IN THE ILLINOIS
INDEPENDENT TAX TRIBUNAL

Michael Rothman and Jennifer Rothman,	)	
	)	
Petitioners,	)	
	)	
v.	)	Nos. 18 TT 30 & 18 TT 132
	)	
Illinois Department of Revenue,	)	Judge Brian F. Barov
	)	
Respondent.	)	

NOTICE OF SERVICE

TO: See attached Certificate of Service

PLEASE TAKE NOTICE that on April 23, 2021, Petitioners, Michael and Jennifer Rothman, through its counsel JONES DAY, are serving **Petitioners' Motion to Compel Discovery**, in the above-captioned matter, true copies of which are attached hereto and herewith served upon you.

Dated: April 23, 2021

Respectfully submitted,

/s/ Michael J. Wynne

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CERTIFICATE OF SERVICE

I, Douglas A. Wick, one of the undersigned attorneys for the Petitioners, Michael and Jennifer Rothman, hereby certify that on April 23, 2021, I caused a copy of **Petitioners' Motion to Compel Discovery**, in the above-captioned matter, to be served on all parties of record in this cause by electronic mail addressed to the attorneys below:

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Illinois Department of Revenue,	)	Judge Brian F. Barov
	)	
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PETITIONERS' MOTION TO COMPEL DISCOVERY

NOW COME Petitioners, Michael Rothman and Jennifer Rothman, pursuant to Illinois Supreme Court Rules 201, 213, and 214, and move this Honorable Tribunal to compel Respondent, the Illinois Department of Revenue ("Department"), to respond to certain properly served document production requests and interrogatories. In support of this motion, Petitioners incorporate the attached exhibits and state the following:

I. Introduction

Michael and Jennifer Rothman became nonresidents of Illinois and residents of Florida for the 2013 tax year. In 2017, the Illinois Department of Revenue ("Department") audited the Rothmans for the 2014 and 2015 tax years, and concluded that the Rothmans were still Illinois residents. The Rothmans disagreed with the Department, but the amount of tax owed was de minimis in contrast to the money and time required to fight the Department. The Rothmans made the pragmatic choice to pay the small amount of tax proposed for assessment in the audit

and request a reasonable cause abatement of the late payment penalty also proposed.[1] After they paid the small tax assessment, however, the penalties were not abated. Instead, a negligence penalty was assessed in a Notice of Deficiency ("NOD"). Next, the Department advised the Rothmans it would initiate an audit of the 2013 and 2016 tax years. The Rothmans filed action 18 TT 30 to challenge the penalty NOD, and, a claim for refund of the tax payment they had made. When their claim for refund for 2014 and 2015 was denied, they filed action 18 TT 132 to challenge that denial. The Tax Tribunal consolidated the actions.

In this case, the Department has already: (i) admitted it originally furnished Petitioners with an incomplete audit file, and (ii) submitted an inaccurate Answer, under penalties of perjury, and accordingly had to amend and re-file its Answer. Discovery was delayed until the Answer was re-filed. The Department's attorneys have since engaged in protracted discovery here. Meanwhile, its Audit Bureau has used that time (i) to conduct its audit for 2013 and 2016 and to propose liability presently before the Informal Conference Board, and (ii) to conduct an audit for 2017 and 2018, ongoing at this time. In each audit, the Department has requested the same and additional documentation to what it sought here in discovery, including through the issuance of administrative subpoenas.

The Discovery At Issue

Documents produced in discovery partially revealed a scheme by the Department to reap a tactical – and if need be, a penalty-coerced – admission from the Petitioners for tax years *not under audit* by the unusual step of delaying initiating an audit for the 2013 and 2016 tax years until *after* the Rothmans committed to pay the 2014 and 2015 proposed tax assessment. Tax

[1] See attached **Exhibit 1**, "Hi Greg, To clarify, Mr. and Mrs. Rothman do not admit or concede that they are Illinois residents for tax purposes. Instead, they are paying the tax and interest in order to avoid the time and expense of litigation." (email to Department auditor on Dec. 1, 2017).

audits are not regularly conducted out of chronological sequence. Why, and how, the Department did so here is properly a focus of Petitioner's discovery.

Department auditor Greg Nelson plainly lays out an entrapment scheme in an email written to his supervisor on November 16, 2017:

> I don't think we should "take the money and run" or worry about them not agreeing since we're penalizing them. '14 & '15 is [sic] only totals about $70k tax/Int/LP Pen. '13 is [REDACTED]MIL and '16 is $[REDACTED]MIL alone in Tax. 1. I think if we assess Negligence, they'll try to settle and ask to just pay LP, or 2. They agree, pay tax only, and go to BOA.[2] ***Either way, this locks them into residency in the middle years, making it that much harder to argue non-residence, especially in '13.*** I don't think this is a "we're scaring them off situation".

See attached **Exhibit 2**. (Emphasis added; tax amounts not at issue in this case redacted). Auditor Greg Nelson also wrote:

> I say let them take their chances with BOA. Since we have other cases pending/sandwiched on either side, the [penalty] abatement would lock us in. We lose our leverage. . . . I just don't think we should give it up so easily, just to get a few bucks, when we have bigger fish awaiting [2013 & 2016 tax years].

Id. (emphasis in original).

At the time of that email, the Rothmans were unaware of the "other cases" the Department had yet to initiate but had already determined against them. Likewise, the Rothmans were unaware that the Department would intentionally increase the penalty in their "middle years" – from a late-payment penalty to a negligence penalty – in order to coerce and lock them into what the Department believed would be a residency admission for the earlier and later years for which the Rothmans were not yet under audit.

Moreover, the Department's approval of the coercive scheme relied on its analysis that "it won't end up in court," *i.e.*, it would not be exposed to sunlight through discovery. The auditor

[2] "BOA" stands for Board of Appeals area of the Department empowered to abate penalties for reasonable cause after a liability has been finalized and is no longer able to gain judicial review. "LP" appears to be short-hand for a late payment penalty.

assured audit management that "this won't end up in Court," and management sought reassurance of that, and of the role of the penalty in the scheme. Audit management asked the auditor, "How do you know it won't end up in court? So they will look for a settlement and that is where the penalty is abated, right?" See attached **Exhibit 3**. After a second assurance by the auditor that "it won't end up in court," audit management approved the assessment of the negligence penalty to coerce the Rothmans into an admission and a settlement that a court was not intended to see.

Now the Department refuses to produce to the Rothmans several categories of documents relevant to the Department's legal positions, policies, and behavior that underlie the scheme revealed by discovery so far. Our reasonable attempts to resolve this discovery dispute have failed. Petitioners therefore move pursuant to Illinois Supreme Court Rule 219 to compel answers to their discovery requests.

II. The Disputed Discovery

On April 17, 2019, Petitioners served their First Request for Production. The Department responded on May 22, 2019. After providing substantial responses to the Department's own discovery to them, Petitioners noted deficiencies in the Department's responses and sent the Department a Rule 201(k) letter on April 20, 2020. Petitioners' 201(k) letter identified the following deficiencies:

- Department's response to Request Nos. 1, 2, 5, & 9: the Department produced only three emails in its entire production. The Department identified three other emails that were privileged. Petitioners request production of the emails identified in Request Nos. 1, 2, 5, & 9. Petitioners request the Department disclose and consult with Petitioner on the search terms it will use to compile this response.

- Department's response to Request No. 4: an Illinois court recently ruled that, in reviewing a request for the Department's entire "audit manual," the audit manual is not exempt from disclosure under the Illinois Freedom of Information Act. *See Tax Analysts v. Ill. Dep't of Rev.*, 18-MR-001018 (Sangamon Cty. Cir. Ct. Dec. 18, 2019) (Department

must turn over audit manual pursuant to FOIA request). The Department should supplement its response to Request No. 4 by producing all portions of the Department's audit manual responsive to the Request.

- Department's response to Request No. 2: the Department demurred because no notices were issued in the 2013 & 2016 audit at the time. The Department has issued a Notice of Proposed Deficiency for tax years 2013 and 2016, totaling approximately $4 million. Please provide a response to No. 2.

- Department's response to Request Nos. 4 & 5: the Department did not produce a privilege log for the communications, records, or portions of the Department's audit manual which it asserted were privileged. Please provide a privilege log, taking into account *Tax Analysts v. Ill. Dep't of Rev.*, 18-MR-001018 (Sangamon Cty. Cir. Ct. Dec. 18, 2019) with respect to the Department's audit manual.

The parties had a meet-and-confer conference on December 17, 2020 in an attempt to resolve discovery disputes in satisfaction of Illinois Supreme Court Rule 201(k). Petitioners' counsel then sent the Department an email on December 17, 2020 clarifying the modified requests after the conference.

In response, on March 8, 2021, the Department produced 84 additional pages, many of which were heavily redacted. The Department's responses and production are still either non-responsive, deficient, or both. Therefore, for the reasons detailed below, we move to compel a complete response to Petitioner's discovery, as required by Tax Tribunal Rules.

III. Argument

The Tax Tribunal Act requires that parties comply with Illinois Supreme Court Rules for civil proceedings. *See* 35 ILCS 1010/1-60(a). Regulations also state that the Illinois Code of Civil Procedure is applicable. 86 Ill. Admin. Code § 5000.325(a). Under these rules, "a party may obtain by discovery full disclosure regarding any matter relevant to the subject matter involved in the pending action . . . ." Ill. S. Ct. R. 201(b)(1). Further, parties are permitted to request documents or information relevant to the subject matter of the case. *See* Ill. S. Ct. R. 214(a).

A. DEFICIENT EMAIL PRODUCTION

Request Nos. 1, 2, 5, & 9 all request, *inter alia*, emails regarding relevant subject matter. See attached **Exhibit 4** (Department's Response to Petitioner's First Set of Requests for Production). **Request No. 1** requests emails related to the audit file for tax years 2014 and 2015. **Request No. 2** requests emails related to the audit file for tax years 2013 and 2016. **Request No. 5** requests all communications related to any investigation, audit or other activities that took place before or after the audit of tax years 2014 and 2015. **Request No. 9** requests production of documents referenced in the auditor's report that are not contained in the audit file produced to Petitioners.

(i) Department's Method of Search and Production

In response to these Requests, the Department produced three emails and identified three other emails that it claimed were privileged. Noting the implausibility of these being the only responsive emails, Petitioners requested through the 201(k) process a more thorough email production, including the standard electronic discovery procedure of (1) identifying the relevant email custodians; (2) mutually agreeing to search terms; (3) having a computer specialist run the search terms against the email accounts of the relevant custodians; and (4) producing the resulting emails. The Department eschewed that standard process. An unknown process resulted in the Department producing an additional 71 pages of emails, many heavily redacted, and most of which are duplicative.

We do not know whether or which search terms were used, or whether auditor Greg Nelson was the only custodian whose email account was reviewed. The Audit log produced in discovery inexplicably has no entries beyond 6 months into an audit that went on for an additional 6 months. Petitioners requested a complete audit log in their 201(k) conference, but

none was produced. Many of the emails in the supplemental production are for periods in the last 6 months of the audit. The truncated audit log is therefore useless to gauge of whether the supplemental production correlates to audit events.

The limited email production has also illustrated that the Department's response to Interrogatory No. 2 was woefully incomplete. Interrogatory No. 2 asked for the identity of "every person who has worked on, analyzed, commented on, or otherwise been involved with, any income tax audits or investigations of Petitioners, for the Relevant Tax Period." The Department's response identified only auditor Greg Nelson. See attached **Exhibit 5** (Department's Responses to Petitioners' First Set of Interrogatories). Emails show, however, that at a minimum the following other Department employees were involved in this audit: Suzanne Nation, Laurie Riva, Joe Myers, Barry Stout, and Brian Fliflet. There may be others whose identity the Department withheld. To our knowledge, none of these employees have produced their emails relevant to this case, let alone has any production followed standard electronic discovery procedures (defined custodians and search terms).

(ii) Relevance of the Requested Emails

The emails sought here are relevant. Discovery is permitted where documents would be sufficiently relevant and material to be admissible at trial or if they lead to such relevant and material evidence. *Cordeck Sales, Inc. v. Constr. Sys., Inc.,* 394 Ill. App. 3d 870, 879 (1st Dist. 2009). But information may be discoverable even if it is not admissible in evidence. *Bauter v. Reding*, 68 Ill. App. 3d 171, 175 (3d Dist. 1979). Evidence is relevant when "it has any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence." Ill. R. Evid. 401.

Under Illinois law, a Notice of Deficiency ("NOD") "shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax and penalties due." 35 ILCS 5/904(a). The *prima facie* evidence of validity in tax cases emanates in part from the "presumption of administrative regularity" of official acts – that "whatever is required to give validity to the official's act in fact exists." *Borg Warner v. Commissioner*, 660 F. 2d 324, 330 (7th Cir. 1981). "No doubt, the presumption of regularity is subject to be rebutted. It stands until dislodged." *R. H. Stearns Co. v. United States*, 291 U.S. 54, 63 (1934). Facts dislodge presumptions. Petitioner seeks facts about an already highly irregular series of audit events that the Department did not intend the Tax Tribunal would ever see.

For a scheme that relied on the coercive effect of a negligence penalty, we do not know whether that penalty was supported by a mere hunch of negligence, or by the proper standard for negligence applied to cherry-picked and assumed facts, or by that standard as applied to all the relevant facts. We do not know whether it is a permitted practice for the Department to take action in an audit to "lock in" a taxpayer position for years in which the taxpayer is not under audit, nor what legal basis there is for such a practice. We do not know whether the likelihood that an audit will not "end up in court" is a Department criterion for any action, nor the legal basis for such a criterion. The answer to each of these questions, whatever it may be, is rendered more or less likely by production of the emails we seek. Emails probative of these facts are relevant to the case because they go toward determining whether the Department will forfeit the presumption of administrative regularity and thus of the correctness of its notices in this case.

Request Nos. 1, 2, 5, & 9 are relevant because when "evidence opposing the presumption comes into the case, the presumption ceases to operate, and the issue is determined on the basis of the evidence adduced at trial as if no presumption had ever existed." *Diederich v. Walters*, 65

Ill. 2d 95 (1976); *see also Franciscan Sisters Health Care Corp. v. Dean*, 95 Ill. 2d 452, 462 (1983) ("[O]nce evidence is introduced contrary to the presumption, the bubble bursts and the presumption vanishes."); *Ball v. Kotter*, 723 F.3d 813, 828 (7th Cir. 2013) (citing *Franciscan Sisters*, 95 Ill. 2d 452) (a court can determine as a matter of law "whether the 'bubble has burst' and whether the case should then be decided on factual matters."). Practically speaking, the bubble of *prima facie* correctness is burst when an assessment is shown to be "arbitrary and erroneous." *See Ruth v. United States*, 823 F.2d 1091, 1094 (7th Cir. 1987) (citing *United States v. Janis,* 428 U.S. 433, 441–42 (1976) and *Helvering v. Taylor,* 293 U.S. 507, 514–15 (1935)). If the Department's assessment was "arbitrary and erroneous," then it should not be presumed correct. *See id.*

(iii) Attorney-Client Privilege Objections

The Department objected to Request Nos. 1 and 5 on grounds of attorney-client privilege and work product privilege. These objections are meritless. First, the Department has not provided a privilege log that describes which documents are withheld and the specific basis for the privilege in each instance. Blanket claims of privilege are not allowed. *See* Ill. S. Ct. R. 20l(n) ("When information or documents are withheld from disclosure or discovery on a claim that they are privileged . . . any such claim shall be made expressly and shall be supported by a description of the nature of the documents, communications or things not produced or disclosed and the exact privilege which is being claimed."). "Ordinarily, one who claims to be exempt by reason of privilege from the general rule which compels all persons to disclose the truth has the burden of showing the facts which give rise to the privilege. His mere assertion that the matter is confidential and privileged will not suffice." *Thomas v. Page,* 361 Ill. App. 3d 484, 497 (2d Dist.

2005) (cleaned up). The Department has not met its burden in illustrating any of these documents are actually privileged.

Second, most of the identified custodians are not attorneys, making it unlikely that many of the responsive emails are protected by attorney-client privilege. The essential elements for attorney-client privilege are: "(1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived." *People v. Adam*, 51 Ill. 2d 46, 48 (1972). (citing 8 Wigmore, Evidence, § 2292 (McNaughton Rev. 1961)). The attorney-client privilege must be confined to its narrowest limits. *Waste Mgmt. v. Int'l Surplus Lines Ins. Co*., 144 Ill. 2d 178 (1991). The privilege is limited "solely to those communications which the claimant either expressly made confidential or which he could reasonably believe under the circumstances would be understood by the attorney as such." *Id.* at 190 (*citing Consolidation Coal Co. v. Bucyrus-Erie Co.*, 89 Ill. 2d 103, 117–18 (1982)); McCormick Evidence § 91, at 217 (3d ed. 1984)).

(iv) Work Product Privilege Objections

Third, the work product doctrine only applies to documents created in anticipation of litigation. *See Monier v. Chamberlain,* 35 Ill. 2d 351, 360 (1966) (Work product is limited to "materials generated in preparation of litigation which reveal the mental impressions, opinions or trial strategy of an attorney."). The auditor here stated explicitly "this won't end up in court" and when challenged by his supervisor ("how do you know it won't end up in court"?), further emphasized "[i]t won't end up in court because the evidence is against them." See attached **Exhibit 3** (emails between auditor and his supervisor). His supervisor then agreed with Mr.

Nelson and authorized his plan of denying penalty relief on the basis that no court would review the Department's actions. *See id.* Further, attorneys authored few if any of the requested emails. Therefore, these emails are not covered by the work product doctrine because they were not made in anticipation of litigation.

(v) Years Not "At Issue" Relevance Objection

The Department objected to Request No. 2 because "tax years 2013 and 2016 are not the tax years at issue. The Department acknowledges that tax years 2013 and 2016 are currently under audit, but notices have not been issued." First, a notice of proposed liability has since issued in the 2013/2016 audit, so the objection is no longer valid. Second, to the extent the Department challenges the relevance of these tax years, its regulatory presumption of residency references prior-year residency status and therefore makes the 2013 tax year indisputably relevant. *See* 86 Ill. Admin. Code § 100.3020(f) (regulatory presumption). In addition, the documents produced so far reveal that, although it was unknown to the Rothmans, the 2013 and 2016 tax years were the tax years *at issue for the Department* in the audit of 2014 and 2015 that is before the Tax Tribunal. The Department's objections to Request No. 2 are meritless.

(vi) Remaining Email Relevance Objections

The Department objected to Request No. 5 because it may cover the audit manual, which the Department claims is irrelevant. We cover that argument *infra* in Part III.B. The Department further objects to Request No. 5 because it is "overly broad and unduly burdensome" and "it is vague and ambiguous as to the term 'other activities' as it is not defined." To the extent those objections had merit, they were resolved during and after our 201(k) conference when Petitioners agreed to narrow the scope of Request No. 5 to emails from Department of Revenue employees involved in the audit covering the subject matter.

The Department did not object at all to Request No. 9—it simply directed Petitioner's to see the already produced audit file. The documents requested here were documents referenced in the audit file but not included in the audit file produced to Petitioners. The Department's response is, therefore, non-responsive and evasive. *See* Ill. S. Ct. R. 137 ("The signature of an attorney or party constitutes a certificate by him that he has read the . . . paper; that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact . . . , and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.").

B. AUDIT MANUAL – RELEVANCE AND PRIVILEGE OBJECTIONS

Request No. 4 asked for the portions of the Department's audit manual related to residency and penalties. The Department objected, claiming it was subject to attorney-client privilege, work product privilege, and that it is not relevant to the proceedings.

An Illinois court recently ordered the Department to release its entire audit manual under the Illinois Freedom of Information Act. *See Tax Analysts v. Ill. Dep't of Rev.*, 18-MR-001018 (Sangamon Cty. Cir. Ct. Dec. 18, 2019). After appealing, the Department settled the case on December 3, 2020 and agreed to release most of the audit manual to the public. There is no plausible basis to assert privilege over what was determined to be a public document. The Department has again not provided a privilege log identifying which portions of the residency and penalty sections of the audit manual are privileged and why. Moreover, the Department produced a portion of the Audit Manual dated September of 2019. That is not the Audit Manual in use when audit management made decisions in the 2014-2015 audit.[3] The Department should

[3] The audit manual was released to an organization who is charging the general public to view the manual. The Department had ample time to "clean up" the Audit Manual during the pendency of the *Tax Analysts* litigation, so the "publicly available" audit manual does not necessarily reflect what the audit manual said at the time Mr. Nelson was actually auditing the Rothmans several years earlier.

supplement its response to Request No. 4 by producing all portions of the Department's audit manual in use at the time the audit was conducted that are responsive to the Request.

As to relevancy, again, the presumption of administrative regularity and the *prima facie* correct effect of the Department's assessment are very much in question given the scheme laid out by the documents produced so far, and given the gaps in the production. What the requested audit manual sections are, what they say, and whether it is correct,[4] and whether the audit flouted or followed these, is plainly relevant and the Department should produce the requested sections.

The Department recently produced seven pages of the residency portion of the audit manual on March 8, 2021. These pages are heavily redacted, and we have reason to believe other portions addressing residency were not produced. For example, the Department did not produce Chapter 49 of the audit manual, which according to the small portion produced contains guidance on the case law regarding residency. Further, the Department has not produced any portion of the audit manual dealing with the standards and procedures for imposing penalties.

C. AUDIT FILES

(i) Audit File for Tax Years 2013 & 2016

As already noted, in Request No. 2 Petitioners asked for the audit file for the 2013/2016 audit of the Rothmans. The Department objected to Request No. 2 because "tax years 2013 and 2016 are not the tax years at issue. The Department acknowledges that tax years 2013 and 2016

[4] We have a good faith basis to believe that either the Auditor applied his own view of how the regulations apply that is contrary to the regulations, or that the Audit Manual or other internal guidance incorrectly described the law. In an October 30, 2017 email requesting approval for a negligence penalty asserting the Rothman's "contempt and intentional disregard of our Statute[,]" the Auditor says: "The fact that they changed their licenses, voter's registrations and bought a couple of vacation homes is not exercising 'ordinary business care . . .' when our Regulations contain specific examples showing time spent is a significant factor." The examples in the regulation are original to the 1981 version of the regulation adopting a rebuttable presumption of residency when more than 9 months were spent in Illinois. The examples were unchanged when the regulation was amended in April of 2013 to presume residence when one is a resident of Illinois in the prior year *and* in the following year spends more time in Illinois than in one other state. The regulation the Auditor applied does not specify a time period. The examples in the regulation look to the activity of the taxpayer in the states, not to a set period of time. Evidence of out-of-state activities rebuts the presumption derived from time in Illinois. The Auditor applied the opposite formulation.

are currently under audit, but notices have not been issued." A notice has since issued in the 2013/2016 audit, so the objection is no longer valid. To the extent the Department challenges the relevance of these tax years, its regulatory residency presumption which references prior-year residency status makes these tax years indisputably relevant. The Department's objections to Request No. 2 are therefore meritless.

(ii) Incomplete Audit File for Tax Years at Issue (2014 & 2015)

The Department admitted once that it produced an incomplete audit file for the tax years at issue. We are still not confident the entire file was produced; many documents referenced therein are not included in the file, and the activity log is missing the last six months of the audit.

IV. Conclusion

Department auditor Greg Nelson regarding Petitioners' income tax audit:

> I'm going to initiate the '13 MFS audit on [Mrs. Rothman] in which she did not file IL ($[REDACTED]MIL AGI). If we abate now, we'll have to abate the '13 penalties AND the '16 (new audit just requested) on their joint income of $[REDACTED]MIL filed las month as Non-residents. ***I think we should abate nothing, this won't end up in Court*** (they'll be compelled to actually provide information).

See attached **Exhibit 3** (emphasis added; tax amounts not at issue in this case redacted). Contrary to Mr. Nelson's predictions, we are in Court, and it is now the Department who is reluctant to provide information. Petitioners have every right to discover all the facts regarding the Department's highly irregular audit process.

WHEREFORE, we respectfully request that this Tribunal grant Petitioners' Motion to Compel Discovery, and any further relief the Tribunal deems appropriate.

Dated: April 23, 2021

Respectfully submitted,

/s/ Michael J. Wynne

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