

ST 14-04

Tax Type: Sales Tax
Tax Issue: Unreported/Underreported Income (Fraud Application) and Books and Records Insufficient

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

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

ABC BUSINESS,

Taxpayer

No. XXXX
Account ID XXXX
Letter ID XXXX
XXXX
Period 1/07-12/09

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Michael Coveny on behalf of the Illinois Department of Revenue; Sachin Shah of The Agrawal Firm, LLC 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 June 26, 2012 for taxes assessed under the Retailers’ Occupation Tax Act (“ROTA”) 35 ILCS 120/1, *et seq.*, and related taxes. 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.

An evidentiary hearing was held on August 15, 2013 regarding this matter. After reviewing the transcript and documents presented at hearing, I recommend that the Notices of Tax Liability be made final.

Findings of Fact:

1. The taxpayer is a corporation doing business in Illinois. Department Exhibit (“Ex.”) 1. The Department conducted an audit of the taxpayer's records for the period January 1, 2007 through December 31, 2009. Department Ex. 2.
2. During the Department’s audit, it determined that the taxpayer had failed to keep books and records as required by the ROTA (35 ILCS 120/7), and that it had underreported gross receipts for 2007 by 39%, for 2008 by 46% and for 2009 by 27%. Department Ex. 2. Based on these findings, the Department assessed a fraud penalty for the period 1/07 through 2/08.*Id.*
3. 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.
4. On June 26, 2012, the Department issued Notices of Tax Liability that were based upon the EDA-105-R Audit Reports, assessing tax due. *Id.*

Conclusions of Law:

The ROTA requires every taxpayer to report to the 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 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 audit period. 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. Accordingly, it prepared audit reports calculating a deficiency, a late payment penalty, a negligence penalty and a fraud penalty. On June 26, 2012, it issued Notices of Tax Liability Letter ID number XXXX and number XXXX to the taxpayer. Department Ex. 1.

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 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.” Masini, *supra* at 15. 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 this case, the Department's *prima facie* case was established when the Department's Notices of Deficiency 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 but did not offer any oral testimony or documentary evidence on behalf of the taxpayer. Accordingly, the taxpayer failed to produce any competent evidence identified with its books and records to overcome the Department's *prima facie* case and, with the exception of the fraud penalty, the Department's *prima facie* determination of liability must be finalized and affirmed.

The Department has also assessed the taxpayer with a fraud penalty for the period 1/07 through 12/08. Department Ex. 2. Section 3-6 of the Uniform Penalty and Interest Act 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 735/3-6.¹ The standard for determining whether a fraud penalty is appropriate is clear and convincing evidence. Pueblo v. Department of Revenue, 117 Ill. App. 3d 260 (4th Dist. 1983). To establish fraud, intent must be shown. Vitale v. Department of Revenue, 118 Ill. App. 3d 210 (3rd Dist. 1983). Clear and convincing evidence of intent to defraud can be circumstantial in nature. *Id.*

In the instant case, the Department determined that the taxpayer significantly underreported its monthly gross receipts. Tr. pp. 10, 11. During her audit, Karen Macudzinski, the Department's auditor, found that the taxpayer reported gross receipts of \$XXXX in 2007, but failed to report

¹ The fraud penalty was assessed for the period 1/07 through 12/08 (Department Ex. 2). Taxes due for this period were eligible for tax amnesty pursuant to 35 ILCS 745/1 *et seq.* Since the taxpayer did not pay the taxes due under amnesty, the fraud penalty was doubled pursuant to 35 ILCS 735/3-6(d) of the Uniform Penalty and Interest Act.

\$XXXX in gross receipts for that period. Department Ex. 2. She found that the taxpayer reported gross receipts for 2008 of \$XXXX but failed to report additional gross receipts of \$XXXX. *Id.* In sum, during each of the aforementioned years, for which a detailed audit was conducted, the taxpayer's actual gross receipts were 39% more than its reported receipts in 2007 and were 46% more than its reported receipts in 2008. *Id.*

In Vitale, the court identified certain facts as constituting circumstantial evidence of fraud. Vitale, *supra* at 213. 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 the Department's ROTA regulations. *Id.* Moreover, as in the instant case, in Vitale, the taxpayer's actual gross receipts exceeded its reported gross receipts by more than 27% - 50% in two of the three years the Department audited. Vitale, *supra* at 212. Based on the similarity between the circumstantial evidence presented by the record in this case and the evidence found sufficient to establish an intent to defraud in Vitale, I conclude that the Department has established clear and convincing evidence that the taxpayer filed returns during the audit period with an intent to defraud. 35 ILCS 735/3-6; Vitale, *supra* at 213.

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

Ted Sherrod
Administrative Law Judge

Date: September 23, 2013