

ST 04-11
Tax Type: Sales Tax
Issue: Tangible Personal Property

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

THE DEPARTMENT OF REVENUE)
OF THE STATE OF ILLINOIS) No. 02-ST-0000
) IBT No. 0000-0000
 v.) NTL No. 00 0000000000000000 and
) 00 0000000000000000
ABC SYSTEMS,) Kenneth J. Galvin,
 TAXPAYER) Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Mr. John Doe and Ms. Jane Doe on behalf of ABC Systems; Mr. Shepard Smith, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

This matter comes on for hearing pursuant to ABC System's ("ABC") protest of Notice of Tax Liability No. 00 0000000000000000 issued December 21, 2001 and No. 00 0000000000000000 issued December 28, 2001. The only amount unpaid and still at issue on the Notices of Tax Liability is \$10,889 in use tax which the Department assessed on materials used in the installation of cabling. An evidentiary hearing was held in this matter on November 22, 2003 with Mr. Joe Blow, President, and Mr. Smith testifying for ABC and Mr. Charles Schoen, Revenue Auditor, testifying for the Department of Revenue. Following a review of the testimony and the evidence, it is recommended that the Notices of Tax Liability be finalized for the \$10,889 in unpaid use tax plus interest. In support thereof, the following "Findings of Fact" and "Conclusions of Law" are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of Notice of Tax Liability No. 00 00000000000000 issued December 1, 2001 and No. 00 0000000000000000 issued December 28, 2001. Tr. pp. 7-8, 13-14; Dept. Ex. No. 1.
2. Approximately 70% of ABC's business involves the installation of network communication systems for end-users and resellers. ABC does not install cabling outside of the structure, which is usually handled by XXXX. End-users use the installation provided by ABC. Resellers package ABC's physical installation with their own computer systems and sell the total package to their customers. Tr. pp. 15-17, 49-51.
3. The cabling installed by ABC is used for the transmission of data and information from one personal computer to another at high speed. Tr. pp. 18-19.
4. Some of ABC's business consists of replacing existing cabling systems with new, higher speed cabling. If a user increases its computer power but doesn't increase the speed of its cabling, it limits the ability of the new equipment to perform at its full potential. Tr. pp. 20-22, 75.
5. The first "category" for cable was ratified in 1995. Since then, there have been three categories of cable with a fourth being discussed. Each category improves the speed in which the signal gets from the main computer bank to a personal computer, and also gives more bandwidth. Bandwidth gives cable the ability to transmit pictures. Tr. pp. 73-75.
6. When ABC is installing cable, they first install "J-hooks." A J-hook is a hanging system. The J-hook is physically attached to a stringer. A stringer is a framework attached to the facility itself. Stringers may be threaded rods or V-networks in the rafters of the ceiling. J-hooks may be attached to stringers above the drop ceiling for ceiling installation. J-hooks must also be

attached to something in the structure for raised flooring installation. The cabling is then laid in the J-hooks. The cabling is distributed from one or more closets in the building through the J-hooks to the locations where the computers are located. Industry standards require a main closet in every facility and intermediate closets if the facility is large enough. If the cable goes down through a wall, it may be pulled through existing conduits to a box in the wall. If the cable is not in a conduit, a “D-ring,” which ABC bolts to the wall of the structure around the cabling, holds the cable in place. The cable is then terminated at a jack, the jack is clipped onto a faceplate, the faceplate is screwed onto a box. The computer is then attached to the box by a patch cord. Tr. pp. 29-30, 33, 37, 53-56, 59-60, 63, 125-126, 128-129; Dept. Ex. No. 3.

7. J-hooks cost from 15 to 25 cents each and ABC hangs them every 5 to 6 feet of cabling. Tr. pp. 66, 128-129.
8. Usually, conduit has been preinstalled by an electrical contractor. Cable in the conduit is fed through it but is never attached to the conduit. If cable is replaced or upgraded, the old cable is pulled out and new cable is fished through. ABC does not disassemble the conduit to pull out cable or put new cable in. Tr. pp. 31-32.
9. A plastic piece, called a pie rack, is clipped together around the cable to hold it. The pie rack is put through the J-hook to make a loop. Cable can be pulled out from one end and the J-hooks do not have to be disassembled. Tr. pp. 32-33.

Conclusions of Law:

The sole issue to be decided in this case is whether the taxpayer owes use tax on the cost of materials used in the installation of cabling during the audit period in controversy. The Use Tax Act, 35 ILCS 105/1 *et seq.* (hereinafter referred to as the “UTA”) imposes a tax “upon the privilege of using in this State tangible personal property purchased from a retailer...” *Id.* at 105/3.

The UTA was passed to complement and prevent evasion of the Retailers' Occupation Tax Act ("ROTA"). Needle Co. v. Department of Revenue, 45 Ill. 2d 484 (1970). On December 21 and 28, 2001, the Department issued two Notices of Tax Liability ("NTL") to ABC. Section 12 of the UTA (35 ILCS 105/12) incorporates by reference Section 4 of the ROTA (35 ILCS 120/1 *et seq.*), which provides that an NTL issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due. *Id.* at 120/4. Once the Department has established its *prima facie* case by submitting the NTL's into evidence, the burden shifts to the taxpayer to overcome the presumption of validity. Clark Oil & Refining v. Johnson, 154 Ill. App. 3d 773 (1st Dist. 1987). On examination of the record in this case, I find that the taxpayer has failed to demonstrate by testimony, through exhibits or through argument, evidence sufficient to overcome the Department's determination that use tax is due on the materials at issue.

The two NTL's issued to ABC on December 1 and 28, 2001, total \$17,771 including interest. Dept. Ex. No. 1. At the hearing on November 22, 2003, counsel for the Department stated that ABC had paid \$1,999 on February 19, 2002. Tr. p. 7. The Department's counsel stated further that the Department will "also concede the issue of resales disallowed in the amount of \$2,228." Tr. p. 8. The Department's Brief, filed on January 5, 2004, states that "the pre-hearing order does not specify that the small late filing penalty for the period July 1998 through November 1998 is at issue and as a result this will be conceded to the taxpayer." Dept. Brief, p. 2. This penalty was \$10.

The only remaining item unpaid in the NTL's and at issue is the assessment of use tax amounting to \$10,889 on the cost of materials used in the installation of cabling. In order to calculate the use tax due, the auditor made a schedule of the selling price of the materials used in the installations over a six-month period. The taxpayer provided documentation detailing the cost

percentage of the material, estimated to be 45.52% of the selling price. The selling price exceptions for the sample period were multiplied by the cost percentage to arrive at a monthly average of the cost price of the material. The monthly average was then projected over the 30 months of the audit period resulting in use tax due of \$10,889. Tr. pp. 87-88; Dept. Ex. No. 2.

According to the Department's auditor, the \$10,889 is composed of "Illinois installation sales where no tax was collected from the customer." Dept. Ex. No. 2. On direct examination, the auditor stated that his audit assessed use tax on the cost of materials taxpayer used in its local cabling installations where no tax was collected. Tr. pp. 86-87. In redirect examination, the auditor was asked "in arriving at your \$10,889 which is at issue here, you assessed use tax on installations where no tax was collected?" He responded "[T]hat's correct." Tr. p. 119. It is well settled in Illinois law that in order to overcome the presumption of validity accorded a corrected return, a taxpayer must produce competent evidence, identified with its books and records, showing the Department's return is incorrect. Massini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978). This burden is not unreasonable because it is the taxpayer who has control over its own books and records. No documentary evidence at all was presented by ABC at the evidentiary hearing. Accordingly, I must conclude from the record in this case that no tax was paid by ABC either on its purchase of the materials at issue or on its transfer of the materials to end-users.

The Department's auditor testified at the evidentiary hearing that ABC was a "construction contractor" because they were the end-users of the materials incorporated into their installations and that as a "construction contractor," ABC was liable for the use tax on the cost of the materials at issue. Tr. pp. 88, 103. The term "construction contractor" includes general contractors, subcontractors and specialized contractors. "Contractor means any person who is engaged in the occupation of entering into and performing construction contracts for owners." 86 Ill. Adm. Code

§ 130.1940(a)(1). The ROTA describes a “construction contract” for the improvement of real estate as consisting of engineering, installation, and maintenance of voice, data, video, security, and all telecommunication systems. 35 ILCS 120/1. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real estate. As end users of such tangible personal property, contractors incur use tax liability for such purchases based upon the cost price of the tangible personal property. 86 Ill. Adm. Code § 130. 1940(c).

In the instant case, ABC’s operations fit squarely into the definition of “construction contractor” as described in the ROTA and the Department regulations. Mr. Joe Blow, President of ABC, testified that the company’s “primary business is the installation of network communications systems for customers so that their computers can talk to each other.” Tr. p. 15. Mr. Blow stated that 70% of ABC’s business “is comprised of doing installation of cabling systems.” Tr. p. 16. “The cabling is effectively a set of railroad tracks that information travels on for network PC’s.” Tr. pp. 18-19. “Our cabling is installed to accept the high speed of data transfer that computers today and computers tomorrow will definitely need to use.” Tr. p. 20. Mr. Blow’s description of ABC’s operations as the “installation” of systems for “data transfer” is entirely consistent with the description of a construction contract in the ROTA as including, *inter alia*, the “installation” of “data” and “telecommunications systems.” 35 ILCS 120/01. Based on this, I must agree with the auditor’s conclusion that ABC is a construction contractor as this term is defined in the Illinois statutes and regulations.

86 Ill. Adm. Code § 130.1940(c) states that a construction contractor does not incur retailers’ occupation tax on tangible personal property (materials) and fixtures incorporated into a structure as an integral part thereof when furnished and installed as an incident of a construction contract. “The construction contractor incurs use tax on the cost price of the tangible personal

property that is incorporated into real estate.” *Id.* 86 Ill. Adm. Code § 130.1940(a)(5) then defines “materials” as all of the tangible personal property, including fixtures which enter into a structure or otherwise become incorporated into real estate. Although ABC never presented evidence that it paid the tax at issue, Mr. Blow argued at the evidentiary hearing that ABC is not a construction contractor because “none of the materials were permanently affixed to the real property” and because the cabling installed by ABC is nonpermanent. Mr. Blow testified that “a lot” of ABC’s business is replacing existing cabling systems with new, higher, speed cabling. Tr. pp. 9, 20-22, respectively.

The Department cited and relied on several cases that are concerned with determining whether materials were “permanently affixed to real estate.” These cases are significantly distinguishable from the instant case in that they were decided under the Property Tax Code and involve large pieces of equipment, machinery or actual fixtures.

It must be noted that the Department’s administrative regulations do not require that the tangible personal property be “permanently affixed to real estate” but require only that it be “incorporated into real estate.” “Incorporated” in this sense means joined with something already formed or made part of another thing. Webster’s New World Dictionary 684 (3d ed. 1988).

Mr. Blow testified that depending on the structure involved and the location of the computer terminals, ABC installed cabling for data transfer above the drop ceiling, below the raised flooring, and down the wall sometimes through conduits. Tr. pp. 29-30, 33. The cabling is laid in J-hooks. The J-hooks may be attached to a “stringer” which is a threaded rod “that’s bolted to the ceiling.” The J-hooks “have to be attached to something above the drop ceiling or below the raised flooring if we’re installing in a raised floor environment.” Tr. p. 33. ABC may bolt a D-ring to the wall of the structure to hold the cabling in place. Tr. pp. 125-126. This cabling, laying in a J-hook, with

the J-hook attached to something in the structure, or hanging down the wall with a D-ring attached to the structure holding the cabling in place, is incorporated into the structure in which it's installed.

The ROTA's description of a construction contract as including installation and maintenance of voice, data, video, security and all telecommunications systems obviously envisioned the use of cabling in engineering these systems. ABC offered no explanation as to why their operations should be excluded from the ROTA description of construction contracts.

Additionally, ABC's argument that they are not a construction contractor because the cabling they install is nonpermanent and may be replaced with newer, higher speed cabling has no merit under the UTA. The UTA imposes a tax on the privilege of using in Illinois tangible personal property purchased from a retailer. "Use" for purposes of the UTA means the exercise of any person of any right or power over tangible personal property incident to the ownership of that property, which ABC clearly engaged in. 35 ILCS 105/2. There is no requirement under the UTA that rights be exercised over tangible personal property for a minimum period of time or that the tangible personal property never be replaced in order for use tax to be assessed on it. The exercise of rights over property gives rise to the taxable event. The permanence and frequency of the replacement of the tangible personal property are not considerations under the UTA.

In order to overcome the presumption of validity attached to the NTL's in this case, ABC had to produce competent evidence, identified with its book and records showing that the NTL's are incorrect. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991). Documentary proof of tax-exempt status is required to prevail against an assessment of tax by the Department. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990). ABC, having failed to

admit any document showing that the use tax was paid in this matter, has failed to rebut the *prima facie* correctness of the NTL's.

WHEREFORE, for the reasons stated above, it is my recommendation that NTL 00 00000000000000 and NTL 00 0000000000000000 be finalized for the \$10,889 in unpaid use tax plus interest.

March 17, 2004

Kenneth J. Galvin
Administrative Law Judge