UT 11-07
Tax Type: **Use Tax**
Issue: **Books & 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** **Account ID XXXXX** **Letter ID XXXXX** **Period XXXXX**
v.	
ABC BUINESS, **Taxpayer**	**Ted Sherrod** **Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Shepard Smith on behalf of the Illinois Department of Revenue; Rouhy Shalabi, Esq. of Shalabi & Associates on behalf of ABC Buiness.

Synopsis:

This matter arose from a protest filed by the taxpayer on December 17, 2009 to a Notice of Tax Liability issued to ABC Buiness ("taxpayer"), by the Department of Revenue ("Department") on October 27, 2009 for taxes assessed under the Retailers' Occupation Tax Act ("ROTA") 35 **ILCS** 120/1, *et seq.*, and related taxes. The issue is whether the taxpayer reported the correct amount of gross receipts from its sales and paid the proper amount of tax incurred on these sales. An evidentiary hearing was held on March 7, 2011 regarding this matter. After reviewing the transcript of the hearing and documents presented at hearing, I recommend that the fraud penalty be revised to reflect a penalty for negligence, and that as so adjusted, the Notice of Tax Liability be made final.

Findings of Fact:

1. The taxpayer is a corporation doing business in Illinois. Tr. pp. 7, 8. The Department conducted an audit of the taxpayer's records for period January 1, 2005 through June 30, 2007. Department Exhibit ("Ex.") No. 1.
2. At the conclusion of the audit, the Department prepared a Form SC-10-K Audit Correction and/or Determination of Tax Due ("corrected return"). *Id*.
3. On October 27, 2009, the Department issued a Notice of Tax Liability to the taxpayer assessing tax due. *Id*.

Conclusions of Law:

The ROTA requires every taxpayer to report to the Department the total amount of gross receipts on forms prescribed by the Department. 35 **ILCS** 120/3. The statute, at 35 **ILCS** 120/4, also requires the Department to examine these returns and to issue notices of tax liability if it determines additional taxes to be due. Specifically, the latter statute provides 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. ... In making a correction of transaction by transaction, monthly or quarterly returns covering a period of 6 months or more, it shall be permissible for the Department to show a single corrected return figure for any given 6-month period. …
>
> If the tax computed upon the basis of gross receipts as fixed by Department is greater than the amount of tax due under the return or returns as filed, the Department shall … 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 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.

In the instant case, the Department examined the tax returns filed by the taxpayer for the audit period. At the conclusion of the audit, the Department determined that the gross receipts of the taxpayer's business during the audit period were greater than the amounts reported on the tax returns the taxpayer filed. Accordingly, it prepared a corrected return calculating a deficiency and it assessed penalties including a fraud penalty. On October 27, 2009, it issued Notice of Tax Liability Letter ID number XXXXXX to the taxpayer. Department Ex. No. 1.

It is well established that a corrected return as prepared by the Department is deemed *prima facie* correct. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). At the hearing in this case, the Department established its *prima facie* case by introducing the corrected return into evidence. The burden then shifted to the taxpayer to overcome the Department's *prima facie* case. Anderson v. Department of Finance, 370 Ill. 225 (1938); Masini, *supra* at 15.

"In order to overcome the presumption of validity attached to the Department's corrected returns, [the taxpayer] must produce competent evidence identified with their books and records and showing that the Department's returns are incorrect." Masini, *supra* at 15. See also Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276 (1943); Howard Worthington, Inc. v, Department of Revenue, 96 Ill. App. 3d 1132 (2nd Dist. 1981).

In this case, the Department's *prima facie* case was established when the corrected return was entered into evidence under the certificate of the Director of the Department. The burden then shifted to the taxpayer to overcome the Department's *prima facie* case.

The taxpayer's attorney appeared at the hearing but he did not offer any oral testimony or documentary evidence on behalf of the taxpayer. Accordingly, the taxpayer failed to produce any competent evidence identified with its books and records to overcome the Department's *prima facie* case and the Department's *prima facie* determination of liability must be affirmed.

Before this matter can be properly concluded, however, I must address the question whether the fraud penalty assessed in this matter is supported by the evidence contained in the record. If the Department alleges that an underpayment of tax is due to fraud, the statute provides a penalty to be assessed equal to 50 percent of the tax deficiency determined by the Department. 35 **ILCS** 735/3-6. When the fraud penalty has been imposed, the burden of proof as to the fraud issue is on the Department, not the taxpayer. Brown Specialty Co. v. Allphin, 75 Ill. App. 3d 845 (3d Dist. 1979). In Brown Specialty, *supra*, the court held that the Department must provide clear and convincing evidence of fraud when fraud is asserted under the ROTA. In the instant case, the Department offered no evidence that the deficiency assessed is due to fraud. Therefore, the fraud penalty must be revised to reflect a penalty for negligence.

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

> Penalty for negligence. …
> (a) If any return or amended return is prepared negligently, but without intent to defraud, and filed, in addition to any penalty imposed under Section 3-3 of this Act, a penalty shall be imposed in an amount equal to 20 percent of any resulting deficiency.
> (b) Negligence includes any failure to make a reasonable attempt to comply with the provisions of any Tax Act and includes careless, reckless or intentional disregard of the law or regulations.
> (c) No penalty shall be imposed under this Section if it is shown that failure to comply with the tax Act is due to reasonable cause. A taxpayer is not negligent if the taxpayer shows substantial authority to support the return as filed.
> 35 **ILCS** 735/3-5(a)-(c)

As indicated by the foregoing, section 3-5 of the UPIA authorizes a penalty for a negligently prepared and filed return. Paragraph (b) of this provision defines negligence and paragraph (c) of this provision provides for ways that the taxpayer might avoid a negligence penalty. 35 **ILCS** 735/3-5. Paragraph (c) also clearly places the burden for showing that a penalty should not be assessed on the taxpayer. 35 **ILCS** 735/3-5(c); see also, Branson v. Department of Revenue, 168 Ill. 2d 247, 261 (1995) ("After the Department presents a prima facie claim for tax penalty liability, our construction of section 131/2 places the burden on the taxpayer to establish that one or more elements of the penalty are lacking.").

In this case, the taxpayer has provided no evidence to rebut the imposition of the negligence penalty pursuant to section 35 **ILCS** 735/3-5. Accordingly, I find that the negligence penalty is properly imposed in this matter.

WHEREFORE, for the reasons stated above, it is my recommendation that Notice of Tax Liability Letter ID number XXXXX be finalized with the fraud penalty being revised to reflect a penalty for negligence.

Ted Sherrod
Administrative Law Judge

Date: April 22, 2011