

ST 14-22
Tax Type: Sales Tax
Tax Issue: Unreported/Underreported Receipts (Non-Fraudulent)

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

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

v.

**ABC BUSINESS,
Taxpayer**

No. XXXX
Account ID XXXX
Letter ID XXXX
XXXX
Period XXXX

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Michael Coveny on behalf of the Illinois Department of Revenue; Akram Zanayed of Akram Zanayed & Associates on behalf of ABC Business.

Synopsis:

This matter arose from a protest filed by ABC Business (“taxpayer”) to Notices of Tax Liability issued to the taxpayer by the Department of Revenue (“Department”) on April 22, 2013 for taxes assessed under the Retailers’ Occupation Tax Act, 35 ILCS 120/1, *et seq.* These Notices of Tax Liability were issued at the conclusion of an investigation of the taxpayer’s records for the period January 1, 2007 through December 31, 2009. The issue is whether the taxpayer reported the correct amount of gross receipts from its sales and paid the proper amount of tax incurred on these sales. The taxpayer is also seeking the abatement of penalties assessed in this case based upon “reasonable cause” pursuant to section 3-8 of the Uniform Penalty and Interest Act, 35 ILCS 735/3-8.

An evidentiary hearing was held on June 2, 2013 regarding this matter. During the hearing the Department established its *prima facie* case by introducing the Department's Notices of Tax Liability based upon its corrected returns into evidence. The taxpayer introduced testimony, but no documentary evidence, into the record. After reviewing the transcript and documents presented at hearing, I recommend that the Notices of Tax Liability be made final. In support of this recommendation, the following "findings of fact" and "conclusion of law" are made.

Findings of Fact:¹

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of Notice of Tax Liability ("NTL") Letter ID number XXXX and NTL Letter ID number XXXX issued April 22, 2013 showing a deficiency of \$XXXX, including penalties and interest, for the period January 1, 2007 through December 31, 2009. Department Exhibit ("Ex.") 1.
2. The taxpayer, a retailer engaged in the operation of gasoline and diesel fuel service stations, and convenience stores selling liquor, cigarettes, soft drinks, snacks and other products, is a subchapter S corporation doing business in Illinois. Department Ex. 1, 2. The taxpayer is owned by John Doe. Department Ex. 2.
3. The taxpayer has two locations, one in Anywhere, Illinois and the other in Happyplace, Illinois. Tr. p. 22; Department Ex. 2. While gasoline is sold at both of the taxpayer's service stations, diesel fuel is only sold at its Anywhere service station. Department Ex. 2.

¹ Unless otherwise noted, findings of fact apply to the tax period in controversy.

4. During 2010 through 2012, the Department conducted an audit of the taxpayer's books and records for the period January 1, 2007 through December 31, 2009. Department Ex.
5. At the conclusion of this audit, the Department's auditor determined that the taxpayer had underreported its Retailers' Occupation Tax for the audited period by \$XXXX. Department Ex. 1. Based upon this determination, the Department assessed late payment penalties in the amount of \$XXXX. *Id.*
5. At the conclusion of the audit, the Department prepared two EDA-105-R, ROT Audit Reports, one for the months 1/07 through 6/09 and the other for the months 7/09 through 12/09. Department Ex. 1.
6. On April 22, 2013, the Department issued Notices of Tax Liability that were based upon the EDA-105-R, ROT Audit Reports, assessing tax due. *Id.*

Conclusions of Law:

The Retailers' Occupation Tax Act ("ROTA") requires every taxpayer to report to the Illinois Department of Revenue ("Department") the total amount of gross receipts on forms prescribed by the Department. 35 ILCS 120/3. The statute, at 35 ILCS 120/4, also requires the Department to examine these returns and to issue notices of tax liability if it determines additional taxes to be due. Specifically, the latter statute provides, in pertinent part, as follows:

As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgment and information. ... In the event that the return is corrected for any reason other than a mathematical error, any return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown therein. ... In making a correction of transaction by transaction, monthly or quarterly returns covering a period of 6 months or more, it shall be permissible for the Department to show a single corrected return figure for any given 6-month period. ...

If the tax computed upon the basis of gross receipts as fixed by Department is greater than the amount of tax due under the return or returns as filed, the

Department shall ... issue the taxpayer a Notice of Tax Liability for the amount of tax claimed by the Department to be due, together with a penalty in an amount determined in accordance with Section 3-3 of the Uniform Penalty and Interest Act. Provided, that if the incorrectness of any return or returns as determined by Department is due to negligence or fraud, said penalty shall be an amount determined in accordance with Section 3-5 or Section 3-6 of the Uniform Penalty and Interest Act, as the case may be.
35 ILCS 120/4.

In the instant case, the Department examined the tax returns filed by the taxpayer for the audited period, January 1, 2007 through December 31, 2009. Department Ex. 2. At the conclusion of the audit, the Department determined that the gross receipts of the taxpayer's business during the audit period were greater than the amounts reported on the tax returns the taxpayer filed. *Id.* Accordingly, it prepared audit reports calculating a deficiency and a late payment penalty. *Id.* On April 22, 2013, it issued to the taxpayer Notices of Tax Liability Letter ID number XXXX and Letter ID number XXXX based upon its EDA-105-R ROT Audit Reports. Department Ex. 1. The taxpayer timely protested the Department's assessment determination and contends that the amount of taxes assessed, and the penalties based on this amount, are incorrect.

It is well established that a corrected return as prepared by the Department is deemed *prima facie* correct. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). At the hearing in this case, the Department established its *prima facie* case by introducing its Notices of Tax Liability based upon its audit reports correcting the taxpayer's returns (Department Ex. 1) into evidence. The burden then shifted to the taxpayer to overcome the Department's *prima facie* case. Anderson v. Department of Finance, 370 Ill. 225 (1938); Masini, *supra* at 15.

“In order to overcome the presumption of validity attached to the Department's corrected returns, [the taxpayer] must produce competent evidence identified with their books and records and showing that the Department's returns are incorrect.” *Id.* See also Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276 (1943); Howard Worthington, Inc. v. Department of Revenue, 96 Ill. App. 3d 1132 (2nd Dist. 1981).

In the instant case, the Department's *prima facie* case was established when the Department's Notices of Tax Liability based upon the Department's correction of the taxpayer's returns were entered into evidence under the certificate of the Director of the Department. The burden then shifted to the taxpayer to overcome the Department's *prima facie* case.

The taxpayer's attorney appeared at the hearing and offered oral testimony from John Doe, the taxpayer's owner, and from Jack Black, the taxpayer's accountant. The taxpayer's owner testified that the Department's audit determination, which was based on the assumption that fuel sales were at a market price, overstated the taxpayer's gross receipts because the taxpayer actually sold fuel at less than cost in order to meet sales quotas set by its supplier. Tr. pp. 23-25, 29. He further testified that the auditor erred in using the average price of gasoline sales in Kingland because both of the taxpayer's locations were in the suburbs. Tr. p. 29. He also testified that the audit overstated gross receipts from cigarette sales by determining that these were sales at retail. Tr. pp. 26-28. He testified that these were actually sales for resale at cost to his employees who, unbeknownst to the owner, arranged for the taxpayer to purchase cigarettes from the taxpayer's suppliers, repurchased them from the taxpayer at the taxpayer's cost of these purchases and then sold them independently through their own private business enterprises. *Id.* Jack Black, the taxpayer's accountant, testified that he prepared the taxpayer's

sales tax returns and that these returns were based upon the taxpayer's books and records. Tr. pp. 31-34. None of this testimony was corroborated by documentary evidence of any kind.

The law requires the taxpayer to produce competent evidence identified with its books and records to overcome the Department's *prima facie* case. Masini, supra; Copilevitz, supra; DuPage Liquor Store, supra; Howard Worthington, supra. Since the taxpayer has failed to produce any documentary evidence to substantiate its claim that the Department's notices of tax liability are incorrect, I find that the evidence the taxpayer has produced is insufficient to rebut the Department's *prima facie* case.

The taxpayer also seeks an abatement of late payment penalties that the Department has assessed based upon "reasonable cause." Section 3-8 of the Uniform Penalty and Interest Act ("UPIA"), 35 ILCS 735/3-8 provides, in pertinent part, as follows:

No penalties if reasonable cause exists. The penalties imposed under the provisions of section 3-3, 3-4, 3-5 and 3-7.5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department.²

35 ILCS 735/3-8

Section 3-8 of the UPIA clearly places the burden on the taxpayer to show that the penalties imposed by the UPIA do not apply. These penalties include penalties for failure to timely file returns and penalties for failure to timely pay tax when due. 735 ILCS 735/3-3. The Illinois General Assembly's placement of the burden on the taxpayer to show that the penalties listed in the UPIA should not apply makes clear that such penalties were intended to be assessed automatically, upon the Department's determination that the correct amount of tax was not paid when due. Moreover, like the Department's determination of tax underpayments, the

² The Department has promulgated rules and regulations governing the determination of "reasonable cause" pursuant to section 3-8 of the UPIA at 86 Ill. Admin. Code, ch. I, section 700.400.

Department's determination of penalties assessed based upon the amount of underpaid taxes is also deemed to be *prima facie* correct. Branson v. Department of Revenue, 168 Ill. 2d 247, 261 (1995); see also Diogenes v. Department of Finance, 377 Ill. 15, 22 (1941)("The taxpayer's return, as amended by the Department to include the 'A' penalty, was prima facie correct, and the duty rested upon the plaintiff to establish that ... the penalty was ...improperly exacted.").

The taxpayer's entire argument that "reasonable cause" exists excusing the taxpayer's failure to timely pay the taxes found by the Department to be due rests upon its owner's undocumented assertion that the Department overstated the amount of its cigarettes sales by failing to credit against these sales various purchases for resale of cigarettes by the taxpayer's employees that the taxpayer unintentionally sold to its employees at cost rather than at a marked up retail price. Tr. pp. 26-28, 36-40. The taxpayer's owner alleges that, without the owner's knowledge, the taxpayer's employees arranged for the taxpayer to purchase these cigarettes, then purchased these cigarettes from the taxpayer at cost and resold them at their retail price through independent retail businesses each of these employees owned. *Id.* While the taxpayer's owner claims that "reasonable cause" for abatement of penalties exists because he was not negligent in failing to catch this scheme, the premise of this "reasonable cause" argument is that cigarette sales determined by the Department were incorrect. However, the Department's auditor determined that the cigarettes purchased from its vendors by the taxpayer were sold by the taxpayer at a retail mark-up over cost of 10% because the taxpayer could not document its claim that these sales were made at cost or for resale. Department Ex. 2, 5. During his testimony, the taxpayer's owner presented no documentary evidence to substantiate his contention that this audit determination was erroneous.

As previously noted, in the absence of documentary evidence, the Department's *prima facie* case is not rebutted. Masini, *supra*; Copelivitz, *supra*; DuPage Liquor Store, *supra*; Howard Worthington, *supra*. Because the taxpayer failed to produce any books or records to substantiate the premise of its "reasonable cause" claim for abatement of penalties, namely that the Department's determination of taxes due based upon its finding that all cigarettes were sold at a mark up from cost, was incorrect, it has offered insufficient evidence to rebut the Department's *prima facie* correct determination of penalties found by the Department to be due in the instant case.

The taxpayer also produced no evidence of any kind to support a finding that its management acted reasonably or in good faith when it filed its returns reporting the incorrect amount of taxes due. Nor has the taxpayer attempted to show that "reasonable cause" for its failure to timely pay exists under criteria for making this determination enumerated in Department regulation 86 Ill. Admin. Code, ch. I, section 700.400 which elaborates upon the scope of section 3-8 by giving examples of factual situations warranting a "reasonable cause" finding. For this reason, and for the reasons previously enumerated, I find that the taxpayer has not established that it is entitled to an abatement of penalties in the instant case based upon "reasonable cause."

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's Notices of Tax Liability at issue in this case, including penalties that have been assessed, be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: August 12, 2014