

UT 11-09

Tax Type: Use Tax

**Issue: Reasonable Cause On Application Of Penalties
Use Tax On Charitable Food And Drink**

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

THE DEPARTMENT OF REVENUE	)	Docket No.	09-ST-0057
OF THE STATE OF ILLINOIS	)	IBT No.	(ABC Business)
3115-7106	)		(XYZ Business)
2084-3161	)	Letter Nos.	(ABC Business)
L1448156928,	)	L0911286016, CNXX XX76 X686 9128	
v.	)	(XYZ Business)	
L1987427072,	)	L1111584896, CNXX X148 4974 4XX1	
ABC BUSINESS,	)	John E. White,	
Taxpayers	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: John Biek and Andrea Dudding, Neal Gerber & Eisenberg, LLP, appeared for ABC Business Stone Crab of Chicago LLC and XYZ Business; Shepard Smith, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter involves two Notices of Tax Liability (NTLs) the Department issued to ABC Business(ABC Business), and two NTLs the Department issued to XYZ Business (XYZ Business). Those NTLs assessed Illinois use tax, penalties, and interest following an audit of ABC Business and XYZ Business (collectively, Taxpayers) for the period from January 2004 through December 2006. Taxpayers paid the tax assessed on

those NTLs, and protested the Department's assessment of late payment penalties. Thereafter, each Taxpayer filed an amended return to request a refund of some of the Illinois use tax they paid regarding the NTLs. The Department issued Notices of Denial (Denials) in response to those amended returns, and Taxpayers protested those denials. Taxpayers' protests of the NTLs and the Denials were later consolidated for a single hearing.

The hearing was held at the Department's offices in Chicago. There are two issues. The first is whether the Illinois use tax Taxpayers paid regarding food and beverages they purchased for resale, and then gave away without charge to customers dining at the restaurants, was paid in error. If not, the second issue is whether some of the late payment penalties assessed in the NTLs should be abated for reasonable cause. I have reviewed the evidence offered at hearing, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the Director finalize the Denials as issued, and that he revise the NTLs to eliminate the late payment penalties that are attributable to the use tax at issue.

Findings of Fact:

1. Taxpayers are restaurants located in Chicago. Department Ex. 2 (copies of audit workpapers), pp. 3-6 (copy of audit narrative report regarding ABC Business), 21-23 (copy of audit narrative regarding XYZ Business).
2. Both Taxpayers began operations as partnerships owned, in whole or in part, by DEF Business (DEF Business), and others. Department Ex. 2, pp. 3, 21. DEF Business manages both restaurants. Hearing Transcript (Tr.) pp. 12-13 (testimony of John Doe).

3. The Department audited Taxpayers for the period from January 2004 through December 2006. Department Ex. 2, pp. 3, 21. Denise Berry (Berry) conducted the audit. *Id.*, pp. 6, 23; Tr. pp. 54-58 (Berry).
4. John Doe (John Doe) is a partner of accounting and operational analysis at DEF Business. Tr. pp. 9-10 (Donohue). John Doe was the contact person that Berry communicated with during the Department’s audit of Taxpayers. Department Ex. 2, pp. 3, 21; Tr. p. 11 (Donohue).
5. As a result of the audit, Berry determined that Taxpayers owed Illinois use tax regarding, among other things, their practice of making food and drink available to certain customers on a complimentary basis. Department Ex. 2, pp. 2, 5, 20, 23; Tr. p. 60 (Berry). Throughout this matter, the parties have referred to the food and beverage items given away by Taxpayers to customers, without charge, as “comps.” Tr. pp. 5-6 (Taxpayers’ opening statement), 16-17 (John Doe), 60-63 (Berry); Taxpayers’ Post-Hearing Brief (Taxpayers’ Brief), *passim*; Department’s Brief, *passim*.
6. When calculating Taxpayers’ use tax liability regarding the comps, Berry used Taxpayers’ cost price of the food and drink given away to customers as the tax base. Department Ex. 2, pp. 3, 7, 24. Berry used the use tax rate of 1% for Taxpayers’ cost price of the food Taxpayers gave to customers without charge, and 6.25% for Taxpayers’ cost price of the drink Taxpayers gave to customers without charge. *Id.*
7. Following audit, the Department issued two NTLs to each Taxpayer. Department Ex. 1, pp. 4-7.
8. The NTLs assessed Illinois use tax, late payment penalties and interest in the following amounts:

Taxpayer	ABC Business	ABC Business	XYZ Business	XYZ Business
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Audit Period	1/04-11/04	12/04-12/06	1/04-11/04	12/04-12/06
Tax	3,189	7,939	1,379	1,790
Late-payment penalty	638	1,587	276	358
Interest	820	1,384	352	316
Payment	3,189	7,939	1,379	1,790
Amount Due	1,458	2,971	628	674

Department Ex. 1, pp. 4-7.

9. The late payment penalties the Department assessed were equal to 20% of the use tax assessed. Department Ex. 1, pp. 4-7; 35 ILCS 105/12; 35 ILCS 120/4; 35 ILCS 735/3-3.
10. As noted on the NTLs, Taxpayers paid the use tax the Department determined was due, and Taxpayers thereafter protested the Department's assessment of late payment penalties. Department Ex. 2, pp. 3, 21; Tr. pp. 43-44 (John Doe).
11. After Taxpayers protested the penalties assessed in the NTLs, Taxpayers filed amended Illinois sales and use tax returns to claim a refund of some of the use tax assessed on the NTLs, and paid by Taxpayers, as having been paid in error. Tr. pp. 43-44 (John Doe).
12. ABC Business amended return sought a refund of use tax in the amount of \$6,998, and XYZ Business's amended return sought a refund of \$1,830. Department Ex. 1, pp. 2-3. The refunds Taxpayers sought in their amended returns were less than the use tax assessed on the NTLs because Taxpayers conceded some of the auditor's determinations that it owed use tax regarding property purchased and used in manners other than the comps at issue. Department Ex. 2, pp. 5, 12, 22-23, 31-32; Tr. pp. 29-30, 33 (John Doe).
13. To the nearest dollar, the late payment penalty attributable to the use tax for which ABC Business claimed a refund is \$1,400. Department Ex. 1, pp. 2, 4-5; 35 ILCS 735/3-3 (20% of 6,998 = 1,399.6). The late payment penalty attributable to the use

tax for which XYZ Business claimed a refund is \$366. Department Ex. 1, pp. 2, 4-5; 35 ILCS 735/3-3 (20% of 1,830 = 366).

14. The Department issued separate Denials in response to each Taxpayer's amended return/claim for refund. Department Ex. 1, pp. 2-3.
15. At hearing, John Doe described Taxpayers' businesses, and identified certain exhibits Taxpayers offered to demonstrate the different types of comps at issue. Tr. pp. 13-22 (Donohue); Taxpayer Exs. A1-A2.
16. John Doe explained that the comps were provided at the restaurant manager's discretion, and ordinarily, as a "way of taking care of a regular guest, or welcoming a first-time guest, or making a situation right if someone was seated late." Tr. p. 15 (John Doe).
17. John Doe explained that the comps came in two basic types, partial and full. Tr. pp. 14-17 (John Doe).
18. John Doe identified Taxpayer Exhibits A1 and A2 as print-outs from DEF Business's point-of-service system showing a partial comp at each restaurant. Tr. pp. 18-22 (John Doe). Those exhibits were admitted as, respectively, an example of how ABC Business documented its partial comp of certain menu items to a customer, and how XYZ Business documented its partial comp of certain menu items to a customer. Taxpayer Exs. A1-A2; Tr. pp. 18-22 (John Doe).
19. Taxpayers' point-of-service system allowed them to keep detailed records showing the specific items given to customers in both full and partial comp situations. Taxpayer Exs. D1-D2.
20. Taxpayers also used the system to identify and account for the different types of comps given by each restaurant. Tr. p. 41 (colloquy during offer of Taxpayer Exs. D1-D2).

21. Within their respective books and records, Taxpayers classified comps as follows:

ABC Business		XYZ Business	
Food Account Headings	Heading description	Food Account Headings	
CG	Customer goodwill	On Us	Customer goodwill
#1 Club	First time customer	LOS	Late on seating
Bday	Birthday	Bday	Birthday
Holiday	Holiday	LT	Late ticket, item served late
		RG	Regular guest
		#1 Club	First time customer
Liquor, Beer, Wine Account Heading		Liquor, Beer, Wine Account Heading	
CG		On Us	

Taxpayer Exs. C1-C2; Department Ex. 2, pp. 17-19, 33-36; Tr. pp. 45-51 (John Doe).

22. John Doe explained that full comps were most often given to regular, frequent customers, and occasionally to celebrities, which he referred to as VIPs. Tr. pp. 23-24 (John Doe). He identified exhibits that were prepared using Taxpayers' books and records showing that full comps were given most often to regular customers. Tr. pp. 24, 42-43 (John Doe); Taxpayer Exs. D1-D2.

Conclusions of Law:

The Department introduced a copy of the NTLs into evidence under the certificate of the Director. Department Ex. 1, pp. 4-7. It also introduced the Denials the Department issued in response to Taxpayers' amended returns/claims for refund. *Id.*, pp. 2-3. Pursuant to § 4 of the Retailers' Occupation Tax Act (ROTA), and §§ 12 and 20 of the Use Tax Act (UTA), those documents constitute the Department's prima facie case in this matter. 35 ILCS 105/12; 35 ILCS 105/20; 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). A taxpayer cannot overcome the statutory presumption

merely by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217, 577 N.E.2d 1278, 1287 (1st Dist. 1991).

Issue and Arguments

Issue 1: Whether Taxpayers' Comps Were Subject to Use Tax

The issue is whether Taxpayers' practice of giving food and drink to customers, without charge, constitutes a use of that property by Taxpayers. If it does, then Taxpayers did not pay such tax in error. *See* 35 ILCS 105/19; 35 ILCS 105/20. To support the claim that they paid the use tax at issue in error, Taxpayers cite to two Illinois Retailers' Occupation Tax regulations (ROTR), §§ 130.201 and 130.2160 (86 Ill. Admin. Code § 130.201; 86 Ill. Admin. Code § 130.2160), and the decision in Boye Needle Co. v. Department of Revenue, 45 Ill. 2d 484, 259 N.E.2d 278 (1970). Taxpayers' Brief, pp. 7-11. I address each in turn.

Regulation § 130.201(b) provides, in pertinent part:

Section 130.201 The Test of a Sale at Retail

b) Sales for Transfer as Gifts, etc.

Sales at retail also include any sale of tangible personal property to a purchaser even though such property may be used or consumed by some other person to whom such purchaser transfers the tangible personal property without a valuable consideration, such as gifts, and advertising specialties distributed gratis apart from the sale of other tangible personal property or service (see Sections 130.2120 and 130.2160 of this Part). For example, when a manufacturer orders, pays for and directly ships point-of sale advertising items to retailers separately from the sale of other tangible personal property or service, the manufacturer is considered the user of the items and incurs Use Tax. For instance, when

a beer manufacturer provides items, such as interior neon signs, clocks, and other devices intended to encourage a demand for the products that they manufacture, to retailers for display, the manufacturer is the user of the property and incurs Use Tax. (*Miller Brewing Company v. Korshak* (1966), 35 Ill.2d 86, 219 N.E.2d 494). However, when the tangible personal property is transferred along with other goods for which a charge is made, that transfer is deemed a sale for resale. When sewing needle display racks, for example, are transferred along with sewing needles for which a charge is made, the transfer is deemed a sale for resale. (*Boye Needle Company v. Department of Revenue* (1970), 45 Ill.2d 484, 259 N.E.2d 278). Grocery store display racks provided free of charge to grocery stores by a manufacturer, in exchange for the right to exclusively display its product on the rack, are another example of this type of sale for resale.

86 Ill. Admin. Code § 130.201(b). Regulation § 130.2160(b) provides, in pertinent part:

Section 130.2160 Vendors of Tangible Personal Property Employed for Premiums, Advertising, Prizes, Etc.

b) When Not Liable for Retailers' Occupation Tax

1) Persons who sell tangible personal property to purchasers who transfer such property to others along with other tangible personal property or service for which a charge is made are selling tangible personal property to purchasers for purposes of resale and are not liable for Retailers' Occupation Tax when making such sales.

2) For example, the sale of match books to a dealer, who transfers such match books to customers along with cigarettes or cigars sold by the dealer to such customers, is a sale of the match books to the dealer for purposes of resale.

86 Ill. Admin. Code § 130.2160(b).

In *Boye Needle Co.*, Boye, a manufacturer and distributor of knitting and sewing supplies, challenged the Department's assessment of Illinois use tax regarding Boye's transfer of displays, without charge, to Illinois retailers to whom the vendor also sold knitting and other supplies for resale. *Boye Needle Co. v. Department of Revenue*, 45 Ill. 2d 484, 259 N.E.2d 278 (1970). The issue was whether Boye owed use tax on its transfers of such displays to the retailers for no valuable consideration. *Boye Needle Co. v. Department of Revenue*, 45 Ill. 2d 484, 259 N.E.2d 278 (1970). The Court addressed the issue by referring to what was then ROTR § 50, and which now codified as ROTR §

130.2160. *Id.* The Court held, “Since, by virtue of Rule No. 50, plaintiff’s suppliers are clearly not taxable under the Retailers’ Occupation Tax Act, we find that section 3 of the Use Tax Act bars the imposition of use tax upon plaintiff.” *Id.* at 487, 259 N.E.2d at 280.

Boye was decided by the Illinois Supreme Court shortly after the Illinois General Assembly amended the ROTA in 1965. The 1965 amendments fundamentally changed ROTA § 1’s statutory definition of “sale at retail,” and added § 2c to the Act. *Compare id. with 35 ILCS 120/1 and 35 ILCS 120/2c* (Smith-Hurd (1992)) (Historical and Statutory Notes). The amendment to ROTA § 1 included sales for resale within the definition of taxable sales at retail, “unless made in compliance with Section 2c of this Act.” 35 ILCS 120/1 (Smith-Hurd (1992)) (Historical and Statutory Notes). Previously, the definition of sale at retail excluded sales for resale. *E.g., Burrows Co. v. Hollingsworth*, 415 Ill. 2d 202, 208, 112 N.E.2d 706, 709 (1953). In other words, before the statutory amendment, sales for resale were, by definition, not retail sales that were subject to ROT. *Id.* After the amendment, sales for resale could be exempt from taxation, but only so long as the seller complied with § 2c. *E.g., Cerro Wire & Cable Co., Department of Revenue*, 111 Ill. App. 3d 882, 444 N.E.2d 771 (1st Dist. 1982). Although nothing within the decision makes clear when the transactions at issue in Boye took place, the Court’s holding strongly suggests they occurred before the 1965 amendments became effective. Boye Needle Co., 45 Ill. 2d at 487, 259 N.E.2d at 280.

Moreover, there are other reasons why the ROT regulations and court decision Taxpayers cite do not lend any meaningful guidance to this dispute. First, ROTR §§ 130.201(b) and 130.2160(b) each describe situations in which a wholesaler’s sales or transfers of certain types of property to retailers might be subject to ROT. 86 Ill. Admin. Code § 130.201(b); 86 Ill. Admin. Code § 130.2160(b). But Taxpayers here are not wholesalers, and the transactions at issue are between retailers and their customers for

consumption. Nor does this matter involve the Department's determination that Taxpayers' vendors, or Taxpayers themselves, are subject to ROT regarding the property they gave away, without charge, to customers. The Department expressly concedes that Taxpayers' comps are not subject to ROT. Department's Brief, pp. 3-4.

Second, unlike the situation in Boye, Taxpayers' vendors did not sell to Taxpayers any property that the vendors or Taxpayers could identify, at the time of Taxpayers' purchases, as being property that Taxpayers would transfer to purchasers without charge. The evidence is clear that comps were given at a manager's discretion. Tr. p. 15 (John Doe). Taxpayers were exercising their discretion, on a daily basis, over which particular items of food and drink they would give away to certain customers. *Id.*; Taxpayer Exs. D1-D2. To put it in statutory terms, when Taxpayers decided that they would make a full or partial comp of food and/or drink to a customer, they were exercising rights and powers over such tangible personal property incident to their ownership of that property. 35 ILCS 105/1. The Illinois General Assembly has defined such an exercise of rights and powers over property as a "use" that is subject to Illinois use tax. *Id.*; 35 ILCS 105/3. The type of "use" that is *not* taxable under the UTA is "the sale of such property in any form as tangible personal property in the regular course of business" 35 ILCS 105/1. The parties agree that Taxpayers did not sell the menu items they comped.

Taxpayers also concede that they owe use tax on certain items of food and drink that they purchased for resale, but which they thereafter used, themselves, when restaurant employees consumed such food and drink at manager's tastings. Taxpayers' Brief, p. 5; Department Ex. 2, pp. 2, 20. That concession acts as a tacit admission that Taxpayers can use — and be subject to use tax on their cost price of — the food and drink they purchased for resale, but which property they did not actually resell at retail.

The Department argues that the comps are taxable under ROTR § 130.2125(c).

Department's Brief, pp. 3-4, 7; 86 Ill. Admin. Code § 130.2125. That regulation provides, in pertinent part, as follows:

Section 130.2125 Trading Stamps, Discount Coupons, Automobile Rebates and Dealer Incentives

b) Discount Coupons

1) Where the retailer receives no coupon reimbursement:

If a retailer allows a purchaser a discount from the selling price on the basis of a discount coupon for which the retailer receives no reimbursement from any source, the amount of the discount is not subject to Retailers' Occupation Tax liability. Only the receipts actually received by the retailer from the purchaser, other than the value of the coupon, are subject to the tax. For example, if a retailer sells an item for \$10 and the purchaser provides the retailer with a \$1 instore coupon for which the retailer receives no reimbursement from the manufacturer of the item or any other source, the retailer's gross receipts of \$9 are subject to Retailer's Occupation Tax.

c) Gift Situations

Where a retailer, manufacturer, distributor, or other person, issues a coupon that entitles the bearer to obtain an item of tangible personal property free of any charge whatever and not conditioned on the purchase of other property, the furnishing of the tangible personal property does not constitute a sale under the Retailers' Occupation Tax Act and the retailer does not incur Retailers' Occupation Tax liability with respect to the transfer. However, the retailer, manufacturer or distributor, or other person, issuing a coupon, as donor, incurs Use Tax liability on his cost price of all tangible personal property actually transferred as a result of the coupon. (See Subpart C of the Use Tax Regulations.)

If a bearer (customer) presents a retailer with a coupon issued by the retailer that entitles the bearer to a free item and the coupon is not conditioned on a purchase, the retailer incurs Use Tax based upon its cost price of the item given away. However, if a bearer (customer) presents a retailer with a coupon issued by the manufacturer that entitles the bearer to a free item and the coupon is not conditioned on a purchase by the customer, the manufacturer incurs Use Tax based upon its cost price of the item given away. However, in many cases, the manufacturer incorporates language into the coupon that requires the bearer (customer) to assume this Use Tax liability.

86 Ill. Admin. Code § 130.2125.

Notwithstanding the Department's argument, by its own terms, this ROTR is not applicable to the facts or issue present in this matter. Taxpayers' decision to comp

individual menu items, or all of the individual menu items, ordered by particular customers, was not initiated as a result of coupons given to them by customers. The comps at issue here had nothing to do with any coupons produced by Taxpayers, or by anyone else. Further, nothing within the applicable part of ROTR § 130.2125(c) persuades me that that part of the regulation should apply to situations where discount or gift coupons are not, in fact, exchanged between the parties to a transaction.

The regulation that is more applicable to the issue here is use tax regulation (UTR) § 150.305. 86 Ill. Admin. Code § 150.305. That UTR provides, in pertinent part:

Section 150.305 Effect of Limitation that Purchase Must be at Retail From a Retailer to be Taxable

a) The limitation in the Act to the effect that the tangible personal property must be purchased at retail from a retailer excludes, from the Use Tax, the use of tangible personal property produced by the user himself or acquired by the user by way of a gift or in some manner other than by means of a purchase.

b) However, although the user is not taxable on the value of the finished product which he produces himself, such user is taxable on the purchase price of the tangible personal property that he purchases and incorporates into such finished product which he uses in this State, such purchase being a purchase at retail or a purchase for use.

c) Although the donee in a gift situation is not a taxable user, the donor who purchases the property and gives it away makes a taxable use of the property when making such gift. For example, if a cellular phone company gives cellular phones to its customers as part of a sales promotion, it owes Use Tax on its cost price of the phones that are given away. In this situation, the cellular company, as donor, is considered to have used the items by giving them away.

86 Ill. Admin. Code § 150.305.

There is no dispute that Taxpayers' comps consisted of food and/or drink that Taxpayers gave to customers without charge. Taxpayers purchased the food and drink in Illinois, and they gave that property to customers in Illinois, without charge. Under Illinois common law, Taxpayers' comps of food and drink to customers were gifts to customers. In re Estate of Hopkins, 214 Ill. App. 3d 427, 438, 574 N.E.2d 230, 237 (2d

Dist. 1991) (“A ‘gift’ is defined as ‘a voluntary, gratuitous transfer of property by one to another where the donor manifests an intent to make such a gift and absolutely and irrevocably delivers the property to the donee.’ ”); 86 Ill. Admin. Code § 150.305(c). Under the plain text of UTR § 130.305(c), Taxpayers’ comps subjected Taxpayers to use tax on the cost price of the property they gave away. 86 Ill. Admin. Code § 150.305(c).

John Doe explained that the comps were given to foster customer goodwill (Tr. p. 13 (John Doe)), and logic and ordinary human experience explain why Taxpayers’ practice would produce such goodwill. Receiving a gift ordinarily produces a positive reaction from the donee towards the donor. John Doe’s testimony makes clear that Taxpayers have made a business decision that the value of the goodwill generated by providing comps is worth more than Taxpayers’ costs for them. A gift has a cost, and it is ordinarily paid by the donor. What this dispute resolves is that Taxpayers’ costs for providing comps must also include tax, at the statutory rate, on their cost price for the food and drink they elected to give away, instead of selling. 86 Ill. Admin. Code § 150.305(c). During audit, Berry determined that the applicable use tax rate was 1% of Taxpayers’ cost of the food given to customers without charge, and 6.25% of Taxpayers’ cost of the drink given to customers without charge. Department Ex. 2, pp. 3, 7, 24.

Taxpayers disagree that their comps were gifts, and instead view their practice of giving partial comps as being a discount to an overall meal. At hearing, John Doe said that sales tax was paid on the net selling price Taxpayers charged for such meals, and that the assessment of additional use tax on items for which Taxpayers did not charge customers was not appropriate. Tr. p. 26. John Doe described that Taxpayers took a broader view regarding full comps given to regular customers. *Id.* In such a case, John Doe said, there was no selling price charged and no sales tax paid, and the customers have paid for several meals over a period of time. *Id.*

The documentary evidence, however, does not support John Doe's testimony, or Taxpayers' view of their practice. First, no documentary evidence was offered to show that either Taxpayer was primarily engaged in the business of selling prix fixe meals. Instead, Taxpayers' records show that all of the individual menu items sold to a customer are listed on the checks they presented to that customer. *See* Taxpayer Exs. C1-C2. When Taxpayers made a partial comp, the checks identify the specific items for which Taxpayers did not charge a customer, and the selling prices for such items was then deducted when calculating the total sum (before tip) listed at the bottom of a check. Taxpayer Exs. C1-C2. Thus, Taxpayers' records do not reflect that they were taking some percentage "off-the-top" of a customer's bill.

Similarly, the evidence does not support Taxpayers' argument that their full comps were discounts on their expected sales of future meals purchased by the same customers. First, no evidence identifies the persons who received full comps. Therefore, there is no way to show that the same persons who received full comps, in fact, purchased food or drink, either before or after the full comp, from either Taxpayer. Taxpayers ask, in effect, that the Department assume a set of facts for which no documentary evidence exists, and which is not consistent with the books and records Taxpayers make and keep in the regular course of business. Taxpayers' full comps were not discounts; they were gifts. *In re Estate of Hopkins*, 214 Ill. App. 3d at 438, 574 N.E.2d at 237; 35 ILCS 105/1; 86 Ill. Admin. Code § 150.305(c).

After considering the evidence, I conclude that Taxpayers have not shown that the use tax they paid regarding their comps was paid in error. Thus, the Department's Denials of their claims for refund should be finalized as issued.

Issue 2: Whether The Late Payment Penalties Attributable to the Comps Issue Should Be Abated

The next issue is whether the late payment penalties assessed, and attributable to the comps issue, should be abated for reasonable cause. The NTLs reflect that the Department assessed a late payment penalty in the amount of 20% of the use tax assessed and paid. Taxpayers have protested the assessment of the penalty, which remains unpaid. Department Ex. 1, pp. 2-3.

Section 12 of the UTA incorporates, among other sections, § 4 of the ROTA. 35 ILCS 105/12. Section 4 of the ROTA authorizes the Department to assess penalties, as part of an NTL, in accordance with Illinois' Uniform Penalty and Interest Act (UPIA). 35 ILCS 105/12; 35 ILCS 120/4. Section 3-3 of the UPIA authorizes a penalty "for failure to pay the tax shown due or required to be shown due on a return on or before the due date prescribed for payment of that tax" 35 ILCS 735/3-3(b-15)-(b-20), (c). Section 3-8 of the UPIA provides that a penalty imposed by UPIA § 3-3, *inter alia*, "shall not apply if the taxpayer shows that his failure to ... pay tax at the required time was due to reasonable cause." 35 ILCS 735/3-8.

The Department has adopted a regulation regarding reasonable cause which provides that, "[t]he determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion." 86 Ill. Admin. Code § 700.400(b). The regulation further provides that, "[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. ***" 86 Ill. Admin. Code § 700.400(c). The burden rests on the taxpayer to show that it acted with ordinary business care and prudence when filing its returns and paying the

correct amount of tax when due. Hollinger International, Inc. v. Bower, 363 Ill. App. 3d 313, 328, 841 N.E.2d 447, 460 (1st Dist. 2005).

There is considerable documentary evidence in this record of Taxpayers' history of making prompt and proper tax filings and payments, its meticulous record-keeping, of the good faith basis of its stance on this particular legal issue. Department Ex. 2, pp. 3-5, 21-23; 86 Ill. Admin. Code § 700.400(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."). Specifically, Berry made the following notes in her audit narratives: "Controls are in place. There was large volumes of detailed paperwork for everything; fixed assets, consumables, withholdings, sales and etc. *** [Taxpayers] have very detailed backup papers therefore, no projections were used for use tax on drinks and food comps." Department Ex. 2, pp. 3, 21. As to good faith, there were other minor issues discovered during the audit, for which Taxpayers agreed with the auditor's determinations, and then promptly paid the resulting tax due. Department Ex. 2, *passim*. On this issue, however, Taxpayers did not agree with the Department's determination. Department Ex. 2, pp. 3-5.

Further, Berry noted in her audit comments that Taxpayers had consulted with counsel during the audit, and that counsel agreed with Taxpayers' view of the comps at issue. *Id.*, p. 3. While "reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence" (86 Ill. Admin. Code § 700.400(c)), I understand that to mean that such reliance will not be determinative of whether a taxpayer exercised ordinary business care and prudence. *See Hollinger International, Inc.*, 363 Ill. App. 3d at 326-30, 841 N.E.2d at 458-62 (reliance on actions of taxpayers' accountants were not sufficient to abate penalty for underpayment of estimated taxes). But Taxpayers' actual reliance on the advice of counsel here, as

documented by Berry (Department Ex. 2, p. 3), is certainly probative of whether it exercised ordinary business care, and it is strongly persuasive on the evidence of Taxpayers' good faith.

Additionally, evidence of Taxpayers' good faith and ordinary business care and prudence includes Taxpayers' citation to two current ROT regulations and to an Illinois Supreme Court case construing a prior version of one of those regulations. Taxpayers' Brief, *passim*. On this point, the reasonable cause regulation provides:

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

8) An Illinois appellate court decision, a U.S. appellate court decision, or an appellate court decision from another state (provided that the appellate court case in the other state is based upon substantially similar statutory or regulatory law) which supports the taxpayer's position will ordinarily provide a basis for a reasonable cause determination.

86 Ill. Admin. Code § 700.400(e)(8).

As a final comment on the evidence regarding Taxpayers' good faith and ordinary business care and prudence, I note the manner in which Taxpayers elected to challenge the Department's audit determination on the comps issue. They paid the use tax determined to be due, before the NTLs were issued, and then filed an amended return to seek a refund of that part of the tax paid that was attributable to the issue over which Taxpayers had a good faith dispute. This action followed a procedure — that is, pay first, contest after — that the tax collector would ordinarily encourage taxpayers to elect.

Based on my review of all of the evidence, I conclude that Taxpayers have shown that they exercised good faith and ordinary business care and prudence when attempting to timely pay its correct tax liabilities regarding this issue. Pursuant to UPIA § 3-8, I recommend that the Director revise the NTLs to eliminate the late payment penalties

which are attributable to this comps issue. Specifically, I recommend that the Director eliminate \$1,400 of the late payment penalties assessed against ABC Business, and \$366 of the penalties assessed against XYZ Business. Department Ex. 1, pp. 2, 4-5; 35 ILCS 735/3-3. I recommend that the NTLs be finalized as so revised, consistent with applicable statutes.

Conclusion:

I recommend that the Director finalize the Denials as issued. I further recommend that the Director revise the NTLs to eliminate the amounts of late payment penalties identified above, together with any amount of interest allocable thereto, and that the NTLs be finalized as so revised, consistent with applicable statutes.

Date: September 2, 2011

John E. White, Administrative Law Judge