

UT 12-03
Use Tax
Issue: Use Tax On Purchases From A Foreign Country

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

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS,
v.

ABC COMPANY,
Taxpayer

No. XXXXXX
Account ID XXXXXX
Letter ID XXXXXX
XXXXXXXX
XXXXXXXX
XXXXXXXX
Period XXXXXX

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: Marc Muchin, Special Assistant Attorney General, for the Illinois Department of Revenue; John Doe of John Doe & Associates, for ABC Business

Synopsis:

This matter comes on for hearing pursuant to a protest filed by ABC Company (“taxpayer”) to the Department of Revenue’s Notices of Tax Liability for Form EDA-94, Auditor-prepared Use Tax Report (ST-44) issued December 10, 2010 for the period 3/31/08 through 12/4/08. The basis for these assessments is the Department’s determination that the taxpayer failed to pay use tax on portable scanners and printers the Department contends the taxpayer purchased on or about March 31, 2008, May 15, 2008, June 30, 2008, July 7, 2008, October 30, 2008, November 20, 2008 and December 4, 2008. The taxpayer protested these assessments claiming that it never purchased or owned the scanners and printers in controversy,

and that its activity with respect to this property was limited to warehousing. An evidentiary hearing was held in this matter on March 2, 2012 during which two witnesses testified on behalf of the taxpayer. During this hearing, both parties submitted documentary evidence. Following a review of the testimony and the evidence submitted by the parties, it is recommended that the Notices of Tax Liability at issue in this case be cancelled. In support of this recommendation, 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, was established by the admission of the Department’s Notices of Tax Liability issued September 2, 2010 under Certificates of the Director pertaining to alleged purchases made by the taxpayer on or about March 31, 2008, May 15, 2008, June 30, 2008, July 7, 2008, October 30, 2008, November 20, 2008 and December 4, 2008 showing a total use tax liability due and owing with respect to these alleged purchases of \$38,292.72. Department Exhibit (“Ex.”) 1-7. The Department’s assessment determinations are based on tariff declarations made in connection with the importation of property from outside of the U.S. for delivery to the taxpayer. Department Ex. 1-7; Taxpayer’s Ex. 2.
2. DEF Business LLP (“DEF Business”) is a Canadian based corporation having its principal office in Anywhere, Canada. Taxpayer’s Group Ex. 1 (DEF Business Equipment Rental Agreement). DEF Business is engaged in the business of purchasing and leasing portable scanners and printers to U.S. and foreign companies for use as bar code readers and printers at trade shows in the United States and other countries. Transcript (“Tr.”) pp. 7, 14-16, 19-21; ABC Business v. The Department of Revenue of

the State of Illinois, Use Tax Hearings Supporting Documents for Protest (“Taxpayer’s Supporting Documents”), pp. A-39 through A-166 (Equipment Rental Agreements).

3. DEF Business’ customers make use of the bar code scanners and printers leased from DEF Business by going on site to trade shows and re-renting the equipment leased from DEF Business to trade show exhibitors. Tr. p. 20.
4. During the period March 31, 2008 through December 10, 2008 at issue in this case, an inventory of DEF Business products was maintained at a public warehouse located in Schaumburg, Illinois, which is owned and operated by ABC Company ("taxpayer"), a corporation registered with the Department to collect and pay sales and use taxes in Illinois. Tr. pp. 17, 18; Department Ex. 1-7; Taxpayer’s Supporting Documents A-13 through A-30 (Warehouse transfer details-Worksheets), A-39 through A-166 (Equipment Rental Agreements and related documents). These products were shipped to the taxpayer from DEF Business by common carrier. Taxpayer’s Group Ex. 1.
5. During the period at issue, printers and scanners from the taxpayer's inventory of these items received from DEF Business located at the taxpayer's warehouse in Schaumburg, Illinois were shipped and delivered to DEF Business’ lessees pursuant to lease contracts entered into between DEF Business and its lessees that were in effect during the period in controversy. Taxpayer’s Group Ex. 1; Taxpayer’s Supporting Documents A-39 through A-166 (Equipment Rental Agreements and related documents).
6. An audit of the taxpayer was conducted by the Department with respect to the taxpayer’s alleged importation and purchase of foreign merchandise during the period at issue. Department Ex. 1-7. As a result of this audit, the Department determined that the taxpayer owed taxes on DEF Business products allegedly imported and purchased by the

taxpayer on March 31, 2008, May 15, 2008, June 30, 2008, July 7, 2008, October 30, 2008, November 20, 2008 and December 4, 2008. *Id.* All of the import transactions determined by the Department to be purchases by the taxpayer during the period at issue related to leases by DEF Business to third parties and involved the delivery of products from the taxpayer's inventory of DEF Business products held at the taxpayer's warehouse to DEF Business' lessee customers. Taxpayer's Group Ex. 1 (Rental Agreement and Checklist); Taxpayer's Supporting Documents A-17 (Warehouse Transfer Details – Worksheet 4), A-24 (Warehouse Transfer Details–Worksheet 7), A-50 (Rental Agreement Checklist), A-55 (Rental Agreement Checklist), A-57 (Rental Agreement Checklist), A-39 through A-166 (Equipment Rental Agreements and related documents).

Conclusions of Law:

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 at retail from a retailer ... [.]” *Id.* at 105/3. The UTA was passed to complement and prevent evasion of the Retailers' Occupation Tax Act. Needle Co. v. Department of Revenue, 45 Ill. 2d 484 (1970). On September 2, 2010, the Department of Revenue (“Department”) issued Notices of Tax Liability (“NTLs”) assessing use tax on the taxpayer. Section 12 of the UTA (35 ILCS 120/12) incorporates by reference section 4 of the Retailers' Occupation Tax Act (35 ILCS 120/4) which, in turn, provides that the NTLs issued by the Department are *prima facie* correct and are *prima facie* evidence of the correctness of the amount of tax due. The burden shifts to the taxpayer to overcome this presumption of validity, once the Department has established its *prima facie* case. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773 (1st Dist. 1987).

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

The Department, in its assessment, alleges that the taxpayer engaged in a taxable use of property imported from outside of the United States for delivery to the taxpayer during the period at issue. Department Ex. 1-7; Taxpayer's Ex. 2. This assessment is based upon tariff declarations made in connection with the taxpayer's receipt of property from DEF Business during this period on or about March 31, 2008, May 15, 2008, June 30, 2008, July 7, 2008, October 30, 2008, November 20, 2008 and December 4, 2008. *Id.* To determine whether use tax was properly assessed in this case, it must first be determined whether the taxpayer used the items purchased in Illinois as the term "use" is defined in the UTA. Section 2 of the UTA defines the term "use" broadly as "the exercise by any person of any right or power over tangible personal property incident to the ownership of the property ... [.]" (emphasis added). 35 ILCS 105/2. The Illinois courts have indicated that "[T]he use tax is not a tax which arises out of the use or operation of tangible personal property, but rather is a tax placed upon the exercise of powers or rights incident to ownership. See Philco Corp. v. Department of Revenue, 40 Ill. 312, 239 N.E. 2d 805, and Miller Brewing Co. v. Korshak, 36 Ill. 2d 86, 219 N.E. 2d 494. Therefore, mere use without rights of ownership cannot be taxed ... [.]" Time, Inc. v. Department of Revenue, 11 Ill. App. 3d 282, 288, 289 (1st Dist. 1973). The decisive issue in this case is

whether the taxpayer's use of the property indicated in the aforementioned tariff declarations in Illinois fits within the statutory definition of "use" contained in Section 2 of the UTA and thus triggers application of the use tax.

As previously noted only a use of property in this state that is attendant to ownership of the property constitutes a taxable use of the property. Time, Inc., *supra*. The taxpayer contends that its acquisitions of property received from DEF Business on or about the dates indicated in the Department's assessments are not taxable pursuant to Section 2 of the UTA, which defines a "use" that can subject property to taxation as "the exercise by any person of any right or power over tangible personal property incident to the ownership of that property ...[.]" 35 ILCS 105/2. It bases this claim upon its contention that the taxpayer's inventory of DEF Business' products was transferred to the taxpayer's custody for warehousing purposes only. Tr. p. 7 ("In our view, the fallacy [of] the State's position in this matter is that first and foremost the entity against whom tax is sought to be imposed, ABC Business, Incorporated, has not purchased and does not own the property in question [...] ... ABC Business merely serves as a fulfillment house for DEF Business, which is the owner of the optical scanners and printers, and has purchased them from its suppliers in a taxable transaction in the province of Canada."). It contends that it never acquired ownership of or title to this inventory but held it temporarily at its warehouse for disposition pursuant to instructions from DEF Business. Tr. pp. 7-9. The Department contends that the taxpayer's claim cannot be corroborated because the taxpayer is unable to produce any contract or other similar agreement to verify that it engaged exclusively in warehousing the property it acquired from DEF Business. Tr. pp. 5, 6.

The record indicates that the assessments in controversy are based upon tariff documents showing when the equipment at issue entered the U.S. and the value of merchandise being

shipped. Taxpayer's Group Ex. 1; Taxpayer's Ex. 2. Taxpayer has provided documentation, as indicated below, relating the tariff records of shipment noted above to DEF Business' conduct of its equipment rental business involving the shipment of items leased by DEF Business for warehousing by the taxpayer. This documentation supports the taxpayer's claim that equipment indicated in the tariff records of shipment, used by the Department in arriving at its assessments, was transferred to the taxpayer for warehousing purposes only and was never owned by the taxpayer. As a consequence, this documentation negates the Department's determination that the taxpayer was the purchaser of the merchandise delivered to it which the Department has inferred from the tariff documentation and the delivery of equipment covered by this documentation to the taxpayer. The nature of the taxpayer's proof is detailed below.

The Department assessed use tax on equipment designated for delivery to the taxpayer which tariff records show entered the U.S. on March 31, 2008. Taxpayer's Ex. 2. The record shows that this equipment was leased to GHI Business pursuant to a rental agreement between DEF Business and GHI Business that is contained in the record. Taxpayer's Supporting Documents A-89. The rental agreement shows the taxpayer as the provider of warehousing services necessitated by this agreement. *Id.* The record also contains shipping information from the taxpayer's books and records indicating the delivery of the aforementioned items to the taxpayer the day after the date of entry shown on the tariff records and stating that this shipment was pursuant to DEF Business' lease agreement with GHI Business noted above. Taxpayer's Supporting Documents A-17 (Warehouse Transfer Details – Worksheet 4).

Similar evidence contained in the record consisting of rental agreement checklists and shipping documentation shows that the Department's assessments on alleged purchases by the taxpayer relate to equipment rented by DEF Business with respect to which the taxpayer served

as the provider of warehousing services. See Taxpayer's Supporting Documents A-24 (Warehouse Transfer Details- Worksheet 7), Taxpayer's Group Ex. 1 (Equipment Rental Agreement and Checklist), and Taxpayer's Supporting Documents A-50 (Rental Agreement Checklist), A-57 (Rental Agreement Checklist) and A-55 (Rental Agreement Checklist) indicating equipment entering the U.S. on May 15, 2008, June 30, 2008, July 7, 2008, October 30, 2008, November 20, 2008 and December 4, 2008 related to equipment movements on or about these dates pursuant to DEF Business' lease agreements contained in the record (at Taxpayer's Supporting Documents A-39 through A-166). The rental equipment checklists noted above are attachments to lease agreements that identify the taxpayer as the provider of warehousing services at its Schaumburg, Illinois warehouse. *Id.*

From the foregoing evidence, I deduce that the equipment treated as having been purchased by the taxpayer from DEF Business based upon tariff information showing imported merchandise designated for delivery to the taxpayer, was delivered to the taxpayer for warehousing purposes only and was never owned by the taxpayer. The record plainly shows that each of the shipments to the taxpayer giving rise to the assessments at issue relate exclusively to lease agreements entered into by DEF Business in connection with its conduct of its equipment rental business.

The aforementioned evidence corroborates testimony given by John Doe ("John Doe"), an employee and manager of DEF Business, who stated that DEF Business is exclusively engaged in the rental of scanners and printers, and does not sell them to the taxpayer or anyone else. Specifically, with respect to the taxpayer's activities pertaining to equipment it ships to DEF Business, John Doe testified as follows:

What role does ABC Business play in the order fulfillment process?

A. They serve as a warehousing operation for us in the U.S. We also have a similar company in Canada that performs the same function. ABC Business sends the equipment out to the customers that we specify, using the shipping method on the contract, it could be under our shipping or it could be under the customer's shipping, and then they serve as a warehousing spot for when the equipment isn't being used at an event.

Q. After the scanners and printers have been used by the short-term renter, what happens to them? Are they returned to ABC Business at that point, generally?

A. Generally, yes. The contract specifies the return warehouse that the equipment will go to, it's nearly always the warehouse that sends it out. Sometimes to meet schedules it will get shipped to a different warehouse but it's nearly always back to the warehouse that it was shipped from.

Q. Okay. Does ABC Business share in any of the revenue that's generated by the rentals?

A. No.

Q. And do they have any input in the contract negotiations or decision-making process relative to these rentals?

A. No. ...

Q. You say you don't buy it at all?

A. No. We don't even sell to our contractors. Our contractors ask us all the time if they can buy it and we say no. We only rent it or lease it on a 12-month basis.

Q. And how long is the rentals to ABC Business in question?

A. We don't rent it to ABC Business.

Q. The fulfillment entity.

A. How long per contract in general?

Q. Yes.

A. Twelve to 15 days is the amount of time that our customer holds the equipment. Our customer is not ABC Business. ABC Business is the warehousing service that sends the equipment to our customer.

Tr. pp. 17, 18, 23, 24.

The foregoing evidence clearly shows that the taxpayer did not receive the equipment upon which use tax has been assessed for the purpose of obtaining ownership of this equipment, but rather took custody of the items it received in order to perform temporary storage and warehousing services needed by DEF Business in connection with its rental business activities. As previously noted only a use of property in this state that is attendant to ownership of the property constitutes a taxable use of the property. Time, Inc., *supra*. Accordingly, based upon the foregoing evidence, I find that the taxpayer has rebutted the Department's *prima facie* case.

The burden shifts to the Department to prove its claim by competent evidence once the taxpayer rebuts the Department's *prima facie* case. Novicki v. Department of Revenue, 373 Ill. 342 (1940). The Department has failed to present any such rebuttal evidence. Accordingly, I find that the Department's *prima faice* determination that the taxpayer exercised rights incident to ownership of the scanners and printers in controversy, activities constituting a taxable use under section 2 of the UTA (35 ILCS 105/2), has been successfully rebutted.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's NTLs at issue in this case be cancelled.

Ted Sherrod
Administrative Law Judge

Date: July 16, 2012