

ST 17-01
Tax Type: Sales Tax
Tax Issue: Books and Records Insufficient

Illinois Department of Revenue
OFFICE OF ADMINISTRATIVE HEARINGS
James R. Thompson Center
100 West Randolph Street, Level 7-900
Chicago, Illinois 60601
(312) 814-6114

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

v.

ABC, INC.,

TAXPAYER

No. XX-ST-XXX
Account ID: XXXX-XXXX
NTL: XXXX XXXX XXXX XXXX

Kenneth J. Galvin
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. Brian E. Hurley, Brian E. Hurley & Associates, appearing on behalf of ABC, Inc; Mr. George Foster, Special Assistant Attorney General, appearing on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to Taxpayer’s protest of the above-captioned Notice of Tax Liability (hereinafter “NTL”), issued by the Illinois Department of Revenue (hereinafter “Department”) on October 31, 2013. An evidentiary hearing in this matter was held on March 24, 2016, with testimony from Mr. John Doe, Owner and President of ABC, and Mr. Jerry Judkins, Revenue Auditor for the Department. Following submission of all evidence and a review

of the record, it is recommended that the NTL be revised after adjustments as detailed in Dept. Ex. Nos. 2 and 3, and that the NTL be finalized as so revised. In support thereof, the following “Finding of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department’s *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of Dept. Ex. No. 1, the NTL, captioned above, admitted under the Certificate of the Director, dated October 31, 2013, covering the audit period July 1, 2009 through March 31, 2012, as adjusted by Dept. Ex. Nos. 2 and 3, agreed to by ABC at the evidentiary hearing, which adjusted and lowered the amount due on the NTL. Tr. pp. 4-11, 66-68; Dept. Ex. Nos. 1, 2 and 3.
2. ABC, located in Chicago, is a convenience store, selling liquor/beer, food, cigarettes, general merchandise and lottery. Approximately 90% of its sales are liquor. Mr. Doe owned and operated a 7-11 franchise before owning ABC. Tr. pp. 15-16; Dept. Ex. No. 1.
3. ABC did not have available for audit all of the books and records that Illinois law requires a retailer to keep. In conducting the audit which led to the NTL at issue, ABC did not have cash register receipts. The Auditor attempted to determine ABC’s purchases for 2011 using EDA questionnaires sent to ABC’s vendors, a record from Springfield of ABC’s liquor purchases and ABC’s records of purchases. After the Auditor determined ABC’s purchases, he calculated a markup for those purchases by first checking the sales price of the products then currently on the shelves. He then asked ABC to verify the sales prices and reconcile any differences. He applied the mark-up to ABC’s purchases and projected the gross receipts for the audit period. The Auditor determined that there were underreported

receipts resulting in additional sales tax liability. Tr. pp. 6-8, 62-68; Taxpayer's Ex. No. 1; Dept. Ex. No. 2.

Conclusions of Law:

The Retailers' Occupation Tax Act requires that every person engaged in the business of selling tangible personal property at retail in Illinois shall keep records and books of all sales of tangible personal property, together with invoices, sales records or copies of bills of sale. "The Department may adopt rules that establish requirements, including record forms and formats, for records required to be kept and maintained by Taxpayers." 35 ILCS 120/7. The Department has established certain "minimum" requirements for record keeping. 86 Ill. Adm. Code § 130.805(a), entitled "What Records Constitute Minimum Requirement," states as follows:

In General. A Taxpayer shall maintain all records that are necessary to a determination of the correct tax liability under the Act. All required records must be made available on request by the Department. When a Taxpayer's business consists exclusively of the sale of tangible personal property at retail, the following records will be deemed by the Department to constitute a minimum for the purposes of the Act:

- 1) Cash register tapes and other data which will provide a daily record of the gross amount of sales.

Mr. Judkins, Revenue Auditor for the Department, testified that he requested, but did not receive, register tapes from ABC. Tr. pp. 62-63. If a taxpayer fails to maintain adequate records, and does not supply the Department with documentation to substantiate its gross receipts, the Department is justified in using other reasonable methods to estimate the taxpayer's revenues. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

In conducting the audit which led to the instant case, the Auditor first looked at ABC's purchases for 2011. The Auditor attempted to determine ABC's purchases for 2011 using EDA questionnaires sent to ABC's vendors, a record from Springfield of ABC's liquor purchases and ABC's own records of purchases. The Auditor testified that he was able to determine "exactly what [ABC] was purchasing and selling." Tr. p. 64. According to Counsel for the Department, the Auditor determined that ABC "reported less in gross receipts even than [it] had purchased for that year." "So the taxpayer would have had to be selling things at a loss for his gross receipts to have been accurate, which couldn't be the case." Tr. pp. 7-8.

According to the Auditor, after determining ABC's purchases, the "next step" was to see "what the prices on the shelf were..." After applying the shelf prices to the purchases, the Auditor testified that he "sent them out to the accountant through the taxpayer to verify." Some of the food items were pre-priced at the suggested retail price and their sales price was not at issue. The Auditor testified that he discussed the markup with ABC and that ABC agreed with the markup. He applied the markup to the 2011 purchases and determined what ABC's gross receipts were for 2011. He compared these receipts to ABC's reported receipts and found that the receipts were underreported in 2011. He used this projection to determine underreported receipts for other years in the audit period, resulting in additional sales tax liability. Tr. pp. 6-8, 62-68; Taxpayer's Ex. No. 1; Dept. Ex. No. 2.

ABC argued at the hearing that the original audit was "inaccurate to the point of being unreasonable." Tr. pp. 5-6. One of ABC's objections was that ending inventory was deducted from marked up purchases rather than non-marked up purchases. The Department adjusted for this resulting in a lower tax liability. Tr. pp. 26-27, 66-67. The Department also added in a spillage factor "which was not used in the original audit which we agreed to make after we had discussions

with opposing counsel.” Tr. p. 5; Dept. Ex. Nos. 2 and 3. Counsel for ABC acknowledged that “these two calculations create a more accurate notice of tax liability.” Tr. p. 6.

ABC’s third objection was that the Auditor used the prices of the goods on the shelves in 2013 to determine the markup for 2011 purchases. According to ABC, the Auditor never asked for “2013 invoices to determine the cost of those goods that were currently being marked up.” Tr. pp. 45-46. The Auditor explained that he used the prices of the goods on the shelves in 2013 as a “starting point.” He knew there might be a difference in the selling prices over the years. He asked that the prices be verified by ABC and any differences reconciled. According to the Auditor, ABC reconciled the differences so any differences in sales prices over the audit period were “taken into account” and ABC agreed with the markup. The Auditor did not ask for 2013 invoices to compare to the prices on the shelf in 2013 because that “would create a whole different set of problems.” The audit period ended in March of 2012, and if “I’m asking for 2013 invoices....Then I’m way out in some other period.” Counsel for ABC asked the Auditor if it was “best” to have the cost of goods sold and sales prices from the same period to determine markup. The Auditor testified that “ideally” this was best, but that this was not an ideal situation. Tr. pp. 65-71. ABC did not maintain adequate records from which the Auditor could determine gross receipts. After listening to the testimony and the arguments regarding the markup, and noting that the Auditor stated several times that he reconciled and verified the selling prices with ABC and that ABC agreed with the markup, I conclude that the Auditor used a “reasonable” method to estimate ABC’s markup for 2011, the total underreported receipts for the audit period and the sales tax due on those receipts.

Sections 4 and 5 of the Retailers Occupation Tax Act provide that the admission into evidence of Department records under the certificate of the Director establishes the Department’s *prima facie* case and is *prima facie* evidence of the correctness of the amount of tax due. 35 ILCS

120/4 and 120/5; Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). Once the Department's *prima facie* case is established, the burden of proof is shifted to the taxpayer to overcome the Department's *prima facie* case. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773 (1st Dist. 1987). The Department's *prima facie* case is a rebuttable presumption. Copilevitz, supra. In the instant case, the Department's *prima facie* case was established by the admission into evidence of the NTL's, under the Certificate of the Director, issued to ABC on October 31, 2013. Dept. Ex. No. 1. The burden of proof then shifted to ABC to overcome the Department's *prima facie* case.

In order to overcome the presumption of validity attached to the Department's determinations of tax due, the taxpayer must produce competent evidence, identified with its books and records showing that the determinations are incorrect. Copilevitz, supra. Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991). Documentary proof is required to prevail against an assessment of tax by the Department. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990). A taxpayer cannot overcome the statutory presumption of correctness by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988). ABC was required by statute to keep detailed records, such as cash register tapes. ABC had the burden of proving by competent evidence that the proposed assessment was not correct. Young v. Hulman, 39 Ill. 2d 219 (1968). Counsel for ABC's arguments about the "best" way to calculate markup is not competent evidence. Counsel's arguments are not sufficient for me to conclude that the Auditor used an unreasonable method to estimate ABC's gross receipts and the arguments regarding the markup are not sufficient to overcome the Department's *prima facie* case.

ABC was assessed a negligence penalty, late filing penalty and late payment penalty.¹ Counsel for ABC argued that the record “will show that there is cause to abate penalties based on the good faith efforts of the taxpayer to properly determine his tax liability, that he exercised ordinary business care.” Tr. p. 10. One of the most important factors to be considered in making a determination to abate a penalty is the extent to which the taxpayer made a good faith effort to determine his proper tax liability. A taxpayer will be considered to have made a good faith effort to determine his proper tax liability if he exercised ordinary business care and prudence in doing so. 86 Ill. Adm. Code § 700.400.

I have no hesitation in finding that ABC did not make a good faith effort to determine its tax liabilities. ABC did not maintain register receipts or a daily record of the gross amounts of sales, which are the Department’s minimum record-keeping requirements for a business that sells tangible personal property at retail. 86 Ill. Adm. Code § 130.805(a). Mr. Doe testified that he has a bachelor’s degree, operated a 7-11 franchise for six years and went through a two to three week training program in order to operate that franchise. Tr. pp. 58-60. Mr. Doe also testified that he was not “aware” that he had to keep cash register tapes and he did not recall that he ever received information at the 7-11 franchise training that the stores had to keep cash register tapes. Tr. pp. 59-60. I find his testimony disingenuous and not credible. It would be unreasonable for me to conclude that ABC made a “good faith effort” to determine its proper tax liabilities when they did not keep records of gross receipts. I cannot recommend that the penalties in this case be abated because it would serve as a reward to ABC for not keeping a record of gross receipts, which they were required to do by Illinois regulations.

¹ All penalties were reduced by the adjustments to the tax liability as determined in Dept. Ex. Nos. 2 and 3.

Accordingly, it is recommended that the NTL be revised in accordance with Dept. Ex. Nos. 2 and 3 and be finalized as so revised.

February 3, 2017

ENTER:

A handwritten signature in cursive script that reads "Kenneth Galvin".

Kenneth J. Galvin
Administrative Law Judge