

ST 12-20

Tax Type: Sales Tax

**Tax Issues: Taxpayer Claims He Is Not A Retailer
Wholesale v. Retail Sale**

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
ANYTOWN, ILLINOIS**

THE DEPARTMENT OF REVENUE)	Docket No.	XXXX
OF THE STATE OF ILLINOIS)	Reg. No.	XXXX
v.)	NTL Nos.	XXXX,
)		XXXX
ABC BUSINESS,)	John E. White,	
Taxpayer)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances:

John Etkorn, appeared for ABC Business; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose after ABC Business (ABC BUSINESS or Taxpayer) protested two Notices of Tax Liability (NTLs) the Illinois Department of Revenue (Department) issued to it after an audit of Taxpayer's business for the months of July 2004 through December 2008. The NTLs assessed tax, penalties and interest as measured by the gross receipts the Department determined ABC BUSINESS received from selling tangible personal property to nail salons in Illinois.

The issues include whether ABC BUSINESS acted as a wholesaler or as a retailer of the supplies and equipment it sold to nail salons in Illinois. After considering the evidence admitted at hearing, I am including in this recommendation findings of fact and conclusions of law. I recommend that the issue be resolved in favor of the Department, and that the NTLs be finalized as issued.

Findings of Fact:

1. ABC BUSINESS was engaged in the business of supplying tangible personal property (goods) to nail salons from a store located on North Broadway Street in Anytown. Department Ex. 1 (copies of NTLs, Corrections of Returns/Determination of Tax Due forms, and other Department papers), pp. 6-7 (Determination of Tax Due forms); Taxpayer Ex. 2 (copy of Lease between ABC BUSINESS, as Tenant, and another corporation, as Landlord, for property on North Broadway Street), pp. 1 (parties and term), 3 (use of property for “Nail Supply Store”); Hearing Transcript (Tr.) p. 23 (describing supplies and equipment sold as powder, liquids and clippers).
2. ABC BUSINESS began to lease the premises on North Broadway beginning in January 2004, for a term of five years. Taxpayer Ex. 2, p. 1.
3. ABC BUSINESS was owned by John Doe (John Doe), who testified at hearing. Tr. pp. 13-14 (John Doe). English is not John Doe’s first language, and an interpreter was used at hearing for some of his testimony. Tr. pp. 11, 17-26 (John Doe).
4. On or about December 2006, the Department issued a Certificate of Registration as a reseller to ABC BUSINESS, after John Doe and a friend went to the Department’s offices in Anytown to apply for a business license. Taxpayer Ex. 3 (copy of ABC BUSINESS’s certificate of registration); Memo from Taxpayer’s Attorney to Department, dated October 27, 2010 (Taxpayer’s Brief), p. 5 & Exhibit titled, Certificate of Registration-Reseller, p. 2 (cover letter for ABC BUSINESS’s certificate of registration, dated December 11, 2006) (hereafter, Taxpayer’s Brief, Ex. 1); Tr. pp. 14-20 (John Doe), 31-36 (testimony of Jack Black (Jack Black)).
5. Although John Doe testified that he went to the Department to apply for a business

customers, nor did it request and keep signed statements from such customers that the goods they purchased from ABC BUSINESS were purchased for resale. *See* Tr. pp. 22-24.

9. The Department conducted an audit of ABC BUSINESS that was completed on or about January 2011. Department Ex. 1, pp. 6-7.
10. Because ABC BUSINESS did not have complete books and records at the time of the audit, the Department had to estimate the amount of gross receipts Taxpayer realized from selling goods in Illinois. *See* Department Ex. 1, pp. 6-7. For the same reason, the Department determined that none of the receipts ABC BUSINESS realized were from exempt sales, and determined that tax was due on all of ABC BUSINESS's gross receipts. *Id.*
11. After estimating Taxpayer's total and taxable gross receipts, the Department auditor prepared a form titled, Corrections of Returns/Determination of Tax Due, regarding the period from July 2004 through and including December 2008. Department Ex. 1, pp. 6-7.
12. As set forth in that Determination of Tax Due, the auditor determined that tax was due in the amount of \$XXX, plus late filing and late payment penalties. Department Ex. 1, pp. 6-7.
13. Thereafter, the Department issued two NTLs to ABC BUSINESS. Department Ex. 1, pp. 2, 4. The NTLs assessed tax, penalties and interest in the following amounts:

NTL Nos.	XXX	XXX
Periods	7/2004 — 11/2004	12/2004 — 12/2008
Tax	XXXX	XXXX
Late Payment Penalty	XXXX	XXXX
Late Filing Penalty	XXXX	XXXX
Interest	XXXX	XXXX

Assessment Totals	\$ XXXX	\$ XXXX
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Department Ex. 1, pp. 2, 4.

14. The two NTLs included the identical statement, that the balance due on the face of each “includes a combination of Retailers’ Occupation Tax, Service Occupation Tax, Use Tax, Service Use Tax, local taxes and fees.” Department Ex. 1, pp. 2, 4.

Conclusions of Law:

The Department introduced the NTLs it issued to ABC BUSINESS into evidence under the certificate of the Director. Department Ex. 1. Pursuant to § 4 of the Retailers’ Occupation Tax Act (ROTA), those NTLs constitute the Department’s prima facie case in this matter. 35 ILCS 120/5, 7. The Department’s prima facie case is a rebuttable presumption. 35 ILCS 120/7; Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). The presumption of correctness that attaches to the Department’s prima facie case extends to all elements of taxability. See Branson v. Department of Revenue, 68 Ill. 2d 247, 258, 659 N.E.2d 961, 966-67 (1995) (Department’s introduction of Notice of Penalty Liability establishes prima facie proof that taxpayer acted with the required mental state); Soho Club, Inc. v. Department of Revenue, 269 Ill. App. 3d 220, 232, 645 N.E.2d 1060, 1068 (1st Dist. 1995) (Department’s introduction of Notice of Tax Liability establishes prima facie proof that taxpayer is engaged in the occupation that is subject to taxation).

A taxpayer cannot overcome the statutory presumption merely by denying the accuracy of the Department’s assessment. A.R. Barnes & Co. v. Department of Revenue,

173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the Department's determinations are not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053.

Issues & Argument

Taxpayer contends that it was a wholesaler, and not a retailer. *See* Taxpayer's Brief, *passim*. That is, it asserts that it did not sell goods to persons for use or consumption in Illinois; rather, it was engaged in selling goods to persons who would resell such goods to persons for use or consumption in Illinois. *Id.*; *see also* Tr. pp. 23-24 (John Doe, testifying that ABC BUSINESS sold "[o]nly to nail salons, not the public.").

The Department, in response, contends that the evidence admitted at hearing shows that ABC BUSINESS sold goods to nail salons, who used or transferred such goods as an incident of making sales of services to their customers. *See* Department's Response Brief (Department's Brief), pp. 4-5. The Department discounts the principal authorities ABC BUSINESS cites in its brief, because they were decided before the Illinois General Assembly passed the Service Occupation and Service Use Tax Acts (respectively, SOTA and SUTA). *Id.*, pp. 3-4. The Department argues that ABC BUSINESS was subject to tax regarding ABC BUSINESS's sales of goods to such customers. *Id.*, p. 6.

The evidence supports the Department's position. On cross-examination, John Doe was asked the following questions and gave the following answers:

Q Is it true that your customers were limited to nail salons?

A Yes.

Q Did you know any of those customers personally?

A Yes. After they came, I recognized them.

Q Did you ever pay a visit to any of those customers' places of business?

A I met them. Sometime I went and stopped by and said hi to them at their stores.

Q What did they do in those stores?

A When I went there, they do nails.

Q Do nails?

A Yes.

Q What does that mean?

A A manicure service.

Q Manicure services.

So if I could just sum this up, these businesses were engaged in providing manicure services for their customers?

A Yes.

Q And they would use items that they bought from you in the course of providing that service?

A Yes.

Tr. pp. 25-26 (John Doe).

The Department distinguishes the type of sales that ABC BUSINESS made with the activities of a wholesaler, who makes sales to purchasers who are, themselves, engaged in the business of retailing. Department's Brief, p. 4. The Department reasons that ABC BUSINESS was not a wholesaler because its customers were servicemen, not retailers. *See id.* ("although identifying itself as a reseller of beauty products, [ABC BUSINESS] was also making a number of sales to end-user purchasers."). It points out that Illinois law treats nail salons as servicemen. *Id.*; 35 ILCS 115/2 ("sale of service" and "servicemen" defined); 86 Ill. Admin. Code § 140.140(g) (other examples of taxable transactions include "sales of hair tonic and oil, pomades, powders, dyes, lotions, creams and other similar tangible personal property by barbers and beauticians as an incident to the furnishing of services in Illinois in such a way that the property remains on the person of the customer of the barber or beautician"). As John Doe's testimony makes clear, ABC

BUSINESS's customers generally purchased goods to transfer to customers as an incident of selling services to customers, or to use when engaging in a service occupation.

Tr. pp. 25-26 (John Doe).

Illinois law also supports the Department's position. For example, retailers' occupation tax regulation (ROTR) § 130.1415 provides:

Section 130.1415 Resale Number - When Required and How Obtained

a) If the purchaser is not registered with the Department as a taxpayer, but claims to be a reseller of the tangible personal property in such a way that such resales are not taxable under the Retailers' Occupation Tax Act or under some other tax law which the Department may administer, such purchaser (except in the case of an out-of-State purchaser who will always resell and deliver the property to his customers outside Illinois) shall apply to the Department for a resale number. Such applicant shall state facts which will show the Department why such applicant is not liable for tax under the Act or under some other tax law which the Department may administer on any of his resales and shall furnish such additional information as the Department may reasonably require.

b) Examples of purchasers for resale who would need a resale number from the Department are **persons who resell only to schools and other totally exempt purchasers** and **persons who resell only to purchasers who in turn resell the property apart from engaging in a service occupation.**

86 Ill. Admin. Code § 130.1415.

The customers to whom ABC BUSINESS sold goods, however, are not described in subsection (b) of that applicable regulation. ABC BUSINESS has produced no evidence to show that its nail salon customers were schools or otherwise totally exempt. Nor did it show that its customers resold the goods they purchased from ABC BUSINESS "apart from engaging in a service occupation." 86 Ill. Admin. Code § 130.1415(b). To the contrary, John Doe conceded facts showing that ABC BUSINESS's purchasers were engaged in a service occupation. Tr. pp. 25-26 (John Doe). Since the evidence is clear that ABC BUSINESS's purchasers were servicemen, they would owe

either use tax, based on their cost price of the goods they purchased from ABC BUSINESS and used when providing services, or service occupation tax (SOT), based either on their cost price or selling price for the goods they transferred to their customers as an incident to providing services for them. *See Hagerty v. General Motors Corp.*, 59 Ill. 2d 52, 54-56, 319 N.E.2d 5, 6-7 (1974); *Mel-Park Drugs, Inc. v. Department of Revenue*, 218 Ill. App. 3d 203, 214, 577 N.E.2d 1278, 1285 (1st Dist. 1991); 86 Ill. Admin. Code § 140.105.

The only documentary support for ABC BUSINESS's argument that it acted as a wholesaler is a copy of the certificate of registration the Department issued to it in 2006. Taxpayer Ex. 3; Taxpayer's Brief, Ex. 1. But the plain text of the certificate notified ABC BUSINESS that it was "... authorized to do business as a reseller in Illinois and is authorized to purchase items and/or services tax-free. The items and/or services must be purchased for resale and all sales must be made in a nontaxable manner." Taxpayer Ex. 3. Despite that express notice — "all sales must be made in a nontaxable manner" (*id.*) — ABC BUSINESS wants me to treat the certificate, itself, as documentary evidence that all of its sales were made in a nontaxable manner. Taxpayer's Brief, pp. 5-6 ("II. Existing Pre-Audit Documents and Conduct Reflect Non-Taxability"). I cannot agree, because both the plain text of the certificate, and applicable Illinois law, places the burden on ABC BUSINESS to document that some or all of its sales were made in a nontaxable manner. 35 ILCS 120/2c; 35 ILCS 115/3-40; 86 Ill. Admin. Code § 140.1001.

Because ABC BUSINESS was issued a resellers number, it was authorized to purchase goods tax free. 35 ILCS 120/2c; Taxpayer Ex. 3. The issue here, however, is not whether ABC BUSINESS's purchases were subject to use tax, but whether its sales were

subject to ROT or SOT. Under ROTA § 2c:

... a sale shall be made tax-free on the ground of being a sale for resale if the purchaser has an active registration number or resale number from the Department and furnishes that number to the seller in connection with certifying to the seller that any sale to such purchaser is nontaxable because of being a sale for resale.

Failure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. This presumption may be rebutted by other evidence that all of the seller's sales are sale for resale, or that a particular sale is a sale for resale.

35 ILCS 120/2c. ABC BUSINESS did not collect, keep and produce for audit any resale certificates from its purchasers. *See* Taxpayer's Brief, pp. 4-5. Since it did not do so, it had none to offer at hearing. Therefore, its sales are presumed to be subject to tax. 35 ILCS 120/2c.

On this point, ABC BUSINESS argues that the decision in Dearborn Wholesale Grocers, Inc. v. Whittler, 82 Ill. 2d 471, 413 N.E.2d 370 (1980), means that ROTA § 2c applies only to retailers, and not to wholesalers. That may well be true, but the evidence and findings of fact in Dearborn are significantly different than the evidence and factual findings here. The Dearborn Court noted that:

*** The plaintiff [Dearborn] did introduce affidavits by its salesmen, ... that whenever a new account was opened the retailer was required by the plaintiff to complete and sign a form prepared by the plaintiff in which the retailer stated that all merchandise to be purchased by him would be resold. The retailer was also required to furnish the registration number or sales number assigned to him by the Department. A blank copy of the form was attached to each salesman's affidavit. After being executed by the retailers these forms were returned to the plaintiff, but the completed forms, for reasons not shown by the record, were no longer in the plaintiff's possession at the time of the audit.

The foregoing evidence by the plaintiff was not controverted, and

on the basis of it the hearing officer made a finding that the plaintiff was a wholesale grocer. He nevertheless concluded that the plaintiff's evidence was insufficient to rebut the Department's prima facie case, since the plaintiff had not documented the resale character of its individual sales as required by section 2c of the Act (Ill.Rev.Stat.1979, ch. 120, par. 441c). ***

Dearborn Wholesale Grocers, Inc., 82 Ill. 2d at 474, 413 N.E.2d at 371.

Unlike in Dearborn, the evidence here shows that ABC BUSINESS does not sell exclusively to retailers. Tr. pp. 25-26 (John Doe). Indeed, ABC BUSINESS failed to show that it made even one sale to a retailer maintaining a place of business in Illinois. ABC BUSINESS is not a wholesaler, as Dearborn was.

Under the Service Occupation Tax Act (SOTA), ABC BUSINESS was a supplier. 35 ILCS 115/2 (“ ‘Supplier’ means any person who makes sales of tangible personal property to servicemen for the purpose of resale as an incident to a sale of service.”); *see supra*, p. 2 (finding of fact number 1). Suppliers of servicemen are obliged to either collect SOT from the servicemen to whom they sell goods intended to be resold as an incident to their sales of services (35 ILCS 115/3-40), or to obtain resale certificates from such purchasers. 35 ILCS 115/12 (ROTA § 2c incorporated into SOTA); 86 Ill. Admin. Code § 140.1001(a) (“A de minimis serviceman who incurs Use Tax as described in Section 140.108 of this Part, should pay the tax to his Illinois-registered suppliers on the cost price of the tangible personal property transferred to his service customers. However, if for any reason the serviceman does not pay tax to his supplier (for example, his supplier is an out-of-State supplier not registered to collect the tax), the serviceman is required to register to remit Use Tax to the Department.”); 86 Ill. Admin. Code § 140.1305(a) (“If a serviceman registered to remit Service Occupation Tax is unable to determine, at the time he purchases tangible personal property, how he will ultimately

dispose of such property, he may certify to his supplier that he is buying all of such tangible personal property for resale and will thereafter account to the Department for the tax on disposing of such property. However, no such certificate shall be valid unless the serviceman who signs it has an active registration or resale number from the Department and includes such number in such certificate.”). ABC BUSINESS did not collect SOT from its purchasers (Tr. p. 22 (John Doe)), nor did it collect and keep resale certificates from them. Taxpayer’s Brief, pp. 4-5.

Instead of offering regularly kept books and records, John Doe and Jack Black, John Doe’s friend, testified regarding the circumstances under which ABC BUSINESS came to be issued the certificate of registration as a reseller. Tr. pp. 11-25 (John Doe), 30-36 (Jack Black). John Doe testified, in summary, that he went to the Department’s offices in Anytown to apply for a business license. He said that, after a woman there told him to describe his business, the same woman told him that ABC BUSINESS was acting as a wholesaler. Tr. pp. 19-20 (John Doe) (“[t]he lady said if it’s sold only to the nail salons, that means it’s a wholesaler.”). Jack Black testified, consistently with John Doe, that a woman they spoke with told them that since ABC BUSINESS would sell only to other businesses, and not to the public, it would be a wholesaler. Tr. p. 35 (Jack Black) (“She just said it was business to business wholesale”). Of the two, only Jack Black could provide even the briefest detail of the woman they said they spoke to years ago, as being “probably in her thirties.” Tr. p. 32 (Jack Black). John Doe said that, shortly thereafter, ABC BUSINESS received its reseller’s certificate in the mail. Tr. pp. 21-22 (John Doe). But again, the only certificate the record reveals was issued to ABC BUSINESS is the one that was issued in 2006, which was two years after ABC BUSINESS began to sell

nail supplies. Taxpayer Exs. 2-3.

To sum up, to rebut Department's prima facie case, ABC BUSINESS offered testimonial evidence of a putative conversation, held years earlier, between the witnesses and some unidentified person associated with the Department. In a nutshell, ABC BUSINESS's proffered defense is that someone at the Department told ABC BUSINESS's owner that it did not have to pay any tax. For the following reasons, I do not consider John Doe and Jack Black's testimony to be the kind of clear and credible testimony, closely identified with its books and records, that is sufficient to rebut the Department's prima facie case. Fillichio, 15 Ill. 2d at 333, 155 N.E.2d at 7.

First, while both testified that each thought that the conversation was held in 2003, the only certificate of registration for ABC BUSINESS in this record is the one issued in 2006. Taxpayer Ex. 3; Taxpayer's Brief, Ex. 1. That does not make me trust their ability to recall when the putative conversation took place.

Moreover, taxpayers are required to apply, in writing, for an Illinois Business Registration number; the application does not consist of an oral interview with a Department employee. 35 ILCS 120/2a; 35 ILCS 120/2c. ABC BUSINESS offered no evidence of the specific information that it entered on any written application it submitted to the Department. And even if John Doe was able to recall, so as to accurately communicate, the specific information he or Jack Black might have entered on ABC BUSINESS's written application for registration, John Doe was often unintelligible at hearing, without an interpreter. *See* Tr. pp. 12-13, 16 (John Doe). I do not trust that, years earlier, he was better able to communicate the information that was required to complete the written application form.

Further, at hearing, both John Doe and Jack Black repeated that the Department employee was asking them whether ABC BUSINESS would sell to businesses, or to the public. But that has no bearing on whether ABC BUSINESS's sales were sales at retail. Retailers are not subject to ROT only for those gross receipts from sales to individual purchasers. Businesses also purchase goods, at retail, to use in their businesses in Illinois. 35 ILCS 105/2 (“ ‘Purchaser’ means anyone who, through a sale at retail, acquires the ownership of or title to tangible personal property for a valuable consideration.”); 35 ILCS 120/1 (identical definition of purchaser). Their testimony on this point appeared to reflect their own understanding of a wholesaler's purchasers, rather than how Illinois law defines such purchasers. 35 ILCS 105/2; 35 ILCS 120/1. Finally, I had the opportunity to observe both John Doe and Jack Black testify. Their testimony on this point was simply not credible.

The Department determined that ABC BUSINESS owed a certain amount of either SOT or ROT on its gross receipts from supplying goods to its nail salon customers (Department Ex. 1), and those determinations are presumptively correct. 35 ILCS 115/5; 35 ILCS 120/5. ABC BUSINESS did not offer credible evidence, closely identified with its books and records, to show that the Department's determinations were in error. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217, 577 N.E.2d 1278, 1287 (1st Dist. 1991) (“To overcome the Department's prima facie case, a taxpayer must present more than its testimony denying the accuracy of the assessments, but must present sufficient documentary support for its assertions.”). To the contrary, the evidence supports the tax assessed in the NTLs. Tr. pp. 25-26 (John Doe).

Conclusion:

I recommend that the Director finalize the NTLs as issued, with penalties and interest to accrue pursuant to statute.

December 27, 2012

John E. White

Administrative Law Judge