

ST 10-09

Tax Type: Sales Tax

Issue: Reasonable Cause on Application of Penalties

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

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

v.

**ABC SALES & SERVICE,
LLC,
Taxpayer**

**No. 09-ST-0000
IBT# 0000-0000
Assessment# 00-000000
Liability Period 11/04**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Marc Muchin on behalf of the Illinois Department of Revenue; Robert Petti, Esq. of the Christopoulos Law Group, LLC, on behalf of ABC Sales & Service, LLC.

Synopsis:

This matter comes on for hearing pursuant to a protest filed by ABC Sales and Service, LLC (“taxpayer”) to the Department’s LTR-201 Request for Abatement issued by the Department on December 3, 2008 refusing to abate a late payment penalty and a late filing penalty resulting from the taxpayer’s late filing of its November 2004 monthly liquor tax return and its late payment of the tax due with this return. The issue presented is whether there exists reasonable cause to abate the statutory penalty assessed by the Department in this matter. A hearing on this matter was held on April 19, 2010. At

hearing John Doe, the taxpayer's general manager, appeared and testified on behalf of the taxpayer and James Barborka, an auditor with the Department, appeared and testified on behalf of the Department. Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department. In support of this recommendation, I make the following findings of fact and conclusions of law.

Findings of Fact:

1. The Department's *prima facie* case against the taxpayer, inclusive of all jurisdictional elements, was established by the admission into evidence of the Department's ETS-52 Notice of Assessment for Liquor Tax issued May 7, 2008. Department Exhibit ("Ex.") 1.
2. The taxpayer is a Limited Liability Company engaged in the sale of various brands of liquor in the City of Chicago. Tr. p. 14; Department Ex. 1.
3. During 2004, John Doe was the general manager of the taxpayer. Tr. p. 13. His responsibilities included supervising the taxpayer's controller who was responsible for the payment of liquor taxes. Tr. pp. 14, 15.
4. The taxpayer files monthly liquor excise tax returns with the Department and remits taxes by electronic funds transfer. Tr. pp. 15, 25, 26; Department Ex. 1, 2. The taxpayer began making payment of taxes by electronic funds transfer in 2003. Tr. p. 26. The taxpayer's controller was responsible for the administration of software acquired by the taxpayer in 2003 for this purpose. Tr. p. 15.
5. The taxpayer was required to report and remit liquor taxes due for November 2004 to the Department on or before December 15, 2004. 35 ILCS 235/8-2. The taxpayer

failed to report liquor tax due for November 2004 prior to the due date for this return, and did not file this return until December, 2006 which was 24 months after the return's due date. Tr. p. 29. The taxpayer also failed to make the tax payment due for November 2004 on or prior to the due date for this payment, and did not make the required tax payment until October, 2008, which was almost four years after it was due. Tr. p. 17.

6. On May 7, 2008, the Department issued an ETS-52 Notice of Assessment for Liquor Tax assessing tax due on the taxpayer's November 2004 return that was not paid when this return was filed. Tr. pp. 29, 30; Department Ex. 1.
7. The taxpayer's failure to report and remit taxes in a timely manner was caused by errors by its controller and imperfections in the taxpayer's electronic systems for keeping records and identifying payments. Tr. pp. 17-19.
8. The Department introduced documentary evidence indicating that there were six other instances in which the taxpayer was assessed a penalty for late compliance during 2003 and 2004. Tr. pp. 32, 33; Department Ex. 2. These assessments were paid in full by the taxpayer. *Id.*
9. The taxpayer requested an abatement of the late filing and late payment penalty assessed as a consequence of the taxpayer's failure to timely file its November 2004 return and pay the tax due with this return. Taxpayer's Ex. 2. This request was denied based upon the Department's determination that "the circumstances described in your request are not considered to be extenuating." *Id.*

Conclusions of Law:

The Department imposed a penalty for the late filing of a liquor excise tax return pursuant to section 3-3(a-10) of the Uniform Penalty and Interest Act ("UPIA"), 35 ILCS 735/3-3(a-10) ("section 3-3(a-10)"). Section 3-3(a-10) includes the following provision:

(a-10) This subsection (a-10) is applicable to returns due on and after January 1, 2001. A penalty equal to 2% of the tax required to be shown due on a return, up to a maximum of \$250, reduced by any tax that is paid on time or by any credit that was properly allowable on the date the return was required to be filed, shall be imposed for failure to file the tax return on or before the due date prescribed for filing determined with regard for any extension of time for filing. However, if any return is not filed within 30 days after notice of nonfiling mailed by the Department to the last known address of the taxpayer contained in the Department records, an additional penalty amount shall be imposed equal to the greater of \$250 or 2% of the tax shown on the return.

The Department also imposed a penalty for the late payment of taxes pursuant to section 3-3(b-10) of the UPIA, 35 ILCS 735/3-3(b-10) ("section 3-3(b-10)"). Section 3-3(b-10) includes the following provision:

(b-10) This subsection (b-10) is applicable to returns due on and after January 1, 2001. A penalty shall be imposed for failure to pay:

(1) The tax shown due on a return on or before the due date prescribed for payment of that tax, an amount of underpayment of estimated tax, or an amount that is reported in an amended return, other than an amended return timely filed as required by subsection (b) of section 506 of the Illinois Income Tax Act (penalty for late payment or nonpayment of admitted liability).

The Department's determination is presumed to correct. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988). Once the presumed correctness of the assessment is established, the burden shifts to the taxpayer to prove that the determination was in error. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987); Vitale v. Department of Revenue, 118 Ill. App. 3d 210 (3d Dist. 1983); Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978); A.R. Barnes & Co., *supra*.

Section 3-8 of the UPIA, 35 ILCS 735/3-8 (“section 3-8”) provides a basis for the abatement of the section 3-3(a-10) and section 3-3(b-10) penalties, stating as follows:

No penalties if reasonable cause exists. The penalties imposed under the provisions of section 3-3, 3-4, 3-5 and 3-7.5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. A taxpayer may protest the imposition of a penalty under section 3-3, 3-4, 3-5 or 3-7.5 on the basis of reasonable cause without protesting the underlying tax liability.

The Department’s regulations emphasize that, in evaluating whether reasonable cause for abatement exists, the primary focus is to be on the question whether the taxpayer made a good faith effort to comply evidenced by its exercise of ordinary business care and prudence in the process of filing returns and paying taxes. See 86 Ill. Admin. Code, ch. I, section 700.400(b), (c).

The taxpayer contends that it exercised ordinary care and prudence by setting up a system of internal controls and procedures that were designed to assure that it timely paid its tax liabilities. Tr. pp. 15, 24, 25. However, the record shows that the taxpayer failed to

comply at least eight times between 2002 and 2004. Tr. pp. 32, 33; Department Ex. 2. Moreover, the taxpayer admits that its failure to comply with respect to its November 2004 return and payment was a result of errors on its part. Specifically, it explained the reasons for its compliance lapses as follows:

A. It came down to two items[.] [O]ne was a person item, the controller we had at that time had failed to accurately reconcile the cash against the general ledger in such a way – correctly, so that we could ... tell that we had missed the payment.

So the first was a performance issue from a person.

The second was in terms of processes. As I mentioned, we had a couple [of] new versions of this ClockWorks software which we [used to] submit our payments, submit our filings and our payments every month. We also had -- in the 2003 area [a] new general ledger and accounts payable system. And though we were getting good reports from the system, the process for double checking ourselves was not as easy in 2004 as it was in 2005 or 2006, when we were able to get better exports from our general ledger system, and better data exports from our banking system through the Internet and tie them together through a separate database to be able to match up items that were in the ledger with payments that were made out of the bank.

Tr. pp. 18, 19.

The record indicates that the taxpayer's internal controls failed to identify the taxpayer's failure to pay its November 2004 liquor tax due December 15, 2004 (see 235 ILCS 5/8-2) and that this tax was not paid until October, 2008, six months after the Department's issuance of a ETS-52 Notice of Assessment for Liquor Tax. Tr. p. 17; Department Ex. 1. The record also indicates that the taxpayer's liquor tax return for November 2004 was not filed until December of 2006, two years after it was due. Tr. p. 29.

Obviously, the failure of the taxpayer's accounting system to properly identify unpaid taxes due for November 2004 does not explain the taxpayer's failure to file its

liquor excise tax return for that month until at least two years after it was due since this return would have been due whether or not the taxpayer's accounting system identified unpaid taxes that needed to be reported. See 86 Ill. Admin. Code, ch. I, section 420.80(a)(3) ("Each manufacturer or importing distributor is required to file a return for each month that his license is in full force and effect, irrespective of the fact that he may not have any tax liability to pay for that month."). Moreover, the fact that the taxpayer's internal controls were insufficient to ever notify the taxpayer of its failure to pay omitted taxes belies the taxpayer's claim that it had an effective system of internal controls in place to insure prompt and timely tax compliance. While the taxpayer's compliance record after 2004 indicates that these internal controls were greatly improved and resulted in no compliance lapses after that year (Tr. p. 40), the issue that is before me in the instant case is whether the taxpayer was exercising ordinary care and prudence when the November 2004 return and payment were due. The evidence of the taxpayer's proper compliance subsequent to November 2004 presented in this case does not show the exercise of ordinary care and prudence at the time its return and taxes for 2004 should have been filed and paid.

The taxpayer also argues that the fact that it immediately paid the tax at issue when it determined that it had not been timely paid is evidence of its good faith effort to comply with the state's tax laws. Tr. pp. 52, 53. While it is fortuitous that the taxpayer paid the delinquent tax as soon as it became aware of its failure to pay this tax when it was due, this does not overcome the fact that no reasonable cause for the taxpayer's failure to timely file the necessary return and timely pay the necessary tax has been proffered by the taxpayer. It is not the taxpayer's failure to file and pay, but rather the

taxpayer's failure to timely file and timely pay that demands a reasonable excuse in order for any abatement to be applicable under the law. See section 3-3(a-10), section 3-3(b-10), section 3-8. Put in its simplest terms, a taxpayer cannot avoid the consequences of the commission of a wrong by the performance of a related good deed subsequent to the wrong. It is not the balance of equities that the UPIA requires. Instead, it is the presence of a reasonable cause for failure to perform an act or duty mandated by law which justifies any abatement in this case.

The Department contends that the circumstances of the taxpayer's late filing and late payment at issue described by the taxpayer did not constitute a reasonable cause for a failure to file and failure to pay as currently defined by the Department. Tr. pp. 42, 43; Taxpayer's Ex 2. Pursuant to authority granted by the Legislature, the Department has promulgated rules interpreting reasonable cause at 86 Ill. Admin. Code, ch. I, section 700.400(e) ("section 700.400(e)"). These rules provide in part as follows:

e) Examples of Reasonable Cause. The following non-exclusive list of situations will constitute reasonable cause for purposes of the abatement 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 injury 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 these 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 records 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 the Internal Revenue Service.
- 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.
- 9) The Department gave erroneous information, or delayed a process under its control. ...
- 10) Taxes withheld by an employer for the wrong state. ...
- 11) Embezzlement or employee fraud not reasonably within the knowledge of the taxpayer.

The taxpayer contends that its failure to timely comply was caused by imperfections in its accounting system and errors made by its controller in reconciling the taxpayer's general ledger with its bank account. Tr. p. 18. As noted above, it also points to the establishment of compliance systems to insure compliance and its prompt payment of delinquent taxes once these were identified as a basis for a reasonable cause determination in favor of the taxpayer in this case. Tr. pp. 6, 15, 25, 26, 52, 53. However, a perusal of section 700.400(e) indicates that it contains no provision for an abatement of late filing and late pay penalties based upon the factual circumstances the taxpayer has enumerated. Accordingly, the Department's contention that the reasons given for the taxpayer's late filing and late payment do not come within the Department's understanding of circumstances constituting reasonable cause is supported by the taxpayer's failure to come within any of the situations listed in section 700.400(e). Nor has the taxpayer cited any other authority for the abatement of late filing or late payment penalties based upon the actions taken by the taxpayer in this case. In the absence of such authority, the taxpayer cannot establish that its actions constituted a basis for rebutting the Department's *prima facie* case.

The taxpayer also argues that it should not be subject to a late filing and a late payment penalty because of its exemplary compliance and payment history. Tr. pp. 7, 23, 24, 52. A taxpayer's payment history is an appropriate basis for determining whether a taxpayer has exercised ordinary business care and prudence when attempting to timely file and timely pay its proper tax liability. 86 Ill. Admin. Code, ch. I, section 700.400(d). The taxpayer's payment history, however, shows that just two months before the period at issue, it was determined to have failed to timely file returns and/or timely pay Illinois

taxes that were due. See Taxpayer's Ex. 2. Moreover, the record shows that during the 15 months preceding November 2004, the taxpayer failed to timely file or timely pay taxes due at least six times, i.e. six of its fifteen payments due during that period were delinquent. Department Ex. 2. While these compliance omissions essentially involved modest computational errors and were not as egregious as the compliance failures at issue in this case, they were, nevertheless, the type of non-compliance that is normally taken into account by the Department in evaluating a taxpayer's compliance record. Tr. pp. 36, 37, 39-42.

Contrary to the taxpayer's claim, the Department contends that the taxpayer's payment history does not help the taxpayer's case. The Department's auditor testified that, according to the Department's records, the taxpayer had 13 assessments for non-compliance during the 24 month period preceding November 2004. Tr. pp. 32, 33. He testified that seven of these assessments for non-compliance during this period were abated, including two that were abated based upon the taxpayer's good filing record at the time these violations occurred. Tr. pp. 33, 44, 45. The other six penalty assessments for non-compliance during this period were paid in full. Department Ex. 2.

The auditor's aforementioned testimony and corroborating documentary evidence indicates that the taxpayer's compliance record, in years preceding 2004 and for the portion of that year prior to the late filing and late payment at issue here, was poor. In this state of the record, with the Department's *prima facie* case that the taxpayer had a poor compliance record prior to and during 2004 being corroborated by documentary evidence and not being contradicted by the taxpayer, I find that the Department's *prima facie* determination was not overcome. As a consequence, I must conclude that

reasonable cause to abate the taxpayer's non-compliance penalties at issue based on the taxpayer's compliance record has not been proven in this case.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's LTR-201 Request for Abatement determination refusing to abate penalties for the delinquent filing and payment at issue in this case be upheld.

Ted Sherrod
Administrative Law Judge

Date: May 24, 2010