ST 98-16
Tax Type: SALES TAX
Issue: Failure To Verify Or Document Interstate Sales

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No.** **IBT No.** **NTL Nos.**
v.	
TAXPAYER **Taxpayer**	**Charles E. McClellan** **Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances

John D. Alshuler for the Illinois Department of Revenue. David A Hughes, Horwood, Marcus & Berk Chartered, for the taxpayer.

Synopsis

This matter involves two Notices of Tax Liability (NTLs) issued to TAXPAYER (taxpayer) by the Department on August 23, 1995. NTL XXXXX involves the periods beginning December 1, 1993 through September 30, 1994. NTL XXXXX involves the periods beginning July 1, 1991 through November 30, 1993.

A pre-trial order was entered on July 23, 1997, setting forth the issues in the case as follows:

1. Whether the carriers in issue, as set forth in the parties' Stipulation of Facts are representatives of the taxpayer's customers such that Retailers' Occupation Tax[1] (ROT) is due on the transactions at issue;

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[1] Unless otherwise noted, all statutory references are to 35 ILCS 120/1, *et seq*., the Retailers' Occupation Tax Act. (ROTA).

2. Whether the taxpayer is entitled to a ROT credit for sales tax paid to the Wisconsin Department of Revenue on the transactions in issue;

3. Whether reasonable cause exists to warrant the full abatement of penalties.

In the pre-trial order, the administrative law judge also found that the taxpayer waived its right to an evidentiary hearing and the parties agreed to have the case decided on the basis of an agreed stipulation of facts that the parties signed on July 22, 1997. I recommend that penalties be waived, that the NTLs be adjusted to exclude certain transactions represented by the copies of bills of lading included in Exhibit D to the stipulation, and that, as so adjusted, the NTL's be made final.

<u>Finding of Fact</u>:

1. Taxpayer is a manufacturer and printer of envelopes. Stip. ¶ 3.

2. Taxpayer manufactures envelopes from raw paper and then prints envelopes to customers' specifications. Stip ¶ 4.

3. Taxpayer operates from four locations: two in California and one each in Indiana and Chicago Illinois. Stip. ¶ 5.

4. The California and Indiana locations are distribution centers for products manufactured in Chicago. Stip. ¶ 6.

5. Taxpayer makes no shipments of its product from the California and Indiana locations to Illinois. Stip. ¶ 7.

6. During the periods in issue, taxpayer sold envelopes from its Chicago location to customers located outside of Illinois.

7. Copies of the bills of lading for these sales to non-Illinois customers are attached to the stipulation and collectively marked Exhibit D. Stip. ¶ 9.

8. Two bills of lading in stipulation Exhibit D list taxpayer as the shipper and Sells Printing Co., Inc., of New Berlin, Wisconsin as the customer. [2] *Id*.

9. The remaining bills of lading in stipulation Exhibit D either list non-Illinois customers as the shipper or list an Illinois customer as the shipper with an out-of-state shipping destination. *Id*.

10. The envelopes sold by taxpayer were not delivered to the non-Illinois customers by taxpayer in its own vehicles nor were they directly picked up by taxpayers customers in their own vehicles at taxpayer's shipping dock in Chicago. Stip. ¶ 10.

11. Envelopes sold to non-Illinois customers were picked up at taxpayer's shipping dock in Chicago by carriers and delivered by the carriers to taxpayer's customers located outside Illinois. Stip. ¶ 11.

12. The carriers that delivered taxpayer's envelopes to its non-Illinois customers were engaged in the business of transporting freight from place to place for compensation. Stip. ¶ 14.

13. The carriers that delivered taxpayer's envelopes to its non-Illinois customers offer themselves to the general public as carriers for hire and carry any person or goods that may be offered as long as room is available, there is no legal reason for refusing to be hired, and the shipper is willing to pay the fare. Stip. ¶ 15.

14. In some cases, brokers contacted and arranged for carriers to pick up and deliver taxpayer's envelopes to out-of-state locations. Stip. ¶ 17.

[2] Three bills of lading show taxpayer as shipper to its customer, LTD Commodities, Inc., in Bannockburn Illinois. These transactions should be excluded from the deficiency calculation because they do not represent transactions which are stipulated to be at issue.

15. Taxpayer's customers arranged for, contracted with and directly paid the carriers and brokers involved in delivering taxpayer's envelopes to its non-Illinois customers. Stip. ¶ 19.

16. Taxpayer did not remit ROT to the Department on the sales in issue because taxpayer considered such sales to be in interstate commerce and subject to tax in the destination states. Stip. ¶ 20.

17. Taxpayer collected and remitted state sales tax in the destination states. Stip 21.

Conclusions of Law:

Issue No. 1

The first issue is whether the carriers in issue are representatives of the taxpayer's customers so that ROT is due on the transactions in issue. The taxpayer argues that the sales in question are sales in interstate commerce and therefore, exempt from ROT under Section 2-60 of the ROTA and Section 130.605 of the Department's regulations. 86 Admin. Code ch. I, § 130.605. The Department argues that the bills of lading (Stip. ¶ 9 Exhibit D) for the sales in question show that the carriers were acting as the agents for the taxpayer's customers when they picked up the customer' orders and, for that reason, the sales were not sales in interstate commerce but were sales taxable in Illinois.

Under Section 7 of the Retailers' Occupation Tax all sales of tangible personal property are subject to tax until the contrary is established and the burden of proof in that regard in on the person claiming exemption. 35 ILCS 120/7. Quincy Trading Post v. Dept. of Revenue, 12 Ill. App. 3d 725 (4th Dist. 1973) Section 2-60 provides that tax under the Act is not imposed upon the privilege of engaging in a business in interstate commerce or otherwise when the business may not be made subject to taxation by Illinois under the Constitution and statutes of the United States. A statute that exempts property from taxation must be strictly construed in favor of taxation. Wyndemere Retirement Comm. v. Dept. of Revenue, 274 Ill. App. 3d 455 (2nd Dist. 1995). In the process of analyzing an exemption, all facts and debatable questions are resolved in favor of taxation. *Id.*

The subsections of the regulations that deal with the interstate commerce exemption are set forth in 86 Admin. Code ch. I, § 130.605 and, in part, provide as follows:

> Where tangible personal property is located in this State at the time of its sale . . . the seller is taxable if the sale is at retail. 86 Admin. Code ch. I, § 130.605(a)
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> The sale is not deemed to be in interstate commerce if the purchaser or his representative receives the physical possession of such property in this State. 86 Admin. Code ch. I, § 130.605(a)(1). This is so notwithstanding the fact that the purchaser may, after receiving physical possession of the property in this State, transport or send the property out of the State for use outside the State or for use in the conduct of interstate commerce. 86 Admin. Code ch. I, § 130.605(a)(2).
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> The tax does not extend to gross receipts from sales in which the seller is obligated, under the terms of his agreement with the purchaser, to make physical delivery of the goods from a point in this State to a point outside this State, not to be returned to a point within this State, provided that such delivery is actually made. 86 Admin. Code ch. I, § 130.605(b).
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> Nor does the tax apply to gross receipts from sales in which the seller, by carrier (when the carrier is not also the purchaser) or by mail, under the terms of his agreement with the purchaser, delivers the goods from a point in this State to a point outside this State not to be returned to a point within this State. 86 Admin. Code ch. I, § 130.605(c).

The parties stipulated that the bills of lading at issue list taxpayer's sales from its Illinois location to out-of-state customers which were shipped to destinations outside of Illinois. Stip. ¶¶ 8 and 9. Two bills of lading at issue as stipulated in Stip. ¶ 9, show taxpayer as the shipper to its customer, Sells Printing Co., Inc., in New Berlin, Wisconsin.

These transactions come within the interstate commerce exemption set forth in 86 Admin. Code ch. I, § 130.605(b) so they should be excluded from the deficiency calculation.

The remaining copies of bills of lading attached to Stip. Ex. D, representing the transactions at issue, show that the transactions fall squarely within 86 Admin. Code ch. I, § 130.605(a)(1). Each of these bills of lading shows the shipper to be one of taxpayer's customers. Each one also shows that the shipment origination point was the taxpayer's facility in Illinois, thereby indicating that the transaction took place in Illinois. These copies of bills of lading are the only evidence of record showing where taxpayer's customers took possession of the goods purchased and because the customers were the shippers they indicate that the customers took possession of the goods in Illinois by hiring the various carriers to transport the goods to their out-of-state locations. 86 Admin. Code ch. I, § 130.605(a)(2).

To be exempt from ROT as sales in interstate commerce, a transaction must fit within the exceptions set forth in either 86 Admin. Code ch. I, § 130.605(b) or (c). Taxpayer does not argue that the exemption provided by 86 Admin. Code ch. I, § 130.605(b) applies to the facts of this case. Rather, taxpayer argues that the sales at issue are exempt under 86 Admin. Code ch. I, § 130.605(c).

To be exempt under 86 Admin. Code ch. I, § 130.605(c), there must be an agreement between the seller and its out-of-state customers obligating the seller to deliver the goods being sold by carrier or by mail from a point in Illinois to a point outside of Illinois not to be returned to Illinois. Taxpayer argues that the sales in question are exempt under this provision because the goods are delivered by carrier from taxpayer's location in Illinois to its customers at locations outside of Illinois. As the Department points out, however, in this case taxpayer, the seller, is not delivering the goods to its customers by carrier to out-of-state locations. There are no documents of record showing that taxpayer was obligated by agreement to ship the goods to its customers at their out-of-state locations. The copies of the bills of lading show in each case that taxpayer's customer was the shipper shipping goods purchased from taxpayer to the customer's out-of-state location, thereby indicating that the transaction was completed in Illinois and the carrier was acting as the customer's representative to transport the goods to its location outside of Illinois. See Union Electric Do. v. Dept. of Revenue, 136 Ill. 2d 385 (1990) Therefore, the sales at issue occurred in Illinois and are not exempt under 86 Admin. Code ch. I, § 130.605(c)

Next, taxpayer argues that the sales at issue are exempt because they are transported from taxpayer's facility in Illinois to its out-of-state customers by common carrier. As authority for this proposition, taxpayer relies on National Bellas Hess v. Department of Revenue, 386 U.S. 753 (1967), Quill Corp. v. North Dakota, 504 U.S. 298 (1992), and Brown's Furniture, Inc. v. Wagner, 171 Ill. 2d 410 (1996). Taxpayer's reliance on these cases is misplaced because those cases involved the issue of nexus under the Due Process and Commerce clauses of the 14th Amendment to the U.S. Constitution. The question at issue in each case was whether a taxing state could require an out-of-state seller to collect use tax on sales to customers in the taxing state if the only contact the seller had with the customers in the taxing state was by U.S. Mail or common carrier. This case does not involve that issue. Rather the issue in this case is whether Illinois can tax sales made by a taxpayer located in Illinois to out-of-state customers who hire carriers to transport the goods purchased from taxpayer's location in Illinois to the taxpayer's out-of-state location.

Taxpayer relies on Quill, *supra*, for the statement that "Bellas Hess followed the latter approach and created a safe harbor for vendors 'whose only connection with customers in the [taxing] State is by common carrier or the United States mail.' Under Bellas Hess, such vendors are free from state-imposed duties to collect sales and use taxes." 504 U.S. at 315. The matter at issue in this case involves a taxpayer in the taxing state whose customers employed common carriers to deliver goods purchased in Illinois to their out-of-state locations. Neither Bellas Hess, Quill nor Brown's Furniture creates a safe harbor for the type of transactions at issue in this case.

In footnote 11 of taxpayer's brief, taxpayer cites Union Electric Do. v. Dept. of Revenue, *supra*, for the proposition that "interstate sales picked up and delivered by common carriers to non-Illinois locations are not subject to ROT. Taxpayer's interpretation of the decision in this case is incorrect. Union Electric and a companion case involved a situation in which out-of-state electric utilities purchased coal from Illinois mining companies. The coal was shipped by rail to companies operating coal loading facilities on the Mississippi River. The coal loading facilities loaded the coal on barges for shipment to electric utilities' locations outside of Illinois. The bills of lading in both cases designated as shippers companies involved in transporting the coal other than the utilities. The Department argued that these companies accepted delivery in Illinois as representatives of the electric utilities so the transactions were subject to ROT. The Court determined that the parties designated as shippers were not acting as agents for the electric utilities because they had no authority to do anything with the coal other than to transport it to the utilities' facilities outside of Illinois. 136 Ill. 2d at 397, 398. In the case at hand the bills of lading list taxpayer's out-of-state customers as the shippers. There are no intervening carriers between taxpayer and its out-of-state customers. Therefore, the Union

Electric decision does not support taxpayer's position in this case. It does, however, support the Department's position because the bills of lading in this case show that the shippers for the transactions at issue were the taxpayer's out-of-state customers and the shipments originated in Illinois.

By hiring carriers to transport goods purchased from taxpayer in Illinois, taxpayer's out-of-state customers made the carriers their agents to transport the goods they purchased in Illinois to their out-of-state locations. Therefore, the transactions are taxable in Illinois. 86 Admin. Code ch. I, § 130.605(a).

Issue No. 2

The second issue is whether the Taxpayer is entitled to a credit against ROT for sales tax paid to the Wisconsin Department of Revenue on the transactions in issue. Taxpayer argues that Section 3-55 of the Illinois Use Tax Act[3] allows it to claim a credit for sales tax paid to Wisconsin on the transactions in issue. That section of the Use Tax Act allows a credit for sales or use tax paid to another state on tangible personal property purchased in another state which is brought to Illinois for use in Illinois. 35 ILCS 105/3-55(d).

Taxpayer's argument is incorrect. The property involved in this case is being taxed under the ROTA not the Use Tax Act, and the ROTA does not contain a provision similar to Section 3-55 of the Use Tax Act. In addition, Section 3-55 of the Use Tax Act deals with property purchased in a state other than Illinois and brought into Illinois for use in Illinois. The instant case involves property shipped out of Illinois to taxpayer's out-of-state customers. Taxpayer is not entitled to a credit for taxes it paid to Wisconsin in connection with the transactions at issue.

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[3] 35 ILCS 105/3-55.

Issue No. 3

The third issue is whether reasonable cause exists to warrant the full abatement of penalties. The statue (35 ILCS 735/3-8) and regulation (86 Admin. Code ch. I, § 700.400) provide for waiver of penalties for late filing and late payment of tax if the failure to file or pay is due to reasonable cause. The determination of whether a taxpayer acted with reasonable cause is made on a case by case basis taking into account all of the relevant facts and circumstances. *Id*. at ¶ (b). The most important factor is evidence showing that the taxpayer made a good faith effort to comply with the law. *Id.* A taxpayer is considered to have made a good faith effort if he exercised ordinary business care and prudence in attempting to comply with the law. *Id*. at ¶ (c). In this case the record indicates that the taxpayer collected and remitted sales tax in the destination states for the transactions at issue, which shows that the taxpayer made a good faith effort to comply with the law as it understood it. This fact establishes reasonable cause and grounds for waiving penalties.

Wherefore, for the reasons stated above, I recommend that penalties be waived, that the Notices of Tax Liability be adjusted to eliminate the transactions set fort in findings of Facts number 8, and that the Notices of Tax Liability as so adjusted be made final.

March 17, 1998 ENTER:

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Administrative Law Judge