

4. Petitioner is in the business of providing telephone, data, Internet, and various communications services to business customers.

BACKGROUND AND RELEVANT FACTS

5. Petitioner filed returns for taxable periods January 1, 2009 through December 31, 2011.
6. On December 4, 2010 the Department issued a *Notice of Proposed Liability* (ID: L0873365152) in the amount of \$4,455,642.00 including interest and penalty.
7. Petitioner filed a *Request for Informal Conference Board Review* on February 4, 2013, contesting the entire *Notice of Proposed Liability*.
8. On October 17, 2013 Petitioner met with the auditor at the Informal Conference Board. Petitioner provided a summary of its requested audit reductions. Petitioner's requested reductions were tied to the auditor's assessment summary and pivot tables, which matched the auditor's work papers.
9. On November 14, 2013, Petitioner met with the auditor to review the adjustments discussed during the October conference and explain the supporting documentation.
10. The adjustments discussed during the conference were:
 - i. Assessment reduction for telecommunication services sold to provide Internet access;
 - ii. Assessment reduction for telecommunication services sold to Internet Service Providers (ISPs) or resellers;
 - iii. Assessment reduction for services sold that were incidental to Internet access;
 - iv. Assessment reduction for credits taken on returns;
 - v. Assessment reduction for private data networks sold to resellers or sold to customers that used the private networks in multiple jurisdictions, therefore, invoking an apportionment reduction; and
 - vi. Assessment reduction for Internet access.
11. On September 3, 2014 the Department issued two *Notices of Assessment*, reducing the assessment amount to a total of \$1,957,476.73 including penalties and interest. The Notice

for the period of January 1, 2009 through June 30, 2009 (Letter ID CNXXX16945X39523) is attached as Exhibit 1; the Notice for the period of July 1, 2009 to December 31, 2011 (Letter ID CNXXX12487393441) is attached as Exhibit 2.

12. In the current appeal, Petitioner's proposed adjustments to these *Notices of Assessment* referred to in paragraph 11 above are discussed below:

JURISDICTION

13. The Illinois Tax Tribunal Act provides that "[e]xcept as provided by the Constitution of the United States, the Constitution of the State of Illinois, or any statutes of this State, including, but not limited to, the State Officers and Employees Money Disposition Act, the Tax Tribunal shall have original jurisdiction over all determinations of the Department reflected on a Notice of Deficiency, Notice of Tax Liability, Notice of Claim Denial, or Notice of Penalty Liability. . ." 35 ILCS 1010/1-45(a).
14. The Tax Tribunal's jurisdiction is limited to certain Illinois taxing statutes, which include the Telecommunications Excise Tax Act. Id.
15. The Tax Tribunal provides an independent administrative tribunal with tax expertise to resolve tax disputes between the Department of Revenue and taxpayers. According to the Tax Tribunal Act, a "Taxpayer" means a person who has received a **protestable notice of assessment**, a claim denial, or a protestable notice of penalty liability within the Tax Tribunal's jurisdiction pursuant to Section 1-45 of this Act. 35 ILCS 1010/1-10 (emphasis added).
16. Petitioner in the current case falls within the Tax Tribunal Act's definition of "Taxpayer," because it has received a protestable "Notice of Assessment" in relation to Illinois'

Telecommunication Excise Tax. Therefore, Petitioner is within the jurisdiction of the Independent Tax Tribunal.

APPLICABLE LAW

Illinois Telecommunication Excise Tax

17. The Telecommunications Excise Tax ("TET") is imposed upon the act or privilege of originated or receiving intrastate or interstate telecommunications in Illinois at the rate of 7% of the gross charge for such telecommunications purchased at retail for retailers. See 35 ILCS 630/2.
18. “ ‘Gross charge’ means the amount paid for the act or privilege of originating or receiving telecommunications in this State and for all services and equipment provided in connection therewith by a retailer, valued in money, whether paid in money or otherwise, including cash, credits, services and property of every kind or nature, and shall be determined without any deduction on account of the cost of such telecommunications, the cost of materials used, labor or service cost or any other expense whatsoever.” 86 Ill. Admin. Code § 495.100(a).
19. “ ‘Telecommunications,’ in addition to the meaning ordinarily and popularly ascribed to it, includes, without limitation, messages or information transmitted through use of local, toll and wide area telephone service; private line services; channel services; telegraph services; teletypewriter; computer exchange services; cellular mobile telecommunications service; specialized mobile radio; stationary two way radio; paging service; or any other form of mobile and portable one-way or two-way communications; or any other transmission of messages or information by electronic or similar means, between or among points by wire, cable, fiber-optics, laser, microwave, radio, satellite or similar facilities.” 35 ILCS 630/2(c).

Internet Tax Freedom Act

20. Under the Internet Tax Freedom Act ("ITFA") and its amendments, state and local governments are barred from imposing taxes on Internet access and multiple or discriminatory taxes on electronic commerce. 47 U.S.C.A. § 151, "Internet Tax Freedom Act."
21. The ban applies regardless of whether such a tax is imposed on a provider of Internet access or a buyer of Internet access and regardless of the terminology used to describe the tax. See CCH Illinois State Tax Guide 60-445, "Internet/Electronic Commerce" (p. 9).
22. Given that the ITFA bans state and local governments from collecting tax on Internet access, services which are defined as "Internet Access" are not subject to the TET. Under the ITFA, "Internet Access" is defined as:

a service that **enables users to access content, information, electronic mail, or other services offered over the Internet** and may also include access to proprietary content, information, and other services as part of a package of services offered to consumers. The term 'Internet access service' does not include telecommunications services, **except to the extent such services are purchases, used, or sold by a provider of Internet access to provide Internet access.**

47 U.S.C.A. § 151, "Internet Tax Freedom Act." (emphasis added).

23. Similarly, the term "Internet" is defined as:

collectively **the myriad of computer and telecommunications facilities, including equipment and operating software**, which comprise the interconnected world-wide network of networks that comply the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio.

Id. (emphasis added).

24. Under the Supremacy Clause of the United States Constitution, state law is null and void if it conflicts with federal law. Performance Mktg. Ass'n, Inc. v. Hammer, 998 N.E.2d 54, 57 (IL 2013).
25. Specifically, the Illinois Supreme Court recently held that part of an Illinois taxing statute was void and unenforceable because it was expressly preempted by the ITFA. Id. at 60. The Court defined express preemption as a situation in which "Congress has expressly preempted state action." Id. at 57. Similarly, the Court defined implied preemption as state action that actually conflicts with federal law. Id.

Bad Debt

26. Under the Illinois TET Act, "[b]ad debt means any portion of a debt that is related to a sale at retail for which gross charges are not otherwise deductible or excludable that has become worthless or uncollectable, as determined under applicable federal income tax standards. If the portion of the debt deemed to be bad is subsequently paid, the retailer shall report and pay the tax on that portion during the reporting period in which the payment is made." 35 ILCS 630/2 (Ch. 120, par. 2002).
27. Therefore, such as the case with Retailers Occupation Tax ("ROT"), a taxpayer is entitled to a bad debt credit with respect to the original sale in which the default has occurred to the extent to which the taxpayer has paid tax on a portion of the price which it does not collect. See 35 ILCS 630/10 (from Ch. 120, par. 2010).
28. According to section 6b of the ROT Act, the Department's denial of a taxpayer's claim for credit constitutes *prima facie* proof that the taxpayer is not entitled to a credit. 35 ILCS 120/6b. The Department's *prima facie* case is a rebuttable presumption. The presumption is overcome, and the burden shifts back to the Department to prove its case, only after a

taxpayer presents evidence that is consistent, probable and identified with its books and records, to show that the Department's determinations are wrong. See Copilevitz v. Dept. of Revenue, 41 Ill. 2d 154, 156-57 (1968); see also A.R. Barnes & Co. v. Dept. of Revenue, 173 Ill. App. 3d 826, 832 (1st Dist. 1988).

Credits

29. Under section 10 of the TET Act, "[i]f it shall appear that an amount of tax or penalty or interest has been paid in error to the Department hereunder by a retailer who is required or authorized to collect and remit the tax imposed by this Article, whether such amount be paid through a mistake of fact or an error of law, such retailer may file a claim for credit or refund with the Department, provided that no credit or refund shall be allowed for any amount paid by any such retailer unless it shall appear that he bore the burden of such amount and did not shift the burden thereof to anyone else, or unless it shall appear that he or she or his or her legal representative has unconditionally repaid such amount to his customer (1) who bore the burden thereof and has not shifted such burden directly or indirectly in any manner whatsoever; or (2) who, if he or she shifted such burden, has repaid unconditionally such amount to his or her own customer; and (3) who is not entitled to receive any reimbursement therefor from any other source than from his retailer, nor to be relieved of such burden in any other manner whatsoever." 35 ILCS 630/10 (Ch. 120, par. 2010).
30. Every retailer maintaining a place of business in the State under this Article and every taxpayer making direct tax payments to the Department under the TET Act shall keep books, records, papers and other documents which are adequate to reflect the information required by Sections 6 and 7 of the TET Act to be reported to the Department by filing timely returns with the Department. See 35 ILCS 630/11 (Ch. 120, par. 2011).

Monthly Commitment Charges

31. When exempt Internet access service charges are aggregated with telecommunications charges or other taxable services, the Internet access charges are still exempt from tax if Petitioner can reasonably identify the charges for Internet access from its books and records kept in the reasonable course of business. See CCH Illinois State Tax Guide 60-445 "Internet/Electronic Commerce" (p. 10).

Penalty

32. No penalty shall be imposed under this Section if it is shown that failure to comply with the tax Act is due to reasonable cause. A taxpayer is not negligent if the taxpayer shows substantial authority to support the return as filed. 35 ILCS 735/3-5(c).
33. Under the Illinois Administrative Code, tax penalties should not apply where the taxpayer shows that the failure to pay tax at the required time was due to reasonable cause. 86 Ill. Admin. Code § 700.400(a).
34. Reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important fact to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion. Id. at (b).

ERROR I

The assessment erroneously included charges related to non-taxable Internet services, including but not limited to sales of telecommunications services used by Petitioner's customers to access the Internet, sales of Internet access, and ancillary charges associated with Petitioner's above referenced sales.

35. Under the ITFA, Illinois is barred from imposing taxes on Petitioner's sales, as a provider of Internet access to its customers. Petitioner provides a service that "enables users to access content, information, electronic mail, or other services offered over the internet" and,

therefore, falls within the ITFA's definition of "Internet access." 47 U.S.C.A. § 151 § 1101(d)(3)(D), "Internet Tax Freedom Act."

36. To the extent that the Illinois state law conflicts with the ITFA, such as how the Internet service is charged on the bill, the IFTA preempts Illinois law. See Performance Mktg. Ass'n, Inc. v. Hammer, 998 N.E.2d 54, 57 (IL 2013).
37. Additionally, the fact that exempt Internet access service charges are separately stated from charges for other taxable services further supports Petitioner's contention that such charges are not taxable. CCH Illinois State Tax Guide 60-445 "Internet/Electronic Commerce" (p. 10).
38. Although "Internet access" does not generally include telecommunications, Petitioner's services fall under the exception because the services are purchased, used, and sold by Petitioner to provide Internet Access to its customers. 47 U.S.C.A. § 151 § 1101(d)(3)(D).
39. As an example, Petitioner's "Network Access Facility" charge is a cost to access Petitioner's local loop network, which Petitioner purchases and uses to provide Internet access to its customers. Without access to such a service, Petitioner's customers would not be able to access the world-wide network that comprises the Internet.
40. Petitioner's services that are incidental to Internet Access, such as "Network Access Facility" charges and "Ethernet" charges fall outside the scope of Illinois TET because such charges fall outside the definition of gross receipts and are barred from taxation by the ITFA. Petitioner uses these services to provide its subscribers access to the Internet. 86 Ill. Admin Code § 495.100(m). 47 U.S.C.A. § 151, "Internet Tax Freedom Act."

41. Specifically, the Department has held that supplementary Internet services, such as web hosting services which are separately stated by a telecommunication company, are not subject to TET. State of Illinois Letter No. ST 98-004-GIL, Jan. 6, 1998.
42. Petitioner's services which are ancillary to Internet access are also included within the ITFA's definition of "Internet Access" since Petitioner uses such services to "enable users to access content, information, electronic mail or other services offered over the Internet." Id. at § 1101 (d)(2)(D).

ERROR II

The assessment erroneously disallowed Petitioner's bad debt write offs taken on its tax returns.

43. According to Illinois guidance, Petitioner validly took tax credits on its returns for tax paid on bad debt accounts in the normal course of its business. See Illinois Dep. of Revenue Letter No. 90-0252.
44. Illinois allows Petitioner to take a bad debt deduction on the following month's tax returns, where it classified certain sales in a previous month's return as bad debt. Petitioner successfully followed this procedure, and therefore should be entitled to a TET reduction for such credits. See 35 ILCS 630/10 (from Ch. 120, par. 2010).
45. Further, Petitioner has processes in place to detail bad debt tax credits taken based off bad debt accounts on returns. Such processes are subject to a system of internal procedures and controls, which Petitioner followed during the assessment period. Additionally, Petitioner's financial statements were subject to audit and no material weaknesses were noted.

ERROR III

The assessment erroneously disallowed tax credits in which Petitioner refunded tax to exempt customers.

46. Petitioner's Tax Liability Analysis Report outlines tax refunds applied to exempt vendors who erroneously paid Petitioner tax.
47. Under section 10 of the Illinois TET Act, Petitioner may claim a credit with the Department because it has met all the requirements for taking a valid credit. One, Petitioner paid TET in error; two, Petitioner is a retailer authorized to collect and remit TET; and three, although Petitioner shifted payment of TET to its customers, it repaid such amounts. 35 ILCS 630/10 (Ch. 120, par. 2010).
48. During the normal course of Petitioner's business it refunded customers who erroneously paid tax on purchases which were exempt from tax. According to Illinois TET procedures, Petitioner subsequently took credits on its own returns for tax refunds it credited its customers. See id.
49. During this time, Petitioner maintained a system of internal procedures and controls which tied credits to customer invoices, as well as a breakdown of the taxes subsequently credited.
50. Similar to Petitioner's bad debt credits, the additional credits taken for its exempt customers were included in Petitioner's financial statements, which were subject to audit. Since no material irregularities were ever noted, and Petitioner followed proper procedures, such credits should reduce the current assessment amount.

ERROR IV

The assessment erroneously included "monthly commitment" charges which included portions of non-taxable services.

51. Petitioner's "Minimum Monthly Commitment" charges are monthly calling plans in which Petitioner's customers agree to a specified monthly revenue commitment. For example, the "XO National Plan" requires a monthly revenue commitment of \$4,000. Customers who do not meet their revenue commitment are still charged the monthly commitment rate.
52. Monthly commitment charges include telecommunications charges as well as Internet access charges. Additionally, Petitioner charges the full monthly commitment amount, even for services that customers never use.
53. Petitioner determined from its books and records kept in the regular course of business that 13% of the total charges were taxable charges subject to TET. The remaining charges were either non-taxable Internet Access Charges or unused services, which can reasonably be distinguished from the taxable charges. See CCH Illinois State Tax Guide 60-445 "Internet/Electronic Commerce" (p. 10).
54. Because the non-taxable Internet access charges and unused services charges can be reasonably distinguished from the taxable charges, the assessment should be reduced by the taxable percentage portion of the monthly commitment charges. Id.

ERROR V

Petitioner requests penalty abatement for the current assessment.

55. The additional amounts due as identified in the above audit were identified despite Petitioner's best efforts to determine and report its proper tax liability. Petitioner filed and paid its returns in good faith, without negligence and without intent to defraud. Petitioner's actions were reasonable and without negligence.

56. Throughout the audit Petitioner maintained a professional attitude and continued to answer various information requests. Petitioner is a large corporation, collecting and remitting large amounts of tax to the state of Illinois annually.
57. As a national telecommunications company, Petitioner has had several large acquisitions over the years including Allegiance Telecom and Concentric Networks. Many of these entities maintained their billing systems and as a result there are several systems that roll into Petitioner's tax filings.
58. As such, both this audit and the issues Petitioner face are complicated and detailed. To some extent, the complexity of Petitioner's billing systems has in isolated incidences caused it to rely on erroneous information when collecting and remitting tax.
59. Petitioner has been a welcome participant to the Illinois business community for years, has maintained the appropriate business records, collected and remitted tax on all clearly taxable revenue, and has maintained the records necessary to establish their sales.
60. Furthermore, and most importantly, Petitioner endeavors to appropriately collect and remit tax on all taxable transactions going forward. Petitioner has acted in good faith and has consistently strived to conduct its business in the city of Illinois in a professional and ethical manner.
61. Petitioner maintains that it made a good faith effort to comply with the law, and therefore is entitled to an abatement of late-filing penalty or late-payment penalty due to "reasonable cause." 86 Ill. Admin. Code § 700.400.
62. Therefore, no penalty should be imposed under this Section because Petitioner has shown that failure to comply with the tax Act is due to reasonable cause. Also, Petitioner is not

negligent as it has substantial authority to support the majority of the returns as filed. 35
ILCS 735/3-5(c).

CONCLUSION AND RELIEF REQUESTED

WHEREAS, Petitioner requests that the Notices be modified or canceled for the reasons contained herein.

XO COMMUNICATIONS SERVICES, LLC

By: 
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Petitioner's Representative
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ARDC No. 6316378
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Pro Hac Vice Compliance

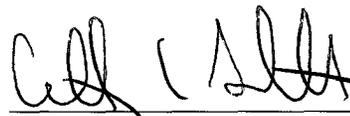
As an attorney authorized to practice law in Pennsylvania, I certify that I have complied with the Illinois Supreme Court procedures for admission to practice *pro hoc vice* in Illinois for this matter and that a *Motion for Admission of Counsel Pro Hac Vice* supported by an Affidavit was filed simultaneously with this *Petition*.



Anthony C. Gulotta, Jr., CPA, Esq.

Certificate of Service

I certify that a copy of XO Communications Services, LLC's *Petition* was sent via certified mail to the Illinois Department of Revenue, Office of Legal Services, 100 W. Randolph St., 7-900, (7th floor of the Thompson Center), Chicago, IL 60601 on September 30, 2014.



Anthony C. Gulotta, Jr., CPA, Esq.

Notice of Assessment
for Form RT-2-A, Telecommunications Tax Audit Return



217 782-6045

_____ #BVNKMVG
_____ #CNXX X169 45X3 9523#
_____ XO COMMUNICATIONS SERVICES LLC
_____ ATTN: TAX PARTNERS LLC
_____ 3100 CMBLD BLVD SE STE 700
_____ ATLANTA GA 30339-5911

September 3, 2014



Letter ID: CNXXX16945X39523

License No: T-06231
Account ID: 40433293



We have audited your account for the reporting periods January 01, 2009, through June 30, 2009. As a result we have assessed the amounts shown below.

To avoid cost of collection fees, additional penalties and interest for this assessment, you must pay on or before Oct 3, 2014.

If you agree, please use the voucher on the enclosed Taxpayer Statement to make your payment.

If you later determine you have overpaid the assessment, you may file a Form EDA-98-E, Claim for Credit Excise Tax, along with any proof that you do not owe the amount stated in this assessment. We will let you know whether we agree with your corrections or the supporting documentation you send us.

	<u>Liability</u>	<u>Payments/Credit</u>	<u>Unpaid Balance</u>
Tax	239,514.00	0.00	239,514.00
Late Payment Penalty	95,805.00	0.00	95,805.00
Interest	73,396.36	0.00	73,396.36
Assessment Total	\$408,715.36	\$0.00	\$408,715.36

If you have any questions, please write us or call our Springfield office weekdays between 8:00 a.m. and 4:00 p.m. Our address and telephone number are listed below.

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

217 785-6579

SEP 19 2014



Penalties and Fees

For detailed information on penalties and rates in effect for specific periods on or after January 1, 1994, see Publication 103.

- 1 Late-filing or Nonfiling penalty** - You owe this penalty if you do not file a return by the due date, including any extended due date, or you file a return that is not processable and you do not correct it within 30 days of the date we notify you.
- 2 Late-payment penalty for underpayment of estimated or quarter-monthly tax** - You owe this penalty if you were required to make estimated or quarter-monthly tax payments and failed to do so, or if you failed to pay the required amount by the payment due date.
- 3 Late-payment penalty for regular tax payments** - You owe this penalty if you did not pay the tax you owed by the original due date of the return.
- 4 Negligence penalty** - You owe this penalty if, in preparing a return or amended return, you do not make a reasonable attempt to comply with the provisions of any tax act, including showing careless, reckless, or intentional disregard for the law or regulations.
- 5 Fraud penalty** - You owe this penalty if any part of a deficiency is due to fraud.
- 6 Cost of collection fee** - You owe this fee if you do not pay the total amount you owe within 30 days after a bill has been issued.
- 7 Bad check penalty** - You owe this penalty if you send a remittance to the Department that is not honored by your financial institution.
- 8 Failure to disclose participation in a reportable transaction penalty** - You owe this penalty if you were required to disclose your participation in an abusive tax shelter transaction and did not do so by the required due date.
- 9 Reportable transaction understatement penalty** - You owe this penalty if you do not report and pay the full amount of your tax liability as the result of participating in an abusive tax shelter transaction.

- 10 100 percent interest penalty** - You owe this penalty if you
- were contacted by the Internal Revenue Service or Illinois Department of Revenue regarding the use of a potentially abusive tax transaction for a taxable year;
 - are later found to have a deficiency in that taxable year that is the result of the tax avoidance transaction; and
 - did not report or pay that liability before we issued a Notice of Deficiency.

11 Audit penalty - You owe this penalty if you did not pay the tax you owed before the start of an audit or investigation.

12 Nonfiling penalty for transaction return - You owe this penalty if you are a retailer required to file a transaction return (ST-556, Sales Tax Transaction Return) by the due date, even if no tax is due on the return.

Are penalties ever abated?

If you were unable to either timely pay the required amount of estimated or quarter-monthly payments, pay the tax you owed by the due date, or file your tax return by the extended due date because of a casualty, disaster, or other similar circumstance, you may request a waiver of penalties due to reasonable cause. To request this waiver, send us a detailed explanation of the cause of the delay and any documentation you have to support your request. Reasonable cause will be determined on a case-by-case basis according to our rules and regulations.

How is interest figured?

Interest is calculated on your tax from the day after the original due date of your return through the date you pay the tax (for certain tax periods interest may also accrue on penalties). Interest accrues at simple rates established by the Internal Revenue Service. See Publication 103 for more information.

Bankruptcy Information

If you are currently under the protection of the Federal Bankruptcy Court, contact us and provide the bankruptcy number and the bankruptcy court. The bankruptcy automatic stay does not change the fact that you are required to file tax returns.

Taxpayer Bill of Rights

- You have the right to call the Department of Revenue for help in resolving tax problems.
- You have the right to privacy and confidentiality under most tax laws.
- You have the right to respond, within specified time periods, to Department notices by asking questions, paying the amount due, or providing proof to refute the Department's findings.
- You have the right to appeal Department decisions, in many instances, within specified time periods, by asking for Department review, by filing a petition with the Illinois Independent Tax Tribunal, or by filing a complaint in circuit court.
- If you have overpaid your taxes, you have the right, within specified time periods, to file for a credit (or, in some cases, a refund) of that overpayment.
- For more information about these rights and other Department procedures, you may contact us. Our contact information is on the front of this notice.

Notice of Assessment
for Form RT-2-A, Telecommunications Tax Audit Return



217 782-6045

#BWNKMGV
#CNXX X124 8739 3441#
XO COMMUNICATIONS SERVICES LLC
ATTN: TAX PARTNERS LLC
3100 CMBLD BLVD SE STE 700
ATLANTA GA 30339-5911

September 3, 2014



Letter ID: CNXXX12487393441

License No: T-06231
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TECHNICAL REVIEW SECTION
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PO BOX 19012
SPRINGFIELD IL 62794-9012

217 785-6579



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- If you have overpaid your taxes, you have the right, within specified time periods, to file for a credit (or, in some cases, a refund) of that overpayment.
- For more information about these rights and other Department procedures, you may contact us. Our contact information is on the front of this notice.