

UT 13-04

Tax Type: Use Tax

Tax Issue: Use Tax On Property Titled To An Out-Of-State Limited Liability Company

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

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**
v.

ABC INDUSTRIES, LLC,
Taxpayer

**Docket No. XXXX
Account ID XXXX
Letter ID XXXX
Period XXXX**

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Lawrence I. Serlin, Esq. of Lawrence I. Serlin, Ltd. appeared for ABC Industries, LLC; Michael Coveny, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose when ABC Industries, LLC, a Montana limited liability company, protested the Notice of Tax Liability the Illinois Department of Revenue (“Department”) issued to it to assess use tax regarding its purchase of a motor home determined by the Department to be for use in Illinois. The issues are whether the taxpayer actually engaged in a taxable use of the motor home in Illinois, and whether its purchase of the vehicle was exempt from tax pursuant to § 3-55(h) of the Illinois Use Tax Act. This case also presents the issue whether the Department correctly assessed a fraud penalty in this matter.

A hearing to consider this matter was held at the Department’s offices in Chicago, Illinois

on October 24, 2012. John and Jane Doe, the taxpayer's only members, appeared at the hearing and testified, and both the taxpayer and the Department presented documentary evidence. The record also includes an Evidence Deposition taken subsequent to the hearing in this matter, by agreement of the parties. I have reviewed that evidence, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the tax issues be resolved in favor of the Department, but that the notice of tax liability be revised to abate the fraud penalty that has been assessed.

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 Notice of Tax Liability showing a liability due and owing under the Use Tax Act in the amount of \$XXXX including penalties and interest for the period 12/13/06. Department Ex. No. 1.¹
2. ABC Industries, LLC ("ABC Industries" or "taxpayer") is a two member Montana Limited Liability Company domiciled in Anywhere, Montana. Tr. p. 12; Department Exhibit ("Ex.") 4.² ABC Industries is owned by its two members, John and Jane Doe. Department Ex. 2. The company has no bank account, receives no income and makes no expenditures. Tr. p. 41.
3. John and Jane Doe, are and during all times pertinent to this matter, were, Illinois residents. Tr. pp. 25, 26.

¹ Unless otherwise noted, findings of fact pertain to the tax period in controversy and subsequent periods referenced herein.

² During the hearing, the Department (at Tr. p. 12) indicated that it is not contesting the legitimacy of the taxpayer's claim to be a Montana limited liability company even though the taxpayer submitted no documentary evidence to support this claim.

4. On December 13, 2006, ABC Industries purchased a motor home, identification number XXXXXXXXX from General Motor Home and Trailer Sales Inc. (“General Motor Home”), a motor home vehicle dealer located in Anywhere, Illinois. Tr. pp. 26, 27; Evidence Deposition taken November 15, 2012 (“Evidence Deposition”) pp. 6-8; Department Ex. 3, 4. John and Jane Doe used their personal funds to make a down payment on this motor home and used their personal vehicle as a trade in. Department Ex. 2, 3, 4; Taxpayer’s Ex. 4. The address and telephone number given for ABC Industries at the time it purchased the motor home was the same as the Does’ home address and telephone number. Evidence Deposition p. 10. Documents executed at the time the motor home was purchased indicate that it was being acquired for the personal use of John and Jane Doe. Department Ex. 6.
5. The motor home purchased on December 13, 2006 was delivered to John Doe, a member of the taxpayer, on that date in Anywhere Illinois. Tr. pp. 42, 43; Evidence Deposition pp. 7, 8, 14, 19, 20, 48-50; Department Ex. 3, 4.³ The dealer issued a drive away sticker to John Doe when he took possession of this vehicle. Department Ex. 3.
6. On December 13, 2006, General Motor Home filed a form ST-556 “Sales Tax Transaction Return (for Vehicles, Watercraft, Aircraft, Trailers and Mobile Homes)” reporting the sale of the motor home for a purchase price of \$XXXX, a trade-in credit of \$XXXX and gross receipts subject to tax in the amount of \$XXXX. Department Ex. 3. The return is checked to show that General Motor Home’s sale to the taxpayer was exempt from Illinois retailers’ occupation tax because the taxpayer was a non-resident

³ For reasons indicated herein below, I do not find credible John Doe’s testimony contained in the record denying that the motor home at issue was delivered to him in his capacity as a member of the taxpayer in Anywhere, Illinois on December 13, 2006.

buyer. *Id.* The return shows that General Motor Home did not charge or collect Illinois tax from the taxpayer on the gross receipts from this sale. *Id.*

7. On June 6, 2007, John and Jane Doe filed an RUT-50 Vehicle Use Tax Transaction Return (“RUT-50”) reporting the purchase of the motor home by them from ABC Industries. Taxpayer’s Ex. 3. The RUT-50 reported use tax due from John and Jane Doe as owners of the motor home of \$XXXX which was paid by them on or about the date on which the RUT-50 was filed. Tr. pp. 33-34; Taxpayer’s Ex. 3.
8. On or about January 14, 2011, Teresa Churchill (“Churchill”), an auditor for the Department completed an audit covering the taxpayer's purchases of motor home vehicles during the period 1/1/06 through 10/31/08. Tr. p. 19; Evidence Deposition p. 31; Taxpayer’s Ex. 4; Department Ex. 2. This audit had initially been commenced by Jason Poling, an auditor for the Department, on October 20, 2008. Evidence Deposition p. 31; Taxpayer’s Ex. 4.
9. Upon completion of her audit, Churchill, on November 17, 2009, issued a Notice of Proposed Liability notifying ABC Industries that the Department intended to issue a notice of tax liability for a proposed amount of \$XXXX including \$XXXX in tax, \$XXXX in penalties and \$XXXX in interest pertaining to the taxpayer’s 2006 purchase of the motor home. Tr. pp. 38, 39; Taxpayer’s Ex. 5. The Notice of Proposed Liability indicated that a notice of tax liability would be issued if the taxpayer did not request a review of the liability proposed by the Department by the Department’s Informal Conference Board within 60 days of the date of the Notice of Proposed Liability which was dated November 17, 2009. Taxpayer’s Ex. 5.

10. No notice of tax liability was issued pursuant to Churchill's November 17, 2009 letter because the taxpayer elected to have the proposed liability indicated in this letter considered by the Department's Informal Conference Board pursuant to 86 Ill. Admin. Code, ch. I, section 215.115(a). Tr. p. 40; Department Ex. 2; Taxpayer's Ex. 5.
11. Subsequent to the completion of its deliberations concerning this matter, the Informal Conference Board issued its final determination on October 13, 2010. Department Ex. 2. Since the Informal Conference Board's deliberations tolled the statute of limitations applicable to the taxpayer's purchase on December 13, 2006, the statute of limitations on the assessment pertaining to this purchase did not expire until April 11, 2011.⁴ *Id.*
12. On February 25, 2011, the Department issued a Notice Tax Liability in the amount of \$XXXX based upon the taxpayer's improper failure to pay tax on its purchase of the motor home from General Motor Home on December 13, 2006. Department Ex. 1. This notice tax liability arose from Department's determination that the taxpayer had improperly failed to pay tax on the purchase of this vehicle, and that the taxpayer's reliance upon the non-resident exemption claimed on the ST-556 form reporting this transaction was improper. Department Ex. 2. The notice of tax liability included tax in the amount of \$XXXX, a late payment penalty of \$XXXX, interest of \$XXXX and a fraud penalty in the amount of \$XXXX. Department Ex. 1. The taxpayer did not agree with the auditor's determination of liability in this case. Department Ex. 2.

⁴ The filing of a Request for Review with the Informal Conference Board acts as a waiver of the applicable statute of limitations that would otherwise prevent the Department from issuing a Notice of Tax Liability following the completion of an audit. In such instances, any applicable limitations period is tolled from the date the Request for Review is accepted by the Informal Conference Board up to and including 180 days following the date of the Informal Conference Board's decision. 86 Ill. Admin. Code, Ch. I, section 215.115(g).

Conclusions of Law:

In the instant case, the taxpayer, ABC Industries, LLC (“ABC Industries” or “taxpayer”) is contesting the Department’s Notice of Tax Liability issued to ABC Industries for liability under the Illinois Use Tax Act arising from ABC Industries’ purchase of a motor home (“motor home”) on December 13, 2006. The Illinois Use Tax Act (“UTA”), 25 **ILCS** 105/1 *et seq.*, imposes a tax “upon the privilege of using in this State tangible personal property purchased at retail from a retailer ...[.]” 35 **ILCS** 105/3. Under the UTA, “use” is defined as “the exercise by any person of any right or power over tangible personal property incident to the ownership of that property ...[.]” 35 **ILCS** 105/2. The definition excludes some uses from taxation (*id*), but none of the uses expressly described in the definition as not being subject to taxation apply to this case.

The Illinois General Assembly incorporated into the UTA certain provisions of the complementary Retailers’ Occupation Tax Act (“ROTA”). 35 **ILCS** 105/12. Among them is section 4 of the ROTA, which provides that the Department’s determination of tax due constitutes *prima facie* proof that tax is due in the amount determined by the Department. 35 **ILCS** 105/12; 35 **ILCS** 120/4. In this case, the Department established its *prima facie* case when it introduced Department Exhibit 1, consisting of a copy of the Notice of Tax Liability at issue under the certificate of the Director. Department Ex. 1. That exhibit, without more, constitutes *prima facie* proof that the taxpayer owes Illinois use tax in the amount determined by the Department. 35 **ILCS** 105/12; 35 **ILCS** 120/4.

The Department’s *prima facie* case is overcome, and the burden shifts to the Department to prove its case, only after a taxpayer presents evidence that is consistent, probable and identified with its books and records, to show that the Department’s determinations were not

correct. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157-58 (1968). Additionally, when a taxpayer claims that a transaction is exempt from a particular tax, the burden of proof is on the taxpayer. 35 **ILCS** 105/12; 35 **ILCS** 120/7; Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1st Dist. 1981) (*citing* Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305 (1976); Bodine Electric Co. v. Allphin, 81 Ill. 2d 502 (1980)).

Taxpayer's Contentions

The taxpayer contests the Department's determination of liability on two grounds. First, the taxpayer argues that the facts contained in the record show that a taxable use of the motor home (the "motor home") in controversy in Illinois did not commence until June 6, 2007, when this vehicle was sold by the taxpayer to John and Jane Doe. It claims that John and Jane Doe filed a RUT-50 on that date acknowledging that in-state use of the motor home had commenced. Secondly, the taxpayer contends that, even if the vehicle was used in Illinois by the taxpayer, the sale of this vehicle by General Motor Home to the taxpayer was exempt because the taxpayer was a Montana limited liability company and therefore qualified for exemption as a non-resident purchaser pursuant to 35 **ILCS** 105/3-55. The taxpayer also contests the Department's imposition of a fraud penalty in this case.

Whether the Taxpayer Engaged in a Taxable Use of its Motor Home in Illinois

With respect to the taxpayer's first contention that it did not engage in a taxable use of the vehicle in controversy in Illinois and therefore cannot be subjected to the Illinois use tax, the taxpayer maintains that the motor home at issue was sold to the taxpayer in Illinois but was picked up by the taxpayer's members in Oregon. Tr. pp. 18, 21, 27, 31, 48, 49, 51, 57, 48, 77. It argues that, subsequent to the delivery of this vehicle to the taxpayer, the vehicle was never brought into Illinois by the taxpayer for use in this state until June 6, 2007, the date on which the

motor home was sold by the taxpayer to John and Jane Doe, as evidenced by the registration of this vehicle with the Illinois Secretary of State's office under their names on that date. Tr. pp. 18, 21, 58, 59, 77, 78; Taxpayer's Ex. 3.

In addition to repeated testimonial denials of any in-state delivery and use by ABC Industries during testimony from John Doe, a member of the taxpayer, and the taxpayer's principal witness, the taxpayer entered into the record a log purporting to show that the vehicle in controversy was picked up in Oregon on February 8, 2007 and driven extensively outside of Illinois prior to its sale to John and Jane Doe. Tr. pp. 29, 30, 51, 52; Taxpayer's Ex. 1. The log (Taxpayer's Ex. 1) is a compilation of multiple records indicating dates when the motor home was at various locations, and purported odometer readings and summaries of gas purchases and gas prices on such dates at such locations, original documentation of which was not introduced into the record. Absent exemption as a business record, this evidence constitutes both hearsay and a violation of the "best evidence" rule (at Illinois Rules of Evidence Rule 1002).

Initially I note that, while the taxpayer's purported log was admitted without objection, ABC Industries did not lay a proper foundation for the admission of this document as a business record. Tr. pp. 51, 52. Consequently, this document constitutes a summary of original documents and out of court declarations that cannot be verified by any authenticated books and records. Hearsay evidence of this nature admitted without objection is to be considered and given its natural probative effect, and the fact finder may give such evidence whatever weight he or she deems proper. Jackson v. Department of Labor, 105 Ill. 2d 501, 508-509 (1985). For the following reasons, I do not give the taxpayer's log any weight on the question whether the taxpayer took delivery of the motor home in Illinois and used the motor home in Illinois prior to its sale to John and Jane Doe.

During the course of the evidentiary hearing, the Department presented documentary proof to corroborate its claim that the motor home was delivered to the taxpayer in Illinois on December 13, 2006 at which time in-state use of the motor home commenced. Specifically, the record in this case includes an ST-556 form filed by General Motor Home and the Sales Contract entered into between General Motor Home and the taxpayer conveying the motor home in controversy to the taxpayer. Department Ex. 3, 4. Both documents expressly indicate that the date on which the motor home in controversy was delivered to the taxpayer was December 13, 2006. *Id.* Both of these documents are executed by John Doe and dated December 13, 2006. *Id.* In light of this documentary evidence, I do not find credible the log the taxpayer introduced to corroborate its denials of in-state delivery and use of the motor home in Illinois.

Moreover, even if the taxpayer's log and related testimony was accorded some probative weight, this evidence clearly shows that the motor home was physically present in Illinois before it was sold. By the taxpayer's own admission, the log shows that this vehicle entered Illinois on May 21, 2007. Tr. pp. 18, 28, 30, 51; Taxpayer's Ex. 1. Section 2 of the UTA defines a taxable "use" broadly as follows:

"Use" means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased, and does not include the use of such property by its owner for demonstration purposes.

35 ILCS 105/2

When a statute defines terms, those terms must be given the plain meaning articulated in the statute. Berwyn Lumber Co. v. Korshak, 34 Ill. 2d 320 (1966).

The taxpayer has admitted that it brought the motor home at issue into Illinois two weeks before selling it in June 2007. When the taxpayer brought the motor home into Illinois, this

action constituted an exercise of rights and power over the motor home in Illinois incident to the taxpayer's ownership of this vehicle. Consequently, its actions in doing so constituted a taxable use of the motor vehicle in Illinois as the term "use" is defined in the UTA. While section 3-55(a) of the UTA, 35 **ILCS** 105/3-55(a) exempts the temporary and transient use in Illinois of a motor vehicle acquired outside of Illinois by a non-resident, the record in this case does not support a finding that the taxpayer acquired the motor home outside of Illinois or that its use of the motor home at issue in Illinois on and after May 21, 2007 constituted either a temporary or transient use of this vehicle here.

As previously noted, pursuant to 35 **ILCS** 120/4, noted above, the Notice of Tax Liability issued by the Department in this case is *prima facie* evidence of the amount of tax due, as shown therein. *Id.* In the instant case, the Department's presumed correct determination includes its finding that the motor home in controversy was purchased and used in Illinois during 2006 and 2007. The taxpayer "must produce competent evidence, identified with ... books and records and showing that [the Department is] incorrect" in order to overcome the Department's case. Masini v. Department of Revenue, 60 Ill. App. 3d 11, 15 (1st Dist. 1978). Oral testimony that is not corroborated by any form of such documentary evidence is insufficient to overcome the *prima facie* correctness of the Department's determination. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988).

During her audit of the taxpayer, Teresa Churchill, the Department's auditor, requested vehicle storage and maintenance records pertaining to the location at which the motor home in controversy was kept and maintained during the period from the date of its purchase by the taxpayer until the date on which this motor vehicle was sold to John and Jane Doe and registered with the Department for use in Illinois. Department Ex. 2. In spite of requests for

documentation confirming the location of the motor vehicle in controversy from the auditor during her audit of the taxpayer, the taxpayer failed to provide any such documentation or any other physical evidence pertaining to the location of the vehicle after the date it was delivered to the taxpayer in Illinois. *Id.* Given the absence of any weight afforded the taxpayer's log, its only documentary evidence of non-Illinois storage and use, the only evidence to support the taxpayer's claim are repeated testimonial denials by the taxpayer's principal witness, John Doe, denying any Illinois delivery or use of the motor home. In the case at hand, such testimony, being uncorroborated by any of the company's books or records, is insufficient to rebut the Department's finding. Masini, *supra*; A.R. Barnes, *supra*.

In sum, although the motor home in controversy was presumably titled by its owner, a Montana limited liability company, in Montana (Tr. pp. 13, 14, 20), the evidence shows that it was purchased in Illinois. Moreover, the taxpayer has provided no credible evidence that the motor home was physically present and being used by the taxpayer in a state other than Illinois more than it was physically present and used in Illinois. Again, the UTA imposes a tax "upon the privilege of using in this State tangible personal property purchased at retail from a retailer ...[.]" 35 ILCS 105/3. Because the evidence clearly shows that the taxpayer purchased the motor home, at retail, from a retailer in Illinois and took delivery of this vehicle in this state (Department Ex. 3, 4), and the taxpayer has failed to rebut the Department's presumptively correct finding that the taxpayer used the motor home in Illinois after it purchased the motor home, the taxpayer's purchase of the motor home was subject to Illinois use tax. 35 ILCS 105/3.

Whether the Taxpayer's Purchase is Exempt Under 35 ILCS 105/3-55

The taxpayer also contends that the motor home at issue was exempt from tax because the taxpayer was a Montana limited liability company and therefore a non-resident of Illinois to

whom the provisions exempting sales to non-residents contained in section 3-55(h) of the UTA apply. Tr. pp. 20, 81, 82. Section 3-55 of the UTA provides a variety of exemptions from use tax. 35 ILCS 105/3-55. One of the applicable subsections of that provision governing sales to non-residents provides as follows:

Sec. 3-55. Multistate exemption. To prevent actual or likely multistate taxation, the tax imposed by this Act does not apply to the use of tangible personal property in this State under the following circumstances:

(h) Except as provided in subsection (h-1), the use, in this State, of a motor vehicle that was sold in this State to a nonresident, even though the motor vehicle is delivered to the nonresident in this State, if the motor vehicle is not to be titled in this State, and if a drive-away permit is issued to the motor vehicle as provided in Section 3-603 of the Illinois Vehicle Code or if the nonresident purchaser has vehicle registration plates to transfer to the motor vehicle upon returning to his or her home state. The issuance of the drive-away permit or having the out-of-state registration plates to be transferred shall be prima facie evidence that the motor vehicle will not be titled in this State.

Under the terms of section 3-55(h) of the UTA, a taxpayer's use of a motor vehicle is exempt pursuant to this provision only if the taxpayer is not a resident of Illinois. The Does contend that the ABC Industries was a Montana LLC and therefore was not an Illinois resident. Tr. pp. 20, 81, 82.

A corporation usually is a legal entity that exists separately and distinctly from its officers, shareholders and directors. Fontana v. TLD Builders, Inc., 362 Ill. App. 3d 491, 500 (2d Dist. 2005). Generally, if a taxpayer forms a separate corporation, it is a separate taxable entity. Moline Properties, Inc. v. Commissioner of Revenue, 319 U.S. 436, 438-439 (1943). Indeed, the United States Supreme Court has stated as follows:

The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as the purpose is the equivalent of business activity or is followed by the carrying on of business by the

corporation, the corporation remains a separate taxable entity. *Id.*

The Supreme Court has recognized, however, that there are exceptions to this rule. “[I]n matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal[.] In such situations, the form is a bald and mischievous fiction.” *Id.* at 439, citing Higgins v. Smith, 308 U.S. 473, 477 (1940); Gregory v. Helvering, 293 U.S. 465 (1935).⁵ The evidence in this case supports a finding that ABC Industries should be disregarded for purposes of applying section 3-55(h) of the UTA because it is a sham.

The record in this case indicates that John and Jane Doe are the sole members of ABC Industries. Department Ex. 2. However, the fact that they are the sole members of this limited liability company and control the activities of the corporation is not relevant to this determination.⁶ Rather, the corporation is a sham because the relationship between John and Jane Doe, the members of ABC Industries, and the corporation are so connected that they cannot be separated; consequently the existence of ABC Industries as an entity apart from John and Jane Doe is an unsupported fiction.

The record contains no evidence that ABC Industries observed any of the formalities incident to its alleged separate corporate existence. Rather, John and Jane Doe used their personal funds to pay for all of the corporation’s expenses and did not maintain any separate books and records, apart from their personal credit card and other records, for the corporation. Department Ex. 2; Taxpayer’s Ex. 1, 2. John and Jane Doe paid a \$XXXX down payment for

⁵ It must be noted that determining whether a corporation is a separate taxable entity from the person who created it under the guidelines of Moline Properties, Inc., *supra* is not the same question as whether the corporation is the individual’s alter ego for purposes of “piercing the corporate veil.” Harris v. United States, 764 F. 2d 1126, 1128 (5th Cir. 1995). The issue of whether the corporate veil should be disregarded generally arises in collection actions and is not used to determine tax liability. Towne v. Martinson, 195 B.R. 137, 144 (1996).

⁶ The Supreme Court has stated that “[u]ndoubtedly the great majority of corporations owned by sole stockholders are ‘dummies’ in the sense that their policies and day-to-day activities are determined not as decisions of the corporation but by their owners acting individually.” National Carbide Corporation v. Commissioner of the Internal Revenue, 336 U.S. 422, 433 (1949).

the motor home from their personal funds. Department Ex. 2, 4. They used their personal vehicle as a trade-in for the motor home (Department Ex. 2, 4; Taxpayer's Ex. 4), and they arranged to pay the balance due on this vehicle from their personal account. Tr. pp. 44-47.

John Doe admitted during testimony that the corporation did not have a separate bank account, received no income and made no expenditures using its own funds. Tr. p. 41. John and Jane Doe had one personal bank account from which they paid both their bills and the company's. Department Ex. 2.

The record in this case also indicates that, while ABC Industries purported to have a Montana business address, the address and telephone number for ABC Industries given at the time of their purchase of the motor home was the Doe's home address and telephone number. Evidence Deposition p. 10. The record contains no evidence that the motor home was driven to Montana after it was purchased or that it was ever even in this state at any time. Moreover, at the time the motor home was purchased, John and Jane Doe indicated on documentation they signed that is included in the dealer's records that this vehicle was being purchased for their personal use. *Id.*; Department Ex. 6. There is no evidence in the record that the motor home was used for anything other than recreational personal travel by the Does. Taxpayer's Ex. 1, 2. Because of the aforementioned facts, I find sufficient evidence to conclude that ABC Industries was a sham and that, for tax purposes, it is not entitled to recognition as a separate taxable entity for purposes of applying section 3-55(h).

In First Chicago Building Corporation v. Department of Revenue, 49 Ill. App. 3d 237 (1st Dist. 1977), the Illinois appellate court ruled that a subsidiary corporation established to take advantage of the sales tax exempt status of its parent could not be disregarded as a sham for purposes of applying the exemption provisions of the Illinois Retailers' Occupation Tax Act.

The court's ruling in this case was primarily based upon its finding that the subsidiary and its parent dealt at arm's-length. First Chicago Building Corporation, *supra* at 241 ("The Bank dealt with its subsidiary, First Chicago, in a fashion which could be reasonably expected between two independent parties ...[.]").

In contrast to the situation presented in First Chicago Building Corporation, the activities of the Does and ABC Industries were indistinguishable and inseparable; there is no evidence that the Does ever engaged in arms-length transactions with ABC Industries or treated this company as anything other than their alter ego. As the court notes in First Chicago Building Corporation, *supra* "The fact that a taxpayer may properly arrange its affairs to minimize taxation does not give it license to create purposeless entities or to engage in transactions with subsidiaries which independent parties would not dream of concluding." *Id.*, citing U.S. Gypsum Co. v. U.S., 452 F. 2d 445, 451 (7th Cir. 1971).

For the aforementioned reasons, I find that the facts in the instant case are distinguishable from those upon which the court relied in First Chicago Building Corporation. Consequently, this case does not support a finding that ABC Industries was not a sham that could not be disregarded in determining whether this entity is exempt from taxation. Given that ABC Industries is a sham that has no identity that is separate and distinct from its members and therefore must be disregarded, the applicability of section 3-55(h) in the instant case turns upon whether the members of this company, John and Jane Doe, were Illinois residents.

Although the UTA does not define the term "resident" or "nonresident", case law indicates that "residence" is synonymous with "domicile." Hatcher v. Anders, 117 Ill. App. 3d 236, 239 (2nd Dist. 1983). "A person can have only one domicile or permanent residence and once it is established it is retained until a new domicile is acquired." *Id.* In order to establish a

new domicile, a person must physically go to a new home and live there with the intention of making it his permanent home. *Id.* “Once a residence has been established, it is presumed to continue until the contrary is shown...[.]” *Id.*

In the present case, the evidence supports a finding that both John and Jane Doe, the sole members of ABC Industries, were residents of Illinois. John Doe testified that he and Jane Doe have resided in Illinois since 1962 (Tr. pp. 25, 26), and neither introduced any evidence that would support a finding that they ever established residence in any other state subsequent to that date. Consequently, I find that John and Jane Doe were clearly residents of Illinois. Because ABC Industries was not a separate entity from John and Jane Doe, and both John and Jane Doe were Illinois residents, I find that the nonresident exemption at section 3-55(h) of the UTA does not apply in this case.

Applicability of the Fraud Penalty

Before this matter can be properly concluded, I must also address the question whether the fraud penalty assessed in this matter is supported by evidence contained in the record. Considering the fraud penalty for the period at issue, if the Department alleges that underpayment of taxes is due to fraud the statute provides a penalty assessed equal to fifty percent of the tax deficiency assessed by the Department. 35 **ILCS** 735/3-6. In the instant case, the fraud penalty that has been assessed has been doubled pursuant to section 3-3(j) of the Uniform Penalty and Interest Act (“UPIA”), 35 **ILCS** 735/3-3(j), which doubles the amount of a penalty assessed where a taxpayer has failed to pay its tax liability during the amnesty period created by recent amendments to the Tax Amnesty Act and the UPIA. 35 **ILCS** 735/3-3(j).

Unlike the proof required to establish the correctness of the Department’s assessment of tax and penalties other than fraud, fraud cannot be established merely through the introduction of

the Department's notice of tax liability into evidence. When fraud has been assessed, the burden of proof as to the fraud is on the Department. Brown Specialty Co. v. Allphin, 75 Ill. App. 3d 845 (3d Dist. 1979). The Department must provide clear and convincing evidence of fraud when fraud is asserted under the Retailers' Occupation Tax Act and its complimentary Use Tax Act. Id.

In the instant case, the Department failed to offer any clear and convincing evidence that the deficiency assessed is due to fraud. Therefore, the fraud penalty assessed in this case must be cancelled.

Conclusion:

I recommend that the Director revise the Notice of Tax Liability at issue in this case to eliminate the fraud penalty assessed, and that it be finalized as so revised, with interest to accrue pursuant to statute.

June 10, 2013

**Ted Sherrod
Administrative Law Judge**