

UT 11-15

Tax Type: Use Tax

Issue: Unreported/Underreported Receipts (Fraud Application)

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

THE DEPARTMENT OF REVENUE)	Docket No.	XXXX
OF THE STATE OF ILLINOIS)	IBT No.	XXXX
v.)	NTL No.	XXXX
ABC BUSINESS,)	John E. White,	
Taxpayer)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: William P. Drew III, William P. Drew III, Inc., appeared for ABC Business; Shepard Smith, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter involves a Notice of Tax Liability (NTL) the Illinois Department of Revenue (Department) issued to ABC Business (ABC Business or Taxpayer). The NTL assessed Illinois retailers' occupation and related taxes, penalties and interest, based on an audit of Taxpayer's business for the months of January 2006 through June 2008. Taxpayer protested the NTL and asked for a hearing. The issues included whether Taxpayer was subject to retailers' occupation and use taxes in certain amounts, and whether it was liable for late payment and fraud penalties.

The hearing was held at the Department's offices in Chicago. I have reviewed the evidence offered at hearing, and I am including in this recommendation findings of fact and conclusions of law. I recommend that the NTL be finalized as issued.

Findings of Fact:

1. Taxpayer operated a bar and restaurant that offered live music and concerts in Anywhere, Illinois. Department Ex. 1, p. 2 (copy of correction of return form).
2. In December 2009, the Department concluded an audit of Taxpayer's business for the period from January 2006 through June 2008. Department Ex. 1, p. 2.
3. During the audit, the auditor had to estimate Taxpayer's gross receipts according to the best information available, because Taxpayer did not keep complete books and records that reflected its daily gross receipts. Department Ex. 1, p. 2.
4. The auditor computed Taxpayer's gross receipts for the audit period by applying a mark-up to the cost of the goods Taxpayer purchased for resale, using Taxpayer's purchase records. Department Ex. 1, p. 2.
5. As a result of the Department's audit, it determined that the total amount of tax due for the audit period was \$195,293. Department Ex. 1, p. 2. On the returns Taxpayer filed for the audit period, it reported total tax due in the amount of \$101,718. *Id.*
6. Following audit, the Department issued an NTL to Taxpayer. Department Ex. 1, p. 3 (copy of NTL). The NTL assessed tax in the amount of \$93,575, a late filing penalty in the amount of \$18,715, and a fraud penalty in the amount of \$46,788, plus interest. *Id.*

Conclusions of Law:

The Department introduced its correction of Taxpayer's returns and the NTL into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the Retailers' Occupation Tax Act (ROTA), those documents constitute the Department's prima facie case in this matter. 35 ILCS 120/4. The Department's prima facie case is a rebuttable presumption. *Id.*; Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968). 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).

The first issue identified in the parties' pre-hearing order is whether Taxpayer is liable for retailers' occupation and use taxes in certain amounts. Since the legislature has given the Department's determinations of the amount of tax due a statutory presumption of correctness (35 ILCS 120/4), Taxpayer had the burden to show that the Department's determinations were not correct. Filichio, 15 Ill. 2d at 333, 155 N.E.2d at 7. Here, after the Department rested, Taxpayer offered no testimony or documents. Instead, counsel for Taxpayer argued that the returns filed by Taxpayer were correct, and that the economic downturn made the Department auditor's use of a mark-up percentage unreasonable. Tr. pp. 8-9. As a matter of law, mere argument is insufficient to rebut the Department's prima facie case. Filichio, 15 Ill. 2d at 333, 155 N.E.2d at 7. Therefore, Taxpayer has not rebutted the Department's presumptively correct determination of the amount of tax due.

The other issues are whether Taxpayer is liable for the late payment and fraud penalties assessed, "subject to Amnesty." Pre-hearing Order. "Subject to Amnesty," as used within the parties' pre-hearing order, means that if either of the two penalties that were assessed are finalized, such penalty shall be subject to either § 3-3(j) or § 3-6(d) of the Uniform Penalty and Interest Act (UPIA). 35 ILCS 735/3-3(j); 35 ILCS 735/3-6(d). Those subsections were added to the UPIA as a result of the passage of Public Act 96-1435 in 2010, which also amended Illinois'

Tax Delinquency Amnesty Act (TDAA). 35 ILCS 745/1 *et seq.* (2010); 35 ILCS 735/3-3(j) (2010); 35 ILCS 735/3-6(d) (2010). Subsections 3-3(j) and 3-6(d) double the respective UPIA penalty rates applicable to eligible taxpayers who failed to take advantage of the 2010 amendments to the TDAA. 35 ILCS 735/3-3(j); 35 ILCS 735/3-6(d). I address each penalty separately, beginning with the late payment penalty.

Section 4 of the ROTA provides, in pertinent part:

If the tax computed upon the basis of the gross receipts as fixed by the Department is greater than the amount of tax due under the return or returns as filed, the Department shall (or if the tax or any part thereof that is admitted to be due by a return or returns, whether filed on time or not, is not paid, the Department may) 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 the Department is due to negligence or fraud, said penalty shall be in 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. As the text of § 4 makes clear, UPIA § 3-3 penalties are automatically assessed whenever a correction of returns reveals a deficiency. *Id.*

The late payment penalty imposed by UPIA § 3-3 is “for failure to pay the tax shown due or required to be shown due on a return on or before the due date prescribed for payment of that tax” 35 ILCS 735/3-3(b-20), (c). For returns due on or after 2005, § 3-3(b-20) applies. 35 ILCS 735/3-3(b-20). The penalty imposed by § 3-3(b-20)(2) is measured using a sliding scale that increases the penalty rate from 2% to 20% of the tax due, depending on the time between the due date and the date the tax is paid. 35 ILCS 735/3-3(b-20)(2). The 20% rate is applicable for “any amount that is paid after the date the Department has initiated an audit or investigation of the taxpayer.” *Id.* The Department assessed Taxpayer with a late payment penalty at the 20% rate. Department Ex. 1, p. 3.

The late payment penalty is one of the penalties that may be abated for reasonable cause.

35 ILCS 735/3-8. The Department has adopted a regulation regarding reasonable cause which provides that, “[t]he determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.” 86 Ill. Admin. Code § 700.400(b). The regulation further provides that, “[a] taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. ***” 86 Ill. Admin. Code § 700.400(c). The burden rests on the taxpayer to show that it acted with ordinary business care and prudence when filing its returns and paying the correct amount of tax when due. Hollinger International, Inc. v. Bower, 363 Ill. App. 3d 313, 328, 841 N.E.2d 447, 460 (1st Dist. 2005).

Since Taxpayer offered no evidence at hearing, it has not shown that it exercised ordinary business care and prudence when calculating and paying the correct amount of its tax liabilities for the months at issue. Therefore, the late payment penalty assessed should not be abated. Hollinger International, Inc., 363 Ill. App. 3d at 328, 841 N.E.2d at 460. Because the months at issue come within the scope of the 2010 amendments to the TDAA and the UPIA, the applicable late payment penalty rate should be revised from 20% to 40%. 35 ILCS 735/3-3(j).

The Department also assessed Taxpayer with a fraud penalty. Section 3-6 of the 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 standard for determining whether a fraud penalty is appropriate is clear and convincing evidence. Puleo v.

Department of Revenue, 117 Ill. App. 3d 260, 268, 453 N.E.2d 48, 53 (4th Dist. 1983). Clear and convincing evidence of an intent to defraud can be circumstantial in nature. Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213, 454 N.E.2d 799, 802 (3d Dist. 1983).

Here, the Department determined that Taxpayer significantly underreported its monthly gross receipts over the course of the 30 month audit period. *See* Department Ex. 1, p. 2. By underreporting its gross receipts, it also underreported its tax liability, by a total of \$93,718. *Id.* That equals approximately \$3,100 of unreported tax for each month in the audit period. *Id.* During the same period, Taxpayer had reported and paid tax in the amount of \$101,718, for an average of approximately \$3,390 per month. *Id.* Thus, Taxpayer filed monthly returns showing tax due that was roughly only half of the amount of tax the Department determined was due. *Id.* During the audit, moreover, Taxpayer had no books and records to support the amount of gross receipts it reported on its monthly returns. *See id.* As a consequence, Taxpayer had no records to offer as evidence at hearing.

In Vitale, the court identified certain facts as constituting circumstantial evidence of fraud. Vitale, 118 Ill. App. 3d at 213, 454 N.E.2d at 802. Specifically, the taxpayer in that case consistently reported only a fraction of its monthly receipts to the Department, and failed to keep books and records as required by the ROTA and regulations. *Id.* Based on the similar circumstantial evidence presented by this record, I conclude that the Department has established clear and convincing evidence that Taxpayer filed returns during the audit period with an intent to defraud. 35 ILCS 735/3-6; Vitale, 118 Ill. App. 3d at 213, 454 N.E.2d at 802. Finally, since the 2010 amendments to the TDAA and the UPIA apply to this matter, the fraud penalty rate should be revised from 50% to 100%. 35 ILCS 735/3-6(d).

Conclusion:

I recommend that the Director revise the NTL to take into account the 2010 amendments to the TDAA and the UPIA, and that the NTL be finalized as so revised.

October 6, 2011

John E. White
Administrative Law Judge