

ST 01-9

Tax Type: Sales 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.	00-ST-0000
OF THE STATE OF ILLINOIS)	Tax ID No.	0000-0000
v.)	NTL No.	00-0000000000000000
JANE DOE d/b/a)		
ABC FOOD MART,)	John E. White,	
Taxpayer.)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Warren Appel appeared for ABC Food Mart; John Alshuler appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose after ABC Food Mart (“ABC” or “taxpayer”) protested a Notice of Tax Liability (“NTL”) the Illinois Department of Revenue (“Department”) issued to it. The NTL assessed retailers’ occupation tax, penalties and interest as measured by taxable gross receipts ABC was determined to have received regarding its sales of tangible personal property at retail during the months beginning December 1, 1993 through and including May 31, 1995.

A hearing on taxpayer's protest was held at the Department’s Office of Administrative Hearings in Chicago. The issue at hearing was whether the Department reasonably calculated ABC’s taxable gross receipts. Taxpayer presented evidence consisting of: certain documents; reports, schedules and other documents prepared by Department personnel and/or agents; documents prepared by other state agencies; and the testimony of its sole proprietor. I have considered the evidence adduced at hearing, and I am including in this recommendation specific findings of fact and conclusions of law. I

recommend that the NTL be finalized after being revised to take into account the fact that ABC stopped doing business in April 1995 instead in May 1995.

Findings of Fact:

1. ABC was a sole proprietorship that was engaged in the business of making retail sales of groceries, merchandise and cigarettes to the public. Department Exhibit (“Ex.”) 1, p. 2 (a copy of the Department’s correction of taxpayer’s returns); Taxpayer Ex. 2 (a copy of a case report prepared by an agent of the Department’s Bureau of Criminal Investigation (“BCI”), under the May 17, 1997 cover letter of Assistant Attorney General James Rustik), p. 2; Taxpayer Ex. 3 (auditor’s comments).
2. ABC was located at 123 ABC Lane, in Anywhere, Illinois. Taxpayer Ex. 2, p. 2; Department Ex. 1. ABC started doing business in November 1993 and stopped doing business in April 1995. *See* Taxpayer Ex. 2, p 12 (agents showing ABC’s former accountant a certified copy of a return filed for ABC regarding the month of April 1995).
3. JANE DOE (“DOE”) signed a Department Form NUC-1 regarding ABC’s business, on which she was named as ABC’s sole proprietor. Taxpayer Ex. 2, pp. 6, 12; Taxpayer Ex. 3, p. 1; Hearing Transcript (“Tr.”), p. 46 (DOE).
4. JOHN DOE (“Mr. DOE”) was DOE’s husband during the audit period. *E.g.*, Taxpayer Ex. 2, p. 2; Tr. pp. 76-79 (DOE).
5. The Department conducted an audit of ABC’s business for the period beginning 12/1/93 through and including 5/31/95. Department Ex. 1, p. 2; Taxpayer Exs. 2-3.
6. DOE signed ABC’s retailers’ occupation tax (“ROT”) returns that were filed regarding the months of 12/93 through and including 7/94, 10/94 and 12/94 through 4/95. Taxpayer Ex. 2, p. 12; Tr. pp. 47 (DOE), 82 (argument). For two months during the audit period, ABC filed unsigned returns. Taxpayer Ex. 2, p.

- 12.
7. During the audit, Department BCI agents obtained vendor records showing the cost of certain tangible personal property (hereinafter “goods”) ABC purchased for subsequent sale at retail. Taxpayer Ex. 2, p. 9; Taxpayer Ex. 3, pp. 1-2.
8. Following a review of those vendor records, the agents determined that, from December 1993 through March 1995, ABC purchased \$1,458,740.00 (one million, four hundred fifty-eight thousand, seven hundred forty dollars) worth of goods for resale. Taxpayer Ex. 2, p. 9. On the sales and use tax returns filed regarding the same months, ABC reported that it received \$129,548 (one hundred twenty-nine thousand, five hundred forty-eight dollars) in total gross receipts from selling goods at retail. *Id.*
9. Because the cost of the goods ABC purchased for resale was more than ten times greater than its reported gross receipts from making sales at retail during the same period, Department personnel determined that ABC was knowingly underreporting its taxable gross receipts on the returns it filed. Taxpayer Ex. 2, p. 2 (“... this investigation disclosed that JANE DOE and JOHN DOE fraudulently filed Retailers Occupation Tax (ROT) returns for the periods covering December, 1993 through March, 1995.”); Taxpayer Ex. 3, p. 1, 3 (explaining that a 50% fraud penalty was assessed as part of the audit, “... since the taxpayer grossly understated receipts during the audit period.”).
10. Department agents issued demands for books and records to Mr. DOE and to ABC’s former accountant. Taxpayer Ex. 2, pp. 5, 11.
11. Following its reconciliation of ABC’s returns with its purchase invoices, and after ABC produced no records in response to the Department’s demands, the Department disregarded the amounts ABC reported as gross receipts on the returns it filed during the audit period. Taxpayer Ex. 3, pp. 1-2; *see also* 35 ILCS 120/4; Puleo v. Department of Revenue, 117 Ill. App. 3d 260, 267, 453 N.E.2d

- 48, 53 (4th Dist. 1983).
12. When calculating the criminal financial harm for a possible prosecution of ABC for a criminal violation of the Retailers' Occupation Tax Act ("ROTA"), the Department's BCI agents did not add any mark-up to ABC's cost of goods for resale, nor did they include any civil penalties. Taxpayer Ex. 2, p. 9. For purposes of the civil enforcement provisions of the ROTA, however, the Department's auditor took into account a reasonable mark-up percentage, and assessed civil penalties. Taxpayer Ex. 3, pp. 1-3; Department Ex. 1.
 13. The Department's auditor added a 10% mark-up to the amount of taxpayer's purchases when calculating taxable gross receipts. Taxpayer Ex. 3, pp. 1-2.
 14. The auditor subtracted the receipts reported by ABC on its returns from the amount of taxable gross receipts calculated using the Department's best available information. Taxpayer Ex. 3, pp. 1-3. The auditor treated the difference as unreported receipts, and multiplied that amount by the appropriate tax rate. *Id.*
 15. The Department assessed a 50% fraud penalty for all months but 12/94, a 15% late payment penalty for the entire audit period, and a 5% late filing penalty for the month of 12/94. Taxpayer Ex. 3, p. 3.
 16. The Department did not take into account the amount of inventory that ABC contends had not been sold when ABC ceased business operations in April 1995. Taxpayer Ex. 2, pp. 8-9; *see also*, Taxpayer Exs. 3-4.
 17. During the course of the Department's BCI investigation, agents interviewed, *inter alia*, Mr. DOE (Taxpayer Ex. 2, pp. 3-6), JOE BLOW, ABC's former accountant (*id.*, pp. 10-13), MR. SMITH, ABC's former attorney (*id.*, pp. 13-14), and MR. JONES (*id.*, p. 14).
 18. JONES told the agents that he purchased ABC's business for \$80,000.00. Taxpayer Ex. 2, p. 14.
 19. DOE claimed at hearing that her husband transferred ABC's remaining cigarette

- inventory to the business of XYZ Food Mart after ABC ceased doing business. Tr. pp. 45-46, 49 (DOE).
20. At or about the time the DOEs were notified regarding the Department's BCI investigation of ABC's business, they hired an accountant, RON DOE ("RON DOE"), and an attorney, MR. SMITH ("SMITH"), to represent them regarding that investigation. *See* Taxpayer Exs. 4-6; Tr. pp. 47-49 (DOE).
 21. Prior to a meeting between SMITH and the assistant Illinois Attorney General representing the State of Illinois, RON DOE wrote a letter to SMITH to outline points for negotiation. Taxpayer Ex. 4.
 22. In that letter, RON DOE referred to the amount of ABC's documented cigarette purchases during the audit period, and also referred to certain amounts of goods which ABC claimed were not sold at retail, or were sold for receipts that were exempt from taxation. Taxpayer Ex. 4. In the final paragraph of RON DOE's letter, he indicated that he expected it to take him two weeks to gather and organize the necessary and pertinent information to support the amounts he referred to as "reductions." *Id.*
 23. There was no evidence offered to show that any bulk sales notification was given to the Department regarding any transfer of inventory regarding ABC's sale to JONES, or regarding any possible transfer of ABC's inventory to XYZ Food Mart. *See* Taxpayer Ex. 2; 35 ILCS 120/5j.
 24. There was no evidence offered to show the specific quantity and type of cigarettes that might have remained unsold when ABC ceased business in March 1995. *See* Taxpayer Ex. 4 (accountant estimating value of ABC's inventory as of April, 1994 as \$227,000.00, and stating that he was in the process of "... gathering and organizing necessary and pertinent information and evidences [sic] ..." for that inventory); Taxpayer Ex. 8 (page 2 of the Schedules C — which is the page on which the amount of a business' remaining inventory would be reported — are

not included in exhibit).

25. When interviewed by BCI agents on August 31, 1995, Mr. DOE stated that the value of the inventory of XYZ Food Mart (“XYZ”) was about \$220,000.00, and about \$200,000.00 of that amount was attributable to cigarettes. Taxpayer Ex. 2, pp. 3-4. There was no indication in the report, however, that Mr. DOE was asked whether the cost of XYZ’s beginning inventory was \$200,000.00, or from what source XYZ’s beginning inventory was obtained. *See id.*
26. ABC was not an Illinois licensed distributor of cigarettes. Taxpayer Ex. 2, p. 15.

Conclusions of Law:

The Department introduced a copy of the NTL it issued to ABC into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the ROTA, that NTL constitutes prima facie proof of the correctness of the amount of tax due. 35 ILCS 120/4. The Department's prima facie case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). A taxpayer cannot overcome the 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. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

The issue in this matter involves the propriety of the Department’s calculation of ABC’s taxable gross receipts. First, ABC argues that the Department’s calculation is

incorrect because it failed to take into account the fact that ABC ceased operations in April 1995, whereas the NTL imposed tax as measured by the gross receipts from sales ABC allegedly made through May 1995. Next, ABC argues that it had a considerable amount of inventory remaining unsold when it ceased doing business in April 1995. It also asserts that the some of the goods it purchased for resale during the audit period were either not sold at retail, or were sold in transactions that were exempt from ROT. Finally, ABC objected to the Department's basis for assessing a fraud penalty. I will address each in turn.

The evidence admitted at hearing confirms ABC's first argument. In Taxpayer Exhibit 2, the Department's BCI agent obtained and referred to a certified copy of a return filed regarding the month of April 1995, while the audit scheduled taxable gross receipts, and assessed tax on such receipts, through May 31, 1995. Taxpayer Ex. 2, pp. 12, 18; Taxpayer Ex. 3, pp. 2-3; Department Ex. 1. Thus, I conclude that taxpayer has rebutted the Department's implicit determination that taxpayer was engaged in business as a retailer, and made taxable sales, through May 31, 1995. Department Ex. 1; Taxpayer Ex. pp. 2-3. There is no evidence in the record to explain the basis for the auditor's determination that ABC made sales during the month of May 1995, and it otherwise appears that the audit was premised on evidence obtained by the BCI agent's investigation reported in Taxpayer Exhibit 2. I recommend, therefore, that the NTL should be revised to eliminate the tax and penalties assessed regarding May 1995.

Before addressing the remaining issues, I will generally describe the evidence ABC offered to support its arguments that the Department erred when it determined that all of the goods ABC purchased during the audit period were subsequently sold at retail.

ABC first offered two related exhibits. One was a copy of a report written by a Department BCI agent. Taxpayer Ex. 2. That report describes the conduct of the agent's investigation of ABC's business regarding the audit period. *Id.* It also offered the Department's written stipulation that, if called as a witness in this matter, the investigator would testify consistent with his descriptions and narrative set forth in that report. Taxpayer Ex. 1. Taxpayer then offered a copy of the audit comments prepared by the Department auditor who conducted the audit of ABC's business using information obtained by the BCI agent. Taxpayer Ex. 3.

Taxpayer Exhibits 2 and 3 describe facts that support the Department's decision to disregard ABC's statements of its gross and taxable gross receipts as reported on the ROT returns filed during the audit period. Specifically, those reports reflect — and ABC has never once contested — that it purchased goods for subsequent resale to others at retail at a rate that was more than ten times greater than the value of the gross receipts it reported on returns filed during the audit period. Taxpayer Ex. 2, pp. 8-9; Taxpayer Ex. 3, pp. 1-3. Taxpayer Exhibit 2 also reflects that ABC and its former accountant were issued demands for the books and records that Illinois law requires retailers to maintain to substantiate the information reported on its filed returns. Taxpayer Ex. 2, pp. 5, 10-11; 35 **ILCS** 120/7; 86 Ill. Admin. Code § 130.805. Those exhibits, as well as the other evidence of record, also show that DOE was ABC's proprietor, and that she signed almost all of the returns filed during the audit period. Taxpayer Ex. 2, p. 12; Taxpayer Ex. 3, p. 1; Tr. p. 46 (DOE).

ABC next offered a letter from RON DOE, its former accountant, to SMITH, its former attorney, dated June 21, 1996. After the salutation, RON DOE wrote:

Pursuant to our phone conversation in this morning concerning the captioned pending case with the Illinois Attorney General's Office, this is to confirm in writing the contents of the point of discussion for you to review before meeting with Mr. Rustik [the Assistant Attorney General] on Monday.

Taxpayer Ex. 4. RON DOE's letter then provides a schedule that begins by referring to the \$1,458,740 worth of cigarettes ABC purchased during the audit period. *Id.* RON DOE's letter then lists several amounts, which his schedule subtracts from the \$1,458,740, to arrive at a total of "Net purchase amount after adjustment and reductions" of \$629,692. Taxpayer Ex. 4.

The first amount RON DOE deducts is \$225,000, which he describes as "On hand inventory at the time of complete closing of the business. April 1995". *Id.* The other amounts are: \$145,000, for "Inventory buy down provided by the makers of all brands of cigarettes"; \$50,000, for "Coupons, Stickers, News paper Ad Slips, etc. redeemable either on site or mailing in"; \$9,500, for "Purchase of food items included above"; \$240,000 for "Sale for resale"; and \$30,000, for "Inventory loss due to theft, December 1994". *Id.* The final paragraph of the letter provides:

For the items A through F, gathering and organizing necessary and pertinent information and evidences [sic] are underway and it is expected that the project should be completed no later than 14 days from this date.

Taxpayer Ex. 4.

After offering a copy of RON DOE's 6/21/96 letter to SMITH into evidence, DOE testified that she gave proof of the items RON DOE referred to his letter to SMITH, and that the papers she gave to SMITH were never returned. Tr. pp. 54, 65, (DOE), 60-61 (arguments). DOE said that she gave the papers to SMITH during a meeting between her

and SMITH in a restaurant in July 1996. Tr. p. 54 (DOE). When RON DOE's letter was offered into evidence, ABC's counsel advised that it was being offered:

... not for the truth of the matter as to whether or not the numbers listed by the accountant are in fact true — that's the testimony — but for the purpose of showing Court that this letter was written in — four years ago, and as corroboration that it is not newly stated evidence that has never been stated before, so it somewhat corroborates; although the accountant, we will stipulate, did not have personal knowledge of those facts.

Tr. p. 52.

There are two problems with counsel's argument that the amounts of the claimed "deductions"¹ were proved by "the testimony" offered by DOE. First, as a matter of law, a taxpayer cannot support a deduction from otherwise taxable gross receipts with mere testimony. 35 ILCS 120/7; A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053. Section 7 of the ROTA expressly provides that:

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be on upon the person who would be required to remit the tax to the Department if such transaction is taxable.

35 ILCS 120/7. It also provides that:

To support deductions . . . authorized under this Act, ... on account of receipts from any ... kind of transaction that is not taxable under this Act, entries in any books, records or other pertinent papers or documents of the taxpayer in relation thereto shall be in detail sufficient to show the name and address of the taxpayer's customer in each such transaction, the character of every such transaction, the date of every such transaction, the amount

¹ I use the word deductions here not in the traditional sense, but only to characterize RON DOE's attempt to show that not all of the goods purchased by ABC were subsequently sold by ABC at retail.

of receipts realized from every such transaction, and such other information as may be necessary to establish the nontaxable character of such transaction under this Act.

Id.

Section 7 requires ABC to present books and records, and not its owner's mere testimony, to support its claim that tax was not due on certain gross receipts. And, as ABC's counsel impliedly acknowledged at hearing, RON DOE's letter is not part of ABC's books and records that would support deductions in the amounts set forth in that letter. It was not prepared by someone with personal knowledge of the matters described in that letter, and it was not a record that was created in the ordinary course of ABC's business. *See* Taxpayer Ex. 4; Tr. p. 52. Rather it was created for the express purpose of contesting the results of the Department's determinations. Taxpayer Ex. 4. Documents prepared in anticipation of litigation lack the inherent reliability enjoyed by regularly kept business records. *See Kelly v. HCI Heinz Construction Co.*, 668 N.E.2d 596, 600, 282 Ill. App. 3d 36, 41 (4th Dist. 1996); M. Graham, Cleary & Graham's Handbook of Illinois Evidence § 803.10 (7th ed.1999). It should not be forgotten, moreover, that the Department made its determinations using the best available evidence *because ABC lacked books and records*. *See* Taxpayer Exs. 2-3. Thus, as a simple matter of statute, DOE's mere testimony that almost \$700,000 worth of the goods ABC purchased for resale were either not sold at retail, or were the subject of exempt sales, cannot rebut the Department's determination of tax due. 35 ILCS 120/7; *A.R. Barnes & Co.*, 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

Second, DOE's testimony regarding the amounts described in RON DOE's letter was largely offered by DOE responding positively to her attorney's leading questions

asking whether Mr. DOE ever told her that certain amounts of goods were either not sold at retail or were sold in exempt transactions. For example, with regard to the claimed deduction for ABC's inventory when it ceased business, DOE was asked the following questions and gave the following answers:

Q: So you and Mr. DOE and Mr. RON DOE had a meeting in Mr. RON DOE's office; is that correct?

A: Yes.

Q: At the time of that meeting, Mr. DOE explained what happened to the inventory; is that correct?

A: Yes.

Q: And the total inventory disclosed on the purchases of the audit were \$1,458,740; is that correct?

A: Yes.

Q: And Mr. DOE explained that when ABC Food Mart closed, the ending inventory was \$225,000?

A: Yes.

Q: And previously you explained that that's the inventory that got moved over to XYZ Food Mart, a different business that Mr. DOE opened?

A: Yes.

Tr. p. 49.

With regard to the deduction RON DOE described as an "inventory buy down" (*see* Taxpayer Ex. 4), DOE testified as follows:

Q: What is an inventory buy down?

A: There is a cigarette company — about five major companies. They have a salesperson come down and inspect the store on a regular basis, and they put five-dollar coupon three-dollar coupon — whenever they have promotion program, they put some buy-downs.

Q: So they put like a five-dollar coupon for a carton of cigarettes?

A: Right.

Q: So if the regular price for the carton was \$20, then the store has to sell it for \$15?

A: The store sells for \$15.

Q: Then they send the coupon to the manufacturer, and the manufacturer sends back the five dollars?

A: Yes.

Q: Okay. And that was \$145,000?

A: Yes, that's the figures.

Tr. p. 50 (DOE).

As to the deduction for sales for resale, DOE answered "Yes" to the question, "And Mr. DOE said that he had done that [made sales for resale] for \$240,000 of items?"

Tr. p. 51 (DOE). With regard to ABC's claimed deduction for the goods purchased for resale, but which, it claimed, were stolen during a December 1999 burglary, DOE again answered "Yes" to the question, "And Mr. DOE said that there was \$30,000 of cigarettes stolen in the burglary?" Tr. p. 52.

Even though none of the questions tendered to DOE regarding the amounts stated on RON DOE's letter was the subject of a Department objection, DOE's answers to the questions posed to her clearly show that DOE had no personal knowledge regarding the quantity and/or value of the goods ABC claims were not sold by it at retail, or were sold in exempt transactions. DOE said she knew such amounts, but the record shows that she merely took her husband's word on the value of the goods referred to in RON DOE's letter. So, not only is mere testimony insufficient to support a claim for deductions, but DOE did not even appear competent to offer the testimony she gave at hearing.

ABC next offered evidence in an attempt to explain why it was unable to offer any documentary support for its arguments. DOE testified that she gave SMITH "proof", in the form of "papers", related to the deductions described in RON DOE's letter. Tr. p. 54 (DOE). DOE, however, never described what type of papers RON DOE was able to gather from ABC and organize for SMITH. *See id.* And while DOE testified that she did not have a copy of the papers she gave to SMITH, she never indicated whether RON DOE might have made copies, or whether she even asked him whether he has such

copies. *Id.*

DOE then offered a copy of a 5/15/97 letter from Assistant Illinois Attorney General James Rustik, notifying her and her former husband that the Attorney General's office would no longer communicate with SMITH regarding the criminal investigation of ABC's business, because he had been disbarred. Taxpayer Ex. 5. She also offered a copy of an order and report issued by the Client Protection Program of the Illinois Attorney Registration and Disciplinary Commission ("ARDC"), regarding the DOE's complaint to the ARDC that SMITH "... failed to provide services that would justify his retention of the legal fees Claimants [the DOEs] paid." Taxpayer Ex. 6.

ABC's counsel explained why the ARDC order and the administrator's report were being offered as evidence. He said:

It's offered for one purpose, certainly, which is that they were cheated by the attorney. And part of their claim was that he stole their documents, and without the documents we are at a huge disadvantage.

Tr. p. 60. Contrary to counsel's argument, however, the administrator specifically recounted the bases for the DOE's complaints regarding SMITH' conduct, and he reported that:

*** Claimants charge that Respondent made misrepresentations to them, to the Department of Revenue, and to the Attorney General's office; that he coerced them into signing incorrect tax returns; that he failed to communicate with them; and that he failed to provide the services they paid for.

Taxpayer Ex. 6, p. 2 (page 1 of the Administrator's Report and Recommendation). Based on a review of documents DOE herself offered into evidence, it is clear that the substance

of the DOE's complaint against SMITH was that he overcharged them for shoddy and unethical work. Taxpayer Ex. 6. Now, however, DOE wants the fact finder to treat the same complaint as though it were based on the DOE's claim that SMITH was given sole possession of, and converted, books and records of the DOE's business. *See* Tr. p. 60 (argument regarding purpose for admission). Taxpayer Exhibit 6 does not warrant that conclusion, and Taxpayer Exhibits 2 and 3 include evidence which factually support a conclusion that ABC never had any such books and records to begin with. Thus, taxpayer's own hearing exhibits contradict its argument.

While I might accept that DOE may have given SMITH some papers from RON DOE, I find absolutely incredible DOE's conclusory testimony that whatever papers she may have tendered to SMITH constituted "proof" that ABC did not sell almost \$225,000 of the cigarettes it purchased for resale during the audit period, and/or that ABC subsequently sold almost \$475,000 of such goods for receipts that were exempt from ROT. *See* Tr. pp. 54-56; Taxpayer Ex. 4. I conclude that ABC introduced no competent and credible evidence to support its claim that the Department's calculation of its taxable gross receipts during the audit period was in error, because the Department did not exclude almost \$700,000 worth of goods ABC purchased for resale to others at retail.

Finally, taxpayer argues that the Department improperly imposed a fraud penalty in this case. Specifically, it argues that the only basis for the Department auditor's determination to impose a fraud penalty was the amount of the unreported receipts. Tr. pp. 85-86. Taxpayer contends that the facts and circumstances of this matter do not warrant a fraud penalty. Tr. p. 86.

Section 3-6 of the Uniform Penalty and Interest Act provides, in part:

Penalty for fraud.

(a) If 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 (1994). The standard for determining whether a fraud penalty is appropriate is "... that of clear and convincing evidence." Puleo v. Department of Revenue, 117 Ill. App. 3d 260, 268, 453 N.E.2d 48, 53 (4th Dist. 1983). Circumstantial evidence is enough to support the imposition of a fraud penalty. Vitale v. Department of Revenue, 118 Ill. App. 3d 210, 213, 454 N.E.2d 799, 802 (3d Dist. 1983).

Here, ABC has never disputed the key facts that support the imposition of a fraud penalty. Those facts are that, during the audit period, ABC purchased goods for purposes of subsequent resale to others at retail at levels that were many times greater than the gross receipts it reported as having received from selling goods at retail. Taxpayer Exs. 2-3. Second, during the Department's investigation of ABC, demands for documentation were served upon ABC's agents, and no records were ever produced. *See* Taxpayer Ex. 2. Finally, taxpayer produced no regularly kept books and records to support its claims at hearing.

At hearing, taxpayer argued that the Department's calculation of its taxable gross receipts exceeded its actual taxable gross receipts roughly by a factor of two. That is to say, it argued that about half of the goods it purchased for resale were either not sold at retail, or were sold in such a way that the gross receipts were not subject to ROT. *E.g.*, Taxpayer Ex. 4; Tr. pp. 85-86. Significantly absent from the evidence and arguments taxpayer offered at hearing, however, is any serious challenge to the Department's underlying determination that, throughout the audit period, DOE signed returns on which

ABC's actual taxable gross receipts were grossly underreported. Taxpayer Ex. 2, pp. 8-9, Taxpayer Ex. 3, pp. 1-3. Here, it is important to recall that this is not a case where the assessed tax liability is based on the Department's disallowance of gross receipts claimed as deductions reported on filed returns, and where the taxpayer did not know how such deductions must be documented and substantiated. Rather, this case involves substantial amounts of gross receipts that were never reported in any manner on the returns filed by taxpayer. Taxpayer Ex. 2, pp. 8-9; Taxpayer Ex. 3, pp. 1-3. Reduced to the simplest terms, DOE's theory at hearing was to merely quibble about the *extent* to which ABC's actual taxable gross receipts were underreported — an argument which belies that the fraud threshold has already been crossed.

Even if I were to conclude that taxpayer had introduced books and records to show that the Department erred in calculating ABC's taxable gross receipts — and I do not make that conclusion — the evidence still shows that ABC failed to report the gross receipts from its sales of over \$700,000 worth of goods purchased for resale during the audit period. *Compare* Taxpayer Exs. 2-3 *with* Taxpayer Ex. 4. That corresponds to more than \$41,000 of unreported receipts for each of the 17 months in the audit period. That amount, again, represents the level of underreporting that ABC *admits*. Compare that with its filed returns, on which it reported, on average, a little more than \$7,620 in taxable gross receipts for each month at issue. *See* Taxpayer Exs 2-4. ($\$129,548$ of taxable gross receipts reported during the audit period $\div 17 = \$7,620.47$). So, even if the amount of ABC's actual taxable gross receipts were reduced by half, I still agree with the Department auditor's determination that ABC grossly understated its taxable gross receipts on the returns DOE signed, and which were filed for ABC during the audit

period. ABC's underreporting is supported by clear and convincing circumstantial evidence in the record. Thus, I conclude that the fraud penalty was properly imposed.

Conclusion:

I recommend that the Director revise the Department's NTL to exclude any tax and/or penalties attributable to gross receipts from sales calculated to have been made during the months of May 1995. The revised NTL should be finalized, with interest to accrue pursuant to statute.

4/9/01
Date

Administrative Law Judge