

ST 02-26

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)
OF THE STATE OF ILLINOIS)

v.)

ABC CORPORATION,)
XYZ FOOD & LIQUORS,)

Taxpayer)

No. 02 ST 0000
IBT 0000-0000
NTL 00-0000000000000000

RECOMMENDATION FOR DISPOSITION

Appearances: Thomas Rueckert for ABC Corporation; Shepard Smith, Special Assistant Attorney General for the Illinois Department of Revenue

Synopsis:

This matter comes on for hearing pursuant to ABC Corporation’s (“taxpayer” or “XYZ”) protest of Notice of Tax Liability 00 0000000000000 (“NTL”) issued by the Illinois Department of Revenue (“Department”) for the tax period of July, 1997 through June, 1998 (“tax period”). The NTL assessed Retailers’ Occupation and related taxes, a civil fraud penalty and interest calculated to the date of the issuance. At a pre-hearing conference in this matter, the parties agreed that the issues herein are: 1) whether the taxpayer is liable for unpaid sales tax of \$6407 for the tax period; and 2) whether the fraud penalty assessed is appropriate. Order, July 23, 2002 The parties also agreed that

there is an issue regarding whether the statute of limitations affects the tax assessment, and further agreed that interest should be assessed on any resulting tax and penalty. Id.

Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the Department, and in furtherance of that recommendation, I make the following findings of fact and conclusions of law:

Findings of Fact:

1. The Department's *prima facie* case for tax and late payment penalty, inclusive of all jurisdictional elements, was established by the admission into evidence of the Audit Correction and/or Determination of Tax Due, showing a tax liability of \$6407, with a late payment penalty of \$1142 for the tax period of July, 1997 through June 30, 1998. Department Ex. No. 1
The Department's Audit Correction and/or Determination of Tax Due also provides for a fraud penalty of \$3204. Id.
2. During the tax period, taxpayer made sales as a retailer, in Chicago, Illinois. Department Ex. No. 1, 3 (felony and misdemeanor complaints against ABC Corporation (felony) and John Doe (misdemeanor))
3. The Department issued the NTL herein on November 28, 2001, assessing base tax, a fraud penalty and interest to date of issuance. Tr. p. 23; Department Ex. No. 2
4. The Department's Bureau of Criminal Investigations (BCI") investigated taxpayer for periods including the tax period. Tr. pp. 33-50 (testimony of Special Agent Gregory Costa); Department Ex. No. 5 (Investigative Report Summary)

5. BCI determined that during the tax period, taxpayer's purchases from its suppliers of liquor, beer and cigarettes exceeded its reported sales by 40%-50%. Tr. pp.37, 39-40
6. The BCI investigation concluded on or about August 3, 2000 (Tr. p. 42), and there was no referral for a civil audit until after that date. Tr. p. 43
7. A two count criminal complaint was filed against this corporate taxpayer (felony count) and against the president of this corporation (misdemeanor) for the period August 20, 1997 through January 20, 2000. Tr. pp. 53, 55, 58 (testimony of Assistant Attorney General James Rustik); Department Ex. No. 3
8. The corporation, through its President, John Doe, pled guilty to one count of filing a fraudulent sales and use tax return for the period of August 1997 through January 2000. Department Ex. No. 3 an Order of Sentence of Probation was entered against the corporation on May 18, 2001 that included the following language: "Defendant understands nothing in this order prohibits the Illinois Department of Revenue from proceeding civilly to recover an additional tax, penalty or interest." Id. On that same date, an Order of Supervision/Conditional Discharge was entered against taxpayer's president, Doe, that included the same language. Id.

Conclusions of Law:

The NTL in this matter was issued by the Department on November 28, 2001 and assessed tax and a fraud penalty for the period July 1997 through June 1998. The

Retailers' Occupation Tax Act, 35 ILCS 120/1 *et seq.*, (“ROT”, “ROTA” or “act”) directs the Department to correct a taxpayer’s returns assessing additional tax (id. at 120/4), however, it mandates that “[n]o such notice of additional tax due shall be issued on and after each July 1 and January 1 covering gross receipts received during any month or period of time more than 3 years prior to such July 1 and January 1.” Id.

This taxpayer argues that the NTL was issued beyond this limitations period, and, therefore, must be dismissed. If the cited provision represented the sole limitations parameter within which the Department could issue its assessment for these taxes, the taxpayer’s position would triumph. However, the same statutory provision provides an exception to the 3-year limitations period. Specifically, the law provides, in pertinent part:

Except in case of a fraudulent return, or in the case of an amended return (where a notice of tax liability may be issued on or after each January 1 and July 1 for an amended return filed not more than 3 years prior to such January 1 or July 1, respectively), no notice of tax liability shall be issued on and after each January 1 and July 1 covering gross receipts received during any month or period of time more than 3 years prior to such January 1 and July 1, respectively. (emphasis added)

Id.

Thus, the legislature provides for an extension of the 3-year limitations period within which the Department may issue a NTL when fraud exists in the filing of the tax return(s). The Department argues that the taxpayer committed fraud when it filed its returns for the tax period, and, therefore, the NTL does not exceed any statutory limitations period. I conclude that the Department’s position is the legally sustainable one.

In order to sustain the fraud penalty, the Department must prove fraud with clear and convincing evidence. Puleo v. Department of Revenue, 117 Ill. App.3d 260 (4th Dist. 1983); Brown Specialty Co. v. Allphin, 75 Ill. App.3d 845 (3rd Dist. 1979) “Proof of fraud requires proof of the element of intent”, and “intent may be shown by circumstantial evidence.” Vitale v. Illinois Department of Revenue, 118 Ill. App.3d 210, 213 (3rd Dist. 1983)

In this case, the evidence provides, and the taxpayer does not disagree, that the taxpayer pled guilty to one felony count of filing fraudulent tax returns for the period August, 1997 through January, 2000, and its president pled guilty to one misdemeanor count of filing, as the corporation’s agent, fraudulent returns for the same period. Further, when the Department’s agent requested books and records from the taxpayer during his investigation for the tax period, the only documents received were some purchase invoices (Department Ex. No. 5, exhibit 10 (evidence inventory and receipt)). The investigator obtained bank statements pursuant to a subpoena duces tecum he caused to be issued (Department Ex. No. 5, exhibit 19 (corporate bank statements)), and he obtained information from several of taxpayer’s suppliers, also pursuant to subpoena duces tecum. Department Ex. No. 5, exhibit 5 (records of Dearborn Wholesalers, Skokie Valley, Judge & Dolph, River North Distributing, Union Liquors, Chicago Beverage, Central Distributing, Romano Bros., Courtesy Distributors, Inc. and Genova Trading Inc.) Nor did the taxpayer present any evidence¹ challenging the BCI determination,

¹ Taxpayer appeared through its legal counsel. The only witnesses called by the taxpayer were James Rustik, the Assistant Attorney General who prosecuted the criminal matters on the Department’s behalf, and Michael Krol, a Department revenue auditor who conducted an audit of the taxpayer for a period subsequent to the one at issue. Taxpayer’s counsel did conduct extensive cross-examination of the Department’s witnesses, James Barborka and Gregory Costas.

based upon the information received, that taxpayer underreported its taxable receipts for the tax period by 40%-50%.

These facts are not dissimilar to those in Puelo v. Department of Revenue, *supra*, wherein the appellate court upheld the Department's fraud penalty assessment. In that case, taxpayer consistently underreported receipts throughout the tax period, and maintained no books and records to support its ROT filings. Additionally, that taxpayer, as in this case, pled guilty to filing fraudulent ROT returns for some months within the tax assessment period. *Id.* at 265 As a result of the undisputed evidence of record and supporting case law, I conclude that the Department has proven that taxpayer fraudulently filed its ROT returns for the tax period.

Because the ROT returns for the tax period were fraudulently filed, the Department is not bound by the 3-year statute of limitations within which it must issue an NTL to taxpayer. Nor can I find any legal support for taxpayer's position that the majority of the months at issue in the criminal proceedings were also outside of a limitations period, and that this fact is fatal to the NTL. If that were the case, taxpayer's remedy was to have pled to the criminal court for a dismissal of those charges. That did not occur. Therefore, the Department's NTL was timely and the fraud penalty properly applied.

Once I determined that the civil assessment at issue was issued timely, it is left to determine whether the \$6407 base tax assessment is correct. Pursuant to the provisions of the ROTA, the introduction into evidence of the correction of returns prepared by the Department is deemed to be *prima facie* correct and *prima facie* evidence of the correctness of the amount of tax shown to be due therein. 35 ILCS 120/4; Fillichio v.

Department of Revenue, 15 Ill.2d 327 (1958) “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.” Copilevitz v. Department of Revenue, 41 Ill.2d 154 (1968); Central Furniture Mart, Inc. v. Johnson, 157 Ill. App.3d 907 (1st Dist. 1987); Masini v. Department of Revenue, 60 Ill. App.3d 11 (1st Dist. 1978) Taxpayer does not overcome the Department’s *prima facie* case by questioning the Department’s correction or returns or merely denying the accuracy of the assessment. Central Furniture Mart, Inc. v. Johnson, *supra* Further, oral testimony is not sufficient to overcome the correctness of the Department’s determinations. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App.3d 826 (1st Dist. 1988)

In this matter, taxpayer presented no evidence regarding the correctness of this civil assessment, that is \$6407 for tax, \$3204 as a fraud penalty and statutory interest.² Rather, there appears to be a disagreement as to whether the tax portion of the assessment at issue was paid with taxpayer’s payment to the Department of \$19,573.76 at the conclusion of the criminal matters. At hearing, Department auditor, Krol, testified regarding his audit of taxpayer for the period subsequent to the one herein. Tr. pp. 68-80. His uncontroverted testimony establishes that taxpayer agreed to his audit results of base

² The Notice of Tax Liability, issued on November 28, 2001, does not assess a late payment penalty. The Correction of Returns entered as Department Exhibit No. 1, was completed on October 11, 2001. Taxpayer protested the NTL, thus, there was no late payment penalty assessment to protest, nor was a late payment penalty raised as an issue in the pre-hearing order. The Uniform Penalty and Interest Act, 35 **ILCS** 735/3-1 *et seq.*, provides for the assessment of a late payment penalty in matters wherein the Department assesses additional taxes due (*id.* at 735/3-3 (b)(2)), however, that penalty does not apply in this protested matter until 30 days after a final assessment is issued by the Department and the time for a court review of the Department’s final assessment has passed. *Id.*

tax liability of \$23,442.³ Tr. p. 75 He further testified that in satisfaction of the liability he determined, the payment that taxpayer made in the criminal matter was applied and the taxpayer tendered a check to him for the remainder of the tax portion of the liability. Id. Therefore, based upon this testimony, whereas taxpayer went far to satisfy the base tax liability for a subsequent audit period, no payment has been made toward the instant assessment.

This testimony is illustrated by the Department's Account Summary for Sales Tax issued on January 6, 2002 and February 3, 2002. Department Ex. No.4 These documents indicate that originally, of the \$19,573.76 tendered by the taxpayer at the close of the criminal proceedings, \$6407.13 was applied to the instant tax liability, and \$13,166.63 was applied to the Krol audit, thus accounting for the \$19,573.76 in total. Id. (January 6 Account Summary) However, the February Account Summary indicates that an adjustment was made to taxpayer's account, whereby the \$6407 previously applied to the instant audit was applied, instead, to the subsequent audit assessment, thereby satisfying the base tax due thereon and further reducing the remaining total liability on that assessment. Consequently, with the removal of the \$6407 payment from the instant assessment, the liability of tax, penalty and interest herein remains fully due.

WHEREFORE, it is recommended that the Department's Notice of Tax Liability No. 0000000000000000 be finalized, as issued, with statutory interest to apply.

9/23/02

Mimi Brin
Administrative Law Judge

³ He testified that his audit resulted in a total liability of "some \$40,000" with \$23,442 being for "base tax". Tr. p. 75 This corresponds to Department assessment 0000000000000000 for the period of July 1998 through November 2000. Department Ex. No. 4 (Account Summary for Sales Tax, January 6, 2002 and February 3, 2002); Tr. 76 (Krol's testimony that his audit did not go "past December 2000")