

**ST 02-21**

**Tax Type:**

**Sales Tax**

**Issue:**

**Audit Methodologies and/or Other Computational Issues**

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

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**THE ILLINOIS DEPARTMENT OF  
REVENUE**

v.

**JOHN DOE, d/b/a  
ABC TAVERN,**

No. 01-ST-0000

IBT: 0000-0000

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Mr. Ronald Forman, Special Assistant Attorney General for the Illinois Department of Revenue; Mr. JOHN DOE appearing *pro se*.

**SYNOPSIS:**

This matter arose following the protest of a Notice of Tax Liability issued by the Department of Revenue (“Department”) on December 4, 2000 to JOHN DOE d/b/a ABC Tavern (“taxpayer”) for the audit period of January 1, 1997 through June 30, 2000.

The issues to be determined at hearing are as follows: a) whether the Department used the correct selling price of beer in projecting gross receipts 2) whether the Department determined the proper percentages for the amount of beer sold by pitcher and the amount of beer sold by the glass 3) whether the Department's projections take into account the sales tax allegedly collected by taxpayer 4) whether the Department correctly determined taxpayer's purchases of cigarettes and soda pop for 1999 and, 5) whether the Department determined the proper allocation between purchases of soda pop and cigarettes for 1997-1999. After reviewing the evidence adduced at hearing, it is my recommendation that the Department's Notice of Tax Liability as revised by the auditor's calculations during the re-audit be finalized.

**FINDINGS OF FACT:**

1. The Department established its *prima facie* case, inclusive of all jurisdictional elements, by the admission of the Department's Notice of Tax Liability. Dept. Ex. No. 1.
2. While this matter was in administrative hearings, the taxpayer provided additional information to the Department auditor. The auditor conducted a re-audit wherein the original NTL was revised. The only periods that remain at issue in this matter are the audit years 1997, 1998 and 1999. Dept. Ex. No. 2.
3. Revenue Auditor Geraldine Edwards ("auditor" or "Edwards") conducted the audit of ABC Tavern. Edwards has conducted sales and use tax audits of taverns

throughout the course of her twenty-seven year career at the Department. Tr. pp. 10, 11.

4. At the start of the audit engagement, Edwards requested the taxpayer's books and records, including the general ledger, the cash register tapes (Z tapes), the purchase invoices and the income tax returns. Tr. p. 14.
5. Taxpayer did not provide the Department auditor with the cash register tapes (Z tapes). Tr. p. 14.
6. During the audit, the auditor verified taxpayer's purchases by mailing forms called EDA-20s to the taxpayer's suppliers and reviewing the federal income tax returns. Tr. pp. 14, 15, 18.
7. During the course of the audit, the taxpayer provided the auditor with the selling price of some items. The auditor used this information to determine the mark-up used during the audit. Tr. pp. 15, 20.
8. The taxpayer provided the auditor with a selling price of \$1.25 for the beer, including Miller Draft, Miller Light, Bud and Old Style. Accordingly, the auditor used this selling price to determine the markup. Tr. p. 22; Dept. Ex. No. 2, p. 4.
9. The taxpayer provided the auditor with a selling price for the keg beer and the liquor, including Crown Royal and Bacardi Rum. Tr. p. 23.
10. The auditor calculated the projected sales amount by multiplying the amount of total purchases for each category: keg beer, beer, and liquor by the mark-up calculated for each audit year, 1997, 1998 and 1999. Tr. p. 21. The auditor then gave the taxpayer credit for the sales reported by subtracting the taxpayer's reported sales on

its ST-1s, the sales and use tax returns filed with the Department. Tr. p. 21. The resulting unreported sales were multiplied by the tax rate of 8.75% to determine the amount of tax due, for example, \$1,165.96 for 1997. Tr. p. 21. This audit methodology was used by the revenue auditor to determine unreported sales and tax due for all three years of the audit period, 1997, 1998 and 1999. Tr. p. 22; Dept. Ex. No. 2, pp. 5, 6.

11. The auditor did not break down beer sales into amounts of beer sold by the pitcher or by the glass because the taxpayer did not provide documentation to establish these two amounts. Tr. p. 23.
12. The auditor did not give the taxpayer credit for tax collected during the audit or re-audit because taxpayer could not provide evidence tied to its books and records which proved that tax was included in the selling price. Tr. p. 25.
13. The auditor determined that the total purchases for 1999 were \$75,262. This determination did not change during the re-audit. Tr. p. 26; Dept. Ex. No. 2, p. 1.
14. The auditor determined that the total 1999 purchases of keg beer and liquor were the exact amount determined in the auditor's original audit. Dept. Ex. No. 3, p. 6; Tr. pp. 26, 27.
15. On re-audit, the auditor determined that the beer purchases for 1999 were \$36,631 which is approximately \$9,000 less than the amount determined in the original report for the same time period. Tr. p. 27; Dept. Ex. Nos. 2, 3. The difference of \$9,000 in purchases between the original audit and the re-audit resulted from the

auditor's review of the additional information that taxpayer provided while the matter was in administrative hearings. Tr. p. 27.

16. On re-audit, the auditor split the \$9,000 difference in beer purchases made during 1999 between the purchase amounts of pop/misc. and cigarettes evenly since taxpayer did not provide documentation as to the exact purchase amounts of pop/misc. and cigarettes. Tr. pp. 29-31.
17. During the reaudit, the revenue auditor determined the taxpayer's unreported sales for 1997 to be \$13,325 with a resulting tax due of \$1,166; unreported sales in 1998 were \$17,709 with a resulting tax due of \$1,550; unreported sales in 1999 were \$10,999 with a resulting tax due of \$962; and unreported sales in 2000 of -0-. Tr. p. 16; Dept. Ex. No. 2, p. 7. As a result, the taxpayer's total tax due for the entire audit period pursuant to the reaudit is \$3,678. Tr. p. 18; Dept. Ex. No. 2, p. 7.

### **CONCLUSIONS OF LAW:**

The Department introduced its Notice of Tax Liability into evidence under the certificate of the Director. Dept. Ex. No. 1. This established *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 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279 (1943). A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's proposed assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833 (1<sup>st</sup> Dist. 1988). Instead, a taxpayer must present evidence that is

consistent, probable and identified with its books and records to show that the proposed assessment is not correct. Filichio v. Department of Revenue. 15 Ill.2d 327, 333 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34.

In Illinois retailers are required under the Retailers' Occupation Tax Act ("ROTA") to maintain adequate books records as follows:

Every person engaged in the business of selling tangible personal property at retail in this State shall keep records and books of all sales of tangible personal property, together with invoices, bills of lading, sales records, copies of bills of sale, inventories prepared as of December 31 of each year or otherwise annually as has been the custom in the specific trade and other pertinent papers and documents.

**35 ILCS 120/7**

Further, the Department's regulations outline what minimum records a retailer must keep under the ROTA: 1) cash register tapes and other data to keep a record of gross daily sales, 2) vendors' invoices and copies of purchase orders maintained serially and 3) yearly inventory records. 86 Ill. Admin. Code §130.805. 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 the present case, taxpayer did not present the auditor with complete books and records since it could not produce the cash register tapes which documented the taxpayer's daily sales. As a result, the auditor was compelled to obtain the amount of the taxpayer's purchases from its suppliers by mailing out EDA-20 forms and reviewing the federal income tax returns. To arrive at a tax liability, the Department's auditor applied a markup to the purchases to determine the sales of keg beer, beer sold in house, beer sold

carry-out, pop and miscellaneous items and cigarettes. Taxpayer has contested various aspects of the audit methodology.

The Illinois supreme court has held that, to survive attack, the Department's audit methodology must only meet a minimum standard of reasonableness. Fillichio v. Department of Revenue, 15 Ill. 2d at 333; Masini v. Department of Revenue, 60 Ill. App. 3d at 14. After the Department presented its *prima facie* case, the burden shifted to the taxpayer to present evidence sufficient to overcome the presumed correctness of the Department's determination. Taxpayer attempted to meet this burden by presenting the testimony of his accountant who contended that 1) the auditor did not use the correct selling price of beer in projecting gross receipts, 2) the Department incorrectly determined the proper percentages for the amount of beer sold by the pitcher and the amount of beer sold by the glass, and 3) the Department incorrectly determined the taxpayer's purchases of cigarettes and soda pop for 1997-1999. Though the taxpayer's accountant testified that the auditor's determinations were incorrect, taxpayer did not present books and records to corroborate his allegations regarding the inaccuracy of the Department's calculations. The only documentary evidence introduced into the record by the taxpayer consisted of: 1) 15 invoices from purchases made in the year 2002, a year not in the audit period (see, Taxpayer's Ex. No. 1); 2) 9 invoices from purchases made in 1997 (see, Taxpayer's Ex. No. 2); and 3) a one page worksheet prepared by the accountant (see, Taxpayer's Ex. No. 3).

First, the taxpayer specifically disputed the selling price of \$4.50 used by the auditor for sales of beer carry out and offered his accountant's worksheet into evidence which used selling prices of \$3.375 for 1997, \$3.50 for 1998 and \$3.75 for 1999.

Taxpayer, however, did not present evidence proving that this spreadsheet was tied to his books and records. Furthermore, at hearing, the auditor gave credible testimony that she used the selling price of \$4.50 because the taxpayer provided it during the audit. Even if taxpayer now disputes the auditor's claim, taxpayer's failure to provide records to prove that the selling price used by the auditor was inherently unreasonable and should be something other than \$4.50 entitles the auditor to use her judgment and rely upon the best information available.

The same reasoning holds true when taxpayer argues that the Department incorrectly determined the proper percentages for the amount of beer sold by the pitcher versus the amount of beer sold by the glass. Taxpayer simply argues that the sales amounts should be broken down into sales by the pitcher and sales by the glass, however, he does not corroborate this contention with any documentary evidence to prove how much beer was sold by the pitcher or by the glass. Thus, once again the auditor was entitled to use her judgment and given these circumstances there is nothing to indicate that her methodology is unreasonable.

Taxpayer also contends that the Department incorrectly determined the taxpayer's purchases of cigarettes and soda pop for 1999 and incorrectly determined the proper allocation between the purchases of soda pop and cigarettes for 1997–1999. During the administrative hearings process, taxpayer brought in additional information which the auditor reviewed. Upon review, the auditor broke out the beer sales into beer sold in house and beer sold carry-out. During the original audit, the auditor used a mark-up of \$3.12. On re-audit, the auditor determined that the mark-up was \$2.60 for beer sold in house and \$1.56 for beer sold carry-out. In addition, the auditor decreased the total beer

purchases by approximately \$9,000 based upon the additional documentation provided during the re-audit. Since the total purchases for 1999 had been verified through information obtained from taxpayer's suppliers and a review of the taxpayer's federal income tax returns, total purchases remained \$75,262 on re-audit. Thus, the auditor determined that the \$9,000 in purchases which heretofore had been attributed to sales of beer should really be attributed to sales of pop/miscellaneous items and cigarettes. Since no detailed sales information was given by the taxpayer regarding his purchases of pop/misc. or cigarettes for 1999, the auditor split the \$9,000 in purchases evenly between the purchase amounts of pop/miscellaneous items and cigarettes. *See*, Dept. Ex. No. 2, p. 6; Tr. pp. 29-30.

Case law in Illinois clearly indicates that merely denying the accuracy of the Department's assessments or offering alternative hypotheses for arguing that its audit methodology is flawed is not enough to overcome the Department's *prima facie* case. A.R. Barnes & Co., *supra*; Central Furniture Mart, 157 Ill. App.3d 907 (1<sup>st</sup> Dist. 1987). No documentary evidence was presented by the taxpayer to prove that the auditor's determination of the amount of purchases of pop/miscellaneous items and cigarettes was arbitrary, capricious, or unreasonable. Thus, the unsubstantiated oral testimony of the taxpayer's accountant is simply insufficient to overcome the *prima facie* correctness of the NTL.

Finally, the taxpayer argues that the Department failed to take into account the tax allegedly collected by the taxpayer. As the auditor testified at hearing, however, taxpayer could not provide evidence which would indicate that sales tax was included in the selling price. In Illinois, a retailer is required to collect the complementary use tax from

his customer which in effect reimburses the retailer for his retailers' occupation tax liability. 35 ILCS 105/3-45. The retailer is also required to collect and state the tax as a separate and distinct item apart from the selling price of the tangible personal property that is being sold. 35 ILCS 105/3A. If the tax is not stated separately, it is assumed that it was not collected. Central Furniture Mart v. Johnson, *supra*; 86 Ill. Admin. Code, ch I, sec. 150.1315. Since the taxpayer only offered the unsubstantiated oral testimony of his accountant to prove that he had been collecting sales tax as a component of the total price charged, he has not met his burden. As a result, the auditor was justified in her decision not to give the taxpayer credit for sales tax allegedly collected by the taxpayer.

As previously stated, the taxpayer must keep books and records of all of its sales (see 35 ILCS 120/7), and without these records the Department is justified in making a determination according to its best judgment and information. 35 ILCS 120/4. The taxpayer has the burden of overcoming the Department's determination by providing more than its own testimony denying the assessment. Mel-Park Drugs, Inc. v. Dept. of Revenue, 218 Ill. App. 3d 203 (1<sup>st</sup> Dist. 1991). In order to show that the auditor's methodology was incorrect, the taxpayer must present documentary evidence that supports his contentions. The taxpayer has failed to present that evidence, therefore, the Department's determinations should be upheld.

For the foregoing reasons, it is recommended that the Notice of Tax Liability, as revised by the process of re-audit, be finalized.

Date: July 23, 2002

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Christine O'Donoghue

## Administrative Law Judge