

**ILLINOIS INDEPENDENT
TAX TRIBUNAL**

PEPPERIDGE FARM INCORPORATED,)	
Petitioner,)	
)
v.)	14 TT 139
)
	Chief Judge James M. Conway
ILLINOIS DEPARTMENT)	
OF REVENUE,)	
Respondent.)	

ORDER ON MOTION TO COMPEL PRODUCTION OF DOCUMENTS

Pepperidge Farm has filed a motion seeking to compel the Department to disclose two sets of documents in discovery pursuant to Illinois Supreme Court Rule 214 and 86 Ill. Adm. Code § 5000.315. Pepperidge Farm is requesting that the Department turn over 1) its income tax audit manual and 2) all documents relating to the proceedings between the two parties before the Department’s Informal Conference Board.

Pepperidge Farm argues that it is entitled to the audit manual as it likely contains information used by the auditor, it likely contains information related to the determinations of the auditor, and because it contains information that could lead to the discovery of relevant information. The Department counters that the audit manual does not contain any facts specific to Pepperidge Farm, the audit manual has no authoritative value, and disclosure of the audit manual would violate public policy.

Pepperidge Farm also contends that it should be provided all documents relating to its proceedings before the Informal Conference Board as those documents are under the control of the Department. The Department opposes that request by stating the Department attorneys on this case do not have access to those files and that ICB files are not subject to disclosure.

1. The Income Tax Audit Manual

The Illinois Department of Revenue, like the Internal Revenue Service and some other states' taxing agencies, provides internal guidance to its auditors on how to conduct audits and how to address certain audit issues in the form of written audit manuals. Unlike the Internal Revenue Service and some other states' taxing agencies, the Illinois Department of Revenue refuses to make its audit manual available to the public. Pepperidge Farm states in its motion that the Director of the Department has announced that the Department will release a copy of its audit manual at some point in the future. Publishing the audit manual will promote transparency as well as confidence in the audit process. Nevertheless, the determination to release internal agency audit protocols and procedures is one for the agency to make, not the Tribunal, unless an argument can be made in a specific case as to why such disclosure is necessary and appropriate for that case.

While audit manuals provide guidance and techniques to auditors, audit manuals provide no legal rights, remedies, or recourse to a taxpayer.¹ Pepperidge Farm has not provided any case law that says otherwise. Whether an auditor is in 100% compliance with any suggested audit protocol or guidance is irrelevant as to whether a taxpayer or the Department will prevail in a particular case before this Tribunal.² The Tribunal is tasked with making its own determination of issues raised before it after a taxpayer and the Department both have presented the underlying facts and the applicable case law relating to those issues to the Tribunal.

It is irrelevant whether an auditor in a case did exactly what an audit manual suggested. Assume that an audit manual encourages or even directs an auditor to take ten different actions before he or she can propose a particular issue at the conclusion of an audit. What if that auditor takes only nine steps? What if the auditor adds an additional step? Who says the Department was even right in concluding that ten steps are adequate to develop the issue? What if ten steps are overkill? None of that matters for a subsequent determination of that issue at the Tribunal. What does matter are the underlying facts and law that are developed and presented to the Tribunal.

The Department claims that disclosure of the audit manual would violate public policy. The Department's sole point in its argument is that taxpayers, armed

¹ See *U.S. v. Caceres*, 440 U.S. 741 (1979) (collection of evidence in violation of the IRS manual held not to be excludable).

² Of course, the facts used by an auditor and the conclusion drawn from such facts which lead to an audit adjustment are fair game through discovery, and can be used at a deposition of the auditor, and at any latter hearing if the auditor is called to testify.

with the now-withheld information contained in the audit manual, would use that information to “avoid Illinois’ tax laws and regulations.” Dep’t Resp. at 3. That argument is rejected. Legitimate tax avoidance, as opposed to abusive, artificial, and non-economic schemes or tax evasion, consists of a taxpayer organizing events and transactions to minimize taxes. That is entirely appropriate. Moreover, the Department does not provide any support for its public policy argument. If some wide-scale abuse had occurred following the disclosure of audit manuals on the federal or state level, surely a taxing agency would have withdrawn its manual from public view. The Tribunal is unaware of any such instance and finds the Department’s fear of disclosure to be unwarranted. The opposite of the Department’s position is more likely true. Taxpayers, armed with the knowledge that an audit manual would provide, could insure that their business and personal transactions were appropriately structured in order to pass any audit scrutiny. That would prevent taxpayers from needlessly falling into some audit trap that could otherwise be avoided.

Pepperidge Farm’s request for the audit manual has to be viewed without regard to the overall disclosure policy arguments advanced by either side. The question for the Tribunal is does the Department’s audit manual provide any relevant information particular to Pepperidge Farm that will be helpful to Pepperidge Farm in the present case? The answer is “No.” There will be nothing in the manual that Pepperidge Farm could argue to the Tribunal in support of any position it takes. In its response, the Department frames the ultimate issue in this case to be whether Pepperidge Farm’s conduct in Illinois vis-à-vis its unitary group’s employees and those of its affiliates during the audit period in question is to be afforded the safe harbor protection under Public Law 86-272. The relevant facts to be presented to the Tribunal will be the conduct of those individuals which will be used to determine what activities did or did not take place by them in Illinois. Those facts need to be proven and independently embraced or rejected by either side in their marshalling of the relevant facts and presentation of relevant case law to the Tribunal. Whether or not the auditor “got it right” through the lens of the Department’s internal view of how to conduct such an audit and what factors explicitly found in the audit manual that the Department believes determinative of the overall issue is of no moment.

Accordingly, Pepperidge Farm’s request for access to the Department’s audit manual is denied.

2. Informal Conference Board Documents

When an Illinois Department of Revenue auditor proposes a tax adjustment to a taxpayer, the taxpayer can take advantage of the Department's Informal Conference Board in order to have the proposed adjustment reviewed, and perhaps overturned or reduced, prior to being issued a Notice of Tax Liability, a Notice of Deficiency, or a Notice of Claim Denial. 86 Ill Adm. Code § 215.100, *et seq.* The ICB affords taxpayers an avenue to come to some resolution with the Department on audit issues before they are faced with protesting adverse audit results through more formal means, including proceeding before the Tax Tribunal. The informal review of audit issues provides a forum that provides taxpayers an opportunity to save time and money in resolving audit disputes.

Seeking redress before the ICB is voluntary. Taxpayers do not have to choose that route in attempting to resolve audit issues. When a taxpayer decides to proceed before the ICB, it has to abide by its rules. The Department's website contains two forms to be utilized by taxpayers who use the ICB process. The forms are the ICB-1 (Request for Informal Conference Board Review) and the ICB-2 (Offer of Disposition of a Proposed Assessment or Claim Denial). Both forms contain their own instructions and both forms refer the reader to the Department's regulation concerning the ICB found at 86 Ill. Adm. Code Part 215.

Pursuant to 86 Ill. Adm. Code § 215.120(e), "Recommendations, notes, memoranda, and other records of the ICB with respect to issues raised in pending ICB matters are not subject to disclosure and do not become part of the audit file."

86 Ill. Adm. Code §215.120(c) reads, in part:

Documentation or information submitted to the ICB does not become part of any formal record and cannot be forwarded to any other agency or judicial body for purpose of that body making a determination on the merits of any case. Both the taxpayer and the Department must present all evidence directly to those judicial bodies in accordance with the rules of those bodies if they wish the evidence to be considered.

As further protection to make sure that taxpayers can trust that proceeding informally will not be detrimental based on positions advanced by them if they eventually decide to litigate an audit issue more formally, the ICB is maintained separate and apart at the Department from the Audit Bureau, the Office of

Administrative Affairs, the Board of Appeals and the Office of Legal Services. 86 Ill. Adm. Code § 215.120(e). Furthermore, no member of the ICB can partake in later involvement in the case. *Id.* Therefore, the ICB operates much like mediation where parties can explore a resolution to their case while being able to walk away from that informal process without anything being held against them in a future formal proceeding.

Pepperidge Farm has requested all documents relating to its ICB proceeding.³ It already knows what documents it provided during the proceeding and it would have received documents during the proceeding provided by the Department, if any, such as copies of original business documents that gave rise to or provides support for the issues debated before the ICB. What Pepperidge Farm is seeking in its current motion are the internal notes, memoranda or other written documentation created by the ICB members who reviewed Pepperidge Farm's case. 86 Ill. Adm. Code § 215.120(e) specifically exempts the internal work product of the ICB from being discoverable. The Department is free to set the ground rules when it provides a process that is voluntary, not mandatory, for taxpayers and that's what it did through that regulation. Turning over internal material from the ICB to Pepperidge Farm would effectively void that regulation, something the Tribunal will not do in this case.

Moreover, even without a regulation prohibiting disclosure of the internal workings of the ICB, that information would not be discoverable to Pepperidge Farm. Whether or not a member of the ICB thought Pepperidge Farm had the better argument than the Department or whether the member thought Pepperidge Farm was on the losing end on an audit issue, the reasons for and against, which may have been memorialized in some written document, are irrelevant to an independent review of an audit issue by the Tax Tribunal. What is relevant is the fact-gathering conducted by and the formal evidentiary presentation made to the Tribunal by both parties. Because there is no relevant information to be gleaned from the ICB, the request by Pepperidge Farm for its records must be denied.

³ Other than citing to several cases that discuss discovery in general terms, Pepperidge Farm has not provided any case law that specifically supports its position that ICB material should be turned over to a taxpayer.

Conclusion

Because any Department audit manual would not provide any particular information that would be relevant to the issues in the present case, Pepperidge Farm's request for an audit manual is DENIED.

Because the work product of the ICB is protected from disclosure by regulation and because that information would not be relevant to the current proceedings before the Tribunal, Pepperidge Farm's request for ICB documents is DENIED.

s/ James Conway
JAMES M. CONWAY
Chief Administrative
Law Judge

Date: January 8, 2016