

IT 95-82

Tax Type: INCOME TAX

Issue: Withholding Tax - Failure To File Return/Make Payment
Statute of Limitations Application

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

DEPARTMENT OF REVENUE)
STATE OF ILLINOIS)
) Docket:
 v.)
)
XXXXXX)
) Wendy S. Paul
) Admin. Law Judge
 Taxpayer(s))

RECOMMENDATION FOR DISPOSITION

APPEARANCES: XXXXX, for Taxpayer.

SYNOPSIS: Taxpayer filed a timely protest of a Notice of Deficiency issued by the Department. The Notice proposed tax liabilities and penalties related to the failure to file withholding tax returns and the failure to pay over to the State of Illinois withheld Illinois income taxes from compensation paid to taxpayer's employees during the 3rd quarter of 1977 through the 2nd quarter of 1989 as required by Article 7 of the Illinois Income Tax Act (35 ILCS 5/701 through 5/713).

Following a hearing, a recommended decision was issued by administrative law judge Dennis L. Karns on January 28, 1993 which recommended that the Notice of Decision be upheld. Taxpayer filed a timely Petition for Rehearing which was allowed by the Department because of its failure to issue a denial within 10 days of receipt of the request pursuant to 35 ILCS 5/908(c). Administrative law judge Karns presided over the rehearing on November 10, 1994. The entire record was reviewed by Wendy S. Paul, administrative law judge, who is issuing the instant Recommendation for Disposition.

The issues to be resolved are:

(1) Whether taxpayer failed to file withholding tax returns and/or withhold and pay over to the State of Illinois amounts from compensation paid to its employees during the 3rd quarter of 1977 through the 2nd quarter of 1989, as required under Article 7 of the Illinois Income Tax Act;

(2) Whether the Notice of Deficiency was barred by a statute of limitations.

FINDINGS OF FACT:

1. A Notice of Deficiency was issued on January 16, 1992. (Dept. Ex. No. 4) 1

2. Taxpayer filed a timely Protest on January 28, 1992. (Dept. Ex. No. 5)

3. The Department's Notice proposed a tax liability of \$6,282.00 for failure to file withholding tax returns and withhold and pay over to the State of Illinois amounts from compensation paid to its employees during the 3rd quarter of 1977 through the 2nd quarter of 1989 as required under Article 7 of the Illinois Income Tax Act. The Notice additionally proposed penalties pursuant to 35 ILCS 5/1001, 5/1002(a), and 5/1005. (Dept. Ex. Nos. 4, 6)

4. In its Protest, Taxpayer alleged that it had filed all required returns (Forms Il-941) but that it did not withhold Illinois income taxes due to "high exemption[s]". Taxpayer also alleged that it was relying upon an unidentified statute of limitations. (Dept. Ex. No. 5)

5. During the 3rd quarter of 1977 through and including the 2nd quarter of 1989 the taxpayer was an employer required to withhold Illinois income taxes from the wages paid to its employees and to pay over the withheld amounts to the Illinois Department of Revenue. (Dept. Ex. No. 4, Tr. p.12)

6. Taxpayer failed to file Illinois Withholding Tax Returns (IL-941s) for any of the quarters at issue. (Dept. Ex. No. 4, 8-11; Tr. pp.

12, 14, 18)

7. Since no returns had been filed for the period in question, and since taxpayer did not respond to several requests by the Department for proof of filing and for information, the Department's auditor conducted an audit with the best available information, which consisted of information concerning taxpayer's federal withholding history for the quarters involved. (Tr. pp. 12-15)

8. From the information obtained from the Internal Revenue Service, the Department determined that taxpayer had paid wages to its employees during the quarters at issue and had withheld federal income taxes therefrom, but that it had failed to withhold and/or pay over to the Department any Illinois income taxes. (Tr. pp. 12-15)

9. From the information obtained from the Internal Revenue Service, the Department was able to determine the gross amount of wages paid per quarter, but was unable to determine the number of employees per quarter or the number of dependents for each employee. (Tr. p. 21)

10. In determining the amounts which should have been withheld and paid over to the state, the Department's auditor multiplied the gross wages per calendar quarter by the tax rate, and she assumed that there was only a single employee per calendar quarter. For the several quarters for which there was no federal information, the auditor estimated the amount of wages based upon the prior and succeeding quarters. (Tr. pp. 23, 33)

11. The audit methodology of the Department's auditor, which was based upon the best information available, was reasonable.

12. There was no evidence to rebut taxpayer's evidence regarding the correct number of employees for 1980, 1981, 1982, 1983, 1984, 1986, 1987, 1988 and 1989, which consisted of copies of Forms W-2 allegedly filed by taxpayer with the Internal Revenue Service. (Taxpayer Exhibits C, D, E, F, G, I, J, K, and L)

13. For 1978, 1979, and 1985, taxpayer failed to present any evidence

regarding the correct number of employees and for these years, the Department's assumption that there was only a single employee for all of these years was reasonable as based upon the best available information.

14. Taxpayer did not introduce into evidence Forms W-3 or W-4.

15. The penalties proposed by the Department were recommended because of taxpayer's failure to file returns, negligence and failure to pay in a timely manner pursuant to 35 ILCS 5/1001, 1002(a), and 1005. (Dept. Ex. No. 4)

16. The amounts of wages paid as reflected on the Forms IL-941 and W-2 admitted as Taxpayer's Exhibits A through L coincided with the wage information which the Department obtained from the Internal Revenue Service, so that there is no dispute regarding the gross amount of wages paid during the audit period. (Taxpayer Ex. A through L; Tr. pp. 83-84)

CONCLUSIONS OF LAW: On examination of the record established, taxpayer has failed to demonstrate by the presentation of testimony or through exhibits or argument, evidence sufficient to overcome the Department's prima facie case. Accordingly, by such failure, and under the reasoning given below, the assessments proposed in the Notice of Deficiency, as modified by the Department's Technical Support Unit, which findings are attached, must stand. In support thereof, the following conclusions are made:

ISSUE #1 Taxpayer does not dispute its status as an employer required to file withholding tax returns. Taxpayer contends that the required returns (Forms IL-941) were timely filed for the quarters at issue but that, because of the number of employees and the number of personal exemptions and deductions those employees were entitled to claim, the returns correctly reflected no withholding tax liability.

The Notice of Deficiency is prima facie correct so long as its proposed adjustments meet some minimum standard of reasonableness. *Vitale v. Illinois Department of Revenue*, 118 Ill. App. 3d 210 (3rd Dist. 1983).

A taxpayer cannot overcome the Department's prima facie case merely by

denying the accuracy of its assessments. (Smith v. Department of Revenue, 143 Ill. App. 3d 607 (5th Dist. 1986); Puleo v. Department of Revenue, 117 Ill. App. 3d 260 (4th Dist. 1983); Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978)) The taxpayer must present evidence which is consistent, probable, and identified with its books and records. Fillichio v Department of Revenue, 15 Ill. 2d 327 (1958). Here, except as to the number of employees as reflected on the Forms W-2, taxpayer's books and records were insufficient to overcome the Department's prima facie case.

Where, as here, the taxpayer fails to file a tax return, the Department shall determine the amount of tax due according to its best judgement and information, which amount so fixed by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due. 35 ILCS 5/904(b). The Department's audit methodology, which relied upon information provided to it by the Internal Revenue Service, in the absence of any returns or other documentation provided by taxpayer, was reasonable.

On the issue of whether Illinois withholding returns (Forms IL-941) were ever filed, taxpayer's accountant testified only that he prepared the returns, but not that they had been filed. XXXXX, taxpayer's president, testified that he filed the returns by mailing them after meeting with the accountant. (Tr. p. 73). Taxpayer failed to produce, however, any corroborating proof that such returns were mailed, such as proof of mailing by the United States Post Office. See 5 ILCS 70.1.25(2) The thrust of Mr. XXXXX's testimony was that it was his usual procedure to meet with the accountant every calendar quarter, and that he would sign and mail all of the various returns prepared by the accountant, which included federal withholding returns as well as corporate and personal income tax returns and sales tax returns. (Tr. 73) It was undisputed that taxpayer's federal withholding tax returns for the quarters at issue had been filed. (Tr. 12-15) Since Mr. XXXXX was not fluent in English and could not read or write

(Tr. 77), his testimony that the state withholding tax returns were filed is questionable, since he would have had no way of distinguishing such returns from the federal withholding or any other returns. Taxpayer's weak evidence as to filing was rebutted by the Department's evidence that, according to its computerized records, there was no record of filing, and that not even one of the 48 returns allegedly mailed had been received by the Department. Nor did the Department have a W-3 on file for taxpayer. Further, in November and December, 1989, the Department had sent taxpayer several notices regarding the lack of any record of withholding returns having been filed (Dept. Ex. No. 9, 10), which probably not coincidentally coincided with the time that the Department's records reflected the beginning of a filing history for taxpayer. (Tr. 79-81)

Taxpayer also contends that it had no withholding tax liability until 1989 because of the number of employees and the number of personal exemptions and deductions those employees were entitled to claim under 35 ILCS 5/702, both of which, if proved, would tend to reduce or eliminate taxpayer's withholding tax liability. Regarding this contention, taxpayer introduced into evidence Forms W-2 which were allegedly prepared by its accountant and filed federally. Although never produced by taxpayer until the hearing, this proof as to the number of employees per quarter was un rebutted by the Department. The gross wages reflected on these forms coincided with the gross wages contained in the information which the Department's auditor received from the Internal Revenue Service. Unlike the taxpayer's alleged proof of filing of the Forms IL-941, which was rebutted by the Department's evidence of non-filing, taxpayer's proof regarding the number of employees, as set out in the Forms W-2, was uncontradicted.

The Department's auditor's methodology for computation of the deficiencies, which was conducted without the benefit of any documentation supplied by taxpayer, despite several requests therefor by the Department, was reasonable at the time the audit was conducted. However, in light of

the W-2s produced at the hearing, the auditor's original computations should be adjusted to account for the information contained in the Forms W-2.

There should be a further modification to the original audit findings in order to provide for one personal exemption for every employee, since this is allowed by statute (35 ILCS 5/702) and since this was not done in the original audit (Tr. 86).

On the other hand, there should be no modification or adjustment to the auditor's original computations for deductions under 35 ILCS 5/702, as there was no competent proof on this issue. When a taxpayer claims that it is exempt from a particular tax, or where it seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer, as deductions and exemptions are privileges created by statute as a matter of legislative grace. *Bodine Electric Co. v. Allphin* (1980), 81 Ill. 2d 502, 410 N.E.2d 828; *Balla v. Department of Revenue*, 96 Ill.App.3d 293 (1st Dist, 1981) Here, there was not even any testimony with regard to the number of deductions to which each employee was entitled and, more importantly, no documentation, such as federal or state withholding exemption certificates (Forms W-4), which would have conclusively established the issue, and which were records that were within taxpayer's control and which taxpayer was required to keep. 35 ILCS 5/501; 86 Admin. Code ch. I, Sec. 100.7110.

In its protest, Taxpayer did not address the issue of the penalties proposed pursuant to 35 ILCS 5/1001 and 5/1002 and the record contains no evidence to overcome the Department's prima facie case or to provide a basis for the abatement of such penalties.

Except for the necessary modifications referred to above, relating to the number of employees and an allowance of one personal exemption for every employee, taxpayer has failed to present sufficient evidence to overcome the Department's prima facie case and the auditor's computations

in support of the tax deficiencies and penalties asserted in the Notice should be upheld.

ISSUE #2 Taxpayer asserts that the Department's Notice of Deficiency is barred by Section 905 of the Illinois Income Tax Act (35 ILCS 5/905(a)(1)) which provides, in general, a limitations period of three years after the date of filing of the return. This statutory section, however, does not control this case. This case is controlled by 35 ILCS 5/905(c). This statutory section provides an exception to the general three-year period of limitations and applies where, as here, no withholding tax returns for the quarters at issue were ever filed. Under such circumstances, a Notice of Deficiency may be issued at any time. 35 ILCS 5/905(c); Mitchell v. Illinois Department of Revenue, 230 Ill.App.3d 795 (1st Dist. 1992). Accordingly, the instant notice of deficiency was not barred by statute.

Accordingly, it is my recommendation that the tax and penalty deficiencies proposed in the Notice of Deficiency be upheld, as modified by the Department's Technical Review Unit to give taxpayer credit for an increased number of employees with personal exemptions, which modifications are attached.

Wendy S. Paul
Administrative Law Judge

1 All references to Exhibits refer to exhibits entered into evidence at the rehearing.