against an assessment of tax by the Department. Sprague v. Johnson, 195 Ill. App. 3d 798 (4<sup>th</sup> Dist. 1990). A taxpayer cannot overcome the statutory presumption of correctness by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1<sup>st</sup> Dist. 1988).

Mr. John Doe offered into evidence his "U.S. Individual Income Tax Returns," for 2008, 2009 and 2010. Taxpayer's Ex. Nos. 1, 2 and 3. These returns contain a Schedule C, "Profit or Loss from Business" for each of the three years. Counsel argued that this tribunal should accept the Schedule C's as evidence of Mr. John Doe's gross receipts for the three years. According to Counsel, the tax forms are "documentation that refutes the *prima facie* case that was set forth by the Department." Tr. p. 57. The tax forms are not signed and whoever prepared them did not testify. Mr. John Doe could not testify as to the accuracy of the numbers on the tax returns. "I couldn't remember because I'm aging and I forgot lot of things." Tr. p. 21. When asked if he believed that the information on the tax forms was accurate, Mr. John Doe responded: "I don't know. I can't understand this." Tr. p. 21.

Mr. John Doe was asked if he gave his accountant "the actual physical receipts that you generated from the monthly sale of food to your customers." He responded that he calculated "how much for sale, how much for purchases, and then I give to my CPA and then he report it." When pressed on the issue, Mr. John Doe emphatically testified that he did not give physical receipts to his accountant. Tr. p. 18. The Audit Narrative also notes that "the owner controls everything." He gives Ms. Sue Blue "a monthly receipt recap of everyday receipts, cash payouts and inventory purchases." "All of this is done in the Chinese language." "The owner is in control of all figures that go on ST-1's and the personal returns." Dept. Ex. No. 2. In light of Mr. John Doe's testimony and the comments in the Audit Narrative, it would be unreasonable for me to conclude that the tax returns provide a more accurate or more reasonable method of estimating Mr. John Doe's gross sales for the three years than the container method used by the Auditor or that the tax returns refute the Department's *prima facie* case, as argued by Mr. John Doe's Counsel.

My conclusion is supported by the case law in this area. In Mel-Park Drugs v. The Department of Revenue, 218 Ill. App. 3d 203 (1<sup>st</sup> Dist. 1991), decided under the Retailers' Occupation Tax Act and the Service Occupation Tax Act, the Taxpayer "offered into evidence tapes that were monthly totals of daily receipts and costs, but did not produce the source documents from which these totals were made, and in fact had destroyed the source documents." *Id.* at 219. The court noted that "cash register tapes and other data which will provide a daily record of the gross amount of sales are minimum requirements under the Administrative Code." *Id.* at 220. The court concluded that Mel Park's summaries were not adequate, as a matter of law, to overcome the Department's *prima facie* case. *Id.* at 218-219. Similarly, Mr. John Doe's summary calculations for sales and purchases, which formed the basis for the filing of his tax returns, are inadequate to overcome the Department's *prima facie* case.

Mr. John Doe also tried to dispute the “container” method used by the Auditor. He was asked how often he would buy a box of containers. He replied: “I didn’t remember those things. I just remember it depends if they’re on sale and ...” “If they are, like, wholesale prices, then I go ahead and get more and put them in the storage room. It depends on their promotion at the time.” He was asked how often he would use a full box of containers. “I didn’t calculate it that way. For example, fried rice, we use small – most of the time small size, but I put in full as much as possible then you staple. And the small size I also use in some sauces for the sales as well.” Tr. pp. 32-33. According to Mr. John Doe, half of his sales were fried rice and 60% of the sales were put in small containers and “maybe 40%” put in larger containers. He also sold seafood, beef and poultry, “mostly small sales.” Egg rolls are put in a “little white bag,” not a container. About 60% of his sales were seafood. Tr. pp. 29-31.

Mr. John Doe was required by statute to keep detailed records, such as cash register tapes. A Taxpayer has the burden of proving by competent evidence that a proposed assessment is not correct. Young v. Hulman, 39 Ill. 2d 219 (1968). Mr. John Doe’s testimony as to the containers that he used, without source documents to support the daily sales totals, is not competent evidence. The testimony is not sufficient for me to conclude that the Auditor used an unreasonable method to estimate Mr. John Doe’s sales. The testimony is not sufficient for me to determine what Mr. John Doe’s actual sales were for the period covered by the NTL’s. A Taxpayer cannot overcome the Department’s *prima facie* case merely by denying the accuracy of the Department’s assessments. Smith v. Department of Revenue, 143 Ill. App. 3d 607 (5<sup>th</sup> Dist. 1986). The Taxpayer must present evidence which is consistent, probable, and identified with its books and records. Fillichio v. Department of Revenue, 15 Ill. 2d 327 (1958). Mr. John Doe’s testimony as to the containers he used is not sufficient to overcome the Department’s *prima facie* case.

Mr. John Doe signed a “first” and then a “second or subsequent” Statute of Limitations Waiver on March 8, 2011 and November 4, 2011, respectively. Taxpayer’s Ex. Nos. 4 and 5. Mr. John Doe’s Counsel argued that Mr. John Doe did “not understand that document because it’s in English.” “It was not translated ... to him.” “And so our position will be [that] he did not effectively waive the statute of limitations in this case...” Tr. p. 7. “So we do assert, you know, the statute of limitations as part of our defense to the tax liability for those years.” “Just because an accountant is present --- an accountant is not a lawyer either.” Mr. John Doe “did not understand the document when he signed it and ... no one explained it to him.” “And that goes directly to due process.” Tr. pp. 55-56.

It would be unreasonable for me to conclude that the Department violated Mr. John Doe’s due process rights by asking him to sign Waivers and I disagree with Counsel’s argument on this matter. It must be noted that both Waivers state that they were executed “for the convenience of the Taxpayer.” Taxpayer’s Ex. Nos. 4 and 5. Signing the Waivers worked to Mr. John Doe’s advantage because it allowed the Department time to perform a more accurate audit, and thereby issue more accurate NTL’s. If Mr. John Doe had not signed the Waivers, the Department would have been obligated to issue NTL’s before the statute of

limitations had run and would likely have projected ABC Business's sales from the past audit.

Furthermore, the Audit Narrative states that the audit was conducted with "Ms. Sue Blue, CPA, her office is located in Happyville." "A POA is on file." "Sue Blue also is his personal financial investor. The Taxpayer is well diversified in stocks, bonds & etc." "The Taxpayer's POA wanted a very detailed audit in November of 2011 when I gave her the audit findings." "She wanted everything completed in detail." Dept. Ex. No. 2. The Waivers were signed in March and November, 2011, when Ms. Sue Blue was still representing Mr. John Doe. Ms. Sue Blue stopped representing Mr. John Doe in 2012. Mr. John Doe's Counsel acknowledged that Mr. John Doe's "accountant" was with him when he signed the Waivers. Tr. p. 56.

The Audit Narrative refers to Mr. John Doe's accountant as a "CPA." The CPA was with him when he signed the Waivers. Her "CPA firm" is in Happyville and I assume she spoke Chinese. As a "CPA" with an office in Happyville, I would expect her to fully understand the forms and documents issued by the Illinois Department of Revenue. I must also assume that she translated the Waivers for Mr. John Doe. Counsel argued that Mr. John Doe did not understand the Waivers and no one explained them to him. If he didn't understand the Waivers, or the translation of the Waivers, his recourse was with his "CPA." If his CPA could not satisfactorily explain the Waivers to him, Mr. John Doe should have retained legal counsel. He knew to get legal counsel for the pre-trial proceedings and the evidentiary hearing in this case. Additionally, Mr. John Doe has appeared at several status conferences in the Department of Revenue with a translator. He knew to get a translator when he didn't understand the law or the proceedings. He could have gotten a translator for the Waivers if he felt he needed one. One is under a duty to learn, or know, the contents of a written contract before he signs it, and is under a duty to determine the obligations which he undertakes by the execution of a written agreement. Nilsson v. NBD Bank of Illinois, 313 Ill. App. 3d 751 (1<sup>st</sup> Dist. 1999). If there was a problem with Mr. John Doe understanding the Waivers, it is due to his failure to get the help he needed in translating and understanding them, rather than a due process violation by the Department.<sup>1</sup>

Moreover, I am not aware of any statute, regulation, obligation or duty on the part of the Department to communicate with Chinese Taxpayers in Chinese or issue Statute of Limitation Waivers in Chinese. Mr. John Doe's Counsel has not referred me to any requirement of the Department to communicate, translate or issue documents in Chinese and it is unclear from Counsel's arguments what the source is, assuming there is a source, of Mr. John Doe's right to have documents

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<sup>1</sup> It must be noted here that the Audit Narrative states that Mr. John Doe was hand-delivered the audit results on April 30, 2012. "He acted like he couldn't speak the English language for at least 9 minutes. Then once I gave him the audit results he started speaking in the English language. I was amazed." Most of my meetings with Mr. John Doe, including the evidentiary hearing, have been with an interpreter present.

translated and explained in Chinese.<sup>2</sup> Generally, where a right is given by a state legislature, the arbitrary denial of that right violates the Fourteenth Amendment. U.S. ex rel. Curtis v. People of the State of Illinois, 521 F. 2d 717 (7<sup>th</sup> Cir. 1975), cert. den. 423 U.S.1023 (1975). The Illinois Legislature has not given Mr. John Doe the right to the issuance of a Chinese translation of the Waivers. And without this right, I cannot conclude that the Department violated Mr. John Doe’s due process rights.

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Recommendation, pp. 3-10 (the footnotes included within the adopted conclusions of law, quoted above, are displayed as notes on this page).

**Additional Conclusions of Law Regarding the Fraud Penalty Assessed:**

Based on a careful review of the evidence admitted at hearing, I reject the Recommendation’s conclusion that the fraud penalty was improperly assessed, and, in its place, adopt the following additional conclusions of law.

Section 3-6 of the Uniform Penalty and Interest Act (UPIA) provides, in pertinent part, “[i]f any return or amended return is filed with intent to defraud, in addition to any penalty imposed under Section 3-3 of this Act, ... a penalty shall be imposed in an amount equal to 50% of any resulting deficiency.” 35 ILCS 735/3-6. Illinois courts place the burden on the Department to prove, by clear and convincing evidence, that a fraud penalty was properly assessed. Puleo v. Department of Revenue, 117 Ill. App. 3d 260, 268, 453 N.E.2d 48, 53 (4<sup>th</sup> Dist. 1983); Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213, 454 N.E.2d 799, 802 (3d Dist. 1983). Clear and convincing evidence of a taxpayer’s intent to defraud can be circumstantial in nature. Vitale, 118 Ill. App. 3d at 213, 454 N.E.2d at 802. Probative evidence that a return was filed with an intent to defraud is evidence that tends to make it more likely than not that a filed return

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<sup>2</sup> 5 ILCS 460/20 states that the “official language” of the State of Illinois is English. 35 ILCS 120/7 requires that all books and records required to be kept by the Retailers Occupation Tax Act “shall be kept in the English language.” 86 Ill. Adm. Code 130.801(e) requires that books and records necessary for a determination of correct tax liability “must be kept in the English language.” In light of these provisions, it would be absurd for me to conclude that the Department must issue its own documents and forms in a language other than English.

contained representations that were false, and that such representations were made with knowledge that they were false. Camco, Inc. v. Lowery, 362 Ill. App. 3d 421, 839 N.E.2d 655, 665 (1<sup>st</sup> Dist. 2005) (“Evidence is probative when to the normal mind it tends to prove or disprove a matter at issue.”); 37 Am. Jur. 2d Fraud and Deceit § 488 (“Evidence that a representation was made with knowledge of its falsity is regarded as proof of an intent to deceive.”).

Before addressing the evidence the Department offered to support the fraud penalty, it is also important to consider the testimony Taxpayer offered regarding how his monthly Illinois tax returns were prepared, and how the Schedule C (profit and loss from business), for each of his federal income tax returns, were prepared. Tr. pp. 16-18 (testimony regarding monthly Illinois returns), 20-21 (testimony regarding annual schedule C). Taxpayer testified that he calculated the amount of receipts he collected at the end of each day, and that he provided a monthly report of such daily amounts to his accountant, together with amounts he paid for purchases. Tr. pp. 17-18. Regarding the annual Schedule C prepared for each of the years corresponding to the second audit period, Taxpayer testified that he did not know if the amounts reported as gross receipts or sales on those schedules were correct, and that he forgot whether such reported amounts were accurate. Tr. pp. 20-21; *see* Taxpayer Exs. 1-3.

This testimony perfectly illustrates why retailers engaged in business in Illinois are required by statute to make, keep, and produce for audit documentary evidence showing, at a minimum, a record of daily sales, all purchases, and an annual report of inventory. Tr. pp. 16-18, 20-21 (Taxpayer); 35 ILCS 120/7; 86 Ill. Admin. Code § 130.805(a). No one is able to recall such amounts without such records. The second thing this testimony reflects is the total absence of any evidence — let alone any argument — offered to show that Taxpayer’s returns accurately

reported the amounts of gross receipts ABC Business realized during the periods at issue. *See* Tr. pp. 55-60 (closing argument).

Moving now to the Department's evidence offered to support the fraud penalty, the auditor's narrative report shows that the audit which led to the two NTLs at issue here was the second time the Department had audited Taxpayer's business. Department Ex. 2, p. 2; Tr. pp. 43-44 (Taxpayer). Regarding the first audit, the Department had provided written notice to Taxpayer, and to his accountant, of the requirement to make and keep records in the English language, including cash register receipts showing daily sales. Department Ex. 2, p. 2.

Next, the evidence shows that, during both the first and second audits, Taxpayer failed to make, keep and produce for audit, cash register tapes showing actual daily sales. Department Ex. 2, p. 2. In the prior audit, the Department auditor was able to use a purchase markup method to estimate Taxpayer's gross receipts, because she was able to obtain for review sufficient records of Taxpayer's purchases to estimate the gross receipts Taxpayer likely would have realized from selling the food purchased for resale. Tr. pp. 43-44 (Taxpayer); *see* Department Ex. 2, p. 2. During the second audit, however, Taxpayer produced less documentation of ABC Business's higher cost purchases of meat and seafood than it had during the first audit. Department Ex. 2, p. 2. Since the records of Taxpayer's purchases of other items were consistent between the two audits, the auditor did not determine that Taxpayer stopped making meat and seafood purchases, and stopped selling dishes including such proteins at retail. *See id.* Rather, she determined that, for the second audit, Taxpayer had either stopped making, or refused to produce, all of ABC Business's purchase records. *Id.* Related to this evidence, Taxpayer conceded, during cross-examination that, during the prior audit, the Department used a purchase markup method to estimate ABC Business's gross receipts from selling at retail. Tr. pp. 43-44.

Failure to keep required books and records is commonly treated as one of the badges of fraud. *See, e.g., Price v. Commissioner*, 87 T.C.M. (CCH) 1239, 2004 WL 859198 (U.S. Tax Ct.), 14 (“Over the years, courts have developed a nonexclusive list of factors that demonstrate fraudulent intent. These badges of fraud include: (1) Understating income, (2) maintaining inadequate records, (3) implausible or inconsistent explanations of behavior, (4) concealment of income or assets, (5) failing to cooperate with tax authorities, (6) engaging in illegal activities, (7) an intent to mislead which may be inferred from a pattern of conduct, (8) lack of credibility of the taxpayer's testimony, (9) filing false documents, (10) failing to file tax returns, and (11) dealing in cash.”); accord *Vitale*, 118 Ill. App. 3d at 213, 454 N.E.2d at 802 (noting the following three factors, which supported a fraud penalty: taxpayer underreported receipts by as much as 200%; taxpayer's bank deposits exceeded its reported gross receipts by \$25,000 per year; and, for one year taxpayer's purchases exceeded sales by 46%).

To be sure, not every failure to maintain adequate records provides evidence of fraudulent intent; it is possible, if not inevitable, that a new business may be operated by a person who, through ignorance, neglect, or some other reason, has not made or maintained records that are required to document a particular claim of nontaxability or exemption. *See* 35 ILCS 120/7. In this case, however, Taxpayer had been in business for over a decade at the time of the second audit, and, during the prior audit, he and his accountant had been given actual notice of the recordkeeping requirements of the ROTA. Department Ex. 2, pp. 1-2.

The critical evidence here is the evidence which shows Taxpayer's acts during the first and second audits, coupled by evidence showing the Department's transmission of actual notice to Taxpayer of the statutory requirement to keep books and records. The evidence shows that Taxpayer knew, after the first audit, that if a retailer did not have daily cash register tapes

available to give to a department auditor, the auditor would use the retailer's purchase records to estimate its gross receipts. Tr. pp. 43-44. Thereafter, during the second audit, Taxpayer produced less purchase records which showed how much of the restaurant's higher priced food items were purchased for resale. Department Ex. 2, pp. 1-2.

This evidence does not tend to show that Taxpayer was unable, because he was old or not fluent in English, to understand the statutory duties imposed on every retailer, or to accurately record and report ABC Business's sales. *See* Recommendation, p. 11. To the contrary, the evidence strongly suggests that the lesson Taxpayer learned from the first audit was to stop producing so many purchase records, which he knew the Department had previously used to estimate gross receipts in excess of those he reported. Tr. pp. 43-44. The inference I draw from the evidence is that Taxpayer's continued failure to make and keep required records was done in a knowing attempt to conceal records that would document the restaurant's actual daily sales, as well as records that would document the cost of all of the food his restaurant purchased for resale.

The evidence also reflects that the auditor went to ABC Business on different occasions and personally purchased food, using a debit card to pay on one or some occasions, and using cash on others. Department Ex. 2, p. 2. When the auditor paid for a meal using a debit card, she received a receipt showing the total amount paid. However, when she paid using cash, no receipt was given. *Id.* This evidence, too, shows that Taxpayer's actions tended to conceal records that would show the amount of gross receipts ABC Business realized from cash sales.

The evidence further shows that the auditor reviewed Taxpayer's available guest checks for June 2010, and determined that the guest checks produced showed sales of \$XXXX, whereas the return Taxpayer filed for that month reported receipts of only \$XXXX. Department Ex. 2, p.

2. This evidence shows that, even if the guest checks the auditor reviewed for June 2010 were all of the guest checks written for that month, such checks documented that Taxpayer's receipts were more than 150% greater than the amount Taxpayer reported on the return filed for that month. *Id.* (15,200/9,941  $\approx$  1.52902); Vitale, 118 Ill. App. 3d at 212, 454 N.E.2d at 801 (noting the Department auditor's determination that taxpayer "understated his receipts by as much as 203% in 1976, 150% in 1977, and 127% in 1978."). Since Taxpayer produced the June 2010 guest checks to the auditor for review, he must have had them in his possession at the time the June 2010 return was filed. At a minimum, the evidence shows that Taxpayer's June 2010 return falsely understated receipts for that month. Vitale, 118 Ill. App. 3d at 212, 454 N.E.2d at 801; 37 Am. Jur. 2d Fraud and Deceit § 488.

Finally, the evidence shows that the auditor determined that Taxpayer used cash realized from sales to purchase savings bonds and to make other personal investments, in amounts that greatly exceeded the gross receipts reported on its returns. *Id.* More specifically, she determined that Taxpayer used cash from sales to purchase bonds in the amount of approximately \$XXXX annually, and that "when I add cash payouts yearly to the bank deposits the taxpayer[ ] ... has unreported receipts which totaled \$XXXX." *Id.*; Vitale, 118 Ill. App. 3d at 213, 454 N.E.2d at 802.

In Vitale, the Illinois appellate court affirmed the Department's assessment of a fraud penalty where evidence in the record showed that the taxpayer had significantly underreported its receipts on the returns it filed, where taxpayer's purchases exceeded its reported receipts, and where taxpayer's bank deposits exceeded its reported receipts by \$25,000 per year. Vitale, 118 Ill. App. 3d at 212-13, 454 N.E.2d at 801-02. Here, the record similarly contains clear and convincing evidence showing the presence of six of the badges of fraud referred to in Price. Price

v. Commissioner, 87 T.C.M. (CCH) 1239, 2004 WL 859198 (U.S.Tax Ct.) at 14. More specifically, the evidence shows that: Taxpayer continued to significantly underreport his receipts over the course of two audit periods (Price, badge number (1)); Taxpayer refused to make and keep the type of records that retailers are required by statute to keep to show actual sales (Price, numbers (2), (5), (7)); Taxpayer's refusal to make and keep cash register tapes, after being notified of the statutory duty to do so, constituted an attempt to conceal ABC Business's actual sales (Price, numbers (2), (5), (7)); Taxpayer attempted to conceal the amount of its purchases of food for resale (Price, numbers (2), (4)-(5)); Taxpayer attempted to conceal the amount of gross receipts realized from cash sales (Price, numbers (4), (7), (11)); and, taken together, Taxpayer's bank deposits, plus the amounts of his personal investments, exceeded the amount of the total receipts reported on ABC Business's monthly sales tax returns by over \$XXXXX annually (Price, numbers (4), (11)). Department Ex. 2, pp. 1-3.

**Conclusion:**

After carefully considering all of the evidence admitted at hearing, the NTLs shall be finalized as issued.

May 20, 2015

Constance Beard, Director  
Illinois Department of Revenue