

Findings of Fact:

1. Taxpayer operated a gas station in Anywhere, Illinois. Department Ex. 2 (copies of certain audit workpapers regarding the Department's audit of Taxpayer), p. 1 (copy of first page of report titled, Auditor's Comments).
2. The Department audited Taxpayer's business and returns for the period from January 2009 through October 2009. Department Ex. 2, p. 2. The auditor created schedules when conducting the audit. *See* Department Ex. 2, pp. 1-6 (referring to schedules not included within exhibit), 7 (copy of Schedule 3).
3. Taxpayer timely filed monthly retailers' occupation tax (ROT) returns for the months in the audit period. Department Ex. 2, pp. 1-2. Taxpayer's ROT returns were prepared by its accountant, and signed by Taxpayer's owner. *Id.*, p. 4.
4. Taxpayer ceased doing business at the end of October 2009. Department Ex. 2, p. 1.
5. Taxpayer did not have available for audit all of the books and records Illinois law requires retailers to keep. Department Ex. 2, p. 1; *see also, generally*, 86 Ill. Admin. Code § 130.805 (What Records Constitute Minimum Requirement).
6. Taxpayer provided the auditor with copies of the following books and records: PST-2 (pre-paid sales tax) returns; ROT returns; and bank statements. Department Ex. 2, p. 1.
7. Since Taxpayer did not have documentary support for the receipts reported on its monthly ROT returns, the auditor had to use an alternate method of verifying Taxpayer's sales. Department Ex. 2, p. 2.
8. The auditor noted that Taxpayer's federal income tax returns reported revenues that were greater than the sum of the total receipts Taxpayer reported on its monthly ROT returns. Department Ex. 2, pp. 1-2, 7.

9. The auditor determined that the revenues reported on Taxpayer’s federal income tax returns were a better indicator of Taxpayer’s total receipts from selling at retail than the amounts reported on its ROT returns. Department Ex. 2, pp. 2, 7. She treated the difference between the revenues reported on Taxpayer’s income tax returns and the receipts reported on its ROT returns as unreported receipts. *Id.*
10. Prior to the completion of the audit, Taxpayer filed amended ROT returns for all of the months in the audit period. Department Ex. 2, p. 2. On those amended returns, Taxpayer reported more tax due than it had on its original returns. *Id.*
11. When correcting Taxpayer’s original monthly ROT returns, the auditor did not take into account any of the changes Taxpayer reported on its amended returns. Department Ex. 2, p. 2.
12. Following audit, the Department issued two NTLs to Taxpayer. Department Ex. 1.
13. The NTLs assessed the following amounts of tax, penalties and interest to Taxpayer, for the following periods:

NTL No.	Reporting periods	Tax	Late-payment penalty	Fraud Penalty	Interest	Total
XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	*XXXX
XXXX	XXXX	XXXX	XXXX	XXXX	XXXX	**XXXX
Totals		XXXX	XXXX	XXXX	XXXX	\$ XXXX

Department Ex. 1, pp. 1-2. * On the first NTL, the Department gave Taxpayer a credit against tax in the amount of X cents. *Id.*, p. 1. ** On the second NTL, the Department gave Taxpayer a credit against tax in the amount of XX cents. *Id.*, p. 2.

Conclusions of Law:

Issue and Arguments

Taxpayer does not contest any amounts of tax assessed. Tr. pp. 15-16. Instead, it argues that the Department failed to offer clear and convincing evidence that it filed returns during the audit period with an intent to defraud. Tr. pp. 9-12. I agree.

Section 3-6 of the Uniform Penalty and Interest Act (UPIA) provides, in pertinent part, “[i]f any return or amended return is filed with intent to defraud, in addition to any penalty imposed under Section 3-3 of this Act, ... a penalty shall be imposed in an amount equal to 50% of any resulting deficiency.” 35 ILCS 735/3-6. The Department bears the burden to show fraud by clear and convincing evidence. Brown Specialty Co. v. Allphin, 75 Ill. App. 3d 845, 851, 394 N.E.2d 659, 663 (3rd Dist. 1979). Clear and convincing evidence of a taxpayer’s intent to defraud can be circumstantial in nature. Puleo v. Department of Revenue, 117 Ill. App. 3d 260, 268, 453 N.E.2d 48, 53 (4th Dist. 1983); Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213, 454 N.E.2d 799, 802 (3rd Dist. 1983).

In this case, the sole basis for the Department’s determination that Taxpayer filed returns with an intent to defraud is that there was a significant difference between the revenues reported on Taxpayer’s income tax returns and the receipts reported on its ROT returns. Department Ex. 2, p. 1 (“There was big difference of sales amount between ST 1 return and income tax return.”). The auditor treated the difference between those amounts as unreported receipts. *Id.* (“The under reported sales was over 100% (See schedule 11). A request to assess 50% Civil Fraud Penalty has been approv[ed].”). Had there been any evidence which showed that the only revenues Taxpayer realized during a given year were the receipts realized from its Illinois-based retailing business, the auditor’s treatment of the difference as being the result of fraud would have been

fully supported. But no such evidence is to be found within this record.

Further, the evidence shows that, prior to the time the audit was concluded, Taxpayer filed amended returns for every single month in the audit period. Department Ex. 2, p. 2. The Department requires taxpayers to file an amended return when the taxpayer determines that it has filed a return containing errors. ST-1-X Instructions, p. 1 (the instructions for preparing an amended ROT return are available to view at the Department's website at: <http://tax.illinois.gov/taxforms/Sales/ST-1-X-Instr-2011.pdf>) (last viewed on February 27, 2014). More specifically, the Department's instruction form for amended ROT returns provides, in part:

Who must file Form ST-1-X?

You must file Form ST-1-X if you are a registered retailer who files Form ST-1, Sales and Use Tax Return, and you need to

- correct your Form ST-1 to pay more tax;
- request a credit for tax you overpaid. Do not use the credit until we notify you that your credit has been approved;
- respond to a notice or bill;
- make corrections to line items but there is no change in the amount of tax due.

ST-1-X Instructions, p. 1. If an error made on an original return caused the taxpayer to report and pay too little tax, it must pay the amount of tax properly due, plus interest, plus penalties. *See id.*, p. 2. Penalties may be abated if taxpayer can show that it exercised good faith and ordinary business care when attempting timely to report and pay the correct amount of tax due. 35 ILCS 735/3-8; 86 Ill. Admin. Code § 700.400(b)-(c). If an error made on an original return caused the taxpayer to report and pay more than the correct amount of tax due, it may request a credit or refund of the tax overpaid in error. 35 ILCS 120/6a; 86 Ill. Admin. Code § 130.1501; ST-1-X Instructions, p. 1.

The evidence shows that the auditor was aware that Taxpayer filed amended returns for the period under audit, yet she either refused or failed to take into account the changes reported

on them. Department Ex. 2, p. 2. The evidence also shows that Taxpayer filed its amended returns after its owner had a discussion with the auditor and her supervisor about the audit, and before the audit was concluded. *Id.*, pp. 1 -2. Finally, Taxpayer's amended returns reported additional amounts of tax due. *Id.* p. 2. Given the Department's own evidence describing the circumstances occurring at and about the time Taxpayer filed its amended returns, the natural and logical inference to draw is that Taxpayer filed its amended returns in order to report errors it realized had been made on its original returns. *Id.*; *see also* ST-1-X Instructions, p. 1. When taking into account the evidence the Department offered to support its assessment of a fraud penalty (Department Ex. 2, p. 2), I cannot ignore the fact that Taxpayer filed amended returns for the audit period, or the inference reasonably drawn from that fact.

There is a difference between a return that contains erroneous or mistaken entries, and one that contains knowingly false entries — that is, entries that the filer knew were untrue when the return was filed. *See State ex rel. Beeler Schad and Diamond, P.C. v. Ritz Camera Centers, Inc.*, 377 Ill. App. 3d 990, 997-98, 878 N.E.2d 1152, 1158-59 (1st Dist. 2007); 37 Am. Jur. 2d Fraud and Deceit § 488 (“Evidence that a representation was made with knowledge of its falsity is regarded as proof of an intent to deceive.”). Generally, a fraud penalty would properly be imposed for the latter, but not for the former. 35 ILCS 735/3-6; *Puleo*, 117 Ill. App. 3d at 268, 453 N.E.2d at 53 (“the record is uncontradicted that the plaintiff admitted to the fraud agents that he had not filed correct returns ...”).

It is possible that, had the record included more audit schedules, or had the Auditor's Comments more specifically described the content of the books and records the auditor reviewed prior to correcting Taxpayer's original returns, there would have been sufficient evidence to support an inference of fraudulent intent. For example, the Auditor's Comments reflect that she

reviewed Taxpayer's filed PS2 returns, but that document does not identify the amount of gasoline (either by cost or gallons) Taxpayer reported that it purchased for later sale at retail. Department Ex. 2. Nor does the record include any schedule of Taxpayer's gasoline purchases, from which the fact-finder, or the Director, might compare Taxpayer's purchases with its reported sales. *See e.g., Vitale*, 118 Ill. App. 3d at 213, 454 N.E.2d at 802. Had the Audit Comments documented that Taxpayer reported spending more to purchase gasoline (as reflected on its PS2 returns) than it realized from selling gasoline at retail (as reflected on its monthly ROT returns), the record would have included clear and convincing circumstantial evidence of fraud. *See id.* Alternatively, had the record contained evidence that all of Taxpayer's income was derived from selling at retail in Illinois, the revenues Taxpayer reported on its income tax returns might be reasonably considered evidence that Taxpayer was knowingly underreporting its receipts on its monthly ROT returns. Department Ex. 2, p. 1; 35 ILCS 735/3-6; *Vitale*, 118 Ill. App. 3d at 213, 454 N.E.2d at 802.

But here, the reasonable inferences drawn from the evidence that was admitted lead just as directly to a conclusion that Taxpayer made a mistake when preparing and filing its original returns — which Taxpayer attempted to correct — as they do to a conclusion that Taxpayer filed returns with an intent to defraud. The party claiming fraud has the burden to prove it by clear and convincing evidence. *Brown Specialty Co.*, 75 Ill. App. 3d at 851, 394 N.E.2d at 663. “Clear and convincing evidence is defined as the quantum of proof which leaves no reasonable doubt in the mind of the fact finder as to the veracity of the proposition in question.” *In re Jones*, 285 Ill. App. 3d 8, 13, 673 N.E.2d 703, 706 (1st Dist. 1996). Where, as here, the evidence admitted to support a fraud penalty reasonably supports a finding of mistake, the party with the burden loses. *Racine Fuel Co. v. Rawlins*, 377 Ill. 375, 380, 36 N.E.2d 710, 713 (1941) (“Fraud is not presumed but

must be proved like any other fact by clear and convincing evidence.”).

The evidence shows that the Department presumed that Taxpayer filed returns with an intent to defraud, and disregarded evidence that may have provided a more innocent explanation. Department Ex. 2, pp. 1-2. Illinois law, however, does not allow one to presume fraud. Racine Fuel Co., 377 Ill. at 380, 36 N.E.2d at 713; Brown Specialty Co., 75 Ill. App. 3d at 851, 394 N.E.2d at 663. After a review of the evidence, I do not recommend that the Director finalize the fraud penalty assessed here.

Conclusion:

The record does not include clear and convincing evidence that Taxpayer filed returns with an intent to defraud. 35 ILCS 735/3-6; In re Jones, 285 Ill. App. 3d at 13, 673 N.E.2d at 706; Brown Specialty Co., 75 Ill. App. 3d at 851, 394 N.E.2d at 663. Therefore, I respectfully recommend that the Director revise the NTLs to eliminate the fraud penalty, and that the NTLs be finalized as so revised, pursuant to statute.

April 14, 2014

John E. White
Administrative Law Judge