

ST 97-36
Tax Type: SALES TAX
Issue: Sales v. Resale Issues

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS

| | | |
|---------------------------|---|--------------------------|
| THE DEPARTMENT OF REVENUE |) | |
| OF THE STATE OF ILLINOIS |) | Docket # |
| |) | IBT # |
| v. |) | NTL # |
| |) | |
| TAXPAYER |) | Linda Olivero |
| Taxpayer |) | Administrative Law Judge |

RECOMMENDATION FOR DISPOSITION

Appearances: Charles Hickman, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; B. Douglas Stephens of Wessels, Stojan & Stephens P.C. for TAXPAYER

Synopsis:

The Department of Revenue ("Department") issued a Notice of Tax Liability ("Notice") to TAXPAYER ("taxpayer") for retailers' occupation and use taxes for the audit period of July 1, 1988 to March 31, 1991. The taxpayer filed a timely protest to the Notice. While this matter was pending in these administrative proceedings, the Department conducted a reaudit based on additional documentation provided by the taxpayer. After the reaudit, the taxpayer has raised the following issues: (1) whether the Department's certified copy of the corrected returns establishes the Department's *prima facie* case; (2) whether material that the taxpayer sold to one of its customers was tax exempt on the basis that it was a sale for resale; (3) whether

the taxpayer is entitled to a credit for taxes paid by one of its customers; (4) whether the taxpayer is entitled to a credit for taxes paid to its vendors for material that was either used in construction projects for charitable or municipal organizations or sold for resale; (5) whether the Department incorrectly calculated the tax on various invoices; (6) whether tax was improperly assessed on items that were either returned to the taxpayer's inventory or used on other jobs; and (7) whether the taxpayer is entitled to an abatement of the interest and penalties. A hearing was held during which the taxpayer presented documentary evidence and testimony from various witnesses. After considering the evidence presented, it is recommended that this matter be resolved in favor of the Department.

Findings of Fact:

1. The taxpayer is a construction contractor. It also manufactures and sells building materials at wholesale and retail. (Tr. pp. 127; 146-147; 162-163).

2. In 1991, the Department audited the taxpayer for the period from July 1, 1988 through March 31, 1991. (Dept. Ex. #1).

3. As a result of the audit, the Department determined that the taxpayer owed taxes on materials used on a construction contract entered into with CUSTOMER. The invoice related to this contract is number 2360, dated January 30, 1989, indicating a total contract amount of \$68,412. The cost of the materials relating to this contract are \$19,908.48. The contract number is 552-89. (Dept. Ex. #2 p. 11; Taxpayer's Ex. #1-4, 1-5; Tr. pp. 18; 102).

4. The taxpayer erected the building for CUSTOMER as a result of the construction contract. (Tr. p. 102-103).

5. The taxpayer provided a blanket Certificate of Resale from CUSTOMER dated September 17, 1987. (Taxpayer's Ex. #1-1; Tr. p. 16).

6. The taxpayer also erected a building for CUSTOMER B ("CUSTOMER B"). The building was leased to Almosta Racing Stable. The cost of the materials used to build the building is \$9,433.59 (Taxpayer's Ex. #2-13 - 2-15, 2-21; Tr. pp. 28, 46).

7. CUSTOMER B filed a tax return and paid taxes on the materials used in this job to the Department. The Department did not assess the taxpayer for taxes on the CUSTOMER B job. (Taxpayer's Ex. #2-16, 2-17; Tr. pp. 34-35, 46, 106-108).

8. The taxpayer constructed buildings for various charitable and municipal organizations. (Taxpayer's Ex. #3-1 - 3-21; Tr. p. 46.)

9. The taxpayer provided exemption certificates for the charitable and municipal organizations. (Taxpayer's Ex. #3-1A, 3-5, 3-9A, 3-12A, 3-16A, 3-19A).

10. The taxpayer paid use taxes to its vendors on materials purchased for use in the construction of buildings for the charitable and municipal organizations. The taxpayer provided the invoices for these purchases. (Taxpayer's Ex. #3-2, 3-3, 3-6 through 3-11, 3-14, 3-15, 3-17, 3-20, 3-21, Tr. p. 109).

11. The taxpayer paid use taxes to its vendors on certain materials that were subsequently sold for resale. The taxpayer provided the invoices for these purchases showing use taxes paid in the amount of \$52.14. (Taxpayer's Ex. #3-25, 3-26, 3-27, 3-29, 3-30, 3-31, 3-35, 3-36, 3-37).

12. The taxpayer provided Certificates of Resale from the purchasers who resold the items. (Taxpayer's Ex. #1-1, 3-22; Tr. pp. 74-87).

13. The taxpayer presented several invoices for which the Department allegedly incorrectly calculated the tax. The invoices show one amount as the selling price, and the Department calculated the tax on that amount. (Taxpayer's Ex. #4-1 through 4-33; Tr. p. 88).

14. The taxpayer did not present documentation showing that the tax had already been included in the amounts shown on the invoices. (Tr. pp. 115-116; 121-122).

15. The taxpayer purchased various material that was intended to be used on construction projects. The taxpayer presented several credit memos that it issued to its customers. The credit memos show the amounts that were credited to the customers' accounts because certain materials were not used on the customers' projects. The taxpayer claims that the materials were either returned to its inventory or used on other construction jobs. (Taxpayer's Ex. #5-1 - 5-9; Tr. pp. 90-92, 112-114).

16. The taxpayer did not present documentation showing which of the items that are included on the credit memos have been used on other jobs or are in inventory. The taxpayer also did not present documentation showing that additional use tax was paid on the material that was used on other jobs. (Tr. pp. 112-123).

17. On November 13, 1991, the Department issued corrected tax returns for the taxpayer for the audit period in question. The auditor had reviewed the taxpayer's job files, which included job cost

sheets and invoices, in order to prepare the corrected returns. A certified copy of the corrected returns was admitted into evidence. (Dept. Ex. #1; Tr. pp. 214-216).

18. The taxpayer did not present evidence indicating that the Department's method of preparing the return did not meet a minimum standard of reasonableness.

19. While this case was pending in the administrative hearings division, the Department conducted a reaudit of the taxpayer for the period in question. (Tr. p. 137).

20. The parties stipulated that after the reaudit, the Department reduced the tax liability for the period in question to \$21,884.78. (Tr. p. 9).

21. The parties stipulated that the Department received a check from the taxpayer for \$1,500 on August 1, 1991 and \$1,000 on September 3, 1991. The parties agreed that the taxpayer's account should be credited for these amounts as of those dates. On March 6, 1996, the taxpayer issued a check to the Department for \$15,292.70, which cleared the bank on March 20, 1996. This check was timely credited to the taxpayer's account. (Taxpayer's Ex. #8-1, 8-2; Tr. pp. 201-202).

22. As a result of these payments, the amount of tax liability that the Department claims is still due from the taxpayer is \$4,092.08. (Tr. p. 10).

23. The corrected returns include the following two penalties: (1) a delinquency penalty for the taxpayer's failure to file tax returns for the periods of November 1989, January 1, 1990 through June 30, 1990, and October 1, 1990 through March 31, 1991; and (2) a

deficiency penalty for the underreported taxes during the audit period. (Dept. Ex. #1, 2; Tr. pp. 148-149).

24. TAXPAYER EMPLOYEE, one of the taxpayer's employees, is the person who was responsible for filing the taxpayer's tax returns during the audit period. (Tr. pp. 155-161).

Conclusions of Law:

The Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*) imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. The Use Tax Act (35 ILCS 105/1 *et seq.*) imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 12 of the Use Tax Act incorporates by reference sections 4 and 5 of the ROTA, which provide that the certified copy of the corrected return issued by the Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 ILCS 105/12; 120/4; 120/5. Once the Department has established its *prima facie* case by submitting the corrected return into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. A.R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 832 (1st Dist. 1988). To prove its case, a taxpayer must present more than its testimony denying the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203, 217 (1st Dist. 1991). The taxpayer must present sufficient documentary evidence to support its claim. Id.

Issue One

The taxpayer first argues that the admission into evidence of the Department's certified copy of the corrected returns does not

establish the Department's *prima facie* case. The taxpayer contends that because the Department did not offer any evidence as to the manner in which the return was prepared, the taxpayer should not be liable for any tax that is in dispute.

The Department is required to correct the tax return according to its "best judgment and information." 35 ILCS 120/4. Nevertheless, there is no requirement that the Department substantiate the basis for its corrected return at the hearing. Masini v. Department of Revenue, 60 Ill.App.3d 11, 14 (1st Dist. 1978). When the corrected return is challenged, however, the method that was used by the Department in correcting the return must meet some minimum standard of reasonableness. Id.; Elkay Manufacturing Co. v. Sweet, 202 Ill.App.3d 466, 470 (1st Dist. 1990).

In this case, the taxpayer argues that its objection to the corrected returns at the hearing constitutes a challenge to the returns. At the time the Department offered the corrected returns into evidence, the taxpayer stated that it had "a general objection to the document on the basis that it has not been in [the taxpayer's] possession." (Tr. p. 9). Not only does this objection not put the Department on notice that its method of preparing the returns is being called into question,¹ as stated earlier, the ROTA provides that the certified copy of the corrected returns is *prima facie* correct. After the returns are admitted into evidence, the burden shifts to the

¹. The taxpayer also did not raise the issue of whether the Department's method of preparing the corrected return met a minimal standard of reasonableness at the pre-trial conference. The pre-trial order designates the issues to be considered at the hearing. (86 Ill.Admin.Code, ch. 1, §200.120(c)).

taxpayer to overcome the presumption that the returns have been prepared in a reasonable manner.

The taxpayer has not presented any evidence showing that the manner in which the Department prepared the returns was arbitrary or unreasonable. Moreover, the auditor testified that she inspected the taxpayer's job folders, which included the job cost sheets and invoices, and she explained how she used this information to prepare the corrected returns. (Tr. pp. 214-216). The Department's method of preparing the returns therefore met a minimum standard of reasonableness.

Issue Two

The second issue is whether certain material that the taxpayer sold to one of its customers, CUSTOMER, was tax exempt on the basis that it was a sale for resale. The invoice for the material in question is dated January 30, 1989 and shows a total amount due of \$68,412. The taxpayer has submitted a blanket Certificate of Resale from CUSTOMER, dated September 17, 1987, which states that all purchases made by CUSTOMER on or after the date of the certificate are for purposes of resale. The taxpayer argues that because it has submitted the Certificate of Resale, it does not owe taxes on the materials.

The Department contends that the Certificate of Resale is irrelevant because the taxpayer's bookkeeper and the auditor testified that the materials that were sold to CUSTOMER on January 30, 1989 were used by the taxpayer to erect a building for CUSTOMER. In other words, the Department claims that the taxpayer was the construction contractor and therefore owes tax on the items used to construct the

building. In response, the taxpayer contends that it is not a construction contractor but merely a subcontractor for CUSTOMER. (Taxpayer's brief, p. 2). The taxpayer also states that it "does not construct buildings; it erects structures using trusses it manufactures." (Taxpayer's brief, p. 4).

The evidence indicates that the taxpayer owes the taxes on the materials relating to this invoice. Although the taxpayer provided a Certificate of Resale, the certificate is irrelevant because the transaction at issue was not a retail sale but rather a use of the materials by the taxpayer. The taxpayer's bookkeeper testified that the invoice related to a construction contract. She testified that the contract price was \$68,412, and the cost of the materials relating to this contract were \$19,908.48. The invoice itself has the contract number on it. A construction contractor's incorporation of materials into real estate is considered to be a use of the materials by the contractor and not a sale of the materials to the contractor's customers. 86 Ill.Admin.Code, ch. 1, §130.2075; Craftmasters, Inc. v. Department of Revenue, 269 Ill.App.3d 934, 940 (4th Dist. 1995). The taxpayer therefore is liable for the taxes on the items.

The taxpayer's argument that it is not a construction contractor is without merit. Section 130.1940 of the regulations states that "Construction Contractor" includes "general contractor, subcontractor and specialized contractor such as a landscape contractor." 86 Ill.Admin.Code, ch. 1, §130.1940(a). The same section states that "Construct" means "build, erect, construct, reconstruct, install, plant, repair, renovate or remodel." Id. Thus, the taxpayer's claim that it is merely a subcontractor that erects structures with trusses

that it manufactures actually puts the taxpayer within the definition of construction contractor.

Issue Three

Next, the taxpayer argues that it is entitled to a credit for an overpayment of taxes paid by one of its customers, CUSTOMER B, under a construction contract with the taxpayer. The taxpayer argues that CUSTOMER B collected the tax from the taxpayer and remitted the tax on behalf of the taxpayer based on an agreement between CUSTOMER B and the taxpayer. (Taxpayer's brief p. 5). CUSTOMER B paid the taxes to the Department, and the Department has not assessed the taxpayer for any taxes on this job. The taxpayer claims that it is entitled to a credit for CUSTOMER B's overpayment and that denying the taxpayer credit for this amount is unfair and amounts to double taxation.

The Department correctly asserts that there is no statutory basis for allowing the taxpayer a credit for the overpayment of taxes that were paid by CUSTOMER B. Section 12 of the Use Tax Act incorporates by reference section 6 of the ROTA, which provides that a credit or refund may be given "to the person who made the erroneous payment." 35 ILCS 105/12; 120/6. See also 86 Ill.Admin.Code, ch. 1, §130.1501(a)(1) ("Where a taxpayer *** pays to the Department an amount of tax *** not due *** such taxpayer may file a claim for credit ***"). The taxpayer in this case has not cited any authority for allowing the credit, and it is therefore not entitled to a credit for the taxes paid by CUSTOMER B. The Department properly notes that if an agreement existed between CUSTOMER B and the taxpayer for the payment of taxes, then the taxpayer must pursue its remedies for any overpayment of the taxes against CUSTOMER B.

Issue Four

The fourth issue is whether the taxpayer is entitled to a credit for taxes paid to its vendors on material that was (1) purchased for use in construction projects for various charitable or municipal organizations or (2) sold for resale. The invoices for the materials used for these projects were admitted into evidence. The exemption certificates from the charitable and municipal organizations and the Certificates of Resale from the purchasers who resold the items were also admitted.

The Department contends that the taxpayer is not entitled to a credit because the taxpayer did not remit the tax to the Department, but rather paid it to its vendors. The Department relies on the authority cited in issue three for the proposition that only the party that actually remitted the tax to the Department is entitled to the credit.

In response, the taxpayer refers to the following portion of section 6 of the ROTA:

"If a retailer who has failed to pay retailers' occupation tax on gross receipts from retail sales is required by the Department to pay such tax, such retailer, without filing any formal claim with the Department, shall be allowed to take credit against such retailers' occupation tax liability to the extent, if any, to which such retailer has paid an amount equivalent to retailers' occupation tax or has paid use tax in error to his or her vendor or vendors of the same tangible personal property which such retailer bought for resale and did not first use before selling it ***" (35 ILCS 120/6) (emphasis added).

The taxpayer claims that the emphasized language in this provision entitles it to a credit.

This portion of section 6 allows a taxpayer a credit for use taxes it paid to its vendor when it purchased property intending to use that property but later **sold it at retail** without having used it. See Cerro Wire & Cable Co. v. Department of Revenue, 111 Ill.App.3d 882, 889 (1st Dist. 1982). As stated earlier, a contractor's incorporation of materials into real estate is considered to be a use of the materials by the contractor and not a sale of the materials to the customers. Craftmasters, Inc., 269 Ill.App.3d at 940. Therefore, as to the materials purchased for the charitable and municipal construction projects, the taxpayer did not sell these items; the taxpayer **used** the items. Although a contractor does not owe ROT or use taxes on property that is converted into real estate that is owned by exclusively charitable or municipal organizations (see 86 Ill.Admin.Code, ch. 1, §130.2075(d)), there is no statutory basis for allowing the taxpayer a credit for the use taxes that were paid to its vendors on these items.

With respect to the items that were sold for resale, the above-quoted portion of section 6 only allows a credit for items that were sold at retail. The ROTA excludes transfers of tangible personal property that are for the purpose of resale from the definition of "sale at retail." See 35 ILCS 120/1. Because the taxpayer did not sell these items at retail, section 6 does not allow the taxpayer a credit for these items. The taxpayer may make a claim for a refund of these taxes from the vendors. See 35 ILCS 105/3-45.

Issue Five

The next issue is whether the taxpayer is entitled to a credit on the basis that the Department incorrectly calculated the tax on

various invoices. The taxpayer presented several invoices that show one amount as the selling price, and the Department calculated the tax on that amount. The taxpayer argues that the tax was already included in the amount listed on the invoice. The taxpayer claims that it is improperly being charged a "tax on tax." (Taxpayer's brief, p. 7).

In response, the Department argues that to the extent that the taxpayer did not list the tax as a separate item, this creates a rebuttable presumption that the tax was not collected. See 86 Ill.Admin.Code, ch. 1, §130.405(g). The Department claims that the taxpayer did not present documentary evidence to show that the tax was included in the amounts shown on the invoices.

If the tax is not stated separately on an invoice, then it is assumed that the tax was not collected. Id.; Central Furniture Mart v. Johnson, 157 Ill.App.3d 907, 910 (1st Dist. 1987). The invoices presented by the taxpayer do not show a separate amount for the tax, and the taxpayer did not present any documentary evidence indicating that the tax had been included in the amounts shown on the invoices. The taxpayer's bookkeeper testified that there were calculation sheets and cost sheets that broke down the separate amounts for the materials, labor, and taxes. Nevertheless, the taxpayer failed to present these sheets at the hearing. The bookkeeper's uncorroborated testimony, by itself, is insufficient to overcome the Department's *prima facie* case. See Mel-Park Drugs, 218 Ill.App.3d at 217. The taxpayer is therefore not entitled to this credit.

Issue Six

The sixth issue raised by the taxpayer is whether tax was improperly assessed on items that were either returned to the

taxpayer's inventory or used on other jobs. The taxpayer paid use tax on certain materials that were intended to be used in construction projects. The taxpayer claims that the materials were either returned to its inventory or used on other jobs. The taxpayer presented credit memos that it issued to its customers showing the amounts that were credited to the customers' accounts because the material was not used on their projects. The Department claims that the taxpayer failed to present documentary evidence showing that additional use tax was paid on these items when they were subsequently used on other jobs.

The taxpayer responds by stating that its bookkeeper and SECRETARY ("SECRETARY"), the corporate secretary, testified that most of the materials that were returned to inventory are still in the inventory. The taxpayer also states that there was testimony that the taxpayer paid tax on the materials that were withdrawn from the inventory and used on other jobs.

Although the taxpayer has presented various credit memos, it failed to present documentation showing which items included in the credit memos have been used on other jobs or are still in inventory. The taxpayer also failed to present documentation showing that additional use tax was paid on the material that was used on other jobs. Furthermore, contrary to the taxpayer's claim, SECRETARY did not testify concerning this issue. The bookkeeper's uncorroborated testimony is insufficient to overcome the Department's prima facie case. See Mel-Park Drugs, 218 Ill.App.3d at 217. It is incumbent upon the taxpayer to present documentary evidence identified with its books and records to support its argument. Id.; see also Sprague v. Johnson, 195 Ill.App.3d 798, 803 (4th Dist. 1990); Howard Worthington,

Inc. v. Department of Revenue, 96 Ill.App.3d 1132, 1134-35 (2d Dist. 1981). Because the taxpayer did not present sufficient evidence to support this claim, it is not not entitled to this credit.

Issue Seven

The last issue raised by the taxpayer is whether it is entitled to an abatement of the interest and penalties. With respect to the interest, the taxpayer first requests an abatement of the interest, and in the alternative, the taxpayer asks that the interest be recalculated. Because there is no statutory authority for the abatement of the interest, it cannot be recommended that the taxpayer receive this relief. The taxpayer also requests that the interest be recalculated on the basis that the auditor used the wrong date for determining when the tangible personal property was put to use on construction projects. The taxpayer claims that the auditor should have started calculating the interest from the date that the taxpayer sent an invoice for the construction projects to its customers. Instead, the auditor used the date on which most of the material for a particular project was acquired.

Use tax on tangible personal property is collected from purchasers by the retailer when the purchase is made. See 35 ILCS 105/3-45. When a construction contractor purchases tangible personal property, however, the Department's regulations provide that if it is impracticable to determine whether the property will be converted into real estate or resold, the contractor may certify to its vendor that the property is being purchased for resale. 86 Ill.Admin.Code, ch. 1, §130.2075(b)(1). The contractor must thereafter account to the Department for the tax "on disposing" of the property. Id.

The taxpayer did not present evidence showing when it "disposed of" or used the property. Although the taxpayer has presented evidence showing the dates that it sent invoices for its construction contracts, there is no evidence concerning the dates that the taxpayer delivered the materials to the job sites or converted the materials into real estate. The taxpayer has therefore failed to present sufficient evidence to overcome the presumption that the Department's method of calculating the interest was reasonable.

The taxpayer has also requested that the two penalties in this matter be abated. The ROTA states that the penalties shall not apply if the taxpayer shows that its failure to file returns or pay taxes was due to "reasonable cause." See Ill.Rev.Stat. 1991, ch. 120, par. 444. Although the ROTA does not define "reasonable cause," the Department has enacted regulations that provide some guidance for determining whether a taxpayer is entitled to an abatement of the penalty. The most important factor to consider is "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." 86 Ill.Admin.Code, ch. 1, §700.400(b).

As to the first penalty for the failure to file returns, the taxpayer argues that the penalty should be abated because SECRETARY was hospitalized from November 16, 1989 until some time in December 1989. The taxpayer claims that SECRETARY was the only person responsible for preparing and filing the returns prior to her illness, and due to the unexpected nature of the illness, there was no opportunity to train someone to prepare and file the returns. (Taxpayer's brief, p. 12).

This argument is not supported by the testimony. SECRETARY testified that one of the taxpayer's employees, TAXPAYER EMPLOYEE, was responsible for preparing and filing the returns during the audit period. SECRETARY testified that she did not acquire responsibility for filing the returns until April 1991, and she could not explain why the returns had not been filed because she was not in charge during the periods in question. (Tr. pp. 148-149). Although the illness of a taxpayer may be a basis for abating the penalty, in the case of a corporation, the illness must have been of an individual having sole authority to file the return. See 86 Ill.Admin.Code, ch. 1, §700.400(e)(2). The evidence does not support the taxpayer's claim that SECRETARY was the sole person responsible for filing the returns, and therefore it will not be recommended that this penalty be abated.

With respect to the deficiency penalty, the taxpayer argues that this should not be imposed on the taxes relating to the construction contracts because the taxpayer made an effort to determine when those taxes should have been reported. SECRETARY testified that sometime during 1989 she contacted an employee of the Department named Ms. Brazier ("Brazier") and asked her when taxes are due on materials used in construction contracts. When Brazier asked how the taxpayer had been reporting the taxes, SECRETARY responded that the taxes had been reported upon the completion of the construction projects. (Tr. pp. 125, 127). According to SECRETARY, Brazier stated that this method was acceptable. SECRETARY later contacted the Department after the audit had begun and received the same information from a woman named Dorothy, whose last name SECRETARY could not remember. (Tr. pp. 129-130).

Although it appears that the taxpayer attempted to determine its proper tax liability, this testimony by itself is not sufficient to recommend an abatement of the penalty. The taxpayer alleges that it made one phone call to the Department during the time period that it underreported its taxes, but the taxpayer does not have any corroborating evidence, such as a memo documenting the call, to verify that it was made. SECRETARY's second call to the Department was not made until after the audit had begun. This is not sufficient evidence to find that the taxpayer made a good faith effort to determine its tax liability at the time the liability was due.

Recommendation

For the foregoing reasons, it is recommended that the remaining tax liability of \$4,092.08, plus interest and penalties, be upheld.

Linda Olivero
Administrative Law Judge

Enter: