

**ST 10-14**  
**Tax Type: Sales Tax**  
**Issue: Books and Records Insufficient**

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

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

v.

**ABC, INC.,**  
**Taxpayer**

**No. 09-ST-0000**  
**IBT#**  
**Letter ID#**

**Period 1/04-2/05**

**Ted Sherrod**  
**Administrative Law Judge**

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Special Assistant Attorney General Shepard Smith on behalf of the Illinois Department of Revenue; James A. Larson of Larson & Associates, P.C. on behalf of ABC, Inc.

**Synopsis:**

This matter comes on for hearing pursuant to the taxpayer's timely protest of Notices of Tax Liability Letter ID number XXXX and Letter ID number XXXX issued to the taxpayer by the Department of Revenue ("Department") on October 21, 2008 for Retailers' Occupation Tax ("ROT"), Use Tax and related taxes. The issue presented in this case is whether the Department correctly determined that the taxpayer should not be

allowed to deduct discounts given customers on fuel sales from total fuel sales used to measure the taxpayer's tax liability and otherwise correctly assessed additional tax due for the period January 2004 through February 2005 (the "tax period"). A hearing in this matter was held on April 14, 2010 during which testimony and documentary evidence was presented. After reviewing the evidence presented in this case, it is recommended that this matter be resolved in favor of the Department on all issues except with regard to the Department's denial of discounts, which the taxpayer should be allowed for the entire tax period at issue.

**Findings of Fact:**

1. The Department's *prima facie* case against the taxpayer, including all jurisdictional elements, was established by the admission into evidence of the Department's SC-10-K, Audit Correction and/or Determination of Tax Due, showing tax due for the period January 2004 through February 2005 of \$32,508 (including penalty). Department Exhibit ("Ex.") 1.<sup>1</sup>
2. The taxpayer is a motor fuel retailer, truck repair garage operator and convenience store vendor engaged in the sale of diesel fuel, gasohol, and other types of motor fuel primarily to over the road truckers. Transcript ("Tr.") pp. 13, 14, 18, 133; Department Ex. 2; Taxpayer's Ex. 2. Products sold through the taxpayer's convenience store operation include, in addition to typical convenience store items, phone cards and CB radios. Tr. pp. 14, 175.

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<sup>1</sup> Unless otherwise noted, findings of fact apply to the tax period.

3. The taxpayer is jointly owned by John Doe (“John Doe”) and Jane Doe (“Jane Doe”), both of whom hold a 50 percent interest in the business. Tr. p. 13. John Doe’s responsibilities include management oversight of the business including supervision of the business' managers. Tr. p. 14. The taxpayer's managers include Mr. Smith, the taxpayer's general manager, and Mr. Jones, the taxpayer's manager of bookkeeping and accounting. Tr. p. 15.
4. The taxpayer commenced operations in 1969 and, during the tax period at issue, was assigned IBT number 0385-5260. Department Ex. 2. The taxpayer's owners during the tax period at issue assumed ownership of the business in 1978. Tr. p. 13. On February 28, 2005, John Doe and Jane Doe, the owners of the taxpayer, completed the sale of the taxpayer's business operations to ABC Trading LLC, an entity owned by Messers XXX and XXX, and ceased to operate under the aforementioned IBT number. Tr. p. 14; Department Ex. 2; Taxpayer Ex. 2.
5. This case arose out of an audit conducted by Charles Schoen, a Department auditor (“Schoen” or “auditor”), who commenced his audit on February 26, 2007 and ended it on March 2, 2007. Tr. p. 138; Department Ex. 2; Taxpayer’s Ex. 1. Schoen's audit was conducted at a restaurant adjacent to the location of the taxpayer's motor fuel sale/garage and convenience store operation. Tr. pp. 140, 141. The audit was conducted after the sale of the taxpayer's business to ABC Trading LLC. Tr. pp. 104, 141.
6. The Department's auditor was not provided with a complete set of the taxpayer’s pertinent books and records for 2004, and was provided with no books and records of any kind for 2005. Department Ex 2; Taxpayer’s Ex. 2. Moreover,

- the taxpayer provided the auditor with no register tapes or invoices for 2004. *Id.* Due to the complete absence of records for some of the months in 2004 under audit the Department's auditor determined the taxpayer's gross sales for 2004 by estimating sales during the months for which records were missing based upon sales information for months for which records were available. *Id.* The auditor also used records of pre-paid sales tax paid to the taxpayer's fuel suppliers on the taxpayer's fuel purchases to determine the taxpayer's total sales. *Id.*
7. No records were provided for the portion of the tax period in 2005. *Id.* To establish the taxpayer's sales tax liability for 2005, the Department's auditor developed a liability for 2004 and projected this audit determination to 2005. *Id.*
  8. The auditor disallowed a portion of the motor fuel tax and gasohol exemptions taken by the taxpayer, finding that these exemptions were improperly computed without deducting motor fuel and gasohol sales previously deducted as resales and not subject to motor fuel and gasohol tax. Department Ex. 2; Taxpayer Ex. 1. The auditor further determined that the taxpayer failed to pay any tax on phone cards sales. Tr. pp. 175, 176; Department Ex. 2; Taxpayer's Ex. 1 (auditor's form EDC-5), 2.
  9. At the conclusion of this audit, the auditor determined that, for the period January through December 2004, tax collected on motor fuel and other sales exceeded taxes reported to the Department by \$20,782. *Id.*; Taxpayer's Ex. 3. While the records reviewed by the auditor led the auditor to believe that discounts "may have" been given customers on the taxpayer's sales, the auditor did not take into

account any such discounts in computing the taxpayer's underreported sales and sales tax. Tr. pp. 160, 168-170, 178-180; Department Ex. 2; Taxpayer's Ex. 1.<sup>2</sup>

10. The auditor disallowed deductions for discounts from the pump price given to some of the taxpayer's customers because there was no supporting documentation for these deductions. Tr. pp. 160, 168-170; Department Ex. 2; Taxpayer's Ex. 2. The taxpayer's claim to a portion of such deductions was confirmed during the hearing by the testimony of XXXXXX, the Comptroller of XXXXXX Systems, a provider of debit cards entitling holders to discounts on fuel purchases from the taxpayer, and by spreadsheets provided by XXXXXX Systems subsequent to the conclusion of the hearing in this case. Tr. pp. 77-85; Taxpayer's Ex. 6.<sup>3</sup>
11. On February 26, 2007, Mr. Smith, an employee of the taxpayer, turned over to the Department's auditor a box of records that consisted of folders containing all of the taxpayer's profit and loss statements and all of its records of discounts given customers including the taxpayer's backup documentation collected each month during 2004 to support the amount shown as discounts on the taxpayer's profit and loss statements. Tr. pp. 31-34, 37, 38, 40, 41, 48, 49, 116, 117, 161; Department Ex. 2; Taxpayer's Ex. 1.

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<sup>2</sup> The auditor used the fuel pump price charged customers on sales of motor fuel in computing the taxpayer's total sales., Taxpayer's Ex. 1 (auditor's EDC-5) ("My calculations were all made from what price was sold at the pump."). The taxpayer contends that discounts were allowed after the retail sale of motor fuel was completed at the pump price, with the appropriate discount being computed after the sale, and customers receiving discounts when paying at the register, or by being billed for the pump price less the appropriate discount allowed. Tr. pp. 23-31, 95-98.

<sup>3</sup>The Department and the Taxpayer agreed to keep the record in this case open for the purpose of receiving this additional evidence. After reviewing this evidence, the Department, by e-mails dated 5/3/10, acknowledged that the evidence provided by XXXXXX Systems corroborated a portion of the discounts taken by the taxpayer and agreed that such discounts should be allowed.

12. The taxpayer's records that were contained in the box turned over to the Department's auditor were lost while in the custody of the Department's auditor and have not been found. Tr. pp. 38, 40, 41, 48, 148-150.

**Conclusions of Law:**

Based on the record before me, I find that the taxpayer has failed to present evidence sufficient to overcome the Department's *prima facie* case of tax liability under the assessment in question, except for so much of the liability as results from the denial of discounts claimed on motor fuel sales during the tax period at issue. Accordingly, by such failure, and under the reasoning given below, the determination by the Department that the taxpayer owes the assessment shown on the Correction of Returns must stand as a matter of law, except for that part of the determination that results from the disallowance of discounts taken on motor fuel sales. The record indicates that the Department lost the taxpayer's books and records pertaining to the taxpayer's deductions for discounts allowed customers. Because the taxpayer's records misplaced by the Department might have allowed the taxpayer to rebut the Department's determination with regard to these deductions, the taxpayer must be allowed the deductions claimed for these items. In support of the foregoing findings, the following conclusions are made.

The record indicates that the taxpayer failed to make available for audit review a complete set of books and records for 2004 and presented no records pertaining to 2005. Department Ex. 2; Taxpayer's Ex. 2. When a taxpayer fails to supply the Department with adequate records to substantiate its gross receipts, the Department is justified in using an alternative method to estimate the taxpayer's gross receipts, and, in doing so, the Department is only required to meet a minimum standard of reasonableness. Mel-Park

Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1<sup>st</sup> Dist. 1991). In this case, the Department's auditor was given minimal books and records for 2004 and no records for 2005. Department Ex. 2; Taxpayer's Ex. 2. The auditor used the minimal information available to arrive at a liability for 2004. *Id.* Moreover, because he was provided with no books and records for 2005, he developed a liability for the portion of the tax period at issue in 2005 by projecting forward the audit results arrived at for 2004. *Id.* The Illinois appellate court has held that the estimation of tax liability using the best information available in the absence of adequate books and records meets the required minimum standard of reasonableness. Vitale v. Department of Revenue, 118 Ill. App. 3d 210 (3d Dist. 1983). The taxpayer has presented no reason to conclude that the holding in Vitale is not applicable here. Therefore, I find that the Department's audit methodology satisfied the minimum standard of reasonableness necessary to avoid overturning the Department's audit determination.

At the hearing, the Department introduced into evidence the Department's correction of return documents. Tr. pp. 10, 11; Department Ex. 1. A corrected return prepared by the Department is deemed *prima facie* correct and the Department establishes its *prima facie* case by having the corrected return admitted into evidence. 35 ILCS 120/4; Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1<sup>st</sup> Dist. 1987). Therefore, when the Department had the corrected return introduced into evidence, its *prima facie* case was established.

A taxpayer cannot overcome the Department's *prima facie* case merely by denying the accuracy of the Department's determination. Central Furniture Mart, *supra*. Simply questioning the accuracy of the Department's assessment or denying its accuracy

is not enough. Quincy Trading Post v. Department of Revenue, 12 Ill. App. 3d 725 (4<sup>th</sup> Dist. 1973). A taxpayer must overcome the Department's *prima facie* case by producing competent evidence identified with the taxpayer's books and records. Vitale at 213. In this case, the taxpayer presented at trial no documentary evidence whatsoever to show that the Department's determination was incorrect.

The taxpayer argues that it was fatally prejudiced by the Department's loss of its books and records delivered to the Department's auditor and that the assessment at issue in this case should be abated for this reason alone. Tr. pp. 89, 208-215. However, the record contains no evidence that the lost records pertained to any information used in arriving at an audit liability other than the denial of reductions in gross sales the taxpayer has claimed for discounts given on fuel sales.

Section 7 of the ROT requires retailers to "keep records and books of all sales of tangible personal property, together with invoices, bills of lading, sales records, copies of bills of sale, inventories prepared as of December 31 of each year or otherwise annually as has been the custom in the specific trade and other pertinent papers and documents." 35 ILCS 120/7. Retailers are required to keep ledger accounts, journal entries, and complete books and records covering receipts from all sales and distinguishing taxable from non-taxable receipts. 86 Ill. Admin. Code, ch. I, section 130.801.

The record in this case indicates that the taxpayer failed to demonstrate that any such books and records were maintained by the taxpayer for 2005 or that a complete set of such records were kept for every month during 2004. Department Ex.2; Taxpayer's Ex. 1. Accordingly, the taxpayer failed to satisfy the statutory record keeping requirement for at least a portion of the tax period at issue. With the exception of the

Department's determination disallowing deductions for discounts given customers discussed below, the absence of such records make it impossible for the taxpayer to rebut the Department's *prima facie* case and therefore clearly justify the Department's assessment determination. Vitale, *supra*.

Insofar as the lost documents that were turned over to the Department are concerned, the record shows that their loss severely prejudiced the taxpayer's rebuttal case by making it impossible for the taxpayer to produce books and records essential to rebut the Department's *prima facie* correct determination denying discounts claimed by the taxpayer. With respect to the contents of the books and records that were lost by the Department, John Doe, the taxpayer's general manager and part owner, testified as follows:

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Well, it was our monthly reports, our discounts, our bank statements, all relevant information for – that we always do every month for all of our month end work, all that was contained in those boxes.<sup>4</sup>  
Tr. p. 38.

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Q. Mr. John Doe, without the return of those boxes, do you have any independent means to calculate the amount of discounts that were afforded customers off the posted pump price?

A. That would be just a near impossibility.

Q. And why is that?

A. We don't have those records. Those records were contained in the files that were in those boxes. They were generated through the computer and, most of all, the billing companies, which we don't have access to. So therefore, all of those were in that. For us to go in to find it, they would have had to have been in those boxes. There's no other place that we would have that information. Tr. pp. 48, 49.

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<sup>4</sup> While the taxpayer testified that the information it turned over to the Department's auditor was contained in 2 boxes (Tr. p. 38), I find that this information was contained in a single box based upon the entry in the auditor's EDC-5 on 12/26/07 stating that he received only one box of documents. Department Ex.2; Taxpayer's Ex. 1.

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John Doe's testimony was consistent with testimony given by Mr. Jones, the taxpayer's manager of bookkeeping and accounting, who testified regarding the monthly records he prepared to document discounts taken that were contained in the box the Department's auditor received. Tr. pp. 100-106.

Based on the foregoing testimony, I find that essential documents were contained in the box that the Department's auditor took custody of from the taxpayer and subsequently lost. Had these records not been lost, the taxpayer would doubtless have been able to produce the documentation required by law to rebut the Department's determination disallowing all of the discounts the taxpayer claimed. This conclusion is corroborated by the taxpayer's duplication of documentation equivalent to a portion of the lost records through XXXXXX Systems a third party that handled certain types of discounts the taxpayer allowed on fuel sales. Taxpayer's Ex. 6. As noted earlier, after reviewing this documentation, the Department agreed that it substantiated the taxpayer's claim as to the portion of discounts these records covered. See footnote 2.

A finding that the Department should not be allowed to prove its case based upon the prejudice to the taxpayer's case caused by the Department's loss of the taxpayer's books and records is supported by the Illinois Supreme Court's holding in Hudson v. Hudson, 287 Ill. 286 (1919). In this case, the court held that a party responsible for the loss, alteration, damage or destruction (i.e. "spoliation")<sup>5</sup> of probative evidence cannot be allowed to benefit from the damage to an opponent's case caused by such actions.

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<sup>5</sup> See 10 ILPRAC 10 ILPRAC §23:32(2008) ("Spoliation is the destruction, significant alteration, or non-preservation of evidence relevant to pending litigation or reasonably foreseeable litigation.").

Hudson at 298, 299. While this case dealt with the deliberate spoliation of evidence “[spoliation of evidence] can occur as the result of actions by parties or by nonparties [.] It can be inadvertent or intentional [.] It can be the product of absolute good faith, or the result of consummate evil.” 10 ILPRAC §23:32 (2008). See also Midwest Trust Services, Inc. v. Catholic Health Partners Services, 392 Ill. App. 3d 204 (1<sup>st</sup> Dist. 2009) (indicating that “spoliation” of evidence can include the careless or negligent failure to preserve evidence if it is shown that “but for the ... loss or destruction of the evidence, the plaintiff had a reasonable probability of succeeding in the underlying suit.” Midwest Trust Services at 210).

Since the books and records the Department’s auditor lost were clearly relevant and would have been dispositive as to the discounts the taxpayer claims, I find in the taxpayer’s favor with regard to such deductions. Therefore, I find that deductions for discounts claimed by the taxpayer should be allowed as reductions to the taxpayer’s fuel sales in the manner claimed by the taxpayer.<sup>6</sup> Moreover, to the extent that the projection of liability for 2005 is based on the auditor’s determination disallowing discounts for 2004, the auditor’s determination of liability for 2005 must also be reversed. For the reasons noted above, except for the portion of the Department’s assessment related to the taxpayer’s claims regarding deductions for discounts taken, the Department’s determination of tax due should be sustained.

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<sup>6</sup> The auditor’s tax accrual (Taxpayer’s Ex. 3) reflects tax due on fuel sales at the undiscounted pump price. Taxpayer’s Ex. 2 (auditor’s EDC-5). Accordingly, the allowance of discounts obviates the tax accrual due to the reduction in the taxpayer’s gross motor fuel sales.

**WHEREFORE**, for the reasons stated above, it is my recommendation that the Department's assessment of additional tax be upheld, except for the portion that resulted from the disallowance of deductions for discounts the taxpayer has claimed for the tax period in controversy.

Ted Sherrod  
Administrative Law Judge

Date: June 27, 2010