

**ST 05-23**

**Tax Type: Sales Tax**

**Issue: Taxation of Delivery Charges  
Whether Certain Purchases Were Exempt**

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

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<b>THE DEPARTMENT OF REVENUE</b>	)	Docket No.	04-ST-0000
<b>OF THE STATE OF ILLINOIS</b>	)	Reg. No.	0000-0000
	)	NTL Nos.	00 00000000000000
	)		00 00000000000000
<b>ABC, INC.,</b>	)		00 00000000000000
v.	)		
	)	John E. White,	
Taxpayer	)	Administrative Law Judge	

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**RECOMMENDATION FOR DISPOSITION**

**Appearances:** Floyd Perkins, Ungaretti & Harris, appeared for ABC, Inc.; Shepard Smith, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

**Synopsis:**

This matter arose after *ABC, Inc.* (“*ABC*” or “taxpayer”) protested three Notices of Tax Liability (“NTLs”) the Illinois Department of Revenue (“Department”) issued to it following an audit of its business for the months of July 1, 2000 through and including July 31, 2003. The parties agreed that there were several issues to be resolved at hearing, which issues generally included: (1) whether certain charges *ABC* included on its invoices under the headings of Cartage, Saturday/Sunday Delivery, After 5:00 p.m. Delivery, Fuel Surcharge, and Overtime Delivery, were subject to retailers’ occupation tax (ROT); (2) whether *ABC*’s purchase of certain tangible personal property used in its business was exempt from Illinois Use Tax (UT); (3) whether the Department properly

assessed late filing and late payment penalties against *ABC*; and (4) if so, whether the rates at which the late payment penalties and interest were assessed was proper.

The hearing was held at the Department offices in Chicago, Illinois. At hearing, taxpayer presented certain books and records, as well as the testimony of two witnesses. I have considered the evidence adduced at hearing, and I am including as part of this recommendation findings of fact and conclusions of law. I recommend the issues be resolved in favor of the Department.

### **Findings of Fact**

#### **Facts Regarding AOC's Business**

1. *ABC* manufactures and sells ready-mix concrete for use by contractors at both residential and commercial properties, and provides services related to such manufacture and sale. Department Ex. 2 (audit workpapers related to Department's audit of taxpayer), p. 2 (audit narrative); Tr. p. 33-34 (testimony of *John Doe (Doe)*, taxpayer's president).
2. *ABC* also has a material yard, at which it offers for sale, sand, stone, bagged cement and related items. Tr. p. 34 (*Doe*).
3. *ABC* uses preprinted, sequentially numbered delivery tickets to document its delivery of ready-mix concrete sold to a customer. Taxpayer Exs. 4-5 (copies of two Advanced delivery tickets prepared during the audit period). A facsimile of an *ABC* delivery ticket is printed on the following page. *Compare infra*, p. 3 with Taxpayer Exs. 4-5.
4. *ABC*'s invoices measured ROT based on a selling price per cubic yard of concrete poured at a customer's site. Taxpayer Exs. 4-5; Tr. p. 42 (*Doe*).

YRDS ORDERED	[company logo] [company phone number]			TIME WANTED
[invoice number]				
DATE	YOUR ORDER NO.	LOAD NO.	TRUCK NO.	
Sold To _____				
Mail Address _____				
Deliver To _____				
Cu. Yrds. Delivered	Bag		Price	Amount
# Calcium Chloride				
ft Expansion Joint				
Slump				
PAYMENT	CASH	CHECK	CHARGE	Sub-Total
RECEIVED BY:				Tax
CARTAGE				
Saturday/Sunday Delivery				
After 5:00 pm Delivery				
Fuel Surcharge				
Overtime Delivery				
Arrive Job	Leave Job	Time on Job	Time Charge	Total
			____ Minutes Per Min	
SALE NO.		READING FINISH		
		READING START		
<b>UNITS DELIVERED</b>				
<p>ALL CONCRETE AIR-ENTRAINED.</p> <p>SIX MINUTES PER CUBIC YARD WILL BE ALLOWED FOR UNLOADING OF TRUCKS EXCESS TIME WILL BE CHARGED AT SELLER'S CURRENT RATE.</p> <p>PURCHASER ASSUMES LIABILITY FOR ALL PROPERTY DAMAGE CAUSED BY OR TO SELLER'S TRUCKS INSIDE OF CURB LINE AND AGREES TO PROVIDE SUITABLE ROADWAY TO POINT OF DISCHARGE.</p> <p>RESPONSIBILITY FOR ANY ADDITIONAL ADDITIVES OR EXTRA WATER ADDED TO THE CONCRETE AT THE JOBSITE IS ASSUMED BY THE PURCHASER OR HIS AGENT WHO ACCEPTS THIS LOAD AND AUTHORIZES EXTRA WATER IN EXCESS OF SPECIFIED SLUMP.</p> <p style="text-align: center;">[***]</p> <p style="text-align: center;"><b>6 MINUTES PER YARD ALLOWED FOR UNLOADING</b></p> <p>Signature _____</p>				

### **Facts Regarding ABC's Delivery & Other Charges At Issue**

5. *ABC's* invoices also included separate charges for: Cartage; Saturday/Sunday Delivery; After 5:00 p.m. Delivery; Fuel Surcharge; and Overtime Delivery. Taxpayer Exs. 4-5; Tr. pp. 42-53 (*Doe*). *ABC* did not charge and collect tax from its customers for those charges. Taxpayer Exs. 4-5; Tr. pp. 42-53 (*Doe*); *see also supra*, p. 3 (facsimile of *ABC's* delivery ticket).
6. *ABC* assessed and collected a Cartage charge from a customer when it delivered and poured less than 5 cubic yards of concrete. Tr. pp. 45, 50 (*Doe*). The cartage charge was in the nature of a minimum load charge. Tr. p. 61 (*Doe*).
7. *ABC* assessed and collected a Saturday/Sunday Delivery charge when a customer needed delivery on a Saturday and/or Sunday. Tr. p. 46 (*Doe*).
8. Similarly, *ABC* assessed and collected an After 5:00 p.m. Delivery charge when it delivered and poured concrete after 5:00 p.m. Tr. p. 48 (*Doe*).
9. *ABC* assessed and collected a flat rate \$10 Fuel Surcharge when it delivered concrete to a customer's site that was located outside a perimeter *ABC* designated. Tr. pp. 50-51, 63 (*Doe*).
10. *ABC* assessed and collected an Overtime Delivery charge whenever it took more time than *ABC* deemed necessary to deliver and pour a given amount of concrete at a customer's location. Taxpayer Ex. 5; Tr. pp. 46-48 (*Doe*). Specifically, *ABC* estimated that it should take six minutes to pour a cubic yard of concrete. Taxpayer Exs. 4-5 ("6 MINUTES PER YARD ALLOWED FOR UNLOADING"). The Overtime Delivery charge was assessed at a rate of \$1 for each minute a truck's time on site exceeded the product of 6 times the number of

cubic yards of concrete delivered. Tr. p. 46-48 (*Doe*). For example, on Taxpayer Ex. 5, the delivery ticket shows that *ABC*'s truck arrived at the customer's location at 3:00 o'clock and left at 3:25, for a total of 25 minutes on site. Taxpayer Ex. 5. That customer ordered and the truck delivered and poured 3.5 cubic yards of concrete. *Id.* Thus, *ABC* allowed 21 minutes ( $6 \times 3.5 = 21$ ) for the job. Taxpayer Exs. 4-5. Since the job required more than the allowed time, *ABC* charged and collected \$4 from the customer, \$1 for each minute of overtime at the site. Taxpayer Ex. 5; Tr. pp. 46-48 (*Doe*).

11. *ABC* calculated its Overtime Delivery rate so as to recoup its hourly cost of operating, after taking into account approximately \$30 per hour of driver expenses, and the related expenses, insurance, taxes, and equipment, which collectively added up to approximately \$60 per hour. Tr. pp. 47-48 (*Doe*). *Doe* did not believe *ABC* made a profit its Overtime Delivery charges. Tr. p. 48 (*Doe*).
12. *ABC* calculated its Saturday/Sunday delivery rate to recoup its costs of paying overtime to its employees. Tr. pp. 48-50 (*Doe*).
13. *ABC* calculated its Fuel Surcharge rate to recoup its increased costs of fuel for its trucks and machinery. Tr. pp. 50-56 (*Doe*); *see also* Taxpayer Ex. 6 (invoices from *ABC*'s fuel vendor).
14. All of *ABC*'s charges were designed to compensate it for various costs of doing business. Tr. pp. 61-62 (*Doe*).
15. Notwithstanding the charges listed on *ABC*'s delivery tickets below the tax line, *ABC*'s business required it to deliver and pour, on site, ready-mix concrete whenever it entered into a contract to manufacture (that is, to combine and mix

the constituent ingredients) and to pour ready-mix concrete at a customer's site. Tr. pp. 44-45 (*Doe*).

16. The auditor determined that *ABC's* Cartage, Saturday/Sunday Delivery, After 5:00 p.m. Delivery, Fuel Surcharge, and Overtime Delivery charges should have been included within its taxable gross receipts, as reported on line 1 of its monthly sales and use tax returns. Department Ex. 2, pp. 6-7, 13, 21-22.

### **Facts Regarding Other Audit Determinations**

17. During the audit period, *ABC* purchased tangible personal property for which it did not pay Illinois use tax to its vendors. *See* Department Ex. 2, pp. 8-9 (audit narrative), 13 (copy of auditor's Schedule 1, Summary Analysis). These purchases included property that the Department's auditor categorized as either consumable supplies, or production/production related parts. Department Ex. 2, pp. 8-9, 38-41.
18. With regard to the Department's audit of *ABC's* purchases of consumable supplies, *ABC* kept a cash disbursement journal that detailed its accounts payable data from only October 2002 onward. Department Ex. 2, p. 8. Thus, the auditor audited a block sample of 7 months of such purchases by *ABC*, from January 2003 through July 2003. *Id.*, pp. 8, 42. He then projected the results of that block sample throughout the audit period. *Id.*, pp. 8, 26. Based on his review and projection, the auditor determined that *ABC* purchased \$21,482 in taxable consumable supplies during the audit period, and that *ABC* owed \$1,343 in Illinois use tax for its use of such property in Illinois. Department Ex. 2, pp. 13, 26.

19. At hearing, and after the Department reconsidered its determination of the amount of use tax *ABC* owed regarding its purchases of consumable supplies, the Department conceded that *ABC*'s use of certain items within the block sample was not taxable, resulting in a use tax liability for consumable supplies for the entire audit period in the amount of \$869. Tr. pp. 101-05 (testimony of Gus Nastos (Nastos), the Department auditor's supervisor, plus oral stipulation of counsel).
20. With regard to the Department's audit of *ABC*'s purchases of production/production related parts, the auditor ran a test sample of such purchases during the months of January 2003 through June 2003. Department Ex. 2, pp. 8, 38-41. The auditor then sought from *ABC* books and records that might help him determine whether such property was, in fact, actually purchased for use as a replacement part for an item of tangible personal property that qualified as exempt manufacturing machinery or equipment. *See id.*, p. 8; Tr. pp. 21, 30 (Nastos). When *ABC* was unable to provide the auditor with such documentation, he projected the results of that block sample throughout the audit period. Department Ex. 2, pp. 8, 27.
21. Since the auditor determined that *ABC* owned and operated some vehicles and/or property that qualified as exempt manufacturing machinery, and some vehicles and/or property that did not, and since he could not determine onto which vehicles or machinery the purchased property was used as replacement parts and/or equipment, the auditor estimated that 50% of such property purchased and used by *ABC* during the audit period qualified as exempt manufacturing machinery &

- equipment. Department Ex. 2, pp. 8, 41. Thus, the auditor determined that *ABC* purchased and used \$124,314 of taxable property, resulting in \$7,770 in Illinois use tax due. Department Ex. 2, pp. 13, 27.
22. The Department auditor determined that *ABC*'s return for February 2002 was filed after the due date. Department Ex. 2, pp. 3, 37. Thus, the auditor determined that *ABC* owed a late filing penalty in the amount of \$59. *Id.*, p. 15.
23. After the Department determined that *ABC* underpaid its correct Illinois ROT and UT liabilities during the audit period, it assessed penalties for late payment, as well as interest on the tax and penalty amounts, at rates pursuant to amendments made to Illinois' Uniform Penalty and Interest Act (UPIA). Department Ex. 2, pp. 9, 14-15, 28; *see also* 35 **ILCS** 735/3-2, 3-3 (UPIA) (as amended by P.A. 93-0026).

**Conclusions of Law:**

The Department introduced a copy of the NTLs it issued to *ABC* 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** 120/4, 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).

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 assessment is 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.

## **Arguments and Analysis**

### **Charges Determined to be Includable Within ABC's Taxable Gross Receipts**

The majority of the tax assessed and at issue here is related to the Department's determination that *ABC* improperly excluded the total of its Cartage, Saturday/Sunday Delivery, After 5:00 p.m. Delivery, Fuel Surcharge, and Overtime Delivery charges from its taxable gross receipts, as was required to be reported on line 1 of its monthly sales and use tax returns. Department Ex. 2, pp. 6-7, 13, 21-22.

*ABC* relies on one subparagraph of the applicable Illinois Retailers Occupation Tax Regulation (IROTR), 86 Ill. Admin. Code § 130.415, to support its argument that the charges at issue were not includable within its taxable gross receipts. Taxpayer's Closing Argument and Brief (Taxpayer's Brief), pp. 6-7 (*partially quoting* 86 Ill. Admin. Code § 130.415(d)). *ABC* asserts that, in each instance in which it prepared a delivery ticket to memorialize its agreement to manufacture, deliver and pour concrete at a specific site, and for which it added one or more of the charges at issue here, it also entered into a separate and discrete oral agreement with each such purchaser, and that, pursuant to those oral agreements, the parties agreed to the additional charges. Taxpayer's Brief, p. 7 (citing Tr. pp. 44-49 (*Doe*)). *ABC* suggests that those oral agreements with its customers satisfy IROTR § 130.415(d)'s evidentiary requirements sufficient to show that its separately stated delivery charges are not taxable.

The Department counters that IROTR § 130.415 must be read in conjunction with related § 130.410, and that § 130.410 does not allow for any deductions from taxable gross receipts that are based on a taxpayer's cost of doing business. Department's Brief, p. 4. It further asserts that IROTR § 130.415(d)'s provision that "[t]he best evidence that transportation or delivery charges were agreed to separately and apart from the selling price, is a separate and distinct contract for transportation or delivery" should be understood to mean a separate and distinct *written*, not oral, contract for the delivery of the goods sold. *Id.*, pp. 4-5. It contends, finally, that in no event does the evidence offered regarding the facts of *ABC*'s business establish that the added charges were properly deductible from taxable gross receipts, pursuant to IROTR § 130.415. *Id.*, pp. 6-7.

There is one fact about *ABC*'s business that is particularly important when approaching the parties' arguments here. That is that *ABC*'s business requires it, in all cases, to deliver the concrete that it agrees to manufacture and pour at a customer's site. Indeed, *Doe*'s testimony and its attorney's arguments consistently establish the truth of this fact. For example, *Doe* was asked the following questions and gave the following answers at hearing:

Q: Let's talk about cartage, the thing that's at the top here, the top item. When would a cartage charge be made?

A: Cartage would be charged under five cubic yards of concrete.

Q: If somebody had six cubic yards of concrete —

A: There would be no charge.

Q: The amount would be at the top [of the delivery ticket]? There would be an amount at the top?

A: There would be an amount that would say five or six where it says cubic yards delivered to the left.

Q: And then there would be tax for that amount?

A: There would be tax for the product delivered, correct.

Q: But you wouldn't have a cartage charge in those circumstances?

A: That's correct.

Tr. pp. 45-46 (*Doe*).

With regard to this same point, *ABC*'s brief explains that,

The minimum load charge for a short order of concrete is an add on delivery charge when the order is small and the normal charge built in to the concrete which includes the delivery to the job site requires the add on delivery charge, for a minimum load, so that the concrete can be sold in the small quantity.

The other ... delivery charges[,] Saturday, Sunday, weekend, and night overtime delivery charges are clearly add on charges. If the buyer accepts the concrete Monday through Friday 9 to 5, he pays a set concrete price. If he contracts for unique delivery services (Saturday, Sunday, weekend, or night overtime) delivery charges are agreed to and added as a separate and distinct item on the buyer's invoice. There is no issue that these other delivery charges are unrelated to the making of concrete, they relate only to delivery. They are associated with the time bringing the machines and materials to and from the manufactured job site. They are costs solely of the time in travel and are related to the cost of Taxpayer.

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Taxpayer's Brief, p. 6.

While I do not agree with the correctness of the broad conclusions articulated in the quoted section of *ABC*'s brief, what *Doe*'s testimony and *ABC*'s brief establish is that *ABC*'s delivery of the concrete to the site where it will be poured is a necessary and constituent part of every contract *ABC* executes for the sale of ready-mix concrete to be poured at a customer's site, and that *ABC*'s selling price of concrete to customers at a particular job site includes an unstated charge for delivery. The charges at issue, therefore, are very clearly not *delivery* charges at all. Rather, as *ABC*'s counsel admits,

the charges at issue “are clearly add on charges ... [that] are associated with the time bringing the machines and materials to and from the manufactured job site [and which] ... are related to the cost of Taxpayer.” Taxpayer’s Brief, p. 6.

Against that factual backdrop, I now discuss the relevant and applicable Illinois law. Section 2-10 of the ROTA provides, in part:

Rate of tax. Unless otherwise provided in this Section, the tax imposed by this Act is at the rate of 6.25% of gross receipts from sales of tangible personal property made in the course of business. \*\*\*

35 ILCS 120/2-10. Gross receipts, in turn, is defined as “the total selling price or the amount of such sales ...” 35 ILCS 120/1. Finally, ROTA § 1 defines “selling price” as:

“Selling price” or the “amount of sale” means the consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property, other than as hereinafter provided, and services, ... and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever, ....  
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35 ILCS 120/1.

IROTR § 130.410 provides:

Section 130.410 Cost of Doing Business Not Deductible  
In computing Retailers’ Occupation Tax liability, no deductions shall be made by a taxpayer from gross receipts or selling prices on account of the cost of property sold, the cost of materials used, labor or service costs, idle time charges, incoming freight or transportation costs, overhead costs, processing charges, clerk hire or salesmen’s commissions, interest paid by the seller, or any other expenses whatsoever. Costs of doing business are an element of the retailer’s gross receipts subject to tax even if separately stated on the bill to the customer.

a) For example, a retailer may choose to accept payment from a customer through the use of a credit or debit card, and the retailer may not receive the full amount

of payment due to the service charges or fees charged by the credit or debit card company. These charges or fees are part of the retailer's cost of doing business and are not deductible from the gross receipts subject to tax.

b) To determine whether outgoing shipping and handling charges are deductible from gross receipts that are subject to tax, see Section 130.415 of this Part.

c) Handling charges represent a retailer's cost of doing business, and are not deductible from the gross charges subject to tax. However, such charges are often stated in combination with shipping charges. In this case, charges designated as "shipping and handling" as well as delivery or transportation charges in general, are not taxable if it can be shown that they are both separately contracted for and that such charges are actually reflective of the costs of shipping. To the extent that shipping and handling charges exceed the costs of shipping, the charges are subject to tax. (See Section 130.415 of this Part.)

86 Ill. Admin. Code § 130.410 (amended at 24 Ill. Reg. 15104, effective October 2, 2000).

IROTR § 130.415 provides:

Section 130.415 Transportation and Delivery Charges

a) Transportation and delivery charges are considered to be freight, express, mail, truck or other carrier, conveyance or delivery expenses. These charges are also many times designated as shipping and handling charges.

b) The answer to the question of whether or not a seller, in computing his Retailers' Occupation Tax liability, may deduct, from his gross receipts from sales of tangible personal property at retail, amounts charged by him to his customers on account of his payment of transportation or delivery charges in order to secure delivery of the property to such customers, or on account of his incurrence of expense in making such delivery himself, depends not upon the separate billing of such transportation or delivery charges or expense, but upon whether the transportation or delivery charges are included in the selling price of the property which is sold or whether the seller and the buyer contract separately for such transportation or delivery charges by not including such charges in such selling price. In addition, charges for transportation and delivery must not exceed the costs of transportation or delivery. If those

charges do exceed the cost of delivery or transportation, the excess amount is subject to tax.

c) If such transportation or delivery charges are included in the selling price of the tangible personal property which is sold, the transportation or delivery expense is an element of cost to the seller within the meaning of Section 1 of the Retailers' Occupation Tax Act, and may not be deducted by the seller in computing his Retailers' Occupation Tax liability.

d) If the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability. Delivery charges are deemed to be agreed upon separately from the selling price of the tangible personal property being sold so long as the seller requires a separate charge for delivery and so long as the charges designated as transportation or delivery or shipping and handling are actually reflective of the costs of such shipping, transportation or delivery. To the extent that such charges exceed the costs of shipping, transportation or delivery, the charges are subject to tax. The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price, is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice.

e) Incoming Transportation Costs

Transportation or delivery charges paid by a seller in acquiring property for sale are merely costs of doing business to the seller and may not be deducted by such seller in computing his Retailers' Occupation Tax liability, even though he passes such costs on to his customers by quoting and billing such costs separately from the selling price of tangible personal property which he sells. The same is true of transportation or delivery charges paid by the seller in moving property to some point from which the property (when subsequently sold) will be delivered or shipped to the purchaser.

86 Ill. Admin. Code § 130.415 (amended at 24 Ill. Reg. 15104, effective October 2, 2000).

Illinois courts have interpreted the ROTA's definitions of gross receipts and selling price as they specifically pertain to the business of manufacturing ready-mix concrete. Material Service Corp. v. Department of Revenue, 98 Ill. 2d 382, 388, 457 N.E.2d 9, 12-13 (1983); Stark Materials, Inc. v. Illinois Department of Revenue, 349 Ill. App. 3d 316, 322, 812 N.E.2d 362, 367 (4<sup>th</sup> Dist. 2004). The issue in Material Service Corp. was whether minimum load charges charged by a corporation engaged in the same type of business as *ABC* were subject to ROT. That case is particularly significant to this matter, since *ABC* concedes that its Cartage charge was, in effect, a minimum load charge that was imposed on all sales in which *ABC* agreed to deliver ready-mix concrete in quantities of less than 5 cubic yards (Tr. pp. 45, 50,61 (*Doe*)), an amount that, coincidentally, corresponds precisely with the threshold at which Material Service Corp. assessed *its* minimum load charges. Material Service Corp., 98 Ill. 2d at 390, 457 N.E.2d at 14. The Illinois Supreme Court analyzed the parties' arguments in Material Service Corp. in the following way:

It is the plaintiff's contention that the minimum load charge is a fee separate from the selling price of a load of concrete and should not be includable in gross receipts taxable under the Act. The plaintiff characterizes the charge as "an additional fee which operates to discourage separate deliveries of small quantities of a bulk product. It provides a negative inducement." The "somewhat arbitrary" charge, the plaintiff says, "looks more like a penalty than anything else." The Department argues that the charge is an inseparable part of a single transaction — the sale and delivery of pre-mixed concrete. As stated earlier, there was evidence that the charge is related to the cost of providing drivers and maintaining the ready-mix

trucks. The Department contends that the minimum load charge is part of the transportation cost of delivering concrete which is includable in the total cost of manufacture.

We agree with the Department's position. It is not disputed that concrete must be delivered in a ready-mix truck so as to maintain a uniform mixture and to prevent it from hardening prior to use. In *Gapers, Inc. v. Department of Revenue* (1973), 13 Ill. App. 3d 199, 300 N.E.2d 779, it was held that where the delivery of goods sold was indispensable to the completion of the sale, and not merely incidental, delivery charges are part of the cost of doing business and may not be deducted from gross receipts for purposes of the retailers' occupation tax. The plaintiff attempts to distinguish *Gapers*, saying that the charge is imposed because of the amount of concrete being transported and not because of the transportation. This argument fails, since the charge is based on the cost of providing drivers to transport the concrete. That Material Service waives or chooses to "absorb" that cost in case of large, and more profitable, sales of concrete is not determinative.

Material Service Corp., 98 Ill. 2d at 388-90, 457 N.E.2d at 13-14.

As the Court acknowledged in Material Service Corp., the business of manufacturing and selling ready-mix concrete requires that the product be delivered by the manufacturer/seller to the pour site (*see id.*), and *ABC* specifically admits that its selling price per cubic yard of concrete includes an unstated charge for delivery. Tr. pp. 45-46 (*Doe*); Taxpayer's Brief, p. 6. Thus, the central holding in Material Service Corp. is specifically controlling regarding the taxability of *ABC*'s Cartage charges.

The Material Service Corp. Court's reliance on the holding in Gapers, Inc. v. Department of Revenue, moreover, makes those judgments similarly controlling regarding all of the other add on charges at issue here. Put another way, if *ABC*'s costs and charges associated with delivering ready-mix concrete to the pour site may not be deducted from gross receipts because delivery is indispensable to the completion of every

such sale, and such costs, thereby, are nondeductible costs of doing business, then why should what *ABC* calls “enhanced” (Taxpayer’s Reply, p. 5) or “special” (Taxpayer’s Reply, pp. 5 n. 9, 7-8) delivery add on charges be treated any differently? All of *ABC*’s add on charges are designed to recover whatever increased costs it might incur as a result of executing a sale that might result in extra overtime (after 5 pm and Saturday/Sunday delivery charges), or that would increase the amount of time *ABC* may have to spend at a particular pour site (overtime delivery), or that would cause it to use more fuel purchased at a higher price (fuel surcharge). The ROTA’s definition of selling price provides that it “shall be determined without any deduction on account of the ... cost of materials used, labor or service cost or any other expense whatsoever, ...” 35 **ILCS** 120/1.

*ABC* responds to the Department’s citation to controlling Illinois case law in two ways. First, it says that it did not know about such case law, and it also asserts that IROTR § 130.415, in effect, superceded those cases. *ABC*’s first response is irrelevant. The ROTA applies to all retailers engaged in business in Illinois, not merely to those retailers who know about the various Illinois court decisions affecting them. Its second assertion, that IROTR § 130.415(d) “has effected a change in the law negating the impact of the former court decisions” (Taxpayer’s Brief, p. 7), is without support in law. After the Illinois Supreme Court’s decision in Material Service Corp., the Illinois General Assembly could have changed the ROTA’s statutory definition of selling price so as to exclude delivery and/or other types of service charges from taxation (Mitchell v. Mahin, 511 Ill. 2d 452, 456, 283 N.E.2d 465, 467 (1972)) — which it did not do — but the

Department, on its own, could not. Gapers, Inc., 13 Ill. App. 3d at 202, 300 N.E.2d at 781.<sup>1</sup>

*ABC* also replies that the appellate court's decision in Airco Industrial Gas Division v. Illinois Department of Revenue, 223 Ill. App. 3d 386, 584 N.E.2d 1017 (4<sup>th</sup> Dist. 1991) developed and refined — in effect, modified — the Illinois Supreme Court's holding in Material Service Corp. Taxpayer's Reply, p. 6. It did nothing of the sort. First, while the appellate court may find that the particular facts of a case before it makes that case not subject to the effect of a prior Illinois Supreme Court holding, it may not overrule or modify judgments of the Illinois Supreme Court. *See Gillen v. State Farm Mutual Automobile Ins. Co.*, 215 Ill. 2d 381, 830 N.E.2d 575, 581 n.2 (2005). Second, the facts in Airco are significantly distinguishable from the facts of Material Service Corp., and from the facts of this contested case.

Airco involved a seller of industrial gases in bulk, liquid form to purchasers who primarily used such property in manufacturing. Airco, 223 Ill. App. 3d at 387, 584 N.E.2d at 1018. To receive the liquified gases, Airco's customers had to have insulated storage facilities on their premises. *Id.* If the customers' needs required them to convert the liquid to a gas for use, they additionally needed vaporizing equipment on their

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<sup>1</sup> The Gapers, Inc. court held:

The pertinent statute necessarily forms the governing basis for the method of computing the tax. As above set forth, the statute expressly provides that the selling price shall be determined without any deduction for labor or service cost or any other expense whatsoever. The meaning of this definition seems clear, definite and unambiguous. It forbids the deduction attempted by plaintiff. It would follow necessarily that the Department would be without legal authority to limit or extend the statutory definition by its own Rules and Regulations. *Ex-Cell-O Corp. v. McKibbin*, 383 Ill. 316, 50 N.E.2d 505.

Gapers, Inc., 13 Ill. App. 3d at 202, 300 N.E.2d at 781.

property. *Id.* Airco’s customers could either purchase their own storage tanks and/or vaporizing equipment, or rent such equipment from Airco. *Id.* If a customer chose to rent storage and vaporizing equipment from Airco, it paid Airco one price to purchase the liquid gas, and an additional fee for the equipment rental. *Id.* Airco retained title to the storage and/or vaporizing equipment, could substitute equipment during the rental period, and would remove the equipment at the end of the rental period. *Id.* at 388, 584 N.E.2d at 1018. In that case, the Department sought to include Airco’s rental charges as part of the selling price for the gas.

As *ABC* correctly notes in its reply, the appellate court rejected the Department’s argument that the rental charges were part of Airco’s selling price for gas. Airco, 223 Ill. App. 3d at 392, 584 N.E.2d at 1021. But *ABC* is incorrect when it argues that “the Airco court’s inseparable link test explains and is the reasoning why certain delivery charges as a separate and non-taxable service, are not taxable” Taxpayer’s Reply, p. 8. The subject regulation, that is, IROTR § 130.415, has, for a long time, specifically identified the test to determine whether delivery charges might be considered deductible at all, and substantially similar versions of that regulation had been in effect since at least the time Gapers, Inc. was decided. The subject regulation, in other words, pre-dated Airco, and not the other way around.

At least to this writer, the easiest way to reconcile Airco with all of the cases discussed therein, and with cases that were decided after Airco, is to acknowledge that the court implicitly saw Airco as being engaged in two separate businesses, one involving the sale of tangible personal property at retail, and one involving its rental of tangible personal property to others for use in Illinois. Under the facts of that case, the court

refused to treat Airco's receipts from renting property to others as though they were, in fact, receipts from selling tangible personal property at retail. In no way, therefore, does the Airco decision help *ABC*. *ABC*'s business is not like Airco's — it does not rent tangible personal property to customers. The charges at issue here, additionally, are not like the rental charges at issue in Airco. While *ABC* provides different services to customers as part of its retail business, its primary business is being a retailer, and the charges at issue are merely incidental to when *ABC* will deliver and pour ready-mix concrete at a customer's site, or to other matters affecting *ABC*'s costs of doing business. *ABC* concedes, moreover, that such charges are designed to help *ABC* recover its own costs associated with manufacturing and delivering ready-mix concrete to a customer's pour site.

I must also reject *ABC*'s argument that IROTR § 130.415, or any part of that regulation, compelled it to consider the charges at issue non-taxable. Taxpayer's Brief, p. 8 ("Taxpayer was directed by this code and regulation not to collect tax thereon and was not required to pay and remit sales tax therefore."). That regulation says nothing at all about whether a retailer may or must collect a corresponding amount of use tax from its customers. In fact, *ABC*'s strained construction of IROTR § 130.415(d) ignores the rest of that section and IROTR § 130.410, and renders the very statutory definition of selling price meaningless.

The close relation between IROTR §§ 130.410 and 130.415 and the ROTA's definition of selling price was made clear in Gapers, Inc. Gapers, Inc. involved the Department's assessment of ROT on charges a caterer made to customers for delivering food and other property the caterer contracted to provide to customers at locations the

customers determined. There, as is the case here, the taxpayer asserted that one of the Department's regulations authorized the non-taxability of the charges at issue, whereas the Department countered that the charges were taxable as the taxpayer's cost of doing business. Gapers, Inc., 13 Ill. App. 3d at 200, 300 N.E.2d at 780. The Gapers court, after analyzing the ROTA's statutory definition of "selling price," and the applicable regulations then in effect, and which regulations subsequently came to be codified as IROTR §§ 410 and 415, held as follows:

[A]lthough plaintiff's argument sounds logical if one reads only § 4(a) of the Rules and Regulations, this is dissipated by an examination of § 3 of the Rules. Certainly in determining this question we cannot confine our examination to any one section or paragraph of the Rules but we must read and study all of them together as one unit. *Mills v. County of Winnebago*, 104 Ill. App. 2d 366, 244 N.E.2d 65 and *People v. Carter*, 376 Ill. 590, 592, 35 N.E.2d 64.

Examining the language of § 3, it states clearly that, in computing tax, plaintiff may not deduct from gross receipts or selling prices any labor or service costs or freight or transportation costs. \*\*\*

Forbidding the deduction by plaintiff also seems quite logical and reasonable in the case at bar. As the hearing referee specifically pointed out, plaintiff has not only agreed to prepare the necessary food and provide the equipment required for its consumption, but has agreed that the contract shall be performed at the home of the customer. In such case, as the referee noted, '\*\*\* the delivery becomes as important to the seller as to the buyer; it becomes an inseparable link in the chain of events leading to the completion of the sale of meals to purchasers and not merely incidental to the purpose of the taxpayer's business of catering private parties in its customers' homes.'

We are in accord with the findings and conclusions of the referee as approved by the trial court after administrative review.

Gapers, Inc., 13 Ill. App. 3d at 202-03, 300 N.E.2d at 781-82.

In its reply brief, *ABC* seeks to diminish the controlling effect of the decisions in Material Service Corp. and in Gapers, Inc. by repeatedly asserting that the former case was decided solely on the basis of a 1966 letter ruling. Taxpayer’s Reply, pp. 3, 6, 9 n.12. That is demonstrably untrue. What the Court said, in Material Service Corp., was that it “need not address the question of whether the letter ruling was binding on the Department since, as the appellate court showed, conditions or terms of the ruling were not satisfied.” Material Service Corp., 98 Ill. 2d at 389-90, 457 N.E.2d at 13. Logic compels me to conclude that when the Illinois Supreme Court expressly declines to address a specific question in a case before it, the Court’s judgment in that case will not have been based on its resolution of that question. Rather, the Court based its decision in Material Service Corp. on the ROTA’s plain and clear definition of selling price, and on its agreement with the appellate court’s reasoning in Gapers, Inc., which included a holding that Department Rule 4 (subsequently recodified, with certain amendments, as IROTR § 130.415) must not be read in isolation of Department Rule 3 (subsequently recodified, with certain amendments, as IROTR § 130.410).

I agree, therefore, with the Department’s assertion that IROTR § 130.415(d) must be read in conjunction with § 130.410. But even before that, it should be read in conjunction with its own, proximate subsections. Subsection 130.415(b) sets forth the test to see whether a seller “may deduct ... amounts charged by him to his customers on account of his payment of transportation or delivery charges in order to secure delivery of the property to such customers, or on account of his incurrence of expense in making such delivery himself ....” 86 Ill. Admin. Code § 130.415(b). That test is “whether the transportation or delivery charges are included in the selling price of the property which

is sold or whether the seller and the buyer contract separately for such transportation or delivery charges by not including such charges in such selling price.” *Id.* Here, *ABC* has conceded that it has an unstated charge for delivery built into the price of the ready-mix concrete it agrees to sell. Tr. pp. 45-46; Taxpayer’s Brief, pp. 5-6. Under the test articulated by IROTR § 130.415(b), and by express operation of IROTR § 130.415(c), that fact alone takes *ABC*’s delivery charges, or what it now refers to as its charges for “enhanced” or “special” delivery, out of the class of delivery charges that may properly be deducted from a retailer’s taxable gross receipts, pursuant to IROTR § 130.415(d). 86 Ill. Admin. Code § 130.415(b)-(d). Moreover, nothing within any subsection of IROTR § 130.415 suggests that, where a seller’s delivery charges themselves are not deductible because such charges are included in the selling price of the property sold, if the seller calls such charges “enhanced” or “special” delivery charges, they *will* be deductible.

Further, the evidence adduced at hearing shows much more than just the fact that *ABC* builds in a delivery charge for every contract into which it enters to manufacture, sell and pour ready-mix concrete. The evidence also shows that each particular add on charge *ABC* puts on an invoice is specifically designed to help *ABC* recoup from its customers different costs of doing business. Tr. pp. 43-51 (*Doe*). These are precisely the types of charges that the ROTA’s definition of selling price, and IROTR §§ 130.410 and 130.415(c), provide should not be deducted from a retailer’s taxable gross receipts. 35 **ILCS** 120/1.

Finally, I must reject *ABC*’s argument that the evidence shows that, in each and every instance in which it imposed one of the charges at issue, it also entered into an oral agreement — an oral agreement that was separate and distinct from the parties’

agreement to sell or purchase poured ready-mix concrete — regarding when the concrete might arrive at the customer’s site, or the likely duration of the pour, or *ABC*’s costs of fuel, and the different charges that might accompany such events. *See* Taxpayer Brief, p. 7 (*citing* Tr. pp. 44-49 (*Doe*)). First, nothing about *Doe*’s testimony makes me confident that he was even competent to testify about the making of an oral agreements for each and every transaction that *ABC* executed during the audit period, and regarding which one or more of the charges at issue was assessed. *See* Tr. p. 44 (*Doe*); Department’s Brief, p. 5. His testimony, moreover, is not consistent with ordinary human or commercial experience. If a business considered it important enough to enter into two separate and distinct agreements surrounding one identifiable transaction *every time it entered into such a particular transaction*, then I would expect to see two separate and distinct *writings* regarding those different agreements. The mere act of entering a separately stated charge on a writing made to document one contract does not ordinarily suggest, let alone prove, the existence of a separate and distinct contract regarding that additional charge.

The better way to understand *Doe*’s testimony describing its agreements is that, in those instances where specific charges at issue were discussed at all,<sup>2</sup> an *ABC* employee would notify a customer that there would be an extra charge when a customer sought to have *ABC* pour concrete after 5 p.m., on weekends, or when the quantity ordered would suggest that the time on site would exceed what *ABC* considered normal. The customer, thereafter, either hired *ABC* or not. However, even for those instances where *ABC* may have made such an express notification to a customer, and which notification was

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<sup>2</sup> For example, *Doe* never testified that *ABC* discussed its fuel surcharges with customers. *See* Tr. pp. 50-52, 60-62 (*Doe*).

thereafter expressly accepted by a customer, I would not conclude that such acts created a contract that was, in fact, separate and distinct from the parties' underlying agreement to sell or purchase poured ready-mix concrete. Instead, and because getting the concrete to the pour site was indispensable to every sale of poured ready-mix concrete *ABC* made, such an agreement would be merely incidental to that retail agreement. Material Service Corp., 98 Ill. 2d at 388-90, 457 N.E.2d at 13-14; Gapers, Inc., 13 Ill. App. 3d at 202-03, 300 N.E.2d at 781-82. Thus, *ABC*'s costs associated with getting the concrete to the pour site, and its charges to customers based on those costs, may not be deducted from its taxable gross receipts. 35 ILCS 105/1.

#### **Taxability of ABC's Purchases**

*ABC* purchased tangible personal property during the audit period regarding which it did not pay use tax to the vendors from whom it purchased such property. Department Ex. 2, pp. 8-9, 13. The auditor reviewed *ABC*'s books and records regarding those purchases, and after that review, he divided such purchases into two categories, consumable supplies and production/production related parts. Department Ex. 2, pp. 8-9, 38-41. The auditor also noted that *ABC*'s cash disbursement journal detailed its accounts payable data only from October 2002 onward. Department Ex. 2, p. 8. That means that, prior to October 2002, *ABC*'s cash disbursement journal did not identify the specific nature of the items of property *ABC* purchased. *Id.* Even after that period, some of *ABC*'s other books and records did not identify the specific nature of the items of property *ABC* purchased. Department Ex. 2, pp. 38-41.

### **Consumable Supplies**

Regarding the Department's audit of *ABC*'s purchases of consumable supplies, the auditor determined that *ABC* purchased \$21,482 in taxable consumable supplies during the audit period, and that *ABC* owed \$1,343 in Illinois use tax for its use of such property in Illinois. Department Ex. 2, pp. 13, 26. At hearing, and after the Department notified the ALJ that it had reconsidered its prior determination of the amount of use tax *ABC* owed regarding its purchases of consumable supplies (Tr. pp. 4-6 (colloquy regarding preliminary matters)), the Department conceded that certain items listed on the block sample were not taxable, resulting in a use tax liability for consumable supplies for the entire audit period in the amount of \$869. Tr. pp. 101-05 (Nastos).

*ABC* acknowledges that, of the block sample items that the Department continues to assert were taxable purchases, the remaining types of property were shirts, shop supplies and towels. Taxpayer's Brief, p. 4. *ABC* first suggests that the Department's projection of the remaining block sample items was erroneous. *Id.* It claims that its purchase of shirts was a one-time event, and argues that the Department wrongly projected a tax liability regarding those purchases to the entire audit period. *Id.*

In a pre-hearing order, the parties set forth all of the specific issues to resolved at hearing. The parties were quite specific, and even included the amount of tax that each individual issue represented. Pre-Hearing Order, dated 1/12/05 (¶ 2A). The parties did not include in that order, however, that *ABC* was challenging the Department's audit methods. Additionally, even if *ABC* had identified that issue as one of the issues to be resolved at hearing, in order to do so, it would have had to show, with books and records, that the block sample used by the Department did not actually represent the true nature

and extent of its consumable supply purchases throughout the audit period. PPG Industries, Inc. v. Department of Revenue, 328 Ill. App. 3d 16, 33-34, 765 N.E.2d 34, 48-49 (1<sup>st</sup> Dist. 2002). At hearing, taxpayer offered no books and records that identified all of the specific items of tangible personal property it purchased during even one single month in the audit period, let alone documents which showed *all* of the specific items of such property that it purchased throughout that period. *ABC*'s introduction of the *Department's* block sample schedule of its purchases (Taxpayer Exs. 1, 3) does not rebut the Department presumptively correct determination that *ABC* owed use tax regarding these purchases.

Nor does the mere general testimony of its president regarding the nature or frequency of such purchases rebut the Department's prima facie case. In fact, *Doe's* testimony is not even consistent with *ABC's* claim that it purchased shirts only once. Tr. p. 68 (*Doe*, testifying that *ABC* bought shirts "[n]ot that often"). Instead, to rebut the Department's presumptively correct determination that it owed use tax regarding these purchases, *ABC* had to present its own books and records to show how the Department's schedules and/or projections (which, in this case, constituted the best information available to the auditor regarding *ABC's* purchases) did not reflect the extent of *ABC's* actual purchases during the audit period. PPG Industries, Inc., 328 Ill. App. 3d at 33-34, 765 N.E.2d at 48-49. Finally, *ABC's* complaint about the Department's use of a test period rings hollow when its own books and records during much of the audit period did not even identify what specific items of property taxpayer was purchasing. Department Ex. 2, pp. 8, 19; *see also id.*, pp. 38-41 (auditor's schedule shows a description given for account entries, but the schedule does not identify the specific items of tangible personal

property, and/or related services that *ABC* purchased); Tr. pp. 65-66 (*Doe*, admitting that he was unable to tell, from the Department's schedule, what item of tangible personal property *ABC* purchased).

Section 7 of the ROTA provides, "It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable." 35 ILCS 120/7. The Illinois Use Tax Act incorporates that section of the ROTA (35 ILCS 105/12), meaning that retail purchasers have the primary burden to establish that their purchase and use of tangible personal property is, in fact, not taxable. Klein Town Builders v. Department of Revenue, 36 Ill. 2d 301, 303, 222 N.E.2d 482, 484 (1967).

Here, *ABC* asserts that *Doe* testified that *ABC* used the towels to wipe down grease during the manufacturing process, and that it used the shop supplies in the manufacturing process. Based on that evidence, *ABC* asserts that it has established that the towels and the shop supplies it purchased are exempt manufacturing equipment. Taxpayer's Brief, p. 4. While *Doe* did, in fact, testify about how *ABC*'s employees and/or agents used the towels *ABC* purchased (Tr. p. 67 (*Doe*)), he was never asked, nor did he say anything about *ABC*'s purchases of shop supplies. *See id.*, pp. 33-68 (*Doe*). Thus, there is no evidence whatever to support *ABC*'s arguments regarding its claimed use of the items described in the block sample as shop supplies.

In sum then, *Doe* testified about how *ABC* used the shirts, which *Doe* testified were mostly used given to and worn by its drivers (Tr. pp. 68-69 (*Doe*)), and he also testified about how *ABC* used the towels it purchased. Based on that evidence, *ABC*

argues that such property qualifies as exempt under the UTA's exemption for manufacturing machinery and equipment (MM&E). Taxpayer Brief, p. 4; 35 ILCS 105/3-5(18). Clearly, neither of those items could be considered machinery. 35 ILCS 105/3-50(3) (defining machinery, for purposes of the exemption). The only real question then is whether towels used to wipe up grease during the process of manufacturing ready-mix concrete, and shirts that drivers wore when they operated the trucks and/or machinery that manufactured ready-mix concrete, might qualify as exempt manufacturing equipment. 35 ILCS 105/3-50(4) (defining equipment). The express text of the applicable IROTR provides that such articles are not subject to the exemption. 86 Ill. Admin Code. § 130.330(c)(3) (“\*\*\*\* The exemption does not include hand tools, supplies (such as rags, sweeping or cleaning compounds), coolants, lubricants, adhesives, or solvents, items of personal apparel (such as gloves, shoes, glasses, goggles, coveralls, aprons, masks, mask air filters, belts, harnesses, or holsters), coal, fuel oil, electricity, natural gas, artificial gas, steam, refrigerants or water. (Section 2-45 of the Act)”). Thus, I conclude that *ABC* has not rebutted the Department's presumptively correct determination that it owed use tax in the amount of \$869 regarding its purchases of consumable supplies.

### **Production/Production Related Purchases**

With regard to the Department's audit of *ABC*'s purchases of property that the auditor scheduled as production/production related parts, the auditor ran a test sample of such purchases during the months of January 2003 through June 2003. Department Ex. 2, pp. 8, 38-41. He then asked *ABC* for books and records that might help him ascertain whether those purchases were, in fact, usable as replacement parts on items of tangible

personal property that were, themselves, exempt. *See* Department Ex. 2, p. 8; Tr. pp. 21, 30 (Nastos). When *ABC* was unable to provide the auditor with such documentation, he projected the results of that block sample throughout the audit period. Department Ex. 2, pp. 8, 27.

Since the auditor determined that *ABC* owned and operated some vehicles and/or property that qualified as exempt manufacturing machinery or equipment, and some property that did not, and since he could not determine onto which vehicles, machinery and/or equipment the purchased property may have been used as replacement parts or otherwise, the auditor estimated that 50% of such property purchased and used by *ABC* during the audit period qualified as being exempt pursuant to the manufacturing machinery and equipment exemption. Department Ex. 2, pp. 8, 41; 35 **ILCS** 105/3-50. Based on that estimate, the auditor determined that *ABC* purchased and used \$124,314 of taxable property, resulting in \$7,770 in Illinois use tax due. Department Ex. 2, pp. 13, 27. Prior to hearing, however, the Department notified the ALJ that its assessment of use tax on *ABC*'s fixed asset purchases during the audit period would not be an issue at hearing, because the Department had conceded that issue. *See* Pre-Hearing Order, dated 1/12/05 (¶ 2A).

This concession forms the sole basis for *ABC*'s claim that the tax assessed on purchases the auditor categorized as production/production related equipment must also be considered exempt. Taxpayer's Brief, pp. 2-3. Specifically, taxpayer argues that the use tax assessment at issue, and detailed on pages 8 and 27 of the Department's Exhibit 2, was originally premised on the auditor's initial determination that *ABC*'s fixed asset purchases included some items that were exempt manufacturing machinery and

equipment, and some items that were not exempt. *See* Department Ex. 2, pp. 7-8, 25. The auditor identified those fixed asset items he determined were *not* exempt as global exceptions on a separate schedule, and assessed use tax on such items. Department Ex. 2, p. 25. The auditor then estimated that approximately 50% of the property that he categorized as perhaps being subject to the MM&E exemption (*see* Department Ex. 2, pp. 38-41) was, in fact, exempt, since he acknowledged that “[a] large percentage of these purchases seem to be repair parts for their ready-mix trucks.” *Id.*, p. 8. Since the Department conceded that all of *ABC*’s fixed assets purchased during the audit period at issue were not subject to tax, *ABC* contends that there can no longer be any question that the property purchased as replacement parts for such fixed assets must also be considered not taxable.

Before I address the Department’s arguments regarding this issue, I first want to point out that *ABC*’s logical argument is based on a faulty premise. *ABC* had more fixed assets than just those that it purchased during the audit period, and both *Doe* and the auditor knew that. Department Ex. 2, p. 8 (“Given the number of trucks that the taxpayer operates and the non-qualifying vehicles, I estimated that 50% of the purchases [of production/production related property] qualify under MM&E. \*\*\*”); Tr. pp. 36-38 (*Doe*, referring to a list of approximately 14 vehicles *ABC* owned). In other words, the auditor did not determine that *ABC*’s purchases of production/production related property could have only been used as replacement parts on the fixed assets that *ABC* purchased during the audit period. Therefore, the Department’s decision, before hearing, not to assess use tax on *ABC*’s fixed asset purchases during the audit period, is not logically inconsistent with its continued determination that taxpayer has not supported its claim that all of the

production/production related property it purchased during the audit period was, in fact, used in an exempt manner. That continued determination was premised on the Department auditor's determination that some of the production/production related property could have been used as replacement parts on assets that were not, in fact, exempt, and which assets had been purchased by *ABC* prior to the audit period. *ABC* has done nothing to rebut the correctness of that determination.

The Department responds that *ABC* has the burden to establish the exempt nature of all items of tangible personal property purchased for use in Illinois. It contends that the schedule the auditor prepared in this matter refers to invoices and account types, without identifying at all what specific items of tangible personal property *ABC* may have purchased. The Department notes that the auditor's schedule includes several invoices that *ABC* itself grouped into accounts labeled repair and maintenance, which the Department asserts could well refer to services that would not qualify for the applicable MM&E exemption. Department's Brief, p. 9; 35 **ILCS** 105/3-50. The Department points out that the only evidence *ABC* offered at hearing to show how *ABC*'s purchases might have been exempt was the testimony of its president, and it urges that, as a matter of law, such evidence is insufficient to support *ABC*'s burden of proof. *Id.*, p. 10.

The burden, again, is on a taxpayer to establish, clearly and conclusively, that its use of tangible personal property brings it within one of the exemptions enumerated in UTA § 3-5. Friends of Israel Defense Forces v. Department of Revenue, 315 Ill. App. 3d 298, 303, 733 N.E.2d 789, 793 (1<sup>st</sup> Dist. 2000). This record presents absolutely no documentary evidence that shows what specific items of property *ABC* is claiming to be exempt. The best evidence available in this record consists of the Department auditor's

schedule, which organizes data gleaned from records *ABC* kept regarding certain expenses incurred. Department Ex. 2, pp. 38-41. That schedule has entries showing the date of a particular invoiced expense, the supplier to whom an expense was paid or from whom *ABC* received a credit, a description of the account *ABC* used to categorize the particular expense or credit, the invoice number, and amount of the particular invoice. Department Ex. 2, pp. 38-41. *ABC*, however, has made no effort to offer documentary evidence, such as copies of the invoices themselves, or a copy of an inventory that it may have kept regarding such property, to show exactly what property it is claiming to be exempt. And while *Doe* was quick to conclude that virtually all of the property included on the auditor's schedule of production/production related property was exempt (Tr. pp. 37-39 (*Doe*)), he also admitted that he could not identify, from the Department's schedule, any particular item that *ABC* purchased during the sample period, and was claiming to be exempt. Tr. pp. 65-66 (*Doe*).

As opposed to the Department's use of best available information, the best that *ABC* could offer was its president's testimonial conclusion that about 98% of the invoices on the auditor's schedule represented its purchases of tangible personal property that was used as replacement parts on property that was, itself, exempt manufacturing machinery and equipment. Tr. pp. 37-39 (*Doe*). That testimony, however, is not corroborated by or closely associated with any of *ABC*'s regularly kept books and records. The evidence offered by *ABC*, in short, constitutes a mere testimonial conclusion that the Department's determination of tax due was wrong. I therefore agree with the Department's argument that such evidence is insufficient, as a matter of law, to rebut the Department's

determination that such property was not exempt from Illinois use tax. Fillichio, 15 Ill. 2d at 333, 155 N.E.2d at 7; A.R. Barnes & Co., 173 Ill. App. 3d at 833, 527 N.E.2d at 1053.

### **Late Filing Penalty**

The Department auditor determined that *ABC*'s return for February 2002 was filed after the due date. Department Ex. 2, pp. 3, 37. Thus, the auditor determined that *ABC* owed a late filing penalty in the amount of \$59. *Id.*, p. 15. Because *ABC* has not argued or established that its February 2002 return was timely filed (Taxpayer's Brief, pp. 9-11), the late filing penalty for that month was properly applied. 35 **ILCS** 735/3-3.

### **Late Payment Penalty & Interest**

After the Department determined that *ABC* underpaid its correct Illinois retailers' occupation and use tax taxes during the audit period, it assessed a penalty for late payment, as well as interest on the tax and penalty amounts. Department Ex. 2, pp. 9, 14-15, 28. The Department determined the amount of the penalty and interest it assessed pursuant to amendments made to §§ 3-2 and 3-3 of the Uniform Penalty and Interest Act (UPIA), 35 **ILCS** 735/3-2(f), 3-3(i), by the same public act that also created the Tax Delinquency Amnesty Act (TDAA), 35 **ILCS** 745/1-999 (2003);<sup>3</sup> P.A. 93-0026.

Taxpayer poses two arguments regarding the penalty and interest assessed here. It first argues that no penalty and interest is due because it did not underpay its Illinois ROT and/or UT liabilities. It next argues that the rate of penalty and interest assessed pursuant to UPIA §§ 3-2(f) and 3-3(i) is improper because those sections themselves are unconstitutional and, therefore, void. I address *ABC*'s second argument first.

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<sup>3</sup> *ABC* mistakenly asserts that the TDAA was an amendment to the UPI, but P.A. 93-0026 both amended certain sections of the UPIA and created the TDAA. 35 **ILCS** 745/1-999 (2003); P.A. 93-0026.

### Constitutionality of UPIA §§ 3-2(f) and 3-3(i)

UPIA §§ 3-2(f) and 3-3(i) provide as follows:

#### § 3-2 Interest

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(f) If a taxpayer has a tax liability that is eligible for amnesty under the Tax Delinquency Amnesty Act and the taxpayer fails to satisfy the tax liability during the amnesty period provided for in that Act, then the interest charged by the Department under this Section shall be imposed at a rate that is 200% of the rate that would otherwise be imposed under this Section.

35 ILCS 735/3-2(f).

#### § 3-3 Penalty for failure to file or pay

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(i) If a taxpayer has a tax liability that is eligible for amnesty under the Tax Delinquency Amnesty Act and the taxpayer fails to satisfy the tax liability during the amnesty period provided for in that Act, then the penalty imposed by the Department under this Section shall be imposed in an amount that is 200% of the amount that would otherwise be imposed under this Section.

35 ILCS 735/3-3(i).

The Department responds to *ABC*'s constitutional arguments by noting that P.A. 93-0026's amendments to UPIA §§ 3-2 and 3-3 must be presumed constitutional, and that, in any event, an ALJ lacks the authority to declare a statute unconstitutional. Department's Brief, p. 11. Counsel is correct on both points. First, statutes are presumed constitutional. Geja's Cafe v. Metropolitan Pier & Exposition Authority, 153 Ill. 2d 239, 248, 606 N.E.2d 1212, 1216 (1992). Second, the Department, as a state agency, is not empowered to declare a legislative act unconstitutional (*see* 20 ILCS 2505/39b (Powers of the Department)), as is a court, pursuant to Article VI of the Illinois Constitution. Ill. Const., art. VI, § 1; Texaco-Cities Service Pipeline Co. v. McGaw, 182 Ill. 2d 262, 269,

695 N.E.2d 481, 489 (1998). Thus, I must reject *ABC*'s invitation to recommend that the Director declare UPIA §§ 3-2(f) and 3-3(i) void.

### **Was A Late Payment Penalty Properly Assessed**

I move now to *ABC*'s arguments that no late payment penalty is due at all, because it did not, in fact, underpay its tax liabilities. I have already concluded that the retailers' occupation tax proposed in this matter was, in fact, due, and that *ABC* has not borne its burden to rebut the prima facie correctness of the Department's determination that *ABC* owed use tax regarding its purchase an use of tangible personal property during the audit period. Thus, I reject *ABC*'s argument that a late payment penalty was not properly imposed.

Nor do I accept taxpayer's implied argument that the late payment penalty should be abated for reasonable cause. *See* Taxpayer's Brief, p. 9; 35 ILCS 735/8. Specifically, *ABC* asserts that, "the facts and circumstances here show that Taxpayer had good faith reasons to believe that no tax was due and owing and under the circumstances here no reasonable person would have anticipated that the Taxpayer was not paying the full taxes due." Taxpayer's Brief, p. 9. Section 8 of the UPIA provides:

§ 3-8. No penalties if reasonable cause exists. The penalties imposed under the provisions of Sections 3-3, 3-4, 3-5, and 3-7.5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. A taxpayer may protest the imposition of a penalty under Section 3-3, 3-4, 3-5, or 3-7.5 on the basis of reasonable cause without protesting the underlying tax liability.

35 ILCS 735/8.

The UPIA's regulation on reasonable cause provides, in pertinent part:

b) The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.

c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.

86 Ill. Admin. Code 700.400(b)-(c).

Since 1973, the law in Illinois has been that when delivery of tangible personal property is required by the nature of a retailer's business, then the retailer's taxable gross receipts will include the retailer's costs of making such deliveries. Gapers, Inc., 13 Ill. App. 3d at 202-03, 300 N.E.2d at 781-82. Since 1983, that specific holding in Gapers, Inc. was made expressly applicable to persons engaged in the business of making retail sales of poured ready-mix concrete to others in Illinois, and more specifically, that such a retailer's charges for minimum loads must be included in the retailer's taxable gross receipts. Material Service Corp., 98 Ill. 2d at 388, 457 N.E.2d at 12-13. Both the decisions in Material Service Corp. and Gapers, Inc. were, in turn, based on the respective courts' reading and reasonable application of the Illinois General Assembly's

plain and clear definition of the term selling price. Material Service Corp., 98 Ill. 2d at 388, 457 N.E.2d at 12-13; Gapers, Inc., 13 Ill. App. 3d at 202-03, 300 N.E.2d at 781-82.

Notwithstanding the clarity of the law during the audit period, *ABC* suggests that it believed that the Department, in IROTR § 130.415, changed the effect of those decisions, and the ROTA's definition of selling price, such that an Illinois retailer was *required* to treat as nontaxable charges that the retailer imposed on customers, to allow it to recoup various costs of doing business. *See* Taxpayer's Brief, pp. 7-9. There are two things wrong with this argument. First, and as I have already concluded, IROTR does not, and could not, have the effect that *ABC* suggests it does. *See supra*, pp. 17-18, 20-23; Gapers, Inc., 13 Ill. App. 3d at 202, 300 N.E.2d at 781. Second, *ABC* offered no evidence to show that *Doe*, or anyone associated with *ABC* and responsible for filing *ABC*'s monthly tax returns, ever read the IROTR that it says it relied on here. Without any evidence that anyone associated with *ABC* even read the regulation it says it relied upon, there could have been no good faith effort to determine its proper liability *according to that regulation*. Just as fundamentally, I find incredible *ABC*'s claims that its actions were guided by the words and effect of an administrative regulation, but that it was unaware of the effect of court decisions that interpreted the statute that the same administrative regulation was promulgated to apply and administer.

In sum, I conclude that, during the audit period and before, the law in Illinois was clear that charges like the ones *ABC* imposed on its customers were includable in *ABC*'s taxable gross receipts. 35 **ILCS** 120/1; Material Service Corp., 98 Ill. 2d at 388, 457 N.E.2d at 12-13; Gapers, Inc., 13 Ill. App. 3d at 202-03, 300 N.E.2d at 781-82; 86 Ill. Admin. Code §§ 130.410, 130.415.

I now address whether the late payment penalty that is based on *ABC*'s use tax assessment should be abated for reasonable cause. Persons who purchase personal tangible property at retail for use in Illinois are responsible for paying use tax regarding such purchases. 35 **ILCS** 105/3. Ordinarily, purchasers pay use tax directly to the retailer from whom it makes a purchase, since the Use Tax Act (UTA) imposes on retailers the obligation of collecting use tax. 35 **ILCS** 105/3-45; Town Crier, Inc. v. Department of Revenue, 315 Ill. App. 3d 286, 291, 733 N.E.2d 780, 784 (1<sup>st</sup> Dist. 2000).<sup>4</sup> However, retailers who purchase property that may or may not be exempt from UT and ROT, based on their use of such property, often purchase such property without paying use tax to their vendor, after providing the vendor with a certificate in which the purchaser attests to such an intended exempt use. *E.g.* 35 **ILCS** 120/1g, 2c; Hess, Inc. v. Department of Revenue, 278 Ill. App. 3d 483, 487, 663 N.E.2d 123, 126 (5<sup>th</sup> Dist. 1996) (“The overall regulatory scheme with respect to exemption certificates necessitates a finding that the underlying purchaser is more capable of bearing the burden of knowledge of use of the materials purchased pursuant to an exemption certificate.”); 86 Ill. Admin. Code §§ 130.210(c), 130.305(a), (m), 130.325(c)(6).

Thus, the question is whether *ABC* exercised ordinary business care and prudence when attempting to determine and pay its Illinois use tax liability. On this question, the auditor determined that *ABC* did not pay tax to its vendors regarding its purchases of the tangible personal property at issue. *See* Department Ex. 2, pp. 19-20, 26-27. Whether

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<sup>4</sup> *ABC* misapprehends the different obligations imposed by the ROTA and UTA when it suggests that its failure to collect a corresponding amount of use tax from its customers for its special or extra delivery charges means that it should not be subject to ROT on such amounts. Taxpayer Brief, p. 8. That has never been the case. *See, e.g., Brown v. Zehnder*, 295 Ill. App. 3d 1031, 1034-35, 693 N.E.2d 1255, 1258-59 (1<sup>st</sup> Dist. 1998).

that initial decision was reasonable, and made in good faith at all, may depend on several factors. The first such factor requires an investigation as to *why ABC* did not pay use tax to its vendors. But *Doe* was never asked why *ABC* did not pay use tax to its vendors when it purchased the property at issue here, nor did *ABC* tender evidence to show that it prepared and tendered exemption certificates to vendors when it purchased such property. *See* Tr. pp. 33-70 (*Doe*). Such evidence may have helped to corroborate *ABC*'s claim of good faith, but a good faith belief that a particular transaction was not taxable is not the only possible reason why one did not pay tax. Another perfectly rational reason why *ABC* may not have paid use tax to its vendors is because it wanted to save money.

The State's desire to affect the natural tension between self-interest and voluntary self-reporting of tax liabilities is, after all, the reason why late payment penalties have traditionally been imposed — to act as a financial disincentive to persons who act on a mistaken belief that they are not or should not be subject to tax, or who act without regard to whether they are or not. *See e.g. Coleman v. C.I.R.*, 791 F.2d 68, 69 (7<sup>th</sup> Cir. 1986) (“Legal penalties change the balance of self-interest; those who believe taxes wicked or unauthorized must nonetheless pay. When the legal system depends on honest compliance ... — and when disobedience is potentially rewarding to those affected by the rule — it is often necessary to impose steep penalties on those who refuse to comply.”). I do not conclude that *ABC* acted in bad faith. Instead, I conclude that *ABC* offered no evidence to show that its nonpayment of use tax was made in good faith. Moreover, I note that nothing within § 8 of the UPIA, or within the UPIA's reasonable cause regulation, suggests that good faith should be presumed, merely because a taxpayer alleges it. 35 ILCS 735/8; 86 Ill. Admin. Code § 700.400.

Since *ABC* did not pay tax to its vendors, the reasonableness of its claim that it acted in good faith must be gauged by an examination of what it did *after* it purchased such goods. When an Illinois retailer has not paid use tax to its vendors for goods purchased for use in Illinois, yet wishes to protect itself from an unwarranted assessment of tax in case they are ever questioned by the tax collector, the retailer must prepare and/or keep books and records “in detail sufficient to show the name and address of the taxpayer’s customer in each such transaction, the character of every such transaction, the date of every such transaction, the amount of receipts realized from every such transaction, and such other information as may be necessary to establish the nontaxable character of such transaction under this Act. \*\*\*\*” 35 ILCS 120/7; 35 ILCS 105/11-12. In other words, a retailer will have acted with ordinary business care and prudence when it prepares and keeps such detailed books and records, and when it presents them for audit or review by the Department.

The evidence at hearing shows that *ABC* did not keep books and records which showed, in sufficient detail, the character of the property it claims were used as replacement parts on exempt manufacturing machinery and/or equipment, or with regard to the shop supplies that the Department categorized as consumable supplies. Department Ex. 2, pp. 8, 38-41. With regard to those purchases, therefore, the evidence does not establish that *ABC* exercised ordinary business care and prudence when attempting to determine and pay its Illinois use tax liabilities. Since *ABC* neither timely paid its Illinois use tax liabilities regarding such property, nor kept books and records that detailed the character of such transactions, I conclude that it has not supported its claim that it made a good faith effort to determine and timely pay its Illinois use tax liabilities.

*ABC*'s books and records regarding its purchases of towels and shirts, which the Department categorized as consumable supplies, was obviously sufficient to show the character of the property *ABC* purchased. Department Ex. 2, pp. 19-20. In that instance, however, Illinois law was clear, during the audit period, that such property was not embraced by the manufacturing machinery and equipment exemption. 86 Ill. Admin Code. § 130.330(c)(3). Based on this record, I conclude that *ABC* has not supported its claim that it exercised ordinary business care and prudence when attempting to determine and pay its Illinois use tax liabilities regarding such towels and shirts. I further conclude that *ABC* has not established that any attempt it made to determine and pay its Illinois use tax liabilities regarding such towels and shirts was, in fact, made in good faith.

### **Conclusion**

I recommend that the Department revise the NTLs so as to take into account the parties' concessions as set forth in the pre-hearing order, and as required by the Department's concession at hearing regarding the use tax assessed on *ABC*'s consumable supplies, and that he finalize those NTLs as so revised. Where necessary, the penalties assessed regarding tax that has now been conceded, should be correspondingly reduced.

Date: 9/9/2005

John E. White  
Administrative Law Judge