FIFTH DIVISION
July 18, 2014

No. 1-12-2094

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT

ARVIND SHAH and NALINI PATEL, Individually and on behalf of CIRCUIT ETCHING TECHNICS, Inc., an Illinois corporation,	)	Appeal from the Circuit Court of Cook County.
Plaintiffs-Appellees,	)	97 CH 04456
v.	)	
RAOJIBHAI PATEL, BABU PATEL, MANU JATSWAL, ASHOK PARIKH, BHARATI PATEL, DENNIS ARCIERI, CIRCUIT ETCHING TECHNICS, Inc., an Illinois corporation, and 700 LEE ASSOCIATES, an Illinois partnership,	)	Honorable Franklin U. Valderama, Judge Presiding.
Defendants-Appellants.	)	

JUSTICE TAYLOR delivered the judgment of the court.
Presiding Justice Gordon and Justice McBride concurred in the judgment.

ORDER

Held: Pursuant to an agreed order, the parties agreed that defendants would indemnify plaintiffs for certain tax liabilities indicated by an Internal Revenue Service audit, except that defendants were not responsible for any portion of liability that was caused by a change in accounting methods. A dispute arose between the parties as to how much defendants owed under this agreement. Plaintiffs brought suit, and the trial court found in their favor. The trial court's judgment was not against the manifest weight of the evidence where it was supported by expert testimony.

¶ 1 The parties were all shareholders in Circuit Etching Technics, Inc. (CETI). The plaintiffs, Arvind Shah and Nalini Patel, individually and on behalf of CETI filed suit on April 11, 1997, against defendants, Raijibhai Patel, Babu Patel, Manu Jayswal, Ashok Parikh, Bharati Patel, Dennis Arcieri, CETI, and 700 Lee Associates, alleging shareholder oppression. The parties subsequently agreed to mediate this dispute. Mediation was set for September 25, 1997, at which time the case was settled by an agreed order. The agreed order stated that the plaintiffs were to tender all of their shares in CETI to defendants, and contemporaneous with this tender, defendants were to pay plaintiffs in accordance with their proportionate shareholding interest in CETI, the aggregate sum of $510,000. Further, the agreed order contained in paragraph five an indemnity clause whereby defendants were to indemnify and hold harmless plaintiffs for certain tax liabilities.

¶ 2 The parties later became in conflict regarding the interpretation of one of the paragraphs of the agreed order. After years of litigation the case went to trial over the interpretation of paragraph five, which contained an indemnity obligation for certain tax liabilities of shareholders of defendant CETI. Following a two-day bench trial consisting mostly of the parties' experts testimony, the trial court entered a judgment order in favor of plaintiffs.

¶ 3 The indemnity provision required defendants, Raijibhai Patel, Babu Patel, Manu Jayswal, Ashok Parikh, Bharati Patel, Dennis Arcieri, CETI, and 700 Lee Associates, to hold plaintiffs, Arvind Shah and Nalini Patel, individually and on behalf of CETI, harmless from state and federal tax liability that was not related to a change in accounting methods. The only issue before the court was the amount of additional tax liability incurred by plaintiffs which is subject to indemnification.

¶ 4 BACKGROUND

¶ 5 This case involves the application of the indemnity provision found in the settlement agreement between the parties included in the agreed order of September 25, 1997. The agreed order provides in relevant part:

> "5. Defendants shall indemnify and hold harmless Plaintiffs from any and all actions brought against the Corporation(CETI) or Plaintiffs as officers, directors or shareholders of the Corporation, including, but not limited to, any personal guarantees, environmental or state or federal tax liability, except for the current re-assessment of federal taxes for the years 1993, 1994, 1995 and 1996 due to a change in accounting methods."

¶ 6 The 1993, 1994, and 1995 federal income tax returns for CETI were examined by the Internal Revenue Service (IRS), which made certain adjustments to the tax returns per the Internal Revenue Code (Code). CETI'S accountant, Irwin Rosenson, verified the adjustments, and Babu Patel, CETI's chief executive officer and shareholder, agreed to all of the adjustments. Accordingly, CETI made the required adjustments to its federal and state returns and, as a result, plaintiffs incurred increases in their tax liabilities for the year 1993. Following the re-assessment of taxes, the parties could not agree on the amount of money defendants were to reimburse plaintiffs under the indemnification provision. In particular, they disagreed about how much of the increased tax liability was "due to a change in accounting methods" and therefore not included in defendant's liability pursuant to the agreed order. On June 18, 1999, plaintiffs filed a petition for reinstatement and rule to show cause against defendants for failure to indemnify plaintiffs for certain tax liabilities incurred by plaintiffs due to the IRS audit.

¶ 7 After years of litigation, on November 30, 2011, the parties commenced a two day bench trial. The trial consisted mainly of testimony by the parties' expert witnesses; Lawrence Silverman testified for the plaintiffs and Alan Leff testified for the defendants. In sum, Silverman testified he made a calculation of the amount of liability under the indemnity agreement by determining the amount of tax liability imposed by the IRS upon and paid by the plaintiffs. Leff testified he also made a calculation of the amount of taxes the IRS should have imposed upon the plaintiffs. Silverman concluded that the amount of indemnity was $189,860, while Leff concluded that the amount of indemnity was $12,989.

¶ 8 At trial, plaintiffs first called Silverman, a certified public accountant, who testified that the plaintiffs retained him in 1999 to determine their tax liability as a result of the reassessment of CETI's federal taxes for the years 1993, 1994, and 1995. He testified that he reviewed the audit materials by the IRS, including the plaintiffs' form 1040 individual tax returns, because those are generally the materials necessary for a tax expert to evaluate for an S corporation. He opined that CETI was an S corporation and under subchapter S of the Code the owners of a corporation personally pay taxes on all of the corporations income in proportion to their ownership interest. 26 U.S.C.A. §§ 1361-1379 (West 2010). He also reviewed the settlement agreement the IRS and CETI reached with respect to CETI's 1993 federal taxes. According to Silverman, the schedule of adjustments contained in the agreement did not apply to CETI's tax return but, rather, applied to the shareholders individually because CETI was an S corporation. He opined that as a result of the IRS's reassessment of CETI's tax liability for the year 1993, the plaintiffs incurred additional federal tax liabilities that were not related to a change in accounting method.

¶ 9 Silverman testified that the IRS increased CETI'S income by $789,239 during the 1993 tax year due to a change in accounting method. He opined that the adjustments required by changes in method of accounting under section 481 of the Code, the IRS had determined that CETI's accounting method did not properly reflect its income because its sales were reported on a cash basis instead of on accrual basis. 26 U.S.C.A. § 481 (West 2010). Further, as an S corporation, the additional income assessed against CETI "flowed through" as additional income to its shareholders on a *pro rata* basis.

¶ 10 In determining plaintiffs' respective tax liabilities, Silverman testified that he excluded the change of accounting method adjustments and took into account the distribution amounts that were allocated to the plaintiffs as a result of the IRS reassessment of CETI's 1993 taxes. He testified that he factored in the $987,906 of distributions in his calculations because the IRS included this amount in its own determination of plaintiffs' tax liabilities. Silverman testified that the distributions included partnership building rents, direct profit distributions to shareholders, disallowed commissions and offsets to the accumulated adjustments account. He opined that under Code section 1368 shareholders must take into account separately the tax effect of their respective distributions. 26 U.S.C.A. § 1368 (West 2010). The relevant code section 1368(b) requires a shareholder of an S corporation to determine the taxability of a distribution made with respect to its stock at the shareholder level, by first reducing basis in the stock and debt of the corporation (but not below zero) to determine the non-taxable portion, and any remainder being treated as a gain or loss on the sale of property. 26 U.S.C.A. § 1368 (b) (West 2010). He further testified that adjustments with regard to distributions to shareholders are required to be reflected separately than change of accounting method adjustments.

¶ 11 He testified that there were adjustments made to ordinary income as well as to distributions to the shareholders that had not been disclosed in CETI's 1993 tax return. Silverman further testified that this additional income and distribution amounts needed to be dealt with at the shareholder level. According to Silverman, he included those distributions because the IRS had used those amounts in order to determine Shah and Nalini's respective liabilities, and he further opined that they had paid those taxes accordingly. He further testified that an analysis of the plaintiffs' form 1040 individual tax returns was important because an adjustment made with respect to distribution is affected differently by each shareholders' individual return information. Silverman testified that all of his conclusions were based on IRS reports for CETI and the individual shareholders that an IRS agent named Witek had prepared and given to plaintiffs.

¶ 12 Next, Shah testified for the plaintiffs that he was a former shareholder in CETI and that the IRS had reassessed CETI's 1993 taxes. He testified that he filed an amended tax return, after the IRS examination of CETI's federal income tax return for 1993 resulted in additional tax liability.

He also testified that he paid the reassessed taxes and interest.

¶ 13 Jay Patel testified that his wife Nalini was a former CETI shareholder and that he and his wife filed joint tax returns. He testified that the IRS had reassessed their 1993 tax return and that the IRS had made income adjustments to the couple's tax return as a result of CETI's tax errors. He further testified that they had paid those reassessed taxes with interest. He averred that Rosenson, CETI's accountant in 1993, was also their personal accountant in the IRS audit proceedings.

¶ 14 Plaintiffs final witness was defendant Babu Patel. Babu testified that he was CETI's chief executive officer and that he was a CETI shareholder, officer and director since 1993. He testified that CETI had always been an S corporation. According to Babu, CETI made distributions in 1993. He testified that during the IRS reassessment, CETI disclosed to the IRS everything that was distributed. Furthermore, Babu testified that each CETI shareholder was responsible for paying taxes on CETI's distributions. Babu stated that he read through all of the IRS audit materials, including the detailed explanations for each adjustment, before he agreed to the IRS determinations. He maintained that he was the legal authority to act on behalf of CETI. He further testified that Rosenson was present during all of the IRS audit proceedings. Following Babu's testimony, plaintiffs rested.

¶ 15 Defendants then presented their only witness, Leff, a certified public accountant. Leff testified that he had been retained by defendants to analyze the nature of CETI's income and whether the various adjustments made by the IRS were attributed to a change in accounting method. He reviewed various documents including, Witek's report, in order to make a determination as to what portion of the additional assessed taxes for 1993 were due to a change in accounting method. Leff testified that prior to the IRS audit, CETI used the cash basis accounting method, but as a result of the IRS audit, CETI was required to switch to the accrual basis accounting method.

¶ 16 Leff further testified to the method he used to reach his conclusions. He testified that he first found the CETI shareholders' ownership percentages. Leff testified that he took the numbers from agent Witek's report and used them, classifying the numbers as to whether they applied to an accounting adjustment or a non-accounting adjustment. Then he created columns, the first of which referred to adjustments not due to an accounting change, and the second of which consisted of adjustments that were due to an accounting change. He testified that he took the numbers from Witek's report. Leff testified that he based his conclusions on his understanding of the accounting adjustment rules and some of Witek's comments. Leff testified that he concluded that CETI had $103,080 of adjustments that were unrelated to section 481 and not accounting change related. 26 U.S.C.A. § 481 (West 2010). Section 481 allows for adjustments required by changes in method of accounting and indicates a taxpayer is required to take into account any adjustments determined to be necessary to prevent amounts from being duplicated or omitted as a result of the change in accounting method and limits the tax arising from a 481 adjustment. 26 U.S.C.A. § 481 (West 2010). Leff also testified that he reviewed plaintiffs' tax returns but did not take them into account because he had everything he needed from CETI's return.

¶ 17 Leff testified that the plaintiffs' respective CETI ownership percentages were 10.4% for Shah and 19.2% for Nalini, and the amount of plaintiffs' maximum share of taxes for purposes of the agreed order was $12,989. Leff stated that if an S corporation gave a distribution to a shareholder, it should be reflected in the tax forms, but because distributive shares are not always taxable income, there would still need to be analysis as to whether the distribution was taxable.

¶ 18 Leff, further testified that a subchapter S distribution does not constitute taxable income to the shareholder because of rules prescribed under Code section 1368. 26 U.S.C.A. § 1368 (a) (West 2010). Further, Leff testified that under section 1368(a) if the distribution exceeded the amount of income that agent Witek calculated, it would result in additional tax. 26 U.S.C.A. § 1368(a) (West 2010). However, since the distribution was lower than the $1,200,000 income amount, it was not subject to tax. Leff testified that he did not include the $987,906 in his calculations because the distribution, in his opinion did not create an additional tax liability for the plaintiffs. Leff further opined that tax law states that if a distribution of cash exceeds income, it results in additional taxes. According to Leff, since the distribution amount ($987,000) was less than CETI's taxable income ($1,200,000), it was not taxable and he testified that he did not need to do any further investigation.

¶ 19 Leff further testified that he considered the plaintiff's form 1040 tax returns for the year 1993, but he did not rely on the individual tax returns in his analysis. Instead, Leff used CETI's federal income tax returns to derive all of his calculations. He opined that adjustments by the IRS in the taxable year ending 1993 included additional tax liability on the distributions, Leff maintained that the plaintiffs were subject to double taxation.

¶ 20 Leff confirmed that he reviewed Witek's findings, but stated he did not rely on those findings in making his own conclusions, because Witek had improperly included certain figures in his calculations. He further opined that those changes were incorrectly assessed against plaintiffs as CETI shareholders. Leff testified that he did not know if the plaintiffs paid the taxes the IRS reassessed against them.

¶ 21 In rebuttal, Silverman testified that he did not believe that an assessment on taxes as both the ordinary income adjustment and share adjustment amounted to a double taxation. According to Silverman, one assessment represented the cash the shareholders received and the other assessment represented the income that was being attributed to them.

¶ 22 Following closing arguments, this matter was continued to December 19, 2011, for a ruling. On that date, the trial court entered a 14-page opinion and judgement order. The trial court, after considering the exhibits, which included the 1993 IRS audit of CETI, and weighing the testimony of the witnesses, agreed with plaintiffs' expert in finding that the indemnity provision covered $189,867 of tax liability incurred by plaintiffs that was not related to a change in accounting methods. The court therefore awarded Shah $86,692 and Nalini $103,175.

¶ 23 The trial court fully explained its reasoning in its order, which included 24 findings of fact and 27 conclusions of law. The trial court specifically found in finding 17, with which the defendants take issue, that:

> "The IRS increased Circuit Etching's taxable income by approximately $824,503.00 during the 1993 tax year due to disallowed expenses. As an S-corporation, the additional income assessed against Circuit Etching "flowed through" as additional income to its shareholders on a pro rata basis. Consequently, a portion of Circuit Etching's additional income flowed

through to the Plaintiffs, as shareholders of the Corporation."

Finally, the trial court concluded that "Leff's opinion, *** is based on the amount of federal taxes that the plaintiffs should have paid, notwithstanding what the plaintiffs actually paid." On January 13, 2012, defendants filed a motion for rehearing which was denied on June 22, 2012. This notice of appeal was timely filed on July 18, 2012.

¶ 24 ANALYSIS

¶ 25 Defendants contend that the trial court's findings were against the manifest weight of the evidence and therefore in error. First, defendants contend that the trial court's reliance on plaintiff's expert witness was misplaced. Second, defendants maintain that the trial court's findings of fact, especially finding 17, which related to the increase in CETI's taxable income, were unsupported by the evidence. Third, defendants argue that there is no evidence that the plaintiffs actually paid the amounts to which they seek indemnification. Finally, defendants argue that the trial court erred in its interpretation of the relevant internal revenue code sections.

¶ 26 Since these rulings were made following a bench trial, the applicable standard of review is whether the trial court's judgment is against the manifest weight of the evidence. *Judgment Services Corp. v. Sullivan,* 321 Ill. App. 3d 151, 154 (2001). “A judgment is against the manifest weight of the evidence only when an opposite conclusion is apparent or when findings appear to be unreasonable, arbitrary, or not based on evidence.” *Id.* To the extent defendants challenge the trial court's rulings on purely legal grounds, we review the trial court's rulings *de novo. In re Marriage of Ackerley,* 333 Ill. App. 3d 382, 398 (2002); *Dargis v. Paradise Park, Inc*. 354 Ill.

App. 3d 171, 177-178 (2004).

¶ 27 A reviewing court should not overturn a trial court's findings merely because it does not agree with the lower court or because it might have reached a different conclusion had it been the fact finder. *Bazydlo v. Volant*, 164 Ill. 2d 207, 214-15 (1995). As the trier of fact, the trial judge was in a superior position to judge the credibility of the witnesses and determine the weight to be given to their testimony. *Id*. When, as in this case, contradictory testimony which could support conflicting conclusions is given at a bench trial, we will not disturb the trial court's factual findings based on that testimony unless a contrary finding is clearly apparent. *DeLong v. Cabinet Wholesalers, Inc.,* 196 Ill. App. 3d 974, 979 (1990); *Buckner v. Causey* 311 Ill. App. 3d 139, 144 (1999)

¶ 28 Defendants first contend that the trial court erred when it accepted the testimony of plaintiffs expert as to the amount of tax liability assessed upon the plaintiffs that was not related to the change in accounting methods. They contend that their expert's opinion regarding the amount of money subject to indemnification was correct and the opinion of plaintiffs expert was inherently flawed. Specifically, defendants maintain that there is nothing in the record that supports the trial court's finding that the plaintiffs additional tax liability was not due to the change in accounting method.

¶ 29 Defendants further argue that plaintiffs' testimony regarding what the IRS told them to pay and what they actually paid is unsubstantiated. Plaintiffs first point out that defendants have cited to no authority for this position and have therefore waived this argument. It is an elementary rule of appellate practice that an appellant may not make a point merely by stating it without presenting arguments in support of it. *Reichelt v. Anderson*, 222 Ill. App. 176 (1921). This court will not research and argue a case for an appellant. *Nicholl v. Scaletta,* 104 Ill. App. 3d 642, 647 (1982).

¶ 30 First, as to defendants' contention that their expert's opinion was more credible, the plaintiffs argue that the trial court, as the finder of fact, was entitled to find Silverman's testimony more credible that Leff's. Silverman testified that he calculated the amount of liability under the indemnity agreement based upon the amount of taxes that the IRS actually imposed and that plaintiffs paid. Leff, on the other hand, based his opinion upon his own interpretation of the applicable tax laws, which differed from the interpretation used by the IRS in reassessing CETI"s 1993 taxes. Indeed, Leff testified that he reviewed the findings of IRS agent Witek but did not follow them because he believed them to be incorrect. Because of this, the trial court entered an explicit finding that Leff's opinion "is based on the amount of Federal taxes that the plaintiffs should have paid, notwithstanding what the plaintiffs actually paid." Upon these facts, plaintiffs argue that the trial court did not err in finding Silverman's testimony to be persuasive.

¶ 31 When dealing with conflicting expert testimony, our supreme court has aptly stated:

> "This case involved a classic battle of the experts. Witnesses qualified in their fields stated their opinions and gave their reasons for those opinions. Not surprisingly, the plaintiff's experts did not agree with the defense experts. The jury needed to listen to the conflicting evidence and use its best judgment to determine where the truth could be found. The jury found in favor of Snelson and against Kamm, and this court 'should not usurp the function of the jury and substitute its judgment on questions of fact fairly submitted, tried, and

> determined from the evidence which did not greatly preponderate either way.' "*Snelson v. Kamm* 204 Ill. 2d 1, 35-36 (2003).

¶ 32 Moreover, the mere fact that both experts were eminently qualified does not mean that their opinions must or should be given equal weight. This court in *St. Paul Fire & Marine Ins. Co. v. Michelin Tire Corp.* 12 Ill. App. 3d 165, 179 (1973), in reviewing the decision of a trial court which was confronted with the testimony of experts on an issue, stated,

> “The conflicting testimony of expert witnesses normally raises an issue uniquely determinable by the trier of fact, who is in a better position to view the pertinent exhibits and assess the credibility of the witnesses. However, the weight of an expert's opinion must be measured by the reasons given for the conclusion and the factual details marshaled in support thereof. The opinion of an expert is of value only when it is based upon and in harmony with facts which are capable of verification by the court, and, where a factual basis is lacking, the opinion is entitled to little weight.” *Matter of Estate of Lukas,* 155 Ill. App. 3d 512, 523-524 (1987.)

¶ 33 The case at bar, as in *Lukas*, is a classic battle of the experts. However, the trial court specifically found that the evidence supported the calculations derived by plaintiffs' expert, Silverman. Accordingly, under these circumstances, where there has been conflicting testimony about the amount the defendants were to indemnify the plaintiffs, as well as conflicts in the experts' testimonies, we cannot say that a contrary conclusion was clearly evident. Thus, we do not find that the trial court's resolution of the matter was against the manifest weight of the evidence.

¶ 34 Next, with regard to defendants' contention that the trial court made findings of fact that were against the manifest weight of the evidence, they maintain that the trial court's finding 17 is erroneous. Defendants argue that there is no evidence in the record to support either the amount or the correctness of finding 17. As noted above, finding 17 states:

> "The IRS increased [CETI]'s taxable income by approximately $824,503.00 during the 1993 tax year due to disallowed expenses. As an S-corporation, the additional income assessed against [CETI] 'flowed through' as additional income to its shareholders on a pro rata basis. Consequently, a portion of [CETI]'s additional income flowed through to the Plaintiffs, as shareholders of the Corporation."

Defendants maintain that there is no evidence to support a determination that the IRS disallowed $824,503 as a deduction or disallowed it as an expense, thereby creating a tax for which defendants were required to indemnify plaintiffs. Defendants maintain that Leff concluded that CETI had $103,080 of adjustments that were unrelated to section 481 and not accounting-change related. 26 U.S.C.A. § 481 (West 2010). Section 481(b) allows for adjustments required by changes in method of accounting and indicates a taxpayer is required to take into account any adjustments determined to be necessary to prevent amounts from being duplicated or omitted as a result of the change in accounting method and limits the tax arising from a 481 adjustment. 26 U.S.C.A. § 481(b) (West 2010). Leff testified that he took the numbers from agent Witek's report and used them, but classified the numbers differently as to whether they applied to an accounting adjustment or a non-accounting adjustment. Leff also testified that he reviewed plaintiffs' tax returns but did not take them into account because he had everything he needed from CETI's return.

¶ 35 Plaintiffs first respond that CETI agreed to all of the IRS adjustments made to the their 1993 federal income tax return as a result of the IRS examination. Plaintiffs also maintain that Silverman's calculations of the amount of plaintiffs increased tax liability arising from matters not related to the change in accounting methods were reflected in plaintiffs exhibit 2 which is the IRS audit of CETI. Silverman testified that his methodology was based on the IRS calculations of the increase in income reflected in plaintiff's exhibit 2.

¶ 36 Moreover, in the present case, the trial judge found Silverman's testimony persuasive. The trial court specifically stated:

> "Silverman's opinion is based on the amount of tax liability assessed by the IRS against Plaintiffs, which Arvind Shah and Jay Patel testified, is purportedly the same amount that the Plaintiffs subsequently paid. Leff's opinion on the other hand, is based on the amount of federal and state taxes that the Plaintiffs should have paid, notwithstanding what the plaintiffs actually paid. Furthermore, Silverman's calculations account for penalties and interest, whereas Leff's calculations do not. Leff 'considered' the Plaintiffs 1040 tax returns, but he did not 'use' them in any part of his analysis. Consequently, Leff did not entirely consider the impact of the change of accounting method, disallowed expenses, and distributions at the shareholder level. It is the fundamental nature of an S-corporation that income is taxed at the shareholder level and not at the corporate level, and that shareholders must report the income on their own individual income tax returns."

The findings of the trial court will not be disturbed on review unless such findings are against the manifest weight of the evidence. *In re Estate of Zukerman,* 218 Ill. App. 3d 325, 330 (1991). A decision is against the manifest weight of the evidence only when an opposite conclusion is apparent or when the findings appear to be unreasonable, arbitrary, or not based on the evidence. *Rhodes v. Illinois Central Gulf R.R.,* 172 Ill. 2d 213, 242 (1996); *Leonardi v. Loyola University of Chicago,* 168 Ill. 2d 83, 106 (1995); *Bazydlo,* 164 Ill. 2d at 215. We find support in the evidence for the trial court's conclusions and therefore do not find them unreasonable or arbitrary.

¶ 37 Turning to defendants' contention that there is no proof that plaintiffs paid the IRS the money for which they are seeking indemnification, defendants claim that there is no evidence in the record as to how much the plaintiffs actually paid. Plaintiffs, on the other hand, argue that their expert testified that the plaintiffs paid the assessments. Specifically, Silverman testified that he reviewed plaintiffs' tax returns and that Shah and Patel paid the increased taxes. Further, each plaintiff independently testified at trial that they had paid the taxes which were reassessed as a result of the IRS audit relating to the year 1993. The trial court was in the best position to assess the testimony and the evidence, and based upon the foregoing testimony, it cannot be said that the trial court's findings were against the manifest weight of the evidence. See *Rhodes,* 172 Ill. 2d at 242.

¶ 38 Next, defendants maintain that the trial court erred in its interpretation of the relevant Code sections as a matter of law. In reviewing the trial court's conclusions of law, we apply a *de novo* standard of review. See *Norskog v. Pfiel,* 197 Ill. 2d 60, 70–71 (2001); *Woods v. Cole,* 181 Ill. 2d 512, 516 (1998); T. O'Neill & S. Brody, *Taking Standards of Appellate Review Seriously: A*

Proposal to Amend Rule 341, 83 Ill. B.J. 512, 516 (1995).

¶ 39 Defendants contend that Leff testified that agent Witek's report indicating the sum of $987,000 as distributions was incorrect. This amount was less than the income of CETI and therefore, it should not be considered taxable income. They maintain that the trial court erroneously assumed that $987,906 was taxable income subject to the indemnity provision contained in the agreed order. Defendants argue that their expert Leff, consistently testified that a subchapter S distribution does not constitute taxable income to the shareholder because of rules prescribed under Code section 1368. 26 U.S.C.A. § 1368 (a) (West 2010). Further, Leff testified that under section 1368(a) if the distribution exceeded the amount of income that agent Witek calculated, it would result in additional tax. 26 U.S.C.A. § 1368(a) (West 2010). However, since the distribution was lower than the $1,200,000 income amount, it was not subject to tax.

¶ 40 First, plaintiffs respond that defendants are attempting to relitigate and contest the validity of the IRS determination of the amount of tax liability imposed upon plaintiffs. Plaintiffs point out that CETI accepted and agreed to the assessment of taxes. Babu testified that he initialed the agreement to assessment and collection of deficiencies. Further, plaintiffs maintain that the trial court relied on the IRS audit in which CETI had previously agreed to.

¶ 41 Plaintiffs contend that the trial court based its judgment on its interpretation of the indemnity agreement. They maintain that the trial court specifically stated that "notwithstanding whether [CETI] paid too much tax, that fact does not negate the defendant's obligation to indemnify the plaintiffs under the settlement order." Plaintiffs contend that the reasoning of the trial court was based upon the rights to indemnification for all losses or liabilities arising from the

IRS audit of CETI except for matters arising from the change in accounting method. Plaintiffs further argue that even if the IRS was wrong in its calculations of plaintiffs' tax liability, plaintiffs would still be entitled to indemnity because the IRS imposed the liability on the plaintiffs and they paid.

¶ 42 Generally, an indemnity contract covers all losses, damages or liabilities which were reasonably within the contemplation of the parties. *Burns v. Ford Motor Co.,* 29 Ill. App. 3d 585 (1974). The very essence of an indemnity agreement is to hold the indemnities harmless and completely relieved of liability according to the terms of the agreement. *Gatto v. Walgreen Drug Co.,* 23 Ill. App. 3d 628, (1974). Viewed in this light, we believe that in the case at bar defendants agreed to indemnify plaintiffs. Further, the trial court specifically found that:

> "notwithstanding whether CETI paid too much tax, that fact does not negate the defendants obligation to indemnify the plaintiffs under the settlement order. Defendants were responsible to cover any tax liability assessed and paid by the plaintiffs not arising from the change in accounting methods, whether properly assessed by the IRS or not. Defendants were, thus, under the settlement order required to compensate plaintiffs for any harm arising form tax liability not attributed to a change in accounting method, ***."

The trial court also found that:

> "all of the positive adjustments to the federal and state corporate income tax returns of [CETI] during the 1993 tax year, that did not arise from a change in accounting method, are not excluded from indemnity. Therefore, the court found that defendants shall

> reimburse the plaintiffs for the full amount of federal and state tax liability that the plaintiffs paid with respect to the disallowed expenses and distributions assessed by the IRS, totaling approximately $189,867."

¶ 43 At all times relevant, CETI operated as and was taxed as a subchapter S corporation. 26 U.S.C.A. §§ 1361-1379 (West 2010). Under subchapter S of the Code the owners of a corporation personally pay taxes on all of the corporations income in proportion to their ownership interest. The court determined that during the taxable year 1993, plaintiff Shah owned 10.4% of the outstanding shares of stock in CETI and plaintiff Nalini owned 19.2% of the outstanding shares.

¶ 44 Defendants maintain that before the amount of income to an S corporation shareholder arising from a distribution can be considered as income, the basis for the shareholder's S corporation stock must be established. Basis refers to the purchase price of the stock in the corporation and increased by the shareholder's portion of all income items of the corporation passed through to the shareholders, plus the excess of corporations's deductions. The basis is decreased by the portion of distributions that are not included in the shareholder's income due to section 1368, and any loss and deduction items passed through to the shareholders. 26 U.S.C.A. § 1368 (West 2010). Defendants further contend that any conclusion concerning the taxability of the distributions was incorrect because the necessary elements to arrive at such a conclusion were never offered or entered into evidence. Defendants argue that there is no evidence of the basis the shareholders have in CETI's stock and that without that information there can be no calculation of the amount defendants are responsible to indemnify the plaintiff. They maintain that the evidence was a compilation of confusing hearsay and incomprehensible exhibits that Witek prepared out of court.

¶ 45 In the trial court's conclusions of law, it found that adjustments with regard to distributions to shareholders are required to be reflected separately from code section 481(a) change of accounting method adjustments. 26 U.S.C.A. § 481(a) (West 2010). The Code authorizes the IRS to change a taxpayer's accounting method if the method used does not clearly reflect income. Adjustments made pursuant to section 481(a) are averaged between the current tax year with the two prior years. 26 U.S.C.A. § 481(a) (West 2010). Accordingly, the IRS changed CETI's method of reporting sales from a cash basis to an accrual basis. Adjustments made by the IRS under code section 481(a) related to a change of accounting method is limited at the shareholder level based on other information contained in each respective shareholder's individual form 1040. 26 U.S.C.A. § 481(a) (West 2010). The court further found that the IRS determined that CETI made certain distributions to its shareholders that were unrelated to the code section 481 (a) adjustment, including among other things, profit distributions and offsets to the corporation's accumulated adjustments account. 26 U.S.C.A. § 481(a) (West 2010). Next, the trial court found that according to code section 1368 shareholders must take into account separately the tax effect of their respective distributions. 26 U.S.C.A. § 1368 (West 2010). The relevant code section 1368(b) requires a shareholder of an S corporation to determine the taxability of a distribution made with respect to its stock at the shareholder level, by first reducing basis in the stock and debt of the corporation (but not below zero) to determine the non-taxable portion, and any remainder being treated as a gain or loss on the sale of property. 26 U.S.C.A. § 1368 (b) (West 2010).

¶ 46 Further, the trial court found that the IRS increased CETI's income by $987,906 in the year 1993 due to distributions being made to the corporation's shareholders. The court then found that as an S corporation, the additional income assessed against CETI "flowed through" as additional income to its shareholders on a pro rata basis. Consequently, a portion of CETI's additional income flowed through to the plaintiffs, as shareholders of the corporation. The court specifically determined that during the taxable year ended 1993, plaintiff Shah, owned 10.4% of the outstanding shares of stock in CETI. As such, approximately $85,772.85 of additional income was assessed against Shah due to distributions. In a footnote, the court explained its computation by finding the distribution amount and reducing it by the shareholder's basis in stock since the basis is non-taxable. 10.4% of $987,906 is $102,742.22. Thus, the difference is the basis. The court also found that Patel owned 19.2% of the outstanding shares of stock in CETI for the taxable year 1993. As such, approximately $158,350.80 of additional income was assessed against plaintiff Patel due to distributions. The court again reduced the amount by the basis. 19.2% of $987,906 is $189,677.95 Finally, the trial court found that the IRS increased CETI's income and it was specifically calculated on the percentages of stock that the plaintiffs owned and pursuant to section 1368(b) the taxability of a distribution is reduced by the shareholder's basis in stock which is non-taxable and therefore excluded. 26 U.S.C.A. § 1368(b) (West 2010).

¶ 47 Moreover, the record on appeal contained a letter from the IRS to Nalini and her husband, in response to their request for a computation of their basis and tax liability with and without the effects of the accounting method change adjustments. Further, at trial, the following exhibits were entered into evidence,: (I) the settlement order dated September 25, 1997, (ii) IRS audit report of

CETI for the taxable year ending 1993; (iii) defendants' responses to plaintiffs' request to admit; (iv) Silverman's summary of indemnification claim; (v) Leff's computations of CETI's tax liability for the years, 1993, 1994 and 1995; (vi) IRS form 4605-a for the taxable years ending 1993, 1994, and 1995. Finally, the trial court reduced the amount of distributions by the shareholder's basis and included this calculation in its findings. Thus, we find enough support in the record for the conclusions reached by the trial court.

¶ 48 The trial court found that all of the positive adjustments to the federal and state corporate income tax returns of [CETI] during the 1993 tax year, which did not arise from a change in accounting method, are not excluded from indemnity. Therefore, the court found that defendants shall reimburse the plaintiffs for the full amount of federal and state tax liability that the plaintiffs paid with respect to the disallowed expenses and distributions assessed by the IRS, totaling approximately $189,867.

¶ 49 Given the entire record on appeal, we cannot say that the trial court's factual findings were against the manifest weight of the evidence or that its conclusions of law were in error. In reviewing the circuit court's decisions on appeal, we observe that this court reviews the judgment, not the reasoning, of the trial court, and we may affirm on any grounds in the record, regardless of whether the trial court relied on those grounds or whether the trial court's reasoning was correct. *U.S. Bank, Nat. Ass'n v. Avdic*, 2014 IL App (1st) 121759 ¶ 18.

¶ 50 CONCLUSION

¶ 51 For the foregoing reasons we affirm the judgment of the trial court.

¶ 52 Affirmed.