ST 13-1
Tax Type: Sales Tax
Tax Issue: Books And Records Insufficient
Unreported/Underreported Receipts (Fraud Application)

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No. XXXXX**
v.	**Account ID XXXXX**
	Letter ID XXXX
	Period 1/07-6/10
ABC BUSINESS,	**Ted Sherrod**
Taxpayer	**Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Shepard Smith on behalf of the Illinois Department of Revenue; Michael Whelan of Law Offices of Michael Whelan on behalf of ABC Business

Synopsis:

This matter is before this administrative tribunal as the result of a timely protest by the taxpayer, ABC Business d/b/a Happy Supermarket, of Notices of Tax Liability issued by the Department of Revenue ("Department") on December 16, 2010 for the period 1/07 through 6/10. At issue is whether the Department's audit met a minimum standard of reasonableness as required by law and if it did, whether the taxpayer rebutted the Department's *prima facie* case established by the introduction of the Notices of Tax Liability at issue into the record. The pre-trial order entered in this case also identifies as issues to be determined whether penalties for late filing, late payment and fraud were properly assessed. At the hearing held on June 12, 2012, after the Department entered its *prima facie* case into evidence, two witnesses were called by the taxpayer, including John Doe, the taxpayer's owner and store manager, and Denise Berry ("Berry"), an auditor employed by the Department who conducted the audit of the taxpayer giving rise to the liability at issue. Berry also testified on behalf of the Department as a rebuttal witness.

Both the Department and the taxpayer introduced documentary evidence into the record during the hearing proceedings. Upon consideration of all of the evidence comprising the record in this case, it is recommended that the Notices of Tax Liability at issue be affirmed. In support of this recommendation, the following "Findings of Fact" and "Conclusions of Law" are made.

FINDINGS OF FACT:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence, under the certificate of the Director, of the Department's Audit Correction and/or Determination of Tax Due, and the Department's Notices of Tax Liability showing a liability due and owing under section 4 of the Retailers' Occupation Tax Act in the amount of $XXXX including penalties and interest for the period 1/07 through 6/10. Department Ex. No. 1.[1]

2. ABC Business d/b/a Happy Supermarket ("taxpayer" or "ABC BUSINESS") operates a liquor and grocery store located in Anywhere, Illinois. Department Ex. 2 (Audit Narrative). Most of its sales are from the sale of beer, wine and other liquors. Department Ex. 2, Schedule 2A. The taxpayer also sells food and cigarettes, and receives additional revenues from the sale of lottery tickets. Tr. pp. 35, 36; Department Ex. 2 (Audit Narrative).

[1] Unless otherwise noted, findings of fact apply to the period covered by the Department's Notices of Tax Liability, 1/07 through 6/10.

3. The taxpayer is owned by John Doe ("John Doe"). Department Ex. 2 (Audit Narrative). John Doe has been the owner of the taxpayer since 1992. *Id*. John Doe is also the store manager of the business. Tr. pp. 11, 30. In addition to John Doe, ABC BUSINESS employs three additional employees. Department Ex. 2.

4. Denise Berry ("Berry" or "auditor") is a Revenue Auditor employed by the Department. Tr. p. 56. She has been employed by the Department for over 21 years. *Id.*

5. Commencing in September 2009, Berry performed an audit of the taxpayer covering the audit period 1/07 through 6/10. Tr. pp. 30, 31; Department Ex. 2 (Audit Narrative). In response to the Department's request to make all records of business activities available, John Doe provided Berry with Federal and state income tax returns (form 1120s) for 2007 and 2008, fixed asset and purchase invoices, sales and use tax returns, bank statements, cancelled checks, records of lottery sales and IL-941 forms. Department Ex. 2 (Audit Narrative).

6. The taxpayer tendered no cash register tapes indicating total sales. Tr. p. 75; Department Ex. 2 (Audit Narrative). John Doe advised Berry that he had not kept or maintained cash register tapes providing a daily record of the gross amount of sales as required by law (at 86 Ill. Admin. Code, ch. I, section 130.805). *Id.*

7. After reviewing the records supplied by the taxpayer in response to the Department's demand for records, and discovering that the taxpayer had not kept a daily record of sales, Berry determined that the records provided were not adequate to verify the sales reported by the taxpayer on its sales tax returns, and that it would be necessary for her to use the best evidence available to determine the taxpayer's gross receipts. Tr. p. 75; Department Ex. 2 (Audit Narrative).

8. Berry determined the taxpayer's inventory purchases by mailing forms called EDA-20s to the taxpayer's suppliers requesting sales information regarding sales to the taxpayer during the tax period at issue. Tr. p. 75; Department Ex. 2. Berry used this information, along with liquor report information filed with the Department to determine what the taxpayer's purchases were during this period. *Id.* Berry calculated the amount of the taxpayer's sales by adding together the amount of total purchases reported on EDA-20s and on liquor reports filed with the Department for the tax period in controversy and applying a mark-up to this amount. Department Ex. 2, Schedule 2A.

9. The taxpayer provided Berry with no documentary information regarding the taxpayer's mark-up on sales. Tr. p. 33. To estimate this mark-up, Berry used the taxpayer's current (i.e. current when she was conducting her on-site inspection of the taxpayer during her conduct of the audit) selling price for various types of merchandise shown on price tags at ABC BUSINESS's retail location. Tr. p. 76. She also used information from the taxpayer's cost invoices. *Id.*

10. Berry compared her best estimate of the taxpayer's total gross receipts to the receipts as reported on line 1 of the taxpayer's monthly ROT returns for the audit period, and treated the difference as unreported gross receipts. Tr. p. 77; Department Ex. 2, Schedule 3. Berry used her findings based upon a review of available records concerning the period 1/07 through 6/09 to project the taxpayer's tax liability for 7/09 through 6/10. Tr. pp. 78, 79; Department Ex. 2 (Audit Narrative).

11. During her audit of the taxpayer, Berry was advised that there were days during the audit period at issue on which merchandise (primarily liquor) was sold at a discount from its regular price, referred to as "specials". Tr. pp. 12, 13, 33. However, the auditor was never given any documentary evidence showing the amount of liquor sold as "specials" or the amount by which "specials" were discounted from the regular price. Tr. p. 33.

12. The auditor denied the taxpayer's request that an amount be credited for ending inventory deductible in computing the taxpayer's gross receipts because she was given no documentary evidence regarding the amount of ending inventory for each year during the audit period. Tr. pp. 34, 35, 83-86; Department Ex. 2 (Audit Narrative). The auditor also determined that the taxpayer's claims regarding ending inventory were incorrect based upon the fact that the taxpayer continued to purchase inventory in spite of the build-up in existing inventory the taxpayer claimed existed at the end of each tax year during the tax period in controversy. Department Ex. 2 (Audit Narrative).

13. The taxpayer claimed that it is entitled to a reduction from its gross sales determined by the auditor for theft and waste or "spillage." Tr. pp. 13, 14, 33, 34. The taxpayer testified that a majority of losses from the foregoing were from theft. Tr. p. 33. However, it produced no police reports or other documentation to corroborate its claim regarding such losses. Tr. pp. 33, 34. As a consequence, Berry made no adjustments to the taxpayer's gross receipts to account for losses of this nature. Tr. p. 79.

14. Upon completion of her audit, Berry determined that the taxpayer's actual sales exceeded its sales reported on its ST-1 sales tax returns by over 150% in each of the tax years during the period at issue that were audited. Department Ex. 2, Schedule 3.

15. The corrected returns that pertain to the period in controversy include the following penalty assessments: a fraud penalty based on underreported gross receipts, a late payment penalty and a late filing penalty. Department Ex. 1. The auditor made a written request dated August 25, 2010 to her supervisor requesting authorization to impose the fraud penalty on the tax liability established over the entire audit period. Department Ex. 2. This request was approved on September 10, 2010. *Id.*

Conclusions of Law:

The Retailers' Occupation Tax Act ("ROTA"), 35 **ILCS** 120/1 *et seq.*, imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 **ILCS** 120/2. Section 7 of the ROTA provides in part 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. … All books and records and other papers and documents which are required by this Act to be kept shall be kept in the English language and shall, at all times during business hours of the day, be subject to inspection by the Department or its duly authorized agents and employees.
> 35 **ILCS** 120/7

The Department of Revenue ("Department") prepared a corrected return for Retailers' Occupation Tax ("ROT") liability pursuant to section 4 of the Retailers' Occupation Tax Act ("ROTA"), 35 **ILCS** 120/4. Said section provides in pertinent part as follows:

> As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgment and information … In the event that the return is corrected for any reason other than a mathematical error, any return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown therein.
> …
>
> Proof of such correction by the Department may be made at any hearing before the Department or in any legal proceeding by a reproduced copy or computer print-out of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue … Such certified reproduced copy or computer print-out shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax due, as shown therein.

Section 4 of the ROTA provides that the certified copy of the notice of tax liability issued by the Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 **ILCS** 120/4. Once the Department has established its *prima facie* case by submitting the notice into evidence, the burden shifts to the taxpayer to overcome this presumption of validity, A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 832 (1st Dist. 1988). The taxpayer must present sufficient documentary evidence to support its claim. *Id*. As the court stated in Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978):

> The statue (section 4 of the ROTA) has been strictly construed insofar as establishing a prima facie case is concerned and the Illinois courts have uniformly sustained a prima facie case based on corrected tax returns. (Citations omitted). There is no statutory requirement that the Department substantiate the basis for the corrected return or produce the auditor who computed the corrected return in order to support its prima facie case. (Citations omitted). However, the Illinois Supreme Court has suggested that, when it is called into question, the method employed by the Department in correcting a taxpayer's return must meet some minimum standard of reasonableness. (Citations omitted). The reasonableness standard is based upon a statutory provision which requires that the Department's corrected returns be made "according to its best judgment and information." Ill. Rev. Stat. 1975, ch. 120, par. 443; Grand Liquor Co. v. Department of Revenue, 36 Ill. App. 3d 277 …, aff'd, (1977), 67 Ill. 2d 195 … [.]
> Masini, *supra* at 14.

In the case at bar, the taxpayer claims that the Department failed to use its best judgment and the best available information in correcting the taxpayer's returns. Tr. pp. 5-7; 97-100. Essentially, the taxpayer is contending that the Department's audit was not conducted in a manner meeting a "minimum standard of reasonableness" and therefore the Department failed to make its *prima facie* case.

As previously noted, the ROTA has a specific requirement for maintaining books and records. See 35 **ILCS** 120/7, enumerated above. This statutory provision has been construed to require that the taxpayer maintain cash register tapes and other data providing a daily record of the gross amount of sales. 86 Ill. Admin. Code, ch. I, section 130.805. A taxpayer's duty to keep such books and records is mandatory. Smith v. Department of Revenue, 143 Ill. App. 3d 607 (5th Dist. 1986). In the instant case, the taxpayer admitted that it did not keep or maintain such information with respect to the tax period at issue. Tr. p. 75; Department Ex. 2 (Audit Narrative).

As the taxpayer had inadequate books and records corroborating gross receipts to tender to the Department's auditor, Denise Berry ("Berry" or "auditor"), she had to use an alternative method to compute liability. *Id*. In the absence of statutorily required records, Berry elected to use a purchase and mark-up method pursuant to which she developed a mark-up based upon the taxpayer's per unit sales prices indicated by the taxpayer's selling prices determined during her on-site inspection of the taxpayer's business operations and applied this mark-up to purchases indicated by records she requested from the taxpayer's suppliers and from data reported to the Department's liquor licensing regulators. Tr. pp. 74-79; Department Ex. 2 (Audit Narrative).

At no point during the hearing in this case did the taxpayer take issue with the type of method of estimation used by the auditor, i.e., the purchase and mark-up method described above. Rather, the taxpayer contends that the Department did not use the taxpayer's income and sales tax returns or the taxpayer's bank records which were made available to the auditor, in arriving at the taxpayer's gross receipts. Tr. pp. 97-100. It argues that these records constituted the most accurate information available to corroborate the amounts the taxpayer reported as gross receipts. *Id*.

The taxpayer vigorously argues that the Department failed to use the documents provided by the taxpayer and ignored the taxpayer's records. *Id*. With the exception of the taxpayer's bank records, the documents that the taxpayer consistently refers to are the taxpayer's own returns, including the ST-1 forms, which are the same documents that the auditor had a duty to verify.[2] The purpose of the auditor's work is to determine the accuracy of the returns that were filed. The sole reason for the audit is to verify the accuracy of the amounts shown in the ST-1 Sales and Use Tax Returns filed by the taxpayer. Therefore, it makes no sense, as the taxpayer contends, that the very documents that are being audited should be the same documents that the auditor should rely upon in order to determine their accuracy.

The taxpayer also contends that its bank records were sufficient to corroborate its gross receipts as reported on its sales tax returns. *Id*. Since the maintenance of such bank records alone is insufficient as a matter of law to meet the state's minimum record retention requirements noted above, I find that Berry properly refused to rely solely upon these records in reaching her audit determination.

The law requiring the maintenance of daily records of gross receipts (at 86 Ill. Admin. Code, ch. I, section 130.805) fully supports Berry's conclusion that the inadequacy of the taxpayer's books and records warranted the use of other information to determine the taxpayer's sales. If the taxpayer does not have adequate books and records to support its monthly tax returns, the Department is justified in going outside the taxpayer's books and records to obtain information to correct the taxpayer's returns. Young v. Hulman, 39 Ill. 2d 219 (1968).

The taxpayer also takes issue with the auditor's failure to take into account "specials" during which the sales price of the taxpayer's merchandise was discounted, and her failure to take into account theft and "spillage" in making her audit determination. *Id*. Moreover, in computing the taxpayer's gross receipts, Berry determined the taxpayer's gross receipts without

[2] The auditor's refusal to rely on the taxpayer's income tax returns was completely justified in the instant case. During the audit, the taxpayer admitted that these returns were flawed and inaccurate. Department Ex. 2 (Audit Narrative).

allowing any credit for ending inventory deductible from inventory that was sold to generate gross receipts during the tax period. Tr. pp. 84-86. The taxpayer argues that, in addition to her failure to make adjustments for "specials" and for theft and "spillage" noted above, Berry incorrectly failed to take into account the correct amount of the taxpayer's ending inventories in determining the amount of the taxpayer's gross receipts. Tr. pp. 97-100. The taxpayer argues that a credit for ending inventory deductible in computing the taxpayer's tax liability arising from additional gross receipts determined on audit should have been allowed based upon physical evidence of inventory stock at the taxpayer's store location which the auditor inspected during her audit of the taxpayer. *Id*.

With respect to sales or "specials" the taxpayer contends should have been taken into account in arriving at an assessment determination, a review of the record reveals that throughout the hearing proceedings in this case, the taxpayer never indicated the length of time during which there were "specials" or sales of merchandise at discounted prices. Nor did the taxpayer produce any advertisements, price tags or other evidence that any of the "specials" claimed by the taxpayer actually took place. The taxpayer nevertheless contends that it should have been given credit for sales or "specials" even though these could not be corroborated by the taxpayer's inadequate records.

The record further indicates that Berry failed to take into account the taxpayer's claim that it suffered losses, primarily from theft (tr.p.33), but also from "spillage." Tr. p. 79. She refused to take any such losses into account because John Doe, the taxpayer's owner, presented no police reports, insurance claims or other documentation to support the alleged theft losses, and gave no documents corroborating John Doe's estimate of the amount of losses due to "spillage." Tr. pp. 79, 80.

With respect to inventory adjustments demanded by the taxpayer, the auditor, during her audit of the taxpayer, determined the following:

> A visit was made to the liquor store. I observed a huge storage area in the basement. … The owner stated [that] he has a lot of inventory in stock that didn't get sold. He asked for an inventory adjustment during the first visit. … The owner counts his own inventory at year end. The federal and state income tax returns don't reflect true purchases. … I informed him I [would] not give inventory adjustments.
> ….
> The inventory that is unreported yearly is in excess of $325,000. When John Doe was asked why he [didn't] report the correct inventory on the Federal Income Tax Return he stated [that he] forgot to do it. The [Taxpayer] forgot to report correct inventory for 3 years in a [row]. The years are 2007, 2008 and 2009. … John Doe stated [that he did not] sell all of the inventory…[but] just [purchased inventory] in bulk. If this is the case the monthly purchases should [decrease] but they don't. … Based on all of the liquor reports from the suppliers [and] the IDOR liquor reports the taxpayer never decreased his purchases of beer, liquor and wine even though there [was] so much in storage. … The IDOR position is [that] the taxpayer [sold] this inventory [and] therefore, no inventory adjustments will be allowed.
> Department Ex. 2 (Audit Narrative)

As is evident from the foregoing, the only records of the taxpayer's inventory were the amounts reported on the taxpayer's federal income tax returns. The taxpayer admitted during the audit that these amounts were incorrect. Department Ex. 2 (Audit Narrative).

The taxpayer has produced no other books or records of any kind to support its claim that it should be allowed a credit for ending inventory.

Due to the lack of records, the auditor had to rely upon her best judgment and data based upon all available evidence to arrive at a corrected amount of gross receipts. Tr. p. 75. As indicated above, a primary source of information Berry used in arriving at an assessment was the taxpayer's own invoices and on premises pricing information. She also relied upon reports from the taxpayer's suppliers which the taxpayer has not challenged. Given the lack of adequate documentary evidence of the taxpayer's actual sales price and mark-up, it is my determination that the auditor used her best judgment, and the best information available in correcting the taxpayer's returns and determining the tax due. The auditor denied the taxpayer's requested adjustments for "specials", theft and other losses and for ending inventory because she was given no documentary evidence to support any of these changes. The record indicates that the auditor used the limited information she had in a fair-minded manner. As stated in Vitale v. Illinois Department of Revenue, 118 Ill. App. 3d 210 (3rd Dist. 1983):

> This is all the law requires. (Citation omitted). To place a greater burden on the Department would reward the taxpayer for failing to keep the business records the law requires. *Id* at 213.

Having determined that the audit methodology employed by the auditor met a minimum standard of reasonableness, I find that the Department's *prima facie* case was established upon the admission into evidence of the corrected return showing additional tax due. 35 **ILCS** 120/4. The next question is whether the taxpayer rebutted the Department's *prima facie* case. The Vitale case, *supra*, sets forth well settled case law concerning what is necessary to overcome the Department's *prima facie* case.

> The taxpayer can overcome the Department's prima facie case, but only if he produces competent evidence, identified with the taxpayer's books and records, showing that the Department of Revenue's corrected returns are inaccurate. (Masini v. Department of Revenue (1978), 60 Ill. App. 3d 11, 17 Ill. Dec. 325, 376 N.E. 2d 324.) A taxpayer does not overcome the Department's prima facie case merely by denying the Department's case or by suggesting hypothetical weaknesses. He must establish by documentary evidence that the hypothetical weaknesses are relevant to his business.
> Vitale, *supra* at 213

As is evident from the foregoing, The Illinois courts have made it clear that a taxpayer cannot overcome the Department's *prima facie* case merely by denying the accuracy of the

Department's determination. See also Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987). Simply questioning the Department's assessment or denying its accuracy is not enough. Quincy Trading Post v. Department of Revenue, 12 Ill. App. 3d 725 (4th Dist. 1973). A taxpayer can overcome the Department's *prima facie* case only by producing competent evidence identified with the taxpayer's books and records. Vitale, *supra* at 213.

In lieu of documentary evidence, the taxpayer has attempted to rebut the Department's *prima facie* case through testimony designed to provide a plausible explanation for a lower assessment determination based upon the testimony of the taxpayer's owner and store manager, John Doe, concerning mark-ups, discount sales of general merchandise ("specials"), waste ("spillage") and theft losses, and ending inventory. However, oral testimony without corroborating books and records is insufficient to overcome the Department's *prima facie* case. Mel-Park Drugs v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1st Dist. 1991) ("To overcome the Department's prima facie case, the taxpayer must present more than its testimony denying the accuracy of the assessments, but must present sufficient documentary support for its assertions."). The taxpayer's unsubstantiated oral testimony based on the taxpayer's guesses and circumstantial evidence is simply not sufficient to meet the taxpayer's burden in this case. *Id.* Merely denying the accuracy of the Department's assessments, offering alternative hypotheses or arguing that the Department's audit methodology is flawed is not enough to overcome the Department's *prima facie* case. A.R. Barnes & Co., *supra*; Quincy Trading Post Inc., *supra*. A taxpayer can overcome the Department's *prima faice* case only by producing competent evidence closely identified with the taxpayer's books and records. A.R. Barnes & Co., *supra*; Central Furniture Mart, *supra*; Vitale, *supra*.

In the instant case, the taxpayer has presented insufficient documentary evidence to support the aforementioned bases for its claim that the Department's assessment determination was incorrect. The taxpayer introduced no documentary evidence of any kind to support its entitlement to an adjustment for "specials", for theft and "spillage" and for ending inventory during the hearing proceedings. Tr. pp. 32-34. Moreover, it introduced no evidence other than testimony challenging the Department's mark-up determination. *Id.* In sum, the taxpayer herein has challenged the Department's corrected return, but has offered insufficient documentary evidence to substantiate its claims. For the reasons enumerated above, the testimonial evidence the taxpayer has produced is insufficient to rebut the Department's *prima facie* case of liability.

The other issues presented in this case are whether the taxpayer is liable for late payment, late filing and fraud penalties assessed for the tax period in controversy. Section 4 of the ROTA provides, in pertinent part, as follows:

> If the tax computed upon the basis of the gross receipts as fixed by the Department is greater than the amount of tax due under the return or returns as filed, the Department shall (or if the tax or any part thereof that is admitted to be due by a return or returns, the Department may) issue the taxpayer a notice of tax liability for the amount of tax claimed by the Department to be due, together with a penalty in an amount determined in accordance with Section 3-3 of the Uniform Penalty and Interest Act. Provided, that if the incorrectness of any return or returns as determined by the Department is due to negligence or fraud, said penalty shall be an amount determined in accordance with section 3-5 or section 3-6 of the Uniform Penalty and Interest Act as the case may be.
> 35 **ILCS** 120/4

As the text of section 4 makes clear, penalties pursuant to section 3-3 of the Uniform Penalty and Interest Act ("UPIA") are automatically assessed whenever a correction of returns reveals a deficiency. *Id.*

The late filing penalty at issue in this case has been imposed by UPIA section 3-3 "for failure to file the tax return on or before the due date prescribed for filing ….[.]" 35 **ILCS** 735/3-3(a-10). The late payment penalty at issue in this case has been imposed by UPIA section 3-3 "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-20).

The late payment and late filing penalties are penalties that may be abated for reasonable cause. 35 **ILCS** 735/3-8. The Department has adopted a regulation regarding reasonable cause which provides as follows:

> 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.
> 86 Ill. Admin. Code, ch. I, section 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. Cod, ch. I, section 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 (1st Dist. 2005).

Since the taxpayer offered no evidence or testimony at hearing regarding "reasonable cause" for penalty abatement, it has not shown that it exercised ordinary care and prudence when calculating and paying its tax liabilities for the tax period at issue. Therefore, the late payment and late filing penalties assessed should not be abated. Holinger International, *supra* .

The Department has also assessed the taxpayer with a fraud penalty. Section 3-6 of the UPIA provides, in pertinent part, "[I]f any return or amended return is filed with intent to defraud, in addition to any penalty imposed under Section 3-3 of this Act, … a penalty shall be imposed in an amount equal to 50% of any resulting deficiency." 35 **ILCS** 735/3-6.[3] The standard for determining whether a fraud penalty is appropriate is clear and convincing evidence. Pueblo v. Department of Revenue, 117 Ill. App. 3d 260 (4th Dist. 1983). To establish fraud, intent must be shown. Vitale, *supra*. Clear and convincing evidence of intent to defraud can be circumstantial in nature. *Id.*

In the instant case, the Department determined that the taxpayer significantly underreported its monthly gross receipts. Tr. p. 82. During her audit, Berry found that the taxpayer reported gross receipts of $677,189 in 2007, but failed to report $317,289 in gross receipts for that period. Department Ex. 2, Schedule 3. She found that the taxpayer reported gross receipts for 2008 of $664,346 but failed to report additional gross receipts of $365,593. *Id.* For the first six months of 2009, Berry found that the taxpayer reported gross receipts of $276,369, but failed to report additional gross receipts of $152,985. *Id.* In sum, during each of the years for which a detailed audit was conducted, the taxpayer's actual gross receipts were more than 150% of its receipts reported on its sales tax returns. During the period under audit, moreover, the taxpayer failed to maintain books and records required by law to support the amount of gross receipts reported on the taxpayer's returns.

In Vitale, the court identified certain facts as constituting circumstantial evidence of fraud. Vitale, *supra* at 213. Specifically, the taxpayer in that case consistently reported only a fraction of its monthly receipts to the Department, and failed to keep books and records as

[3] The fraud penalty assessed for the period 1/07 through 6/09 was eligible for tax amnesty pursuant to 35 **ILCS** 745/1 *et seq.* and was therefore doubled pursuant to 35 **ILCS** 735/3-6(d) of the UPIA.

required by the ROTA and the Department's ROTA regulations. *Id.* Moreover, as in the instant case, in Vitale, the taxpayer's actual gross receipts exceeded its reported gross receipts by more than fifty percent. *Id.* Based on the similarity between the circumstantial evidence presented by the record in this case and the evidence found sufficient to establish an intent to defraud in Vitale, I conclude that the Department has established clear and convincing evidence that the taxpayer filed returns during the audit period with an intent to defraud. 35 **ILCS** 735/3-6; Vitale, *supra* at 213.

With respect to the fairness and propriety of penalties in the instant case, the taxpayer avers that it would have been eligible for tax amnesty relief pursuant to 35 **ILCS** 745/10 and the abatement of penalties that have been assessed if it had paid all taxes assessed for the tax period in controversy by November 8, 2010. Tr. p. 32.[4] John Doe, the taxpayer's owner, testified that the taxpayer did not take advantage of amnesty because Berry, the Department's auditor, completed her audit report in this case on October 27, 2010, but did not advise John Doe of her final liability determination until several days after November 8, 2010 which was the deadline to pay assessed taxes without penalty. Tr. pp. 24-27; Taxpayer's Ex. 5. The implication of these allegations is that the Department deliberately failed to advise the taxpayer of the final amount of tax due for the tax period in controversy prior to the conclusion of the amnesty period and therefore was responsible for the taxpayer's failure to avoid the penalties reflected on the Department's assessment. The Department's auditor disputes these allegations. Tr. pp. 82-85.

The credibility of the taxpayer's claims regarding the failure to pay taxes under amnesty need not be resolved because, even if the taxpayer's claims are true, they provide no basis for penalty abatement in the instant case. The Department's amnesty regulation expressly states that

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[4] The Tax Delinquency Amnesty Act (35 **ILCS** 745/1 *et seq.*, as amended by L. 2010, PA 96-1435, section 15), provided relief from interest and penalties for taxes paid to the Department from October 1, 2010 through November 8, 2010.

the “Department has no duty to notify taxpayers of liabilities that may make them eligible for participation in the Amnesty Program.” 86 Ill. Admin. Code, ch. 1, section 521.105(a). This regulation further states that “Failure of the Department to notify a taxpayer of the existence or correct amount of a liability eligible for amnesty shall not preclude the taxpayer from participating in the Amnesty program, nor shall such failure be grounds for abating the 200% sanction for failure to pay the liability.” Clearly, the failure of the Department to notify John Doe of the existence or amount of a liability eligible for amnesty does not constitute grounds for abating the penalties that have been imposed in the instant case.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department’s Notices of Tax Liability at issue in this case be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: January 15, 2013