

ORIGINAL

ILLINOIS INDEPENDENT TAX TRIBUNAL

MCGRATH IMPORTS, INC. )
Petitioner, )
v. )
ILLINOIS DEPARTMENT )
OF REVENUE, )
Respondent. )

RECEIVED
JUL 05 2016
BY: \_\_\_\_\_

Case No. 16TT133

PETITION

The Petitioner, McGrath Imports, Inc. ("McGrath" or "Petitioner"), hereby petitions the Illinois Independent Tax Tribunal to dismiss two Notices of Tax Liability issued by the Illinois Department of Revenue ("Department"), as more fully stated below:

STATEMENT OF JURISDICTION

- 1. McGrath brings this petition pursuant to the Illinois Independent Tax Tribunal Act of 2012. 35 ILCS 1010 et seq.
2. This Tribunal has jurisdiction because this matter involves two Notices of Tax Liability issued by the Department on May 9, 2016 with respect to tax alleged to be due in each Notice of Tax Liability in excess of \$15,000, exclusive of interest. 35 ILCS 1010/1-45.

INTRODUCTION

3. Petitioner owns and operates two auto dealers franchises under the names Audi Morton Grove and McGrath Acura of Morton Grove. Its operations include the sale of new and used vehicles, retail parts, and a service department. As explained in detail below, Petitioner was audited by the Illinois Department of Revenue and disputes multiple findings contained in the

Notices of Tax Liability (described below) that were issued upon conclusion of the Department's audit (the "Audit"). In support of its position, Petitioner will provide information that was either not readily available at the time of the audit or was misinterpreted by the Audit Division.

**BACKGROUND, PROCEDURAL HISTORY AND RELEVANT FACTS**

4. Petitioner is an Illinois corporation, whose corporate address is 9105 Waukegan Road, Morton Grove, IL 60053. Petitioner's Taxpayer ID number is 1864-7898. Petitioner's telephone number is (847) 470-2300.

5. On May 9, 2016, the Department issued to McGrath a statutory Notice of Tax Liability, Letter ID: CNXXXXX566421923, for Form EDA-556, Sales Tax Transaction Audit Report, in the amount of \$1,092,338.66 for the reporting period of October 1, 2006 through June 30, 2009 (the "Amnesty Period Assessment"). A copy of this assessment is attached as Exhibit A.

6. The Amnesty Period Assessment was comprised of \$559,063.00 in Tax; \$223,625.00 in Late Payment Penalty; and \$309,650.66 in Interest.

7. On May 9, 2016, the Department also issued to McGrath a second statutory Notice of Tax Liability, Letter ID: CNXXX1856X626X80, for Form EDA-556, Sales Tax Transaction Audit Report in the amount of \$333,203.92 for the reporting period of July 1, 2009 through December 31, 2010 (the "Post-Amnesty Period Assessment"). A copy of this assessment is attached as Exhibit B.

8. The Post-Amnesty Period Assessment was comprised of \$244,047.00 in Tax; \$48,810.00 in Late Payment Penalty; and \$40,346.92 in Interest

9. The Amnesty Period Assessment and the Post-Amnesty Period Assessment shall be referred to collectively herein as the "Assessment."

10. Petitioner disputes numerous aspects of the alleged taxable portion of the Assessment based on items erroneously included (both factually and legally) on the respective Global Taxable Exceptions Reports as taxable items. In addition, Petitioner disputes the applicability of the double penalty and double interest imposed in the Amnesty Period Assessment as more fully explained below.

11. Petitioner timely petitioned the Informal Conference Board (“ICB”), a Hearing was held with the Conferees, and on March 22, 2016, ICB issued an Action Decision granting in part and denying in part, Petitioner’s request for Audit Adjustments (the “Action Decision”). The Action Decision however lacked specificity and merely provided, “Audit is to finalize this case using the figures as revised during the Informal Conference Board process.” Further, “The Audit Bureau is instructed to conclude and process the audit in a manner consistent with this decision.”

12. Taxpayer never received a copy of the ICB’s aforementioned instructions to the Audit Bureau, and thus has only been able to surmise such changes to the Department’s Audit Report.

### **ERROR 1 – IMPROPER SAMPLING METHOD OF TRADE-INS**

13. The Department did not employ a proper sampling methodology with respect to traded-in vehicles and thus, this sampling cannot be entitled to any presumption of correctness. The auditor used a methodology of reviewing the “top 200 deals” for Honda lease trade-ins (associated with the Acura dealership), top 200 VW lease trade-ins (associated with the Audi dealership) and top 200 non-lease trade-ins spanning both dealerships. The “top 200” referred to the 200 deals with the *largest* trade-in deductions for each respective population.

14. Unlike statistical sampling (for which the representativeness of the sample can be calculated) or block sampling (where the selected period presumably contains a representative array of transactions that are similar to the transactions in the other reporting periods within the audit period), the “top 200” methodology does *not* and cannot provide any assurance that the transactions sampled were *representative* of the entire population. In fact, it is *more likely* that this *sample will not be representative* of the entire population because the deals with higher trade-ins are a larger dollar amount of proposed errors, and such transactions more likely to contain errors than the lower trade value transactions. This is borne out by the auditor’s findings. The larger trade-in deductions are far more likely to have multiple trade-ins, application of advance trade credits, combinations of advance trade credits and third party trade credits, which, if found to be in error, would have had a much larger effect on the error rate than a randomized sample of invoices. Thus, the “Top 200” transactions reviewed are qualitatively different from the clear majority of the transactions in the population and do *not* provide any type of reliable basis as a representative sample to project across the population. In addition, any missing documentation such as missing trade titles or drive away permits would produce an outsized result based on the sampling methodology.

15. Notably, this sampling methodology is different than that used in a prior audit of the Petitioner. In the prior audit of the Petitioner, the Department used a combination of random and statistical sampling of smaller transactions and a detailed, non-projected sample of the largest transactions. Further, for the audit of the subsequent period initiated by the same auditor, a combination of random sampling and detailed analysis of the largest transactions is being used again rather than the suspect “Top 200” methodology used in this Audit currently being protested. To illustrate, the average trade-in deduction for the Top 200 samples used were

\$44,708 (Honda Top 200/Acura store), \$43,329 (VW Top 200/Audi store) and \$39,586 (Top 200 non-lease trades, both stores). These figures compare with an average trade-in deduction across all trades of \$24,406. Almost 84% of the trade in deductions for the Audit Period were less than \$20,000.

16. The Auditor did not use a standard, reliable projection method to accurately project potential errors in the sample, and such method deviated from prior and subsequent methodologies used by the same Auditor.

17. Consequently, this sampling method must be deemed *void and invalid* and the Department cannot be entitled to any presumption of correctness.

#### **ERROR 2 – IMPROPER DENIAL OF CERTAIN TRADE-INS**

18. The Department challenged certain trade-in transactions as errors in the Audit Report because the title may not have been available at the time of Audit or the Auditor otherwise required further substantiation that the purchaser was the owner of the traded-in vehicle.

19. Copies of such titles have been ordered and Petitioner will provide such documentation prior to a hearing.

#### **ERROR 3 – IMPROPER TAXATION OF SALES TO EXEMPT OUT OF STATE BUYERS**

20. The Department improperly subjected retailer's occupation (sales) tax ("Sales Tax" or "ROT") on the sales of certain vehicles sold to exempt out-of-state purchases. These transactions include sales of vehicles which are clearly in international or interstate commerce.

21. Illinois Sales Tax is not imposed upon the sale of a motor vehicle in this State even though the motor vehicle is delivered in this State, if the motor vehicle is sold to a nonresident, the motor vehicle is not to be titled in this State, and either a drive-away permit for purposes of transporting the motor vehicle to a destination outside of Illinois is issued to the motor vehicle as provided in Section 3-603 of the Illinois Vehicle Code [ 625 ILCS 5/3-603], or the nonresident purchaser has non-Illinois vehicle registration plates to transfer to the motor vehicle upon transporting the vehicle outside of Illinois. The issuance of the drive-away permit or having the out-of-state registration plates to be transferred is prima facie evidence that the motor vehicle will not be titled in this State. *See e.g.*, 35 ILCS 120/2-5(25) and 86 IL Admin. Code §130.605(b).

22. The documentation required to be retained by the dealer under 86 Il. Admin. Code 130.605(b) changed during the audit period. The auditor appears to have applied the standard and requirements which went into effect July 1, 2008, to all such out-of-state transactions in the audit, including those from October 2006 through June 2008. The Department must evaluate transactions based on the law in effect at the time the transactions occurred.

23. Petitioner will provide evidence to reflect the exemption of such vehicle transactions, including, but not limited to, evidence of proper taxation for out-of-state reciprocal and non-reciprocal sales.

**ERROR 4 – IMPROPER TAXATION OF  
REBATES AND INCENTIVES**

24. The Department improperly subjected certain automobile manufacturer rebates or incentives to Illinois ROT. Automobile manufacturer rebates, incentives and hold-backs are *not*

subject to Illinois Sales Tax if the amounts paid by the manufacturer to the dealership are not conditioned upon the retail sale of a specific vehicle. *See e.g.*, Ill. Admin Code § 130.2125(f).

25. Petitioner will provide evidence to reflect the proper exemption from taxation of such rebates and incentives.

**ERROR 5 – IMPROPER DISALLOWANCE OF  
ADVANCE TRADE-IN CREDITS**

26. The Department improperly disallowed advance trade-in credits allegedly involving different leasing trusts of the same respective automotive manufacturer (i.e., Honda Vehicle Trust vs. Honda Lease Trust and VW Credit versus Audi Financial). These transactions are also commonly known as the “Cab West” or “Van Drunen Ford” issue. It appears that ICB made some audit adjustments related to Honda Vehicle Trust (HVT) owned vehicles consistent with Petitioner’s protest, but there was no accounting of where these adjustments have been applied, and it is not clear that similarly situated deals involving Volkswagen Credit leases have likewise been addressed. The Department must provide an accounting. Overall however, it was improper to deny use of these advance trade-in credits, and thus, these amounts should not be included as taxable events in the Global Exceptions Report. Consequently, the total amount of the Assessment must be reduced accordingly.

**ERROR 6 – IMPROPER DISALLOWANCE OF ADVANCE TRADE-IN CREDITS  
COMBINED WITH THIRD PARTY TRADE-INS**

27. The Department improperly disallowed Petitioner’s use of certain advanced trade credits in combination with third party trade-in credits in the same transaction. The Auditor, without statutory authority, *arbitrarily and capriciously* disallowed the lower dollar trade-in

credit. Petitioner is entitled to combine both types of credits and thus, such disallowance must be reversed and the assessment must be revised accordingly. We disagree with the Auditor's position that 86 IL. Admin Code 130.455 precludes combination of third party trades and advanced trades which are recorded as a single sale transaction. Further, such treatment serves no policy purpose as the vehicles accepted in trade are then subjected to sales tax on a higher retail amount when sold to a retail customer, a result consistent with trades the Department considers "allowable."

28. Ill. Admin Code § 130.425 provides that "selling price" shall *not* include "the value of or credit given for traded-in tangible personal property where the item traded-in is a like kind and character as that which is being sold." *See also*, Ill. Admin Code § 130.455 (same and discussion generally regarding multiple trade-in and combined transactions). At a minimum, the Taxpayer should be allowed to use advance trade-in credits against other vehicle transactions with sales tax liability rather than forfeiting the trade-in deduction entirely.

#### **ERROR 7 – IMPROPER TAXATION OF VIN ETCHING SERVICES**

29. The Department improperly subjected VIN etching services to ROT. VIN etching is a process by which the vehicle's VIN is marked on glass surfaces by removing the upper layer of the glass in the etching process. No tangible personal property is transferred pursuant to this service. The customer has the option of buying or not buying this service and it is available from other service providers. In addition, the charge is separately stated on the sales order.

30. As no tangible personal property is transferred and this service is separately stated, it cannot be subject to ROT and must be removed from the tax base for calculating Retailers Occupation Tax on each respective vehicle.

**ERROR 8 – IMPROPER TAXATION OF VEHICLES NOT OWNED OR SOLD BY  
McGRATH IMPORTS**

31. The Department improperly included vehicles in its Global Taxable Exceptions report which were *not* sold by the Taxpayer to its customers. Specifically, these sales include *courtesy deliveries* for Volkswagen Corporate sales to employees for which the Petitioner merely acted as the delivering dealer – not the retailer, as well as vehicles that were sold to Audi as Audi loaners by a different dealer and entered into Central Vehicle Registration (CVS) by employees of Petitioner. Petitioner will provide documentation previously provided to the Auditor documenting and supporting this assertion.

**ERROR 9 – IMPROPER IMPOSITION OF AMNESTY  
DOUBLE PENALTY AND INTEREST**

32. Petitioner respectfully requests that any Amnesty double penalty and double interest imposed with respect to the Amnesty Period Assessment be abated to single penalty and single interest (subject to Petitioner's request for complete abatement of penalty for reasonable cause as discussed further below).

33. Petitioner was effectively *precluded* from participating in the State's Amnesty Program due to the requirement that amnesty payments must have been made on amended returns (in this case Forms ST-556-X). Notably, *each* vehicle transaction *requires its own tax return* (i.e., a ST-556), which is unlike a monthly ST-1, and there was insufficient information during the limited Amnesty window to determine which transactions, if any, were in error at the time of the Amnesty Program. Additionally, the Department did not permit the Petitioner to make an estimated good-faith payment since it had to be tied to a specific vehicle tax return. And even if such good faith estimated payment could have been permitted, there was substantial

risk leading up to the issuance of the final Amnesty regulations that any overpayment would have been forfeited rather than refunded or applied to other dealership liabilities.

34. Consequently, Petitioner was effectively denied the ability to participate in the Amnesty program and respectfully requests that it does not get penalized for its inability to participate in this program by the imposition of double penalties and double interest.

**REQUEST FOR ABATEMENT OF PENALTY FOR REASONABLE CASUE**

35. Petitioner respectfully requests complete abatement penalty for reasonable cause, in the event any tax is due. Petitioner reasonably relied upon its then outside accountant during the Audit Period at issue. Petitioner has since replaced its accountant with a national accounting firm with specific auto dealer industry knowledge and has engaged in numerous steps to remedy prior issues and improve both compliance and documentary evidence. For example, Petitioner, among other things: (1) commissioned a study of its procedures with recommendations to employ on a going forward basis, (2) invested in training to improve current and prospective compliance, and (3) Petitioner hired an independent third-party company to digitize its records to improve both record retention and accessibility of such information.

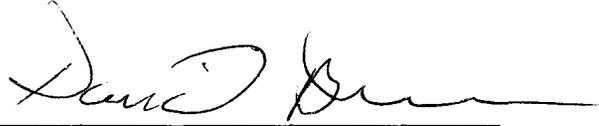
36. Petitioner respectfully reserves the right, to the extent permitted by statute, regulation or practice, to amend, supplement and/or revise this Petition at any time.

*[Continued next page]*

WHEREFORE, Petitioner requests that the Assessment be revised consistent with the Errors identified herein and for the reasons stated above.

Respectfully submitted,

MCGRATH IMPORTS, INC.

A handwritten signature in black ink, appearing to read "David C. Blum", written over a horizontal line.

One of its attorneys

David C. Blum (ARDC # 6242542)  
Akerman LLP  
71 S. Wacker Drive, 46<sup>th</sup> Floor  
Chicago, IL 60606  
p. 312-346-8380  
f. 312-346-8434  
[david.blum@akerman.com](mailto:david.blum@akerman.com)

**EXHIBIT A**

**Notice of Tax Liability**  
**for Form EDA-556, Sales Tax Transaction Audit Report**



\_\_\_\_\_ #BWVKMGV  
\_\_\_\_\_ #CNXX XXX5 6642 1923#  
\_\_\_\_\_ MC GRATH IMPORTS INC  
\_\_\_\_\_ 9105 WAUKEGAN RD  
\_\_\_\_\_ MORTON GROVE IL 60053-2120

May 9, 2016



Letter ID: CNXXXXX566421923

Account ID: 1864-7898

We have audited your account for the reporting period **October 01, 2006 through June 30, 2009**. As a result, we have assessed the amounts shown below.

**If you agree**, pay the assessment total as soon as possible to minimize additional penalty and interest. Mail a copy of this notice and your payment with the voucher on the enclosed Taxpayer Statement. By including a copy of this notice, your payment will be properly applied to the audit liability.

**If you do not agree**, you may contest this notice by following the instructions listed below.

- **If the amount of this tax liability, exclusive of penalty and interest is more than \$15,000 or if no tax liability is assessed but the total penalties and interest is more than \$15,000**, file a petition with the Illinois Independent Tax Tribunal within **60 days** of this notice. Your petition must be in accordance with the rules of practice and procedure provided by the Tribunal (35 ILCS 1010/1-1, et seq.).
- **In all other cases that do not fall within the jurisdiction of the Illinois Independent Tax Tribunal**, file a protest with us, the Illinois Department of Revenue, and request an administrative hearing within 60 days of the date of this notice, which is **July 08, 2016**. Submit your protest on Form AH-4, Protest and Request for Administrative Hearing with the Illinois Department of Revenue (available on our website at [tax.illinois.gov](http://tax.illinois.gov)). Mail Form AH-4 along with a copy of this notice to the address on the form. If you do not file a protest within the time allowed, you will waive your right to a hearing, and this liability will become final. An administrative hearing is a formal legal proceeding conducted pursuant to the rules adopted by the Department and is presided over by an administrative law judge. A protest of this notice does not preserve your rights under any other notice.
- **Instead of filing a petition with the Illinois Independent Tax Tribunal or a protest with us, the Illinois Department of Revenue**, you may instead, under Sections 2a and 2a.1 of the State Officers and Employees Money Disposition Act (30 ILCS 230/2a, 230/ 2a.1), pay the total liability under protest using Form RR-374, Notice of Payment Under Protest (available on our website at [tax.illinois.gov](http://tax.illinois.gov)), and file a complaint with the circuit court for a review of our determination.

If you do not protest this notice or pay the assessment total in full, we may take collection action against you for the balance due, which may include levy of your wages and bank accounts, filing of a tax lien, or other action.

	<u>Liability</u>	<u>Payments/Credit</u>	<u>Unpaid Balance</u>
Tax	559,063.00	0.00	559,063.00
Late Payment Penalty Increase	223,625.00	0.00	223,625.00
Interest	309,650.66	0.00	309,650.66
<b>Assessment Total</b>	<b>\$1,092,338.66</b>	<b>\$0.00</b>	<b>\$1,092,338.66</b>

If you have questions, write or call us weekdays between 8:00 a.m. and 4:00 p.m. Our contact information is listed below.

**BUREAU OF AUDITS  
TECHNICAL REVIEW SECTION  
ILLINOIS DEPARTMENT OF REVENUE  
PO BOX 19012  
SPRINGFIELD IL 62794-9012  
217 785-6579**

# Notice of Tax Liability

for Form EDA-556, Sales Tax Transaction Audit Report



#BWNKMGV  
#CNXX X185 6X62 6X80#  
MC GRATH IMPORTS INC  
9105 WAUKEGAN RD  
MORTON GROVE IL 60053-2120

May 9, 2016



Letter ID: CNXXX1856X626X80

Account ID: 1864-7898

We have audited your account for the reporting period **July 01, 2009 through December 31, 2010**. As a result, we have assessed the amounts shown below.

If you agree, pay the assessment total as soon as possible to minimize additional penalty and interest. Mail a copy of this notice and your payment with the voucher on the enclosed Taxpayer Statement. By including a copy of this notice, your payment will be properly applied to the audit liability.

If you do not agree, you may contest this notice by following the instructions listed below.

- If the amount of this tax liability, exclusive of penalty and interest is more than \$15,000 or if no tax liability is assessed but the total penalties and interest is more than \$15,000, file a petition with the Illinois Independent Tax Tribunal within 60 days of this notice. Your petition must be in accordance with the rules of practice and procedure provided by the Tribunal (35 ILCS 1010/1-1, et seq.).
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- Instead of filing a petition with the Illinois Independent Tax Tribunal or a protest with us, the Illinois Department of Revenue, you may instead, under Sections 2a and 2a.1 of the State Officers and Employees Money Disposition Act (30 ILCS 230/2a, 230/2a.1), pay the total liability under protest using Form RR-374, Notice of Payment Under Protest (available on our website at [tax.illinois.gov](http://tax.illinois.gov)), and file a complaint with the circuit court for a review of our determination.

If you do not protest this notice or pay the assessment total in full, we may take collection action against you for the balance due, which may include levy of your wages and bank accounts, filing of a tax lien, or other action.

	<u>Liability</u>	<u>Payments/Credit</u>	<u>Unpaid Balance</u>
Tax	244,047.00	0.00	244,047.00
Late Payment Penalty Increase	48,810.00	0.00	48,810.00
Interest	40,346.92	0.00	40,346.92
<b>Assessment Total</b>	<b>\$333,203.92</b>	<b>\$0.00</b>	<b>\$333,203.92</b>

If you have questions, write or call us weekdays between 8:00 a.m. and 4:00 p.m. Our contact information is listed below.

**BUREAU OF AUDITS  
TECHNICAL REVIEW SECTION  
ILLINOIS DEPARTMENT OF REVENUE  
PO BOX 19012  
SPRINGFIELD IL 62794-9012  
217 785-6579**

**CERTIFICATE OF SERVICE**

Under penalties as provided by law pursuant to Section 1-109 of the Code of Civil Procedure, the undersigned, a non-attorney, certifies that he served a true and correct copy of the foregoing **Petition** upon the parties listed below, by personal service before 5:00 p.m. on \_\_\_\_\_, 2016.

Illinois Department of Revenue  
Office of Legal Services  
100 W. Randolph Street, 7-900  
Chicago, Illinois 60601

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Houston Bailey

David C. Blum  
AKERMAN, LLP  
71 South Wacker, 46<sup>th</sup> Floor  
Chicago, Illinois 60606  
312-780-8018  
312-424-1948 (fax)