

ST 07-24

Tax Type: Sales Tax

Issue: Unreported/Underreported Receipts (Non-Fraudulent)  
Audit Methodologies and/or Other Computational Issues

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

---

---

THE DEPARTMENT OF REVENUE	)	Docket No.	00-ST-0000
OF THE STATE OF ILLINOIS	)	Reg. No.	0000-0000, 0000-0000
	)	NTL Nos.	00-00000000000000
v.	)		00-00000000000000
ABC, INC.,	)		00-00000000000000
d/b/a XYZ JEWELERS,	)	John E. White,	
Taxpayer.	)	Administrative Law Judge	

---

---

**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Akram Zanayad, Akram Zanayad and Associates, appeared for ABC, Inc.; Marc Muchin, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

**Synopsis:** This matter arose after ABC, Inc., doing business as XYZ Jewelers (XYZ or taxpayer), protested three Notices of Tax Liability (NTLs) the Illinois Department of Revenue (Department) issued to it after an audit of taxpayer's business. The NTLs assessed retailers' occupation tax (ROT), penalties and interest as measured by the gross receipts XYZ received from selling tangible personal property at retail during the months from July 2001 through and including September 2003.

There are two issues; whether the Department correctly calculated XYZ's taxable gross receipts from what the Department determined were underreported sales; and whether the Department properly disallowed deductions XYZ claimed on its returns for sales of service. I have considered the evidence adduced at hearing, and I am including

in this recommendation specific findings of fact and conclusions of law. I recommend that the NTLs be revised, in part, and finalized as so revised.

**Findings of Fact:**

1. XYZ operates two jewelry stores, one in Anywhere and one in Anywhere. Department Ex. 1 (Department's correction of XYZ's returns), p. 1 ("Kind of business" description).
2. XYZ files a single monthly return on which it reports sales from both store locations. Taxpayer Ex. 1 (XYZ's original handwritten sales journals for both stores for the audit period); Department Ex. 1; Hearing Transcript (Tr.) pp. 44-46 (testimony of John Doe (Doe), Doe & Associates, P.C, XYZ's accountant).
3. Jane Doe was XYZ's manager, and an officer of ABC, Inc., during the audit period. Tr. p. 48 (Jane Doe).
4. For each transaction it made, XYZ prepared a handwritten invoice describing the transaction. Tr. pp. 49-50 (Jane Doe). XYZ gave a copy of the invoice to its customer as a receipt, and it kept a copy. Tr. pp. 50-51 (Jane Doe). The customer's copy of the invoice stated that the customer was responsible for keeping the receipt. Tr. p. 51 (Jane Doe).
5. XYZ kept its copy of these invoices until after it filed its return in the month following the month in which it prepared the invoice, and it then destroyed those invoices. Tr. pp. 50, 59 (Jane Doe).
6. XYZ did not allow a customer to return an item after 30 days from the date of sale. Tr. p. 51 (Jane Doe).
7. The Department conducted an audit of XYZ's business regarding the months of July

2001 through and including September 2003. Department Ex. 1.

8. Ivette Ponce (Ponce) performed the audit of XYZ for the Department. Tr. pp. 13-14 (Ponce).
9. During the audit, Ponce reviewed XYZ's handwritten sales journal and its federal and state income tax returns. Tr. p. 15 (Ponce).
10. Jane Doe also tendered other books and records to Ponce during the audit, including bank statements, monthly sales tax forms and purchase invoices. Tr. pp. 25 (Ponce), 53 (Jane Doe).
11. Each page in XYZ's handwritten sales journal included, for one store, daily entries of amounts listed under the following column headings: "Daily Totals" or "Totals"; "Sales"; and "Repairs". Taxpayer Ex. 1. On each page, the "Daily Totals" entry for a given day consistently equaled the sum of the amounts entered for "Sales" plus "Repairs" for the same day. *Id.*
12. Ponce created a spreadsheet in which she entered XYZ's gross receipts as reported on XYZ's handwritten sales journals, and, after comparing those entries with the one on XYZ's returns as filed, she determined that, for certain months, XYZ had more gross receipts than it had reported on its monthly returns. Tr. pp. 17-18, 22-23 (Ponce); *see also* Department Ex. 2 (copies of certain schedules Ponce prepared during her audit of XYZ), pp. 1 (copy of Ponce's Schedule 3, which is a summary reconciliation of underreported receipts), 2 (copy of Ponce's spreadsheet showing entries on XYZ's returns as filed).
13. Ponce therefore calculated the difference between the gross receipts totals reflected on XYZ's sales journal and the gross receipts reported on its monthly tax returns as

underreported receipts. Department Ex. 2, p. 1; Tr. pp. 22-23 (Ponce).

14. Ponce then multiplied the above amounts by the applicable tax rates, to measure tax due on underreported receipts. Department Ex. 2, p. 3; Tr. pp. 22-23 (Ponce).

15. The evidence admitted at hearing does not include the spreadsheet that Ponce testified she created to compare the gross receipts from XYZ's sales journal with the gross receipts XYZ reported on its returns as filed. Department Ex. 2. Therefore, in the table below, I have scheduled, *inter alia*, the monthly amounts of gross receipts recorded in XYZ's sales journal, Taxpayer Ex. 1, for each store.

<b>Month / Year</b>	<b>Anywhere Gross Receipts per S/J</b>	<b>Anywhere II Park Gross Receipts per S/J</b>	<b>Total Gross Receipts per S/J</b>	<b>Anywhere II Park Receipts as % of Total Receipts</b>
Jul-01	26,083.54	60,330.24	86,413.78	70
Aug-01	26,389.56	46,515.16	72,904.72	64
Sep-01	20,704.00	41,466.55	62,170.55	67
Oct-01	26,892.99	45,794.04	72,687.03	63
Nov-01	25,800.30	72,068.01	97,868.31	74
Dec-01	86,246.48	133,342.05	219,588.53	61
Jan-02	29,634.08	39,107.08	68,741.16	57
Feb-02	38,475.11	70,377.62	108,852.73	65
Mar-02	31,465.64	35,630.13	67,095.77	53
Apr-02	29,454.27	46,580.10	76,034.37	61
May-02	37,061.82	64,917.34	101,979.16	64
Jun-02	22,162.98	34,117.94	56,280.92	61
Jul-02	23,575.69	47,615.07	71,190.76	67
Aug-02	23,717.77	44,380.33	68,098.10	65
Sep-02	26,901.48	40,134.07	67,035.55	60
Oct-02	25,483.33	41,417.65	66,900.98	62
Nov-02	28,238.75	44,507.49	72,746.24	61
Dec-02	95,984.53	171,787.81	267,772.34	64
Jan-03	24,426.28	49,802.39	74,228.67	67
Feb-03	37,699.58	50,105.54	87,805.12	57
Mar-03	29,985.49	47,244.67	77,230.16	61
Apr-03	35,196.87	59,256.06	94,452.93	63
May-03	40,592.72	52,700.00	93,292.72	56
Jun-03	24,845.15	52,682.25	77,527.40	68

Jul-03	29,233.29	58,099.87	87,333.16	67
Aug-03	34,042.45	41,519.94	75,562.39	55
Sep-03	41,484.42	79,237.44	120,721.86	66

Taxpayer Ex. 1.

16. In the next table, I have scheduled and compared: the gross receipts as per XYZ's sales journal, Taxpayer Ex. 1; the gross receipts as per XYZ's returns as filed, Department Ex. 2, p. 2; the difference between those amounts; the amounts of underreported gross receipts; and the amounts of underreported receipts as per Ponce's Schedule 3, Department Ex. 2, p. 1.

Month / Year	Gross Receipts per S/J, TP Ex. 1	Gross Receipts per XYZ's Returns, Dept. Ex. 2, p. 2	Difference Between Return & S/J	Underreported Receipts per S/J	Underreported Receipts per Ponce's Schedule 3, Dept. Ex. 2, p. 2	
Jul-01	86,413.78	96,944.00	(10,530.22)		20,335	
Aug-01	72,904.72	75,808.00	(2,903.28)			
Sep-01	62,170.55	62,814.00	(643.45)			
Oct-01	72,687.03	77,076.00	(4,388.97)			
Nov-01	97,868.31	84,244.00	13,624.31	13,624.31		
Dec-01	219,588.53	230,301.00	(10,712.47)			
Jan-02	68,741.16	71,007.00	(2,265.84)			
Feb-02	108,852.73	105,023.00	3,829.73	3,829.73		
Mar-02	67,095.77	69,249.00	(2,153.23)			
Apr-02	76,034.37	71,984.00	4,050.37	4,050.37		
May-02	101,979.16	100,513.00	1,466.16	1,466.16		
Jun-02	56,280.92	54,922.00	1,358.92	1,358.92		
Jul-02	71,190.76	73,754.00	(2,563.24)			
Aug-02	68,098.10	66,506.00	1,592.10	1,592.10		
Sep-02	67,035.55	68,364.00	(1,328.45)			
Oct-02	66,900.98	67,101.00	(200.02)			
Nov-02	72,746.24	71,652.00	1,094.24	1,094.24		
Dec-02	267,772.34	265,975.00	1,797.34	1,797.34		19,268
Jan-03	74,228.67	265,975.00	(191,746.33)			19,725
Feb-03	87,805.12	90,380.00	(2,574.88)			
Mar-03	77,230.16	80,875.00	(3,644.84)			
Apr-03	94,452.93	85,479.00	8,973.93	8,973.93		
May-03	93,292.72	96,502.00	(3,209.28)			
Jun-03	77,527.40	80,345.00	(2,817.60)			
Jul-03	87,333.16	90,586.00	(3,252.84)			

Aug-03	75,562.39	85,482.00	(9,919.61)		
Sep-03	120,721.86	126,047.00	(5,325.14)		
<b>Total Underreported Receipts per S/J:</b>				<b>37,787.10</b>	
<b>Total Underreported Receipts per Schedule 3:</b>					<b>59,328</b>

Taxpayer Ex. 1; Department Ex. 2, pp. 1-2.

17. Because of differences in local or municipal taxes, for the Anywhere II store, the effective tax rate for sales and/or transfers of tangible personal property incident to a sale of service was 7.75% until the end of December 2001, and 8.5% thereafter. Department Ex. 2, p. 3. For the Anywhere store, the effective tax rate was 7.5% until the end of December 2001, and 8% thereafter. *Id.*

18. Taking into account the underreported gross receipts revealed on XYZ's sales journal, as well as the different effective tax rates for the two stores, the correct amount of tax due for underreported gross receipts is as follows:

Month/Year	Amount of Underreported Receipts per S/J	Anywh ere II Park % of Total	Amount of Receipts Attributable to Orland Park	Tax Rate	Tax Due	Amount of Receipts Attributable to Anywhere	Tax Rate	Tax Due
Nov-01	13,624.31	74	10,081.99	7.75%	781.35	3,542.32	7.5%	265.67
Feb-02	3,829.73	65	2,489.32		192.92	1,340.41		100.53
Apr-02	4,050.37	61	2,470.73		191.48	1,579.64		118.47
May-02	1,466.16	64	938.34		72.72	527.82		39.59
Jun-02	1,358.92	61	828.94		64.24	529.98		39.75
Aug-02	1,592.10	65	1,034.87		80.20	557.24		41.79
Nov-02	1,094.24	61	667.49		51.73	426.75		32.01
<b>Total Jul-01 to Nov-02</b>	<b>27,015.83</b>		<b>18,511.68</b>		<b>1,434.64</b>	<b>8,504.16</b>		<b>637.81</b>
Dec-02	1,797.34	64	1,150.30	8.5%	97.78	647.04	8%	51.76
<b>Total Dec-02</b>	<b>1,797.34</b>	<b>64</b>	<b>1,150.30</b>			<b>97.78</b>		<b>647.04</b>
Apr-03	8,973.93	63	5,653.58		480.55	3,320.35		265.63

<b>Total Jan-03 to Sep-03</b>	<b>8,973.93</b>	<b>63</b>	<b>5,653.58</b>		<b>480.55</b>	<b>3,320.35</b>		<b>265.63</b>
---	-----------------	-----------	-----------------	--	---------------	-----------------	--	---------------

*See* Taxpayer Ex. 1; Department Ex. 2, pp. 1-3.

19. XYZ took a deduction on each monthly return that it filed during the audit period for sales of services. Department Ex. 2, p. 2 (copy of schedule showing entries XYZ made on its returns as filed); Tr. pp. 18-20 (Ponce); *see also* <http://tax.illinois.gov/taxforms/sales/st1in.pdf> (online version of instructions for completing form ST-1).
20. Ponce determined that XYZ could not support the amounts it reported on its returns as coming from nontaxable sales of services. Tr. pp. 30-31 (Ponce). That is because XYZ could not produce documentary evidence, such as the invoices it destroyed, clearly showing that XYZ received specific amounts from specific customers in specific transactions that involved only a sale of repair services. *Id.*; 35 **ILCS** 120/7.
21. As a result of that determination, Ponce disallowed half of the amount XYZ had reported as being deductible as receipts from its sales of service, and assessed tax on that amount. Department Ex. 2, p. 3; Tr. p. 18 (Ponce).
22. On the schedule on which Ponce detailed her calculation of the amount of tax due based on XYZ's inability to support the deductions it took for receipts from transactions claimed to be sales of services, Ponce wrote a note that provided: "\*50% Service[.] Since the taxpayer was unable to provide a cost basis on the sales of service[,] fifty percent of the service invoice was deemed to be the selling price [of tangible personal property transferred incident to a sale of service] and taxed at the high rate." Department Ex. 2, p. 3 (bracketed text added for clarity).

23. While the Department's correction of returns includes a penalty for late filing (Department Ex. 1), no such penalty was assessed on the NTLs issued to XYZ.

Taxpayer Ex. 3 (copy of NTLs).

24. Sometime after the Department's audit was completed, a reaudit was conducted by Karen Macudzinski, another Department auditor. Tr. pp. 36-42 (Macudzinski). No change was made to the NTLs as a result of that reaudit. *Id.*

### **Conclusions of Law:**

The Department introduced a copy of the correction of returns it issued to XYZ into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the Retailers' Occupation Tax Act (ROTA), that correction of returns constitutes the Department's prima facie case in this matter. 35 ILCS 120/4, 7. The Department's prima facie case is a rebuttable presumption. 35 ILCS 120/7; Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). A taxpayer cannot overcome the statutory presumption merely by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Filichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053. XYZ's introduction of the NTLs issued to it establish that no penalty was assessed. Taxpayer Ex. 3.

### **Whether the Department Correctly Determined the Amount of XYZ's Underreporting of Taxable Gross Receipts**

The Department determined that XYZ had underreported sales, since, for certain months, the gross receipts reflected on its sales journal were greater than the gross receipts XYZ reported on its monthly returns. *See* Department Exs. 1-2. At hearing, XYZ conceded that the amount of receipts XYZ reported on its returns for one store was less than the receipts reflected on its sales journal for the same store, but it asserted that the Department auditor should have given it a credit for the other store's overreporting of gross receipts. Tr. pp. 64-65 (closing argument).

But this record does not allow me to discern whether taxpayer's specific assertion is true, in part, because the evidence does not include copies of the returns XYZ filed during the audit period. Department Ex. 2, p. 2; Tr. p. 46 (Doe). The Department's schedule of returns as filed includes the amount of gross receipts that XYZ reported on its monthly returns, but does not detail how much of those gross receipts came from each store. Department Ex. 2, p. 2. Further, Ponce testified that she did not recall whether one of the stores reported more receipts on its returns than were reflected on the store's sales journal. Tr. p. 28 (Ponce). Taxpayer, moreover, either did not arrange for anyone, such as Doe, its accountant, to complete such a schedule, or, if it did, it did not introduce such a schedule into evidence.

Instead, XYZ offered into evidence some of the raw data — XYZ's sales journal — and argued that the journal reflects gross receipts that do not coincide with the auditor's calculation of XYZ's underreported receipts. Tr. pp. 64-65 (closing argument). And the evidence does establish that, although not for the reason XYZ asserts. I do not conclude that the Department's determination of the amount of XYZ's underreported gross receipts is incorrect because XYZ is entitled to a credit for amounts it says it

overreported to the Department. That is because this matter does not involve any claim for credit or refund that XYZ has made in accordance with applicable sections of the ROT. 35 ILCS 120/6-120/6c. Those provisions are, as a matter of law, the exclusive means by which a taxpayer might establish that it is entitled to a credit or refund of taxes erroneously paid, as a result of a mistake of fact or law. 35 ILCS 120/6c (“Claims for credit or refund hereunder must be filed with and initially determined by the Department, the remedy herein provided being exclusive; and no court shall have jurisdiction to determine the merits of any claim except upon review as provided herein.”); Dow Chemical Co. v. Department of Revenue, 224 Ill. App. 3d 263, 586 N.E.2d 516 (1<sup>st</sup> Dist. 1991).

And even if I were to treat XYZ’s argument as having the same effect as actually completing and filing a claim for credit as required by ROT §§ 6-6c, the evidence does not make me the least bit confident with taxpayer’s ability accurately to record the correct amount of gross receipts. There is not one month in the audit period in which XYZ reported on its return the gross receipts that were actually reflected within its sales journal. Taxpayer Ex. 1; Department Ex. 2, p. 2 (detailed supra p. 5, finding of fact 17). Further, one instance of XYZ’s claimed overreporting was almost certainly the result of an entry error that Ponce made when scheduling the amounts reported on XYZ’s returns as filed. Specifically, for both December 2002 and January 2003, Ponce scheduled that XYZ’s returns reported the identical amounts of gross receipts, \$265,975.00. Department Ex. 2, p. 2. This would have been the only instance where, for two consecutive months, XYZ reported the identical amount of gross receipts on its returns, and it would have been uncharacteristic of XYZ’s sales history for its January’s sales to be as high as its

December's sales. Department Ex. 2, pp. 1 (*supra* p. 4, finding of fact 16), 2 (*supra* p. 5, finding of fact 17). This likely transcription error, moreover, makes it appear as though XYZ overreported its gross receipts by 191,746.33. Department Ex. 2, p. 2 (*supra* p. 5, finding of fact 17). This record is devoid of any competent, credible evidence showing what mistake of fact or law XYZ might have made when erroneously reporting more gross receipts than it actually had during a particular month. Nor was any evidence offered which identifies the particular transactions from which such receipts might have been realized. *See* 35 ILCS 120/6a (describing the entries that must be made on a claim for refund form filed with the Department). In sum, XYZ is not entitled to any credit or offset for its claimed overreporting of gross receipts.

It is, however, entitled to have the Department revise and correct its determination of the extent of XYZ's underreporting, if it establishes that the Department's determination was not correct. *See* Fillichio, 15 Ill. 2d at 333, 155 N.E.2d at 7; A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053. The evidence shows that the Department's correction of returns and NTLs were based on an error regarding its calculation of the amount of XYZ's underreported gross receipts. Ponce determined that XYZ had underreported receipts of \$59,328 for the audit period; whereas the documentary evidence reflects that XYZ had underreported receipts of only \$37,787. Taxpayer Ex. 1 (detailed *supra*, pp. 4-5 (findings of fact 16 and 17)).

The record does not provide an explanation for how or why Ponce's comparison of XYZ's sales journal with its returns as filed yielded a greater amount of underreported receipts than my comparison did. For example, the record does not include a copy of the schedule Ponce testified that she created when comparing the gross receipts as reported

on XYZ's returns as filed with those written on its sales journal. Department Ex. 2; Tr. p. 17 (Ponce). The Department's applicable exhibit includes, for purposes of this issue, just the schedule of the entries on XYZ's returns as filed, and the results of her comparison of the gross receipts set forth in those returns. Department Ex. 2, pp. 1-2.

Regardless how it might have happened, Macudzinski testified that the sales journal admitted as Taxpayer Exhibit 1 was the sales journal that XYZ tendered to her during the reaudit. Tr. p. 39 (Macudzinski). Based on her testimony, it appears that no one had asked her to review Ponce's schedule of XYZ's sales journal regarding the underreporting issue. Tr. pp. 39-40 (Macudzinski). Macudzinski seems to have limited her reaudit to determining whether the Department should reconsider its determination on the second issue, regarding XYZ's deductions for sales of service. Tr. pp. 38-41 (Macudzinski). Jane Doe also testified that the sales journal admitted as Taxpayer Exhibit 1 was the journal that he personally kept and maintained during the audit period, and which he presented to Ponce during the Department's audit. Tr. pp. 50-52 (Jane Doe). Finally, the Department did not object to the exhibit when it was offered into evidence. Tr. p. 52.

Taxpayer's burden is to show, with documentary evidence closely identified with its books and records, that the Department's presumptively correct determination is wrong. Filichio, 15 Ill. 2d at 333, 155 N.E.2d at 7; A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053. Regarding this first issue, XYZ did just that with its sales journal. Taxpayer Ex. 1. That documentary evidence corroborates XYZ's claim that the Department's determination of the amount of XYZ's underreported gross receipts was not correct. The correct amount of XYZ's underreported gross receipts was \$37,787.

The NTLs, therefore, should be revised to reflect the amount of tax properly assessed on that correct amount of underreporting. *See supra*, p. 6 (finding of fact 19).

**Whether the Department Correctly Disallowed Fifty Percent of the Amount That XYZ Reported as a Deduction for Sales of Service**

This issue involves the Department's determination that XYZ had not supported its claimed deduction for receipts it reported as being deductible because they were derived from its sales of service. Tr. pp. 18 (Ponce), 38-41 (Macudzinski). The Department made this determination because taxpayer was not able to produce documentary evidence that showed that the receipts claimed to be nontaxable were, in fact, derived from transactions in which XYZ neither sold tangible personal property, nor transferred tangible personal property as a mere incident to a sale of service. Tr. pp. 18 (Ponce), 38-41 (Macudzinski). There is no dispute that XYZ routinely destroyed its copies (or originals) of the invoices that it created for each transaction that it entered into with a customer. Tr. pp. 49-51 (Jane Doe).

Section 7 of the ROTA provides, in pertinent part:

\*\*\* Every person who is engaged in the business of selling tangible personal property at retail in this State and who, in connection with such business, also engages in other activities (including, but not limited to, engaging in a service occupation) shall keep such additional records and books of all such activities as will accurately reflect the character and scope of such activities and the amount of receipts realized therefrom. \*\*\*

\*\*\*

To support deductions made on the tax return form, or authorized under this Act, on account of ... receipts from any other kind of transaction that is not taxable under this Act, entries in any books, records or other pertinent papers or documents of the taxpayer in relation thereto shall be in detail sufficient to show the name and address of the taxpayer's customer in each such transaction, the character of every such transaction, the date of every such

transaction, the amount of receipts realized from every such transaction and such other information as may be necessary to establish the non-taxable character of such transaction under this Act.

\*\*\*

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable. \*\*\*

\*\*\*

35 **ILCS** 120/7; *see also* 86 Ill. Admin. Code § 130.810(b) (regulation titled, Records Required to Support Deductions).

Since XYZ did not keep the invoices it created when entering into a transaction from which it took receipts that it reported as being nontaxable because the transaction was a sale of service, it is unable to show: “the name and address of the taxpayer’s customer in each such transaction, the character of every such transaction, the date of every such transaction, [and] the amount of receipts realized from every such transaction ....” 35 **ILCS** 120/7; 86 Ill. Admin. Code § 130.810(b). Notwithstanding XYZ’s absolute inability to satisfy its burden under ROTA § 7 or regulation § 130.810(b), the Department did not determine that all of the receipts that XYZ reported as being nontaxable were subject to tax. Instead, it determined that 50% of those receipts would be taxable. Department Ex. 2, p. 3. The record and applicable Illinois law provide ample authority for this determination.

The auditor’s worksheet for this issue includes the following note: “\*50% Service[.] Since the taxpayer was unable to provide a cost basis on the sales of service[.] fifty percent of the service invoice was deemed to be the selling price [of tangible personal property transferred incident to a sale of service] and taxed at the high rate.”

Department Ex. 2, p. 3. That note makes clear that the Department had determined that, in addition to being engaged in the occupation of selling tangible personal property at retail, XYZ's business of making repairs of property owned by customers also made XYZ a serviceman, as that term is used in the Service Occupation Tax Act (SOTA). *Id.*; 35 ILCS 115/3; *see also* Tr. pp. 55-57 (Department's questions to Jane Doe regarding his knowledge of the Illinois tax imposed on servicemen).

The SOTA "impose[s] upon all persons engaged in the business of making sales of service (referred to as "servicemen") on all tangible personal property transferred as an incident of a sale of service ...." 35 ILCS 115/3. The SOTA provides for the following different methods of calculating tax:

§ 3-10. Rate of tax. Unless otherwise provided in this Section, the tax imposed by this Act is at the rate of 6.25% of the "selling price", as defined in Section 2 of the Service Use Tax Act, of the tangible personal property. For the purpose of computing this tax, in no event shall the "selling price" be less than the cost price to the serviceman of the tangible personal property transferred. The selling price of each item of tangible personal property transferred as an incident of a sale of service may be shown as a distinct and separate item on the serviceman's billing to the service customer. If the selling price is not so shown, the selling price of the tangible personal property is deemed to be 50% of the serviceman's entire billing to the service customer. When, however, a serviceman contracts to design, develop, and produce special order machinery or equipment, the tax imposed by this Act shall be based on the serviceman's cost price of the tangible personal property transferred incident to the completion of the contract.

\*\*\*

35 ILCS 115/3-10.

During closing argument, counsel for XYZ argued that XYZ's purchase records supported its claim that it was making repairs of customer's property, and gave as the

following example, “if you purchase many chains, you would be conducting many sales, whereas if you purchase any clasps and items of repair, it would show that there were more repairs than sales.” Tr. p. 63. But the Department did not determine that XYZ made no repairs of property for its customers. Rather, it determined that XYZ’s business of making repairs for customers also included XYZ’s transfer of tangible personal property to customers as an incident to such sales. Department Ex. 2, p. 3. This determination is fully supported by the record, given the significant proportion of XYZ’s gross receipts that it documented as having been realized from sales of repair services. Taxpayer Ex. 1. XYZ’s own argument, moreover, reflects what should be apparent — that the business of repairing property for others often involves a transfer of property to replace a worn or broken part, which worn or broken part gives rise to the customer’s need for the repair services in the first place. 86 Ill. Admin Code § 140.140(*l*) (“Other Examples of Taxable [Service] Transactions [include] \*\*\* sales of repair parts, repair materials and other tangible personal property by persons who repair, remodel or recondition tangible personal property for others, as an incident to their furnishing of service to their customers ....”

Since XYZ destroyed its invoices, the Department could not determine whether XYZ stated on its invoice to the service customer, as a distinct and separate item, its charge for the tangible personal property transferred as an incident to its sales of repair services. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 220-21, 577 N.E.2d 1278, 1289 (1<sup>st</sup> Dist. 1991). The Department, therefore, heeded § 3-10 of the SOTA, and deemed that the “selling price of the tangible personal property [was] ... 50% of the serviceman’s entire billing to the service customer.” 35 **ILCS** 115/3-10;

Department Ex. 2, p. 3. The Department's decision to disallow the deductions claimed by XYZ on its returns, and the manner, extent, and authority for that determination, were in all respects proper.

**Conclusion:**

I recommend that the Director revise the NTLs so as to reduce the amount of underreported gross receipts from \$59,328 to \$37,787, and to reflect the amount of tax and interest properly due on that reduced amount. I recommend that Director otherwise finalize the NTLs as issued, with interest to accrue pursuant to statute.

February 2, 2007  
Date

John E. White, Administrative Law Judge