

**ILLINOIS INDEPENDENT  
TAX TRIBUNAL**

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SKYLINE CORNER MART, INC.,	)	
Petitioner,	)	
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	)	
v.	)	15 TT 150
	)	Judge Brian F. Barov
ILLINOIS DEPARTMENT	)	
OF REVENUE,	)	
Respondent.	)	

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**FINAL JUDGMENT ORDER**

The Petitioner, Skyline Corner Mart (“Skyline”), a gas station and mini-mart, challenged a June 8, 2015 Notice of Tax Liability (“NTL”), in which the Department of Revenue (“Department”) assessed it additional sales tax, interest and penalties. The Notice’s penalty assessment included a fraud penalty of \$55,310, in addition to late-payment and late-filing penalties. A hearing was held, at which Skyline’s attempt to introduce documents into evidence that had not been submitted at the final pretrial conference was denied. After the hearing, the Tribunal ordered the parties to file post-hearing briefs and directed them to brief the admissibility of Skyline’s untimely submitted evidence.

In its post-hearing brief, Skyline conceded the assessment of tax, interest and the late-filing and late-payment penalties. Further, it did not argue that the Tribunal erred in denying the admission of the untimely submitted evidence, waiving this issue also. The sole post-hearing argument advanced by Skyline, and the only remaining issue to be decided here, is whether the evidence supports the Department’s fraud penalty assessment.

## Summary of Evidence

The Notice at issue arose out of a Department audit of Skyline for a period extending from February 2012 to December 2013. Dep't Ex. 1. The audit was triggered by multiple claims for credit and amended returns filed by Skyline without any back-up documentation. Dep't Ex. 2 at 1; Tr. 23-25.

According to the Department's auditor, Skyline's officers, E. Thomas Kaczmarek, his wife, Patricia Kaczmarek, and their son, Timothy Kaczmarek, were uncooperative throughout the audit. Tr. 24; *see also* Dep't Ex. 2 at 1. Skyline did not provide documents to support its claims for credit, nor did the Kaczmareks, particularly Patricia, who was the auditor's primary contact, respond to the numerous document requests both informal and formal, including a Department subpoena, made during the course of the audit. Dep't Ex. 2 at 1; Tr. 24-27, 34. Other than copies of its amended tax returns and documents evidencing some gasoline sales, Tr. 34, Dep't Ex. 2 at 1-2, Skyline never provided the auditor with any records of purchases, invoices, daily sales records, register tapes, or any other documents with which to substantiate its taxable sales or its claims for credit. Tr. 26-27. Skyline admitted that it did not maintain the books and records required by law. Joint Final Pretrial Order Stip. 6.

Because Skyline refused the Department's record requests, the auditor used an alternative methodology to determine Skyline's taxable sales. *See* Final Pretrial Order Stip. 7; Tr. 27. Under this alternative method, the auditor determined the amount of Skyline's purchases from its vendors, to which she added standard industry mark-ups to calculate gross taxable sales. Final Pretrial Order Stip. 7; Tr. 28. For example, the auditor calculated the amount of gasoline sales based on the PST-2 reports provided by gasoline distributors documenting sales to Skyline, which she multiplied by a federally recognized Midwest average of gasoline prices. Tr. 28-29; Dep't Ex. 2 at 2. Based on this calculation, the auditor found little difference between expected sales and reported sales. Tr. at 29. The auditor noted,

however, that a gasoline vendor of Skyline had collected sales tax from it, and thus credited Skyline with \$45,735 in tax paid to this vendor. Tr. 28-29; Dep't Ex. 2 at 2.

The auditor purchased cigarettes from Skyline, identified cigarette vendors based on the vendor stamps found on cigarette packages, and contacted those vendors to obtain information on the amount of cigarettes sold to Skyline. Tr. 30. Skyline's gross receipts for liquor were verified from reports its liquor vendors made to State regulators, to which the auditor applied an average mark-up. Tr. 30-31. Other mini-mart merchandise sales were reconstructed by contacting Skyline's known vendors who provided the amount of merchandise sold to Skyline. Tr. 31-32. These merchandise sales were divided between high and low tax items, and the auditor applied an appropriate mark-up to each. *Id.* As a result of her calculations, the auditor determined that Skyline had erroneously reported high tax items as low tax items, and thus substantially underreported taxes on its mini-mart sales during the audit period. Tr. 32-33; Dep't Ex. 2 at 2.

The auditor requested permission to impose a fraud penalty, writing:

This taxpayer has shown intent to defraud the State of Illinois by their actions.

Taxable sales reported during the year of 2/12-12/12 were \$1,141,522.00, and based upon their known marked-up purchases and PST2's it is indicated that amount should have been \$1,880,179.00. Results for 2013 are even worse. The taxpayer reported tax paid of \$191,948.00 during the audit period and the audit established that another \$144,832.00 in tax is due. It does not appear that the taxpayer has taken any steps to bring themselves into compliance. They were extremely uncooperative for this audit even considering that fact that they were asking for a claim for credit. It is clear that this taxpayer has substantially under-reported their sales.

By her own admission during one meeting with the owner's wife, Patricia, she admitted that the family takes care of everything for the business. The taxpayer's are the only ones that handle bank deposits; and also are responsible for preparing the ROT returns. The taxpayer has chosen to be very uncooperative. There has been no

attempt by this taxpayer to participate with this audit or to keep accurate books and records nor report accurate sales figures.

It is this auditor's recommendation that the civil fraud penalty be assessed.

Dep't Ex. 3 at 197

On cross-examination, however, the auditor testified that the fraud penalty was not requested based on Skyline's uncooperative behavior or its failure to provide books and records. Tr. 36. Instead, she testified that the fraud penalty was requested due to the amount of Skyline's underreporting. Tr. 37

The only testimony Skyline offered was that of Tim Kaczmarek, Patricia and Thomas's son. Tr. 19. Tim testified that he was not an employee of Skyline but became involved in the business in July 2013, after his father became ill. Tr. 19, 20. He stated that he only "had knowledge of the gasoline portion of the business." Tr. 19. According to Tim, his father would provide Skyline's sales to Skyline's accountant, Anne Marie Wozinak, who managed the company's books and records. Tr. 20. Wozinak has since passed away, *id.*, but both his father and mother, Patricia Kaczmarek, who ran the business, are still alive. Tr. 21.

### **Analysis**

As noted, Skyline is no longer challenging the assessment of sales tax, interest and late-payment or late-filing penalties. It did not contest the reasonableness of the Department's audit method, nor has it provided any evidence to meet its statutory burden to rebut the presumption of correctness of the Department's assessment. *See* 35 ILCS 120/4. As such, the Department's assessment of tax, interest, and the late-payment and late-filing penalties, must be upheld.

Skyline challenges only the Department's imposition of fraud penalties. There is no presumption that favors the Department's determination of fraud. *See Brown Specialty Co. v. Allphin*, 75 Ill. App. 3d 845, 850-51 (3d Dist. 1979). The

Department has the burden to prove fraud, and it must do so clearly and convincingly. *Id.*

Fraud requires a showing of intent to avoid paying taxes, and that intent may be proved circumstantially. *Vitale v. Ill. Dep't of Revenue*, 118 Ill. App. 3d 210, 213 (3d Dist. 1983). Illinois courts offer little guidance on the specific factual circumstances that evidence a fraudulent intent to avoid paying taxes, but they have applied the same clear and convincing standard used by federal courts in such cases. *See Brown Specialty Co.*, 75 Ill. App. 3d at 851 (citing *Bryan v. Comm'r*, 209 F.2d 822, 825 (5th Cir. 1954) and *Cirillo v. Comm'r*, 314 F.2d 478, 482 (3rd Cir. 1963)). Federal courts have looked to various “badges” of fraud to guide their decision making in these matters. *Bradford v. Comm'r*, 796 F.2d 303, 307 (9th Cir. 1986). These “badges of fraud” include:

- 1) understating income;
- 2) failing to maintain adequate records;
- 3) offering implausible or inconsistent explanations;
- 4) concealing income or assets;
- 5) failing to cooperate with tax authorities;
- 6) engaging in illegal activities;
- 7) providing incomplete or misleading information to the taxpayer’s tax [ ] return preparer;
- 8) offering false or incredible testimony;
- 9) filing false documents, including filing false income tax returns;
- 10) failing to file tax returns; and
- 11) engaging in extensive dealings in cash.

*Good v. Comm'r*, 104 T.C. Memo 2012-323, 2012 WL 5869369, at \*16.

These badges of fraud are non-exclusive and should be weighed together. *See Inner-City Temporaries, Inc. v. Comm'r*, T.C. Memo 1990-489, 1990 WL 130150; *see also In re Wyly*, 52 B.R. 338, 391-92 (Bank. N.D. Tex. 2016). The *Vitale* court, for example, relied on three of these indicia of fraud to affirm the imposition of fraud penalties in that case: substantial underpayment of taxes, lack of cooperation during the audit and failure to explain the reasons for the underpayment. 118 Ill. App. 3d at 213. There, the taxpayer understated taxable sales over a three-year period by 200%, 150% and 127% respectively, and its bank deposits exceeded its gross receipts by \$25,000. *Id.* at 212-13. For one year, its purchases exceeded its

sales by 46%. *Id.* at 312. Further, the taxpayer failed to explain its tax underpayment or to maintain business records. *Id.*

Here, Skyline underreported taxable sales by about 25% in 2012 and underpaid taxes by over 50% in 2013; amounts less egregious than seen in *Vitale*, but still significant enough to support an inference of fraud. *See Gagliardi v. United States*, 81 Fed. Cl. 772, 779 (citing *Lollis v. Comm’r*, 595 F.2d 1189, 1191-92 (9th Cir. 1979)); *Inner-City Temporaries*, T.C. Memo 1990-489. Moreover, Skyline admitted that it did not keep business records required by law, and the evidence was undisputed that it refused to cooperate with the audit, including going so far as to ignore a Department subpoena. Final Pretrial Order Stip. 7; Tr. 25-27.

Finally, Skyline has never offered any explanation for its underpayment. Skyline’s principal officers, Patricia and Thomas Kaczmarek, the persons with the most knowledge of Skyline’s business operations, did not offer any explanation to the auditor as to the underpayment, they did not testify at trial, and their absence has not been explained. The only testimony came from Tim, the son, who testified that he knew about only “the gasoline portion of the business.” Tr. 19.

Skyline’s ongoing failure to explain the reasons for the underpayment extends to arguments made before the Tribunal. *See, e.g., Good*, 2012 WL 586939, at \*19. In its post-trial brief, not only has Skyline not provided any argument as to why it under paid its taxes, it also mischaracterizes the basis for the Department’s audit findings of that underpayment. Skyline contends that “the sole basis” for the fraud finding was “there was a significant difference between the revenues reported on Taxpayer’s income tax returns and the receipts reported on its ROT returns.” Pet’r Br. at 6. In fact, the audit did not include an examination of Skyline’s income tax returns; the audit findings were based on an estimate of taxable sales computed through reviewing third party vendor purchase records. Dep’t Ex. 2 at 2-3; Tr. 27-29.

Skyline also argues that fraud penalties were improperly retaliatory because the audit was triggered by its refund claim. But it provides no authority to support an argument the Department acted improperly in conducting an audit to determine

the correctness of unsubstantiated amended returns and claims for credit. Pet'r Br. at 6. It is true, and somewhat puzzling, that, at the hearing, the auditor disavowed her reliance on lack of cooperation and lack of books as a basis for her fraud recommendation and testified that the recommendation was based on the amount of overpayment. *See* Tr. 36. But lack of cooperation and lack of books and records are both recognized badges of fraud, *see Vitale*, 118 Ill. App. 3d at 213, and thus cannot form the basis for an improper retaliatory intent.

The other difficult fact here is that the auditor found that during the audit period a gasoline vendor had wrongfully collected sales tax on some of the gasoline sold to Skyline, and the Department credited Skyline for its overpaid tax. Tr. 27-28; Dep't Ex. 2 at 2. Skyline's error in paying sales tax to its gasoline vendor could suggest business ineptitude rather than the intent to avoid its tax reporting and tax paying obligations, *see Gagliardi*, 81 Fed. Cl. at 785 (holding business not liable for fraud penalties where the evidence showed mere "benign ineptitude"), but Skyline never advanced this argument.<sup>1</sup>

Thus, while the record here is not ideal, Skyline's failure to provide any explanation for its tax underpayment or to provide any meaningful argument as to why the fraud penalties should not be imposed undoes its case. Coupled with its lack of cooperation in the audit, and a significant tax deficiency, I am compelled to conclude that the Department has sufficiently proved its claim that Skyline intentionally avoided paying its taxes, and that fraud penalties were properly imposed. Any other result would reward a taxpayer that stonewalls the Department's legitimate efforts to ascertain a correct tax liability. *See Vitale*, 118 Ill. App. 3d at 213.

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<sup>1</sup> At oral argument, for the first time in this case, the Department attorney argued that Skyline could be found liable for negligence penalties as an alternative to the fraud penalty assessment. Skyline's counsel objected to this possibility. Given that the Department's request for negligence penalties was not presented at or before trial, and Petitioner does not seek it, I will not consider this argument.

### **Conclusion**

The Notice of Tax Liability is affirmed in its entirety. The assessment of sales tax, interest, late-filing and late-payment penalties is affirmed. The fraud penalty assessment is also affirmed.

This is a final order subject to review under section 3-113 of the Administrative Review Law, and service by email is service under section 3-113(a). The Illinois Independent Tax Tribunal is a necessary party to any appeal.

s/ *Brian Barov*  
BRIAN F. BAROV  
Administrative Law Judge

Date: March 9, 2017