

**ST 01-27**

**Tax Type: Sales Tax**

**Issue: Unreported/Underreported Receipts (Fraud Application)**

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

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<b>THE DEPARTMENT OF REVENUE</b>	)	Docket No.	99-ST-0000
<b>OF THE STATE OF ILLINOIS</b>	)	Reg. No.	0000-0000
v.	)	NTL No.	00-0000000000000000
<b>JOHN DOE, d/b/a</b>	)		
<b>ABC GROCERY,</b>	)	John E. White,	
Taxpayer.	)	Administrative Law Judge	

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:**

Mark Rosenbloom appeared for JOHN DOE, d/b/a ABC Grocery; John Alshuler appeared for the Illinois Department of Revenue.

**Synopsis:**

This matter arose after JOHN DOE, owner of ABC Grocery (“ABC”) protested a Notice of Tax Liability (“NTL”) the Illinois Department of Revenue (“Department”) issued following an audit of that business. The NTL assessed retailers’ occupation tax (“ROT”), penalties and interest as measured by the gross receipts ABC received from selling tangible personal property at retail during the months beginning January 1, 1994 through and including September 30, 1998. Following taxpayer’s request, the Department conducted a reaudit, during which it reviewed books and records not previously examined.

A hearing on taxpayer’s protest was held at the Department’s Office of Administrative Hearings in Chicago. During that hearing, taxpayer stipulated to the results of the reaudit with the sole exception being taxpayer’s objection to the Department’s assessment of a negligence penalty for 1994. I have considered the evidence adduced at hearing, and I am including in this recommendation specific findings

of fact and conclusions of law. I recommend that the NTL, with the negligence penalty, be finalized as revised by reaudit.

**Findings of Fact:**

**Facts Regarding ABC's Business**

1. During 1994, ABC was a sole proprietorship owned by JOHN DOE ("Doe" or "taxpayer". Taxpayer Exhibit ("Ex.") 3 (a copy of taxpayer's 1994 Schedule C ("Profit or Loss From Business")); Hearing Transcript ("Tr.") pp. 47-48 (testimony of JOHN DOE ("Doe")). After 1994, Doe incorporated ABC. Tr. p. 48 (Doe).
2. ABC is in the business of making retail sales of liquor, groceries, and other merchandise to the public. Department Ex. 1, p. 1 ("Kind of business" description on the Department's original correction of taxpayer's returns); Taxpayer Ex. 3.
3. ABC is located at Anywhere, Illinois. Department Ex. 2, p. 2; Department Ex. 1.
4. Doe opened ABC in 1981. Tr. p. 50 (Doe).
5. During 1994, Doe's accountant was Jane Doe, a CPA. Tr. pp. 48, 58 (Doe); Taxpayer Ex. 3. Jane Doe prepared ABC's 1994 monthly ROT returns and Doe's 1994 federal individual income tax return. Tr. pp. 48, 58 (Doe); Taxpayer Ex. 3.
6. After Jane Doe gave Doe the 1994 federal income tax return she prepared, he signed and filed it without reviewing it. Tr. p. 51 (Doe).
7. Sometime in 1995, Doe went to his bank seeking a business loan for ABC. Tr. pp. 49-51, 61-62 (Doe).
8. After presenting the bank with a copy of his original 1994 federal income tax return and Schedule C, the bank informed Doe that they would not be able to provide him with a loan. Tr. pp. 49, 51, 57 (Doe).
9. In approximately October of 1995, Doe then hired a different accountant, Joe Blow ("Blow"), also a CPA, to prepare an amended federal income tax return for 1994. Tr. pp. 23-26 (testimony of Blow), 49-50, 53-54 (Doe).

10. Blow prepared an amended federal income tax return for the Doe', together with related schedules and attachments. Taxpayer Ex. 2, pp. 1 (cover letter from Blow to the Doe'), 3-24 (copy of amended return, schedules and attachments).
11. Blow also prepared the Doe' original Illinois income tax return for 1994. Taxpayer Ex. 2, pp. 25-27 (copy of the Doe' 1994 IL-1040, signed by Blow on 11/3/95).
12. Blow signed the Doe' amended federal income return and original Illinois return, as the preparer, on 11/3/95. Taxpayer Ex. 1, p. 2; Taxpayer Ex. 2, p. 24.
13. When amending Doe' federal income tax return, Blow increased the amount of the Doe' adjusted gross income ("AGI") for 1994 by \$209,459 (two hundred nine thousand, four hundred fifty-nine dollars). Taxpayer Ex. 1.
14. The increase in the Doe' 1994 AGI was directly attributable to changes Blow made to Doe' Schedule C, on which Doe was required to report the profit or loss attributable to ABC's 1994 operations. *Compare* Taxpayer Ex. 1 *with* Taxpayer Ex. 3; Tr. pp. 23-26 (Blow).
15. On the amended Schedule C, Blow increased ABC's 1994 sales by \$95,991, to \$873,304. Taxpayer Ex. 1, p. 5 (on the amended Schedule C, the line 1 (Gross receipts or sales) amount is \$873,304); Taxpayer Ex. 3, p. 3 (on the original Schedule C, the line 1 amount is \$777,313); Tr. pp. 29-30 (Blow).
16. At or about the time Doe hired Blow to prepare his amended 1994 federal income tax return, Doe also hired Blow to prepare ABC's monthly ROT returns. Tr. p. 55 (Doe).
17. Doe gave Blow the same information to use when preparing ABC's monthly ROT returns as he had previously given to Jane Doe. *See* Tr. p. 57-58 (Doe).
18. No amended monthly ROT returns were ever filed by Doe to report to Illinois the additional receipts reported on Doe' amended Schedule C for 1994. *See* Tr. pp. 38 (Blow), 55 (Doe). Doe did not ask Blow to prepare such returns, and Blow did

not advise Doe that such amended returns should be prepared and filed. Tr. pp. 38 (Blow), 55 (Doe).

### **Facts Regarding the Department's Audit and Reaudit**

19. The Department conducted an audit of ABC's business for the period beginning 1/1/94 through and including 9/30/98. Department Ex. 1.
20. After ABC protested the NTL, it asked that a reaudit be conducted because it had records available that had not previously been reviewed by the Department. Department Ex. 2 (copy of audit report and schedules prepared during the reaudit requested by ABC) pp. 1, 34.
21. On the monthly ROT returns filed for 1994, Doe reported that ABC had gross receipts of \$732,258. Department Ex. 2, p. 7. That is \$141,046 less than the gross receipts Doe reported on line 1 of his amended 1994 Schedule C. *Id.*; Taxpayer Ex. 1, p. 9.
22. On the original audit and during the requested reaudit, the Department disregarded the amounts ABC reported as gross receipts on the returns it filed during the audit period, following its reconciliation of ABC's returns with its limited books and records, and with Doe's amended federal income tax return for 1994. Department Exs. 1-2. Certain deductions claimed by Doe on ABC's filed ROT returns were also disregarded by the Department's auditor because Doe did not keep and maintain the type of books and records required to be kept to substantiate those deductions. *Id.*; 35 ILCS 120/7; 86 Ill. Admin. Code § 130.810 (Records Required to Support Deductions).
23. At hearing, Doe stipulated to the results of the tax determined to be due following the reaudit, except for the assessment of a negligence penalty for the year 1994. Tr. pp. 12 ("... the fact is that we are stipulating to the State's figures, because we have done the best we can on the re-audit. There is only one and only one issue still that we disagree with. And that is should a penalty be imposed by the State

against Mr. Doe, and particularly for the year 1994.”), 14 (“So the only issue in this case ... [is] the penalty being assessed against Mr. Doe, d/b/a ABC Grocery, for the year 1994. That is the only issue.”), 15-16 (“But in any event, the issue is should the State impose a penalty against the taxpayer for the year 1994 for the sales tax that is stipulated that is due and owing.”).

24. The tax computed pursuant to the requested reaudit is based on the following Department determinations, among others:

- For each of the years or periods in the audit, the monthly ROT returns Doe filed underreported gross receipts by the following amounts:

	<u>Year/Period</u>	<u>Amount of Underreporting</u>
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- For each of the years or periods at issue, the monthly ROT returns Doe filed overstated the amount of the gross receipts from ABC’s sales of food for consumption off premises, which are taxed at a lower rate than gross receipts from the sales of general merchandise (35 ILCS 120/2-10):

	<u>Year/Period</u>	<u>Amount of Overreporting of Food Sales</u>
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Department Ex. 2, pp. 7-12.

25. The penalty assessed against Doe and ABC was based on the Department’s determination that Doe was negligent when having ABC’s monthly sales and use tax returns prepared and filed for the months of 1994. Department Ex. 2, p. 4 (penalty computation schedule); 35 ILCS 735/3-5(a).

**Conclusions of Law:**

The Department introduced a copy of the NTL it issued to ABC into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the ROTA, that NTL constitutes prima facie proof of the correctness of the amount of tax due. 35 ILCS 120/4. The Department's prima facie case is a rebuttable presumption. 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 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); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

When preparing the NTL issued in this matter, the Department assessed a 50% fraud penalty. Department Ex. 1, p. 2. After Doe protested the NTL, he asked that the Department reconsider its assessment, after reviewing books and records not previously available to the Department. Department Ex. 1, Department Ex. 2, pp. 1, 34. Following that reaudit, the Department withdrew the fraud penalty and assessed a 20% negligence penalty. Department Ex. 2, p. 4. Doe concedes that he owes a negligence penalty for the returns filed after the period ending 12/31/94, just as he concedes the correctness of the tax determined to be due following reaudit. Tr. pp. 12, 14-16 (opening statement). But

Doe contends that he should not have to pay a negligence penalty for the returns he filed regarding the months during 1994. *Id.*

Section 3-5 of the Uniform Penalty and Interest Act (“UPIA”) provides:

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, a penalty shall be imposed in an amount equal to 20% 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 regulations.

(c) No penalty shall be imposed under this Section if it is shown that failure to comply with the tax Act is due to reasonable cause. A taxpayer is not negligent if the taxpayer shows substantial authority to support the return as filed.

35 **ILCS** 735/3-5 (1994). In a nutshell, paragraph (a) of § 3-5 authorizes the penalty for a negligently prepared and filed return, paragraph (b) defines negligence, and paragraph (c) provides for the ways that a taxpayer might avoid a negligence penalty. 35 **ILCS** 735/3-5. Paragraph (c) also clearly places the burden for showing that a penalty should not be assessed on the taxpayer. 35 **ILCS** 735/3-5(c); *see also*, Branson v. Department of Revenue, 68 Ill. 2d 247, 261, 659 N.E.2d 961, 968 (1995) (“After the Department presents a prima facie claim for tax penalty liability, our construction of section 13½ places the burden on the taxpayer to establish that one or more of the elements of the penalty are lacking.”).

Section 3-5(c) provides two ways for a taxpayer to show that it is not subject to a negligence penalty. One way is to establish reasonable cause, the other is to show

substantial authority to support the return as filed. 35 ILCS 735/3-5(c). The Department has promulgated a regulation regarding each subject. I will discuss the second way first.

Regulation § 700.320 addresses § 3-5 of the UPIA, and provides, in pertinent part:

\* \* \*

c) Penalty for negligence shall not apply where an assessment results from a reasonable difference of opinion as to taxability. (Section 3-5 of the Act) A reasonable difference as to taxability may be established by evidence that shows that the issue in dispute between the taxpayer and the Department is:

- 1) not resolved by the plain language of the statute;
- 2) an issue about which the Department has not adopted a rule of general applicability;
- 3) an issue about which the Illinois Supreme Court has not ruled and there are inconsistent opinions of the Illinois Appellate Courts.

86 Ill. Admin. Code § 700.320 (1994).

Here, Doe never argued that substantial authority supported the amounts of gross receipts and deductions he reported on the ROT returns ABC filed for 1994. Rather, his attorney unequivocally agrees that Doe cannot and does not contest the amount determined to be due following reaudit. Tr. pp. 12, 14-16 (opening statement); Dora v. Indiana Insurance Co., 67 Ill. App. 3d 31, 32-33, 384 N.E.2d 595 (1979) (statements made by counsel at hearing can act as a judicial admission which binds client), *aff'd*, 78 Ill. 2d 376 (1980). Nor did Doe offer any evidence to show that he had a difference of opinion about the taxability of any of the items reported on his original ROT returns. Taxpayer Exs. 1, 3; *see also* Tr. pp. 12, 14-16 (opening statement).

Doe was unable to show substantial support for the amounts reported on ABC's 1994 ROT returns because he failed to keep the type of books and records that are required to be kept by all retailers doing business in Illinois. The plain language of the

ROTA provides, *inter alia*, that retailers are required to keep and maintain books and records showing the amount of their daily sales. 35 ILCS 120/7; 86 Ill. Admin. Code § 130.805(a). The same section of the ROTA requires retailers to keep and maintain books and records sufficient to show the nontaxable nature of gross receipts claimed to be exempt for any purpose. 35 ILCS 120/7; 86 Ill. Admin. Code §§ 130.810. If Doe had reasonably complied with those statutes and regulations, that is, had he made a good faith effort to make sure that the amounts of gross receipts and deductions that were reported on ABC's monthly returns filed for 1994 coincided with the amounts reflected on the books and records he was supposed to keep, Doe would have been able to show substantial authority for his original returns. 35 ILCS 735/3-5(c); 86 Ill. Admin. Code § 700.320(c). Since Doe did not comply with the clear letter of the law, he is unable to bear that burden.

Additionally, Doe has never offered any evidence to show — nor has he ever even presented the argument — that the Department's decision to ignore the amount of gross receipts reported on the returns filed for 1994 was incorrect. *See* Tr. pp. 14-16 (opening statement). Doe himself had an amended 1994 Schedule C for ABC prepared to correct the original schedule filed with his individual federal and Illinois income tax returns. Taxpayer Ex. 1; Tr. p. 48. The original Schedule C showed that ABC had a loss of \$141,092. Taxpayer Ex. 3, p. 3. Doe' amended Schedule C shows that ABC, in fact, had a profit of \$72,537. Taxpayer Ex. 1. That \$200,000 swing from loss to profit was based, in part, on an almost \$100,000 increase in the reported gross receipts realized by the business. *Compare* Taxpayer Ex. 1, p. 9 (amended Schedule C) *with* Taxpayer Ex. 3, p. 3 (original Schedule C). There is simply no dispute that ABC had more receipts in

1994 than were reported on the monthly ROT returns Doe signed and filed for that year. Taxpayer Ex. 1, p. 9; Department Ex. 2, p. 4. Since Doe does not and cannot dispute that fact (Tr. pp. 12, 14-16), Doe has failed to show substantial support for the returns as filed. 35 ILCS 735/3-5(c); 86 Ill. Admin. Code § 700.320(c).

As to the second means of showing that a negligence penalty should not be assessed, § 700.400 of the Department's UPIA regulations provides, in pertinent part:

Reasonable Cause

\* \* \*

b) The 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.

c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.

d) The Department will also consider a taxpayer's filing history in determining whether the taxpayer acted in good faith in determining and paying his tax liability. Isolated computational or transcriptional errors will not generally indicate a lack of good faith in the preparation of a taxpayer's return.

e) Examples of Reasonable Cause. The following non-exclusive list of situations will constitute reasonable cause for purposes of the abatement of penalties:

1) Reasonable cause for abatement of penalty will exist if a liability results from amendments made by the Department to regulations or formal

administrative policies or positions after the return on which the liability was computed was filed.

2) Reasonable cause for abatement may also be based on the death, incapacity or serious illness of the taxpayer (or his tax preparer) or a death or serious illness in his or her immediate family which causes a late filing and payment of tax due. In the case of a corporation, estate, trust, etc., the death, incapacity, or serious illness must have been of an individual having sole authority to file the return (not the individual preparing the return) or make the deposit/payment, or a member of such individual's immediate family.

3) An unavoidable absence of a taxpayer (or tax preparer) due to circumstances unforeseeable by a reasonable person may also constitute reasonable cause for purposes of abatement of the penalty. An unavoidable absence does not include a planned absence such as a vacation. In the case of a corporation, estate, trust, etc., the absence must have been of an individual having sole authority to file the return (not the individual preparing the return) or make the deposit/payment.

4) Inability to timely obtain records necessary to determine the amount of tax due to reasons beyond the taxpayer's control. For example, some taxpayers, particularly those with income from banks, partnerships, trusts, estates or Subchapter S corporations, must secure information from those entities in order to properly compute the amount of tax due.

5) Factors beyond taxpayer's control such as destruction by fire, other casualty or civil disturbance, of the taxpayer's residence or place of business records.

6) Taxpayer mailed the return or payment to the Department in time to reach the Department on or before the due date, given the normal handling of the mail. However, through no fault of the taxpayer, the return or payment was not delivered within the prescribed time period. This fact situation would constitute reasonable cause for abatement of the penalty.

7) Reasonable cause will exist for purposes of abatement of the penalty if a taxpayer makes an honest mistake, such as inadvertently mailing a Department of Revenue check to a local government, another state's

Department of Revenue, or to the Internal Revenue Service.

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11) Embezzlement or employee fraud not reasonably within the knowledge of the taxpayer.

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f) Relevant factors used by the Department in determining the existence of reasonable cause.

1) Could the taxpayer's federal filing status have caused confusion about his or her Illinois filing requirements? Under Illinois law, many taxpayers that are not required to file with the Internal Revenue Service are required to file with the Department.

2) Does the taxpayer's reason address the penalty assessed? For example, if a taxpayer was assessed both a late filing and late payment penalty for the same return, the taxpayer's explanation of the failure to file and pay may apply to one penalty, but not the other.

3) Does the length of time between the reason cited and the actual violation support abatement? If the taxpayer cites a specific event or set of events (e.g., illness, unexpected absence, or natural disaster) or set of events that led to the imposition of the penalty, the Department will determine whether those events are directly related to the return or payment under review.

4) Could the event cited have been reasonably anticipated? Was the event one that should have been anticipated (e.g., a vacation or scheduled absence) or was it unexpected, unavoidable, or otherwise unplanned (e.g., an emergency or disaster).

5) Was ordinary business care and prudence exercised? In the absence of new or unusual circumstances, most filing and payment requirements are common knowledge or are readily available to most taxpayers. If the taxpayer did all that could be reasonably expected of him or her and was still unable to file or pay on time, reasonable cause may be present.

86 Ill. Admin. Code § 700.400 (2001).

The relevant inquiry here is, did Doe, in any way, "... fail[ ] to make a reasonable attempt to comply with the provisions of any [the ROTA] ..." or did he "... careless[ly], reckless[ly], or intentional[ly] disregard ... the law or regulations" when he caused others

to prepare the ROT returns for 1994. 35 ILCS 735/3-5(b). The Department determined that he did, and it assessed a negligence penalty for the entire audit period. Department Ex. 2, p. 4. Contrary to Doe' argument, the evidence shows that he did not exercise ordinary business care and prudence when attempting to determine ABC's monthly tax liabilities for 1994. 86 Ill. Admin. Code § 700.400(b)-(c).

First, Doe concedes that he cannot dispute the accuracy of the Department's corrections of ABC's ROT returns, including those filed for the months in 1994. Tr. pp. 12, 14-16 (opening statement). Since Doe does not dispute the amount of tax assessed against him, he cannot dispute that during 1994, the ROT returns he caused another to prepare failed to include over \$227,000 in gross receipts that should have been reported on them. Department Ex. 2, pp. 7, 12. Doe, moreover, agrees that he is subject to a negligence penalty for the returns filed after 1994. Tr. pp. 12, 14-16 (opening statement). Given that Doe concedes that ABC's 1994 ROT returns failed to include almost a quarter of a million dollars worth of gross receipts, and that the same returns overstated by \$388,000 the amount of gross receipts ABC realized from selling food during that year, the more specific inquiry must be, what reasonable and prudent actions did Doe undertake in 1994 that he concededly did not perform thereafter?

Doe, however, did not attempt to show how he acted more reasonably during 1994 than he did later in the audit period. Instead, Doe' posture at hearing was to blame any negligence on Blow, ABC's accountant. In particular, counsel for Doe asserted that Blow was negligent when he lost, during a burglary of his office, a computerized general ledger that he began to keep for ABC. Tr. pp. 30 (Blow), 36 (colloquy between ALJ and Doe' counsel). Doe also argued that Blow was negligent by failing to notify Doe that he

should file amended monthly ROT returns to report the additional receipts that were included on Doe' amended Schedule C for 1994. Tr. p. 55 (Doe), 69-70 (closing argument).

But nothing Blow did — and nothing he could have done — could have had any effect on whether ABC's 1994 ROT returns were carefully or reasonably prepared. That is because Doe hired Blow in late 1995, which was well after the return for December 1994 was filed. Tr. p. 54 (Doe) (testifying that he hired Blow about a month before Blow prepared Doe' amended federal income tax return, which was signed by Blow on 11/9/95); 35 ILCS 120/3 (monthly ROT returns are required to be filed not later than the 20<sup>th</sup> day of the following month). Moreover, even if Blow was negligent when he lost the computerized general ledger that he began to keep for ABC's business, that negligence has nothing to do with the monthly ROT returns Doe signed and filed in 1994. Blow only began to keep a general ledger for ABC in 2000. Tr. pp. 36-37 (Blow). Using the language of the UPIA's reasonable cause regulation, Doe' theory that Blow was the negligent party does not address the penalty assessed because the reason cited — Blow's alleged negligence — occurred well after the returns at issue were prepared and filed. 86 Ill. Admin. Code § 700.400(f)(2)-(3).

And even if Blow had told Doe, in late 1995, that he should file amended monthly ROT returns for 1994, that has no effect on the question whether Doe used ordinary business care and prudence when attempting to determine ABC's monthly tax liabilities in 1994. Correcting a mistake might well lead to a more accurate answer, but it doesn't change the fact that a mistake was made in the first place. The issue here is, was the

mistake, i.e., the original negligently prepared 1994 ROT returns, the result of Doe's negligence. Again, the evidence shows that it was.

Counsel for Doe portrays his client as wholly ignorant of accounting and/or his tax obligations, and who mistakenly relied on trained professionals. Tr. pp. 66-71 (closing argument). When asking Doe leading questions about his business and tax knowledge, Doe counsel was able to get his client's agreement that he relied on accountants to prepare his tax returns. *See* Tr. pp. 50-51 (Doe). But Doe's testimony about his alleged ignorance of his tax reporting obligations, even if true, only confirms his own failure to make a good faith effort to follow the applicable tax laws and regulations when attempting to determine ABC's monthly tax liabilities. 35 **ILCS** 735/3-5(b). For example, Doe admitted at hearing that he signed his original 1994 federal income tax return without reviewing it (Tr. p. 51 (Doe)), a failure which in and of itself is clearly within the definition of negligence, as defined in UPIA § 3-5(b).<sup>1</sup> *Compare* 35 **ILCS** 735/3-5(b) *with* Taxpayer Ex. 3 (Doe signed the return in a section which included the following oath, "Under penalty of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct and complete."). The documents introduced as evidence, moreover, firmly support the Department's determination that Doe failed to exercise ordinary business care and prudence when attempting to determine ABC's monthly ROT liabilities

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<sup>1</sup> Doe's failure to even review his 1994 federal income tax return before signing and filing it is not direct evidence of his negligence when having ABC's monthly 1994 ROT returns prepared and filed. His admission does, however, provide circumstantial evidence of the standard of care with which Doe reviewed the tax returns he caused to have prepared regarding the relevant period, and thereafter, signed and filed.

in 1994. Perhaps the best evidence is the information included on the amended returns Doe introduced as evidence here.

On those returns, Doe wrote that he was self-employed, and that his primary business was ABC. Taxpayer Exs. 1, 3. Additionally, Doe testified that he started ABC in 1981. Tr. p. 50 (Doe). By 1994, therefore, he had been a small retailer for thirteen years. On his original and amended 1994 federal income tax returns, Doe checked the box to report that he materially participated in the operation of ABC during 1994 (Taxpayer Exs. 1, 3), and his amended Schedule C shows that ABC had \$140,000 more receipts from sales than Doe reported on his monthly returns. Taxpayer Ex. 1; Department Ex. 2, p. 7 (comparing receipts as reported on ABC's 1994 monthly returns with receipts as reported on Doe' amended Schedule C).<sup>2</sup>

Doe cannot shed himself of any responsibility over the content of ABC's filed ROT returns for the months in 1994, simply by claiming ignorance of his tax reporting obligations, or by pointing the finger at Blow. Blow had nothing to do with the preparation of Doe' ROT returns in 1994, and it is black letter Illinois law that a person cannot rebut the statutory presumption of correctness that attaches to the Department's corrected returns simply by claiming that such determinations are incorrect. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34, 527 N.E.2d 1048, 1053 (1<sup>st</sup> Dist. 1988) ("A taxpayer cannot overcome the DOR's prima facie case merely by

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<sup>2</sup> And while Doe blames Blow for any negligence related to ABC's 1994 ROT returns, Blow clearly testified that Doe never asked him to make any corrections to ABC's 1994 ROT returns. Tr. p. 38 (Blow). Nor did Doe hire Blow because he wanted to more carefully identify the amount of money ABC received from selling tangible personal property at retail. Instead, he hired Blow to correct his personal income tax returns so he could get a business loan. Tr. pp. 49-51, 57, 61-62 (Doe).

denying the accuracy of its assessments. Instead, evidence must be presented which is consistent, probable, and identified with its books and records.”).

In a case involving a penalty based on a different mental state, willfulness, the Illinois Supreme Court has held that “... lack of willfulness is not proved simply by denying conscious awareness of a tax deficiency that could have been easily investigated by an inspection of corporate records.” Branson, 68 Ill. 2d at 267, 659 N.E.2d at 971. Here, in a case involving a penalty based upon negligence — which is clearly a lesser standard — an individual taxpayer’s mere testimony that he knows nothing of the contents of the tax returns he signed and filed, or his silence on whether he knew what the actual gross receipts were for the business he personally operates, similarly should not be accepted as “proof” that he made a good faith effort to determine his proper tax liability. 86 Ill. Admin. Code § 130.700.400(b). As the Illinois Supreme Court indicated in Branson, if all a taxpayer had to do to avoid a negligence penalty was to say, “No I wasn’t,” or “I didn’t know,” the statute authorizing the penalty would be rendered a practical nullity. *See* Branson, 68 Ill. 2d at 267, 659 N.E.2d at 971.

Moreover, all of the errors on the returns at issue are clearly traceable to Doe’s failure to keep accurate books and records that showed what the business’ gross receipts were, what receipts were taxable or not taxable, and at what rate. Department Ex. 2, pp. 7-12. Especially when one considers that Doe has been engaged in the same business for over a decade (Tr. p. 50 (Doe)), and that he was materially engaged in the management of that business in the year at issue (Department Exs. 1, 3), his failure to make a good faith effort to abide by § 7 of the ROTA and the regulations promulgated by the Department pursuant to that statutory provision, seems to be a quintessential example of negligence.

35 ILCS 120/7, 735/3-5(b); 86 Ill. Admin. Code §§ 130.801-810, 700.400(b)-(c). On this point, I note that, when interpreting the text of Illinois statutory provisions imposing other tax penalties, the Illinois Supreme Court has often referred to judicial interpretations of the text of similar penalties imposed by federal tax law. *E.g.*, Branson, 68 Ill. 2d at 261, 659 N.E.2d at 968 (and Illinois cases cited therein). Section 6662 of the Internal Revenue Code, like § 3-5(a) of the UPIA, imposes a twenty percent penalty on the portion of an underpayment attributable to one or more accuracy-related deficiencies, including negligence or the disregard of rules or regulations. 26 U.S.C. § 6662(a), (b)(1); Hayden v. Commissioner, 204 F.3d 772, 775 (2000). The term “negligence” as defined by § 6662, again, like UPIA § 3-5(b), includes any failure to make a reasonable attempt to comply with the provisions of the Code or to exercise ordinary and reasonable care in the preparation of a tax return. Hayden, 204 F.3d at 775 (*citing* 26 U.S.C. § 6662(c); Treas. Reg. § 1.6662-3(b)(1)). Under the applicable treasury regulation interpreting § 6662, negligence includes any failure to keep adequate books and records or to substantiate items properly. Hayden, 204 F.3d at 775 (*citing* Treas. Reg. § 1.6662-3(b)(1)).

ABC is Doe’ business. Taxpayer Exs. 1, 3. It is, in fact, his livelihood. *E.g.*, Taxpayer Ex. 3, pp. 1 (Doe described his occupation as “self-employed”), 3 (Schedule C, line “I”); Tr. p. 50 (Doe). All the evidence introduced at hearing showed that Doe was the person who managed or supervised ABC’s operations. Taxpayer Exs. 1, 3. If Doe signed ABC’s monthly ROT returns for 1994 while being wholly unaware of what ABC’s actual monthly gross receipts were, he was not exercising ordinary business care and prudence when attempting to determine ABC’s proper tax liability. 86 Ill. Admin.

Code § 700.400(b)-(c). If Doe knew what ABC's gross receipts really were during the months at issue, and signed and filed the 1994 ROT returns while failing to notice, for twelve successive months, that those returns reported, on average, only about 69% of the gross receipts ABC actually received, he did not exercise ordinary business care when attempting to determine ABC's monthly ROT liabilities. Department Ex. 2, p. 7 (227,441 ÷ 732,258 ≈ .3106); *see also*, 86 Ill. Admin. Code § 700.400(d) (clearly, these were not “[i]solated computational or transcriptional errors ...”). If Doe merely signed and then filed the monthly ROT returns without reviewing them, as he admits he did with his original 1994 federal income tax return (Tr. p. 51 (Doe)), he did not make a good faith effort to determine ABC's monthly ROT liabilities. Specifically, he failed to heed the oath written on each and every ROT return required to be submitted to Illinois. 86 Ill. Admin. Code § 700.400(b)-(c). Finally, Doe was negligent by failing to keep, maintain and use, when having others prepare ABC's 1994 ROT returns, the books and records that are required to be kept by any and all retailers operating in Illinois. 35 **ILCS** 120/7; 86 Ill. Admin. Code §§ 130.801-130.810, 700.400(f)(5).

I further note that where a tax preparer is an independent contractor and not an employee, it is the taxpayer that tenders the appropriate information to the contractor to use when preparing returns. Here, Doe tendered to both Jane Doe and Blow the same type of information each used to prepare ABC's monthly ROT returns, namely, bank statements and cancelled checks. Tr. pp. 54, 57-58 (Doe). Doe never argued — let alone offered the documents themselves to show — that such records accurately identify the total amount of ABC's 1994 sales. *See* 35 **ILCS** 120/7; 86 Ill. Admin. Code § 130.805(a) (What Records Constitute Minimum Requirement). Moreover, I fail to see how such

records could have possibly identified the amount of ABC's gross receipts from selling food for consumption off site, or the amount of ABC's gross receipts that were not subject to ROT. 35 ILCS 120/7; 86 Ill. Admin. Code § 130.810 (Records Required to Support Deductions).

In sum, this record shows that the monthly ROT returns Doe filed for ABC during 1994 did not include all of the gross receipts from ABC's sales. Tr. pp. 12, 14-16 (opening statement); Department Ex. 2, p. 12. The same returns overstated the amount of gross receipts ABC realized from selling food for consumption elsewhere. Department Ex. 2, p. 12. The amount of ABC's underreported gross receipts during 1994 is, on average, consistent with that during the rest of the audit period. *Id.*<sup>3</sup> The record also establishes that, as the sole proprietor of ABC in 1994, and for the thirteen years before that, Doe is the person who was responsible for keeping and maintaining the books and records required to be kept all retailers doing business in Illinois. *See* Taxpayer Exs. 1, 3; Tr. p. 50 (Doe); 35 ILCS 120/7; 86 Ill. Admin. Code §§ 130.801-130.810. Doe was the person who provided information about ABC's operations to the persons who prepared ABC's ROT returns, which he signed and filed thereafter. Tr. pp. 54, 57-58 (Doe). Doe concedes that he allowed ROT returns to be negligently prepared and filed after 1994. Tr. pp. 12, 14-16 (opening statement). Doe further admits that he signed his original 1994 federal income tax return without ever reviewing it. Tr. p. 51 (Doe). After taking into

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<sup>3</sup> The audit period consists of  $4\frac{3}{4}$  years, or 57 months. Department Exs. 1-2. The reaudit report, the accuracy of which, except for the 1994 negligence penalty, Doe does not dispute (Tr. pp. 12, 14-16 (opening statement)), calculates that ABC underreported \$1,073,228 of gross receipts for the entire audit period. Department Ex. 2, p. 12. Thus, Doe concedes that ABC's returns underreported, on average, about \$18,829 worth of gross receipts for each month in the audit period, or about \$225,948 for each year of the audit period. Department Ex. 2, p. 12 ( $\$1,073,228 \div 57 \approx \$18,829 \times 12 = \$225,948$ ). That is consistent with ABC's conceded underreporting of about \$227,000 of gross receipts for 1994. *Id.*; Tr. pp. 12, 14-16.

account all of those facts, it is not unreasonable to conclude, as the Department determined, that one of the reasons why ABC's 1994 ROT returns were not accurate was because Doe was as negligent in 1994 as he concedes he was in the remaining years of the audit period. Department Ex. 2, p. 4; Tr. pp. 12, 14-16 (opening statement); 35 ILCS 735/3-5(b).

**Conclusion:**

I conclude that Doe has not shown that he exercised ordinary business care and prudence when attempting to make a good faith effort to determine ABC's monthly ROT liabilities during 1994. I recommend, therefore, that the Director revise the Department's NTL to be consistent with the results of the reaudit Doe requested. Department Ex. 2, p. 2; Tr. p. 12. The revised NTL should be finalized, with the negligence penalty applied for the entire audit period, with interest to accrue pursuant to statute.

9/27/01  
Date

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Administrative Law Judge