

ST 97-5
Tax Type: SALES TAX
Issue: Unreported/Underreported Receipts (Fraud)

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

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	No.
)	IBT No.
v.)	NTL No.
)	NTL No.
TAXPAYER,)	Charles E. McClellan
Taxpayer)	Administrative Law Judge
)	

RECOMMENDATION FOR DISPOSITION

APPEARANCES: Mr. Mark Dyckman, Special Assistant Attorney General, for the Department of Revenue; Mr. Akram K. Zanayed for TAXPAYER.

Synopsis:

This matter comes on for hearing pursuant to the taxpayer's timely protest of Notices of Tax Liability (NTL) issued to TAXPAYER by the Department of Revenue dated February 28, 1995 for Retailers' Occupation Tax ("ROT") and Use Tax. These Notices of Tax Liability are numbered as follows: XXXXX and XXXXX. The issues are:

1. Whether the taxpayer met its burden of showing that the Department's calculation of the tax liability for the periods May 1, 1988 through September 30, 1990, based on unreported and underreported gross receipts is incorrect;

2. If the taxpayer failed in its burden, whether the under-reporting of gross receipts from sales during the audit period as determined by the Department was due to fraud;

3. If the Department's assessment of fraud penalty is unsupported by fact or law, whether the Statute of limitations bars the Department's assessment of tax liability;

4. Whether the Department properly credited the restitution payments made by taxpayer;

5. Whether TAXPAYER was the proper taxpayer for the audit periods May 1, 1988 through September 30, 1990.

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 on all issues.

Findings of Fact:

1. The Department's *prima facie* case against TAXPAYER, including all jurisdictional elements, was established by the admission into evidence of the Correction of Returns, showing tax due of \$9,158 penalty of \$2,748 plus statutory interest for the audit periods May 1, 1988 through September 30, 1990. (Tr. p. 6; Dept. Grp. Ex. No. 1).

2. Included in the assessments were fraud penalties assessed under 35 ILCS § 120/4. (Tr. pp. 8, 9; Dept. Grp. Exs. No. 1).

3. TAXPAYER was in the business of selling used automobiles as a sole proprietor under the name TAXPAYER¹. (Tr. p. 30; Dept. Grp. Ex. No. 3).

4. An audit of taxpayer's books and records was conducted jointly with the Department's Bureau of Criminal Investigations ("BCI") for the periods set forth above. (Tr. p. 17; Dept. Grp. Ex. No. 3) .

5. The auditor examined certified copies of Illinois Department of Revenue Forms RR-556 (automobile dealers' Retail Occupation Tax transaction reporting forms), the reports of interviews conducted by the BCI investigator with customers of the taxpayer, and a schedule that the BCI investigator prepared from the taxpayer's "deal jackets" (records of taxpayer's used car sales)². (Tr. p. 18, 76).

¹. TAXPAYER and TAXPAYER are hereinafter collectively referred to as "taxpayer."

². The Department's auditor refers to the taxpayer's "general ledger" several times (Tr. pp. 18, 19, 20, 58-61). The taxpayer, however testified that he had no general ledger. (Tr. p. 66). It is apparent from later testimony of Sam Rossi, the Department's BCI investigator (Tr. p. 68), and the auditor (Tr. pp.

6. The auditor compared sales recorded in taxpayer's records with sales reported to the Department on the RR-556 forms and the sales reported in the interview reports and determined that the ratio of unrecorded sales was 59.655%. (Tr. p. 20, 61; Dept. Grp. Ex. No. 3)

7. The auditor computed deficiencies by subtracting the amounts reported on RR-556 returns from amounts recorded in the months in which RR-556 returns were filed. (Tr. p. 20).

8. The auditor computed delinquencies on sales for months in which no RR-556 forms were filed. (Tr. p. 20).

9. As a result of the audit Mr. TAXPAYER was convicted of a felony for filing fraudulent sales tax returns and was ordered to make restitution to the Department of Revenue in the amount of \$14,283.19. (Tr. p. 34; Dept. Grp. Ex. No. 2).

10. Taxpayer sold cars during the entire audit period. (Tr. pp. 31-39).

11. The bills of sale for taxpayer's car sales and the related Forms RR-556 were often inconsistent, reflecting different selling prices. (Dept. Grp. Ex. No. 3).

12. Taxpayer did not give his customers copies of the RR-556 returns reporting their purchases. (Dept. Grp. Ex. No. 3).

13. In some cases, taxpayer collected more tax from customers than he reported and paid to the Department, and, in some cases, he failed to report the transactions at all. (Dept. Grp. Ex. No. 3).

14. Taxpayer sold some cars for higher amounts than were recorded in its records. (Dept. Grp. Ex. No. 3).

Conclusions of Law:

75, 76) that the auditor thought a schedule later admitted into evidence as taxpayer's exhibit no. 61 (Tr. p. 63) was prepared from the general ledger. In fact, this schedule was prepared by Mr. Rossi from taxpayer's deal jackets (Tr. p. 68) and taking all of this testimony in context, it is apparent that this schedule was the basis of the auditor's testimony when he used the term "general ledger."

The record in this case, shows that this taxpayer has failed to demonstrate by the presentation of testimony or through exhibits or argument, evidence sufficient to overcome the Department's *prima facie* case of tax liability under the assessments in question. Accordingly, by such failure, and under the reasoning given below, the determination by the Department that TAXPAYER d/b/a TAXPAYER owes the assessments shown on the Corrections of Return must stand as a matter of law. In support thereof, the following conclusions are made:

ISSUE # 1

The first issue to be decided is whether the taxpayer met its burden of proving that the Department's calculation of the tax liability based on unreported and underreported gross receipts was incorrect. That depends, initially on whether the Department met a minimal standard of reasonableness in making its determination of additional tax due for the periods May 1, 1988 through September 30, 1990. When a taxpayer fails to supply the Department with records to substantiate its gross receipts, the Department is justified in using the markup method to estimate the taxpayer's gross receipts, and, in doing so, the Department is required only to meet a minimum standard of reasonableness. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203 (1st Dist. 1991). In this case, the Department's auditor found the taxpayer's records to be unreliable. Therefore, he resorted to the markup method by marking up the taxpayer's recorded sales by the percentage of unrecorded sales determined by interviewing the taxpayer's customers. To determine unreported sales, he reduced the total amount calculated in the preceding step by the sales reported by the taxpayer on the Forms RR-556. Since the Forms RR-556 filed by the taxpayer were so unreliable as to sales, he also disallowed the trade-in information which could not be confirmed as true. (Dept. Grp. Ex. No. 3). The only records available to the Department's auditor were the deal jackets and the BCI customer interview reports. Because of the lack of any other credible books and records the Department's auditor was justified in using these records to

calculate the taxpayer's gross receipts during the audit periods. Accordingly, the markup method applied by the auditor to the available records satisfied the requirement to meet a minimum standard of reasonableness.

At the hearing in this case, the Department introduced into evidence the Department's correction of return documents (Dept. Grp. Ex. No. 1) and a memorandum prepared by the auditor explaining how he determined taxpayer's gross receipts during the audit periods. (Dept. Grp. Ex. No. 3). These documents, coupled with the uncontroverted testimony of the Department's auditor, show that the Department's determination was not arbitrary or unreasonable, but rather was based on reasonable statistical assumptions. The Department's technique was made necessary because the taxpayer's records were patently unreliable. See Vitale v. Department of Revenue, 118 Ill.App.3d 210 (3d Dist. 1983). 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 (1st Dist. 1987). Therefore, when the Department introduced the corrected returns, 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 v. Johnson, *supra*. Simply questioning the Department's assessment or denying its accuracy is not enough. Quincy Trading Post v. Dept of Revenue, 12 Ill App.3d 725 (4th Dist. 1973). A taxpayer can overcome the Department's *prima facie* case by producing competent evidence identified with the taxpayer's books and records. Vitale, *supra*, at 213. In this case the taxpayer presented no documentary evidence whatsoever to show that the Department's determination was arbitrary, capricious or unreasonable. To the contrary, taxpayer's exhibits numbered 2 through 58, which are copies of the taxpayer's RR-556 forms, demonstrate the unreliability of taxpayer's record keeping. The sales amounts shown thereon do not agree with those recorded in the taxpayer's sales records in many cases (Dept. Grp. Ex. No. 3) and a number of the forms bear no seller's

signature. Absent any competent documentary evidence to controvert the Department's *prima facie* case, the Department's determination as reflected in the Corrections of Returns must be sustained.

ISSUE # 2

The second issue to be decided is whether the under-reporting of sales determined by the Department was due to fraud. Where civil fraud under Section 4 of the Retailers' Occupation Tax Act (35 ILCS § 120/4) is alleged, the Department must show intent. Intent for this purpose can be shown by circumstantial evidence. Vitale, *supra* at 213. In the Vitale case, *supra*, the court found the necessary intent from a number of facts, including the following: the taxpayer had understated his gross receipts by as much as 200%; in one year the taxpayer's purchases exceeded his sales by 46%; finally, the taxpayer failed to maintain business records. Vitale, *supra* at 213.

In this case there are a number of factors that show the taxpayer's fraudulent intent. The sales recorded in the taxpayer's records were understated by 59%. (Tr. p. 61; Dept. Grp. Ex. No. 3). In some cases the taxpayer sold cars for higher amounts than were recorded in its records. (Dept. Grp. Ex. No. 3). The bills of sale for taxpayer's car sales were often inconsistent with the amounts reported on the RR-556 forms. (Dept. Grp. Ex. No. 3). In some cases, taxpayer collected more tax from customers than he paid to the Department, and, in some cases, he failed to report the transactions. (Dept. Grp. Ex. No. 3). The taxpayer maintained no books and records other than the police book, which only records the identities of the taxpayer's sources and customers, and the deal jackets. (Tr. p. 66, 68). This pattern prevailed throughout the audit period and clearly shows taxpayer's intent to defraud. Finally, the taxpayer was convicted of a felony for filing a fraudulent tax return and ordered to pay over \$14,000 in restitution. (Dept. Grp. Ex. No. 2). These factors constitute clear and convincing circumstantial evidence of intent to commit fraud. Therefore, the Department's assessment of fraud penalties must be sustained.

ISSUE # 3

The third issue is whether the Department is barred by the statute of limitations from assessing tax liability. Since the Department's assessment of fraud penalties is supported by clear and convincing evidence of fraud, the Department is not barred by the statute of limitations from assessing tax for the audit periods. (35 ILCS 120/4).

ISSUE # 4

The fourth issue is whether the Department properly credited the restitution payments paid by the taxpayer. The Department's Group Exhibit No. 2 shows that the taxpayer was ordered to pay restitution, and it also states that nothing in the order precludes the Department from collecting additional amounts due. Restitution is mentioned in the hearing transcript several times (Tr. pp. 11, 12, 28, 89), but no documentary evidence was introduced to prove that the taxpayer ever paid the restitution ordered or, if paid, that the payment was applied to this taxpayer. The order of probation (Dept. Grp. Ex. No. 2) states that the taxpayer in this case also operated another enterprise by the name of ENTERPRISE and that he was convicted of defrauding the Department in that operation as well as this one, *i.e.*, TAXPAYER. If payment was made, it might have been credited to the account of ENTERPRISE not the account of TAXPAYER. In any case, the Department's records for this taxpayer do not reflect any restitution payment. As noted previously, the taxpayer's testimony alone does not overcome the presumption of correctness of the Department's *prima facie* case. Vitale, *supra*. Therefore, lacking any evidence of payment in the record, the question of whether it was properly credited must be decided in favor of the Department.

ISSUE # 5

The final issue is whether TAXPAYER was the proper taxpayer for the audit periods May 1, 1988 through September 30, 1990. Mr. TAXPAYER testified that he applied for his license in December of 1987. (Tr. p. 30). Taxpayer's counsel stipulated and later admitted that the evidence in the record proved that his

client owned the business from at least May of 1988 until June of 1989. (Tr. pp. 37, 82). The taxpayer testified that he sold the business in June of 1989 for cash. However, he introduced no documentary evidence in support of that allegation. (Tr. pp. 30, 36). The RR-556 forms which the taxpayer introduced as exhibits 2 through 58 were filed at various times throughout the audit period and all of them are filed under the taxpayer's name and registration (IBT) number. Taxpayer admitted signing RR-556 forms reporting automobile sales under his name and IBT number after June of 1989, even into October 1990 which is after the audit period. (Tr. pp. 38, 44-52). The fact that taxpayer did not sign all of them, that some other person signed some of them as seller, and the fact that some are not signed at all does not change the fact that these sales were reported by or for the taxpayer as his sales. Since he is the sole proprietor of this business, his denial that the sales are not his is not credible. Mr. TAXPAYER was the proper taxpayer for the audit period.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's assessment, including the assessment of fraud penalties, be upheld in full.

Date

Charles E. McClellan
Administrative Law Judge