

ST 14-06

Tax Type: Sales Tax

Tax Issue: Medicines & Medical Appliance Exemption (Low Rate)

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

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS

v.

ABC BUSINESS,
Taxpayer

Ted Sherrod

No. XXXX
Account ID XXXX
Letter ID XXXX
Period 1/07-5/09

Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General John Alshuler on behalf of the Illinois Department of Revenue; James A. Stola, Esq. of The Law Office of James A. Stola on behalf of ABC BUSINESS

Synopsis:

This matter arose from a protest filed by ABC BUSINESS (“taxpayer”) to a Notice of Tax Liability issued to the taxpayer by the Department of Revenue (“Department”) on March 30, 2011 for taxes assessed under the Retailers’ Occupation Tax Act (“ROTA”) 35 ILCS 120/1, *et seq.*, and related taxes. This Notice of Tax Liability was issued at the conclusion of an investigation of the taxpayer’s records for the period January 1, 2007 through May 31, 2009. The sole issue to be decided in this case, as agreed to by the parties pursuant to the pre-trial order entered September 28, 2012, is whether certain items sold by the taxpayer constitute “medical

appliances” under the Illinois sales and use tax statutes.¹ The taxpayer contends that various items it sold were “medical appliances” and therefore qualify for the low rate of tax applicable to such items pursuant to 35 ILCS 120/2-10.

An evidentiary hearing was held on August 1, 2013 regarding this matter. After reviewing the transcript of the hearing and documents presented at hearing, I recommend that the Notice of Tax Liability at issue be made final. In support of this recommendation, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The taxpayer is a corporation doing business in Illinois. Department Exhibit (“Ex.”) 1. The Department conducted an audit of the taxpayer's records for the period January 1, 2007 through May 31, 2009. *Id.*
2. At the conclusion of the audit, the Department prepared a Form SC-10-K Audit Correction and/or Determination of Tax Due (“corrected return”). *Id.*
3. On March 30, 2011, the Department issued a Notice of Tax Liability that was based upon the corrected return, assessing tax due. *Id.* The Department’s Notice of Tax Liability is based upon its determination that lift chairs are not “medical appliances” and therefore are taxable at the generally applicable state tax rate of 6.25% rather than the 1% rate applicable to “medical appliances.” Department Ex. 2.²

Conclusions of Law:

The ROTA requires every taxpayer to report to the Department the total amount of gross receipts on forms prescribed by the Department. 35 ILCS 120/3. The statute, at 35 ILCS 120/4,

¹ The issue raised by the taxpayer during the hearing of whether any software items purchased by the taxpayer constituted the purchase of non-taxable services is not enumerated as an issue in the pre-trial order and, therefore, is not addressed in this recommendation. 86 Ill. Admin. Code, ch. I, section 200.120(c).

² “Wheelchairs”, “nebulizers” and “elevated leg rests”, which the taxpayer contends were also improperly included as items taxable at the higher rate (taxpayer’s Group Ex. 1), are not separately enumerated as taxable items in the Department’s work papers. Department Ex. 2.

also requires the Department to examine these returns and to issue notices of tax liability if it determines additional taxes to be due. Specifically, the latter statute provides as follows:

As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgment and information. ... In the event that the return is corrected for any reason other than a mathematical error, any return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown therein. ... In making a correction of transaction by transaction, monthly or quarterly returns covering a period of 6 months or more, it shall be permissible for the Department to show a single corrected return figure for any given 6-month period. ...

If the tax computed upon the basis of gross receipts as fixed by Department is greater than the amount of tax due under the return or returns as filed, the Department shall ... issue the taxpayer a Notice of Tax Liability for the amount of tax claimed by the Department to be due, together with a penalty in an amount determined in accordance with Section 3-3 of the Uniform Penalty and Interest Act. Provided, that if the incorrectness of any return or returns as determined by Department is due to negligence or fraud, said penalty shall be an amount determined in accordance with Section 3-5 or Section 3-6 of the Uniform Penalty and Interest Act, as the case may be.

35 ILCS 120/4.

In the instant case, the Department examined the tax returns filed by the taxpayer for the period at issue. At the conclusion of this audit, the Department determined that the gross receipts of the taxpayer's business during this period were greater than the amounts reported on the tax returns the taxpayer filed. Accordingly, it prepared a corrected return calculating a deficiency and assessed late payment and late filing penalties. On March 30, 2011, it issued Notice of Tax Liability Letter ID number XXXX to the taxpayer. Department Ex. 1.

It is well established that a corrected return as prepared by the Department is deemed *prima facie* correct. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). At the hearing in this case, the Department established its *prima facie* case by introducing its Notice of Tax Liability and the corrected return into evidence. *Id.* The burden then shifted to the

taxpayer to overcome the Department's *prima facie* case. Anderson v. Department of Finance, 370 Ill. 225 (1938); Masini, *supra* at 15.

“In order to overcome the presumption of validity attached to the Department's corrected returns, [the taxpayer] must produce competent evidence identified with their books and records and showing that the Department's returns are incorrect.” Masini, *supra* at 15. See also Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276 (1943); Howard Worthington, Inc. v. Department of Revenue, 96 Ill. App. 3d 1132 (2nd Dist. 1981).

Section 120/2-10 provides that “medical appliances” shall be taxed at the rate of 1%, rather than the generally applicable state tax rate of 6.25%. 35 ILCS 120/2-10. This statutory provision does not define the term “medical appliances.” It only provides that they must be for human use. However, the Department has adopted a regulation that defines this term. The applicable regulation interpreting this statutory section is 86 Ill. Admin. Code, ch. I, section 130.310(c) which, as in effect for the period at issue, provides in relevant part as follows:

(c) Medicines and Medical Appliances

(2) A medical appliance is an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the human body. These items may be prescribed by licensed health care professionals for use by a patient, purchased by health care professionals for the use of patients, or purchased directly by individuals. Purchases of medical appliances by lessors that will be leased to others for human use also qualify for exemption. Included in the exemption as medical appliances are such items as artificial limbs, dental prostheses and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines (including the dialyzer). Corrective medical appliances such as hearing aids, eyeglasses and contact lenses qualify for exemption. Diagnostic equipment shall not be deemed a medical appliance, except as provided in Section 130.310(d). Other medical tools, devices and equipment such as x-ray machines, laboratory equipment, and surgical instruments that may be used in the treatment of patients but that do not directly substitute for a malfunctioning part of the human body do not qualify as exempt medical appliances. Sometimes a kit of items is sold so the purchaser can use the kit items to perform treatment upon himself or herself.

The kit will contain paraphernalia and sometimes medicines. An example is a kit sold for the removal of ear wax. Because the paraphernalia hardware is for treatment, it generally does not qualify as a medical appliance. However, the Department will consider the selling price of the entire kit to be taxable at the reduced rate when the value of the medicines in the kit is more than half of the total selling price of the kit.

86 Ill Admin. Code, Ch. I, section 130.310.³

In the case at hand, the taxpayer sold items identified by the taxpayer as lift chairs, nebulizers, elevated leg rests and manual wheelchairs. Taxpayer's Group Ex. 1. It contends that these items constituted "medical appliances" taxable at the 1% tax rate. *Id.*

As previously noted, in this case, the Department's *prima facie* case was established when the corrected return was entered into evidence under the certificate of the Director of the Department. The burden then shifted to the taxpayer to overcome the Department's *prima facie* case. *Anderson, supra; Masini, supra.*

The taxpayer's attorney appeared at the hearing but he did not offer any oral testimony or documentary evidence on behalf of the taxpayer. The only "evidence" propounded on the taxpayer's behalf was an enumeration of devices the taxpayer claimed constitute "medical appliances" and a statement that the "[P]atient lift systems, vertical chairlifts, floor lifts, slings [and] ceiling lifts" are items that "qualify for the lower rate of tax." Taxpayer's Group Ex. 1. No testimony was offered to explain what any of the devices the taxpayer claims to be taxable at the low rate actually are or how they are used by the taxpayer's customers. Moreover, no invoices, contracts, leases or other documentation relevant to the nature or use of these devices was offered into evidence. It was incumbent upon the taxpayer to produce such evidence in order to

³ Effective in 2010, the Department revised section 130.310 from one that addressed food, drugs and medical appliances to one that addressed only the types of property that would (or would not) be considered food subject to tax at the low rate. 34 Ill. Reg. 12935, 12946-71 (issue 36) (September 3, 2010)(effective August 19, 2010). It removed the medicine and medical appliance subsections that were previously included within section 130.310, and substantially rewrote those subsections within a newly numbered regulation section 130.311, bearing the heading, "Drugs, Medicines, Medical Appliances and Grooming and Hygiene Products." 86 Ill. Admin. Code, ch. I, section 130.311(2010); 34 Ill. Reg. 12963-71.

rebut the *prima facie* correctness of the Department's finding that the devices the taxpayer sold were taxable at the state tax rate of 6.25%. Masini, supra; Copilevitz, supra; DuPage Liquor Store, supra; Howard Worthington, supra.

The record in this case contains no statement, medical conclusion or other indicative evidence, and no documentation supporting any such conclusion, that would establish a direct or inferential qualification of the devices the taxpayer contends are taxable at the 1% rate as meeting the qualifications of regulation 130.310(c) governing the classification of items as "medical appliances." Such evidence would have to show that such items "directly [substitute] for a malfunctioning part of the human body." 86 Ill. Admin. Code, ch. I, section 130.310(c). The absence of any such evidence is fatal to the taxpayer's claim.

In sum, for the reasons enumerated above, I find that the taxpayer has failed to produce any testimony or competent documentary evidence identified with its books and records to overcome the Department's *prima facie* case. Since such proof is required in order for the taxpayer to prevail, I conclude that the Department's *prima facie* determination of liability must be finalized and affirmed.⁴

WHEREFORE, for the reasons stated above, it is my recommendation that the Notice of Tax Liability at issue be finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: December 26, 2013

⁴ Wheelchairs are included as a type of item qualifying as a "medical appliance" pursuant to regulation 130.310(c) and are not specifically identified as taxable at the higher rate in the Department's work papers. Department Ex. 2. As a consequence, the taxpayer was required to produce at least some competent evidence that the devices it identified as "wheelchairs" in its enumeration of items that were improperly taxed were in fact taxed at the higher rate and were types of devices the Department considers "wheelchairs" for purposes of applying this regulation. In the absence of competent documentary evidence to the contrary, the presumed correctness of the Department's finding that wheelchairs the taxpayer claims were improperly taxed were not taxed at the higher rate, or are not covered by regulation 130.310(c), stands un rebutted. Masini, supra; Copilevitz, supra; DuPage Liquor Store, supra; Howard Worthington, supra.

