UT 16-01
Tax Type: Use Tax
Tax Issue: Use Tax On Property Titled To An Out-of-State Limited Liability

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS

v.

JOHN DOE, *et al*.

Taxpayers

Docket # XXXX
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RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; David R. Reid of Reid Law Office, LLC for John Doe, ABC Business, LLC, DEF Business, LLC, GHI Business, LLC, and JKL Business, LLC

Synopsis:

The Department of Revenue ("Department") conducted an audit and issued a total of XXX Notices of Tax Liability ("NTLs") to the following taxpayers: John Doe ("Mr. John Doe") (6 NTLs), ABC Business, LLC ("ABC Business") (286 NTLs), DEF Business, LLC ("DEF Business") (3 NTLs), GHI Business, LLC ("GHI Business") (2 NTLs), and JKL Business, LLC ("JKL BUSINESS") (62 NTLs) ("taxpayers"). Mr. John Doe is the sole member of all of the other taxpayers (*i.e.*, all of the LLCs). The taxpayers filed timely protests to the NTLs.[1] The

[1] The Department had also issued 4 NTLs to MNO Business, LLC ("MNO Business"), docket #11-ST-0074, and 24 NTLs to PQR Business, LLC ("PQR Business"), docket #XXXX. Mr. John Doe (through his attorney) filed a protest for those NTLs because the NTLs mistakenly showed Mr. John Doe' address as the address of MNO Business and PQR Business. Mr. John Doe is neither a member nor an owner of either MNO Business or PQR Business. (Taxpayer Ex. #46, 47; Tr. I pp. 154-155, 170) After the hearing in this matter, Mr. John Doe withdrew

NTLs assess vehicle use tax on the purchase of XXX vehicles during the time period of January 22, 2007 through December 31, 2008. The cases were consolidated for purposes of the evidentiary hearing. After the hearing, the Department issued XX additional NTLs to DEF Business for which DEF Business requested and was granted a late discretionary hearing. Those additional NTLs assess vehicle use tax on the purchase of XX vehicles during the time period of February 17, 2010 through August 6, 2010. Because they concern the same issues, the parties agreed to include those in the present case. The three issues presented by the parties according to their pretrial order are the following: (1) "Whether the Taxpayer has sufficient 'minimum contacts' with the State of Illinois for the State to assert jurisdiction to assess said use taxes;" (2) "Whether the Taxpayer has sufficient books and records to refute the Department's assessment of Illinois Use Tax on vehicles purchased by the Taxpayer;" and (3) "Whether there is a sufficient basis and jurisdiction to support the Notices of Tax Liability for use taxes issued to the Taxpayers in this case." During the hearing, the taxpayers raised the issue of whether they are entitled to costs and attorney's fees pursuant to the Illinois Taxpayers' Bill of Rights Act (20 ILCS 2520/7). The parties filed briefs in support of their arguments. After reviewing the briefs, testimony, and exhibits, it is recommended that all of the NTLs issued to the LLCs be dismissed, X of the X NTLs issued to Mr. John Doe be dismissed, and the request for costs and attorney's fees be denied.

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his protest in those cases, and those cases were closed. The Department then initiated collection actions against Mr. John Doe for the MNO Business and PQR Business liabilities because the addresses for MNO Business and PQR Business had not yet been changed in the Department's computer system. Mr. John Doe then filed a Motion to Supplement Taxpayers' Reply Brief in which he requested that the record be supplemented with documents showing that the Department had initiated collection actions against Mr. John Doe. An Order was not entered regarding the Motion because the Motion was deemed waived pursuant to section 200.185(b) of the Department's regulations. 86 Ill.Admin.Code, ch. 1, §200.185(b). Nevertheless, the Department subsequently corrected the addresses for MNO Business and PQR Business, and the Department ceased its collection actions against Mr. John Doe for the MNO Business and PQR Business liabilities. Although the parties included references to those cases in their briefs, those cases have remained closed.

FINDINGS OF FACT:

1. Mr. John Doe lives in Illinois and is in the business of buying and selling motor vehicles. During the time periods at issue, neither Mr. John Doe nor the LLCs were registered with the Department as retailers, and they did not have a resale number. They also did not have a dealer's license from the Secretary of State.[2] (Taxpayer Ex. #1-5, 9, 10; Tr. I pp. 143-147)
2. Mr. John Doe previously worked at car dealerships. (Dept. Ex. #1, p. 18; Tr. I p. 143)
3. While working at the car dealerships, Mr. John Doe became aware that the manufacturers of the vehicles had limitations on the areas where the dealerships were allowed to sell new vehicles. (Tr. pp. 144-145, 162)
4. While working at a dealership, Mr. John Doe organized the LLCs in order to avoid the restrictions that manufacturers placed on where new vehicles may be sold. Mr. John Doe intended to facilitate the sale of new vehicles to customers who lived outside of the dealer's sales area, including customers in other states and other countries. (Tr. I pp. 144-145, 164-165, 170, 177)
5. On April 18, 2006, DEF Business, LLC was organized in the State of Alaska. (Taxpayer Ex. #15, p. 7)
6. On September 21, 2007, ABC Business, LLC was organized in the State of Alaska. (Taxpayer Ex. #13, #14)

[2] Mr. John Doe explained that during the time periods at issue, he considered himself to be a "broker" rather than a "dealer," and Illinois does not offer a broker's license. (Tr. I p. 147) In order to get a dealer's license, it was necessary to have a place or lot to display vehicles. (Tr. I p. 148) At the time of the hearing, Mr. John Doe was a licensed dealer. (Tr. I p. 162)

7. On January 18, 2008, JKL Business, LLC was organized in the State of Alaska.[3] (Taxpayer Ex. #18)
8. Mr. John Doe is the sole member of the LLCs. (Taxpayer Ex. #13-19)
9. The mailing addresses for the LLCs are in Montana. (Tr. p. 165)
10. Although the LLCs were organized in Alaska, the LLCs do not have an office or bank account in that state. Mr. John Doe never travels to Alaska or Montana. (Tr. p. 166)
11. The Department conducted an audit of the taxpayers for the time period of January 1, 2007 through August 6, 2010. (Dept. Ex. #1-7)
12. During the time periods at issue, Mr. John Doe had a home office in Illinois, and he performed all of the business activities from that office. The telephones, bank accounts, computers, employees, and assets for the LLCs were all located in Illinois. (Tr. I pp. 146, 165-166)
13. The taxpayers' business process worked as follows:
    a. Mr. John Doe would receive a phone call or email from someone who was looking to purchase a specific vehicle.
    b. Mr. John Doe would then search on the internet and find the vehicle either at a dealership or with another broker, and he would negotiate the purchase price of the vehicle.
    c. Mr. John Doe would then negotiate the selling price with the buyer who initially contacted him.
    d. After all the parties agreed on the price, the paperwork for the transactions would be sent, via overnight delivery, from either the dealership or the broker to one of

[3] The record does not include articles of organization or other documentary evidence for GHI Business, LLC. In their brief, however, the taxpayers admitted that GHI Business is an Alaska single member LLC with Mr. John Doe as its sole member. (Taxpayer's brief, p. 2)

the LLCs (*i.e.*, Mr. John Doe) at his address in Illinois.[4] Mr. John Doe, on behalf of the LLC, would sign the paperwork and send it back to the seller.

e. The buyer would then wire the money to Mr. John Doe at his address in Illinois.

f. Mr. John Doe would wire the money (or send a money order) to the seller.

g. Mr. John Doe would then send the paperwork that is needed for the title (odometer statement, certificate of origin, and application for the title) to Alaska Tags and Title for title and registration. For all of the purchases from a dealership, the title would be issued in the name of one of the LLCs. For purchases from another broker, the vehicle would not be re-titled.

h. The title was then sent to Mr. John Doe in the name of one of his LLCs.

i. Either the buyer or Mr. John Doe (on behalf of the LLC) would arrange for pick up of the vehicle from the dealership. "From time to time" vehicles were brought to Mr. John Doe' residence in Illinois to wait for another pickup (driver), which would take from 1 to 7 days, on average, depending on the availability of the driver. (Taxpayers' Ex. #33, p. 3; Tr. I pp. 145-146, 166-167, 170, 176)

14. The taxpayers purchased some of the vehicles from Illinois dealers. For these purchases, the dealers prepared and filed with the Department Form ST-556, Sales Tax Transaction Return.[5] No tax was paid with these returns because the box next to "Nonresident buyer" was marked, and the state name that was written on that line was Alaska. Mr. John Doe signed the returns on behalf of the LLCs. (Taxpayers' Ex. #1, 43; Tr. I pp. 148, 168, 172-173)

[4] Although the LLCs had addresses in Montana, the paperwork was sent to Mr. John Doe' Illinois address.

[5] Every motor vehicle retailer doing business in Illinois is required to file a separate return on Form ST-556 for each motor vehicle it sells. 35 ILCS 120/3; 35 ILCS 105/9; 86 Ill. Admin. Code, ch. I, section 130.540(a), (c)(1), (d); 86 Ill. Admin. Code, ch. I, section 150.705(i)

15. The taxpayers purchased the majority of the vehicles from out-of-state dealers. These vehicles were delivered to customers who were either out-of-state or out of the country. (Taxpayer Ex. #1, 5; Tr. I pp. 146, 163)
16. Two of the taxpayers' regular customers were Canadian automobile brokers who testified that they purchased many vehicles from the taxpayers, and they sold all of the vehicles to Canadian customers. (Taxpayer Ex. #7, 8)
17. Once a vehicle is titled, it is considered to be a used vehicle. The taxpayers purchased the vehicles as new and sold them as "used." (Tr. I p. 177)
18. For most of the transactions, Mr. John Doe never saw the vehicles. He completed the transactions while remaining in his home office in Illinois. (Tr. p. 146)
19. Mr. John Doe' mother worked with him in the office in Illinois and did secretarial work. She was paid by ABC Business, LLC. There were no other employees of the LLCs. (Tr. I pp. 179-184)
20. For some of the vehicles Mr. John Doe received license plates, which were kept in the office in Illinois. (Tr. I pp. 167-168)
21. For the vehicles that Mr. John Doe (on behalf of the LLCs) purchased and resold, he did not keep a sales inventory of the vehicles, and the vehicles were not depreciated. (Taxpayers' Ex. #9-12; Tr. II pp. 8-9)
22. During the time periods at issue, the taxpayers did not have a location or lot for customers to visit, inspect and purchase vehicles. (Tr. I pp. 147-148)
23. Mr. John Doe advertised his business on a website. (Dept. Ex. #1, p. 115; Tr. I pp. 171-172)

24. The taxpayers' exhibits #1 and 1A are spreadsheets with lists of most of the vehicles at issue in this case. Exhibit #1 was initiated by the Department's auditor as a list of all the VINs for the vehicles, and then the taxpayers completed the exhibit with information such as the initial purchaser, the dealer who sold the vehicle, and the ultimate buyer of the vehicle.[6] (Taxpayer Ex. #1, 1A; Tr. I pp. 20-21, 150; Tr. II pp. 27-29)
25. For some of the vehicles listed on taxpayers' exhibit #1, the information such as purchaser, dealer, and ultimate buyer was missing. (Taxpayers' Ex. #1; Tr. I pp. 38-39)
26. The Department issued the NTLs in this case because it determined that the taxpayers incorrectly claimed the non-resident exemption for their purchases. (Dept. Ex. #1 p. 45; Taxpayer Ex. #29)
27. On March 16 and 18, 2011, the Department issued a total of XXX Notices of Tax Liability for motor vehicle use tax to ABC Business, LLC that show audit tax plus interest and audit late filing and/or late payment and/or fraud penalties for vehicles allegedly brought into Illinois between September 13, 2007 and December 31, 2008. The XXX NTLs were admitted into evidence under the certificate of the Director of the Department. (Dept. Group Ex. #2)
28. On March 16, 2011, the Department issued X Notices of Tax Liability for motor vehicle use tax to GHI Business, LLC that show audit tax plus interest and audit late filing and late payment penalties for 2 vehicles allegedly brought into Illinois on December 12, 2007 and January 16, 2008. The X NTLs were admitted into evidence under the certificate of the Director of the Department. (Dept. Group Ex. #4, pp. 7-8)

[6] The record is unclear as to when the spreadsheets were completed and whether the Department used them as a basis for issuing the NTLs in this case.

29. On April 6, 2011, the Department issued X Notices of Tax Liability for motor vehicle use tax to John Doe that show audit tax plus interest and audit late filing and late payment penalties for X vehicles allegedly brought into Illinois between January 22, 2007 and November 27, 2007. The X NTLs were admitted into evidence under the certificate of the Director of the Department. (Dept. Group Ex. #1, pp. 3-8)
30. On April 6, 2011, the Department issued X Notices of Tax Liability for motor vehicle use tax to DEF Business, LLC that show audit tax plus interest and audit late filing and late payment penalties for X vehicles allegedly brought into Illinois on August 18, 2008 and August 20, 2008. The X NTLs were admitted into evidence under the certificate of the Director of the Department. (Dept. Group Ex. #3, pp. 3-5)
31. On April 20, 2011, the Department issued XX Notices of Tax Liability for motor vehicle use tax to JKL Business, LLC that show audit tax plus interest and audit late filing and/or late payment and/or fraud penalties for XX vehicles allegedly brought into Illinois between July 20, 2007 and November 12, 2008. The XX NTLs were admitted into evidence under the certificate of the Director of the Department. (Dept. Group Ex. #6, pp. 14-75)
32. Between April 11, 2013 and April 16, 2013, the Department issued XX additional Notices of Tax Liability for motor vehicle use tax to DEF Business, LLC that show audit tax plus interest and audit late filing and late payment penalties for XX vehicles allegedly brought into Illinois between February 17, 2010 and August 6, 2010.[7] (Dept. Group Ex. #7)

[7] Although these XX NTLs were not submitted under the certificate of the Director, the parties agreed that the same facts apply to these NTLs and that they should be included in the analysis of this case.

33. During the evidentiary hearing, the Department agreed that all of the vehicles that were titled in the name of the LLCs were subsequently resold. (Tr. II p. 79)
34. For X of the X vehicles purchased by Mr. John Doe (rather than an LLC), the record includes the bills of sale to verify they were resold. (Dept. Ex. #1, p. 151 and Taxpayer Ex. #5, p. 50 for Letter ID XXXX; Taxpayer Ex. #5, p. 2 for Letter ID XXXX; Taxpayer Ex. #5, p. 3 for Letter ID XXXX; Taxpayer Ex. #5, p. 338 for Letter ID XXXX)
35. For the remaining X vehicles purchased by Mr. John Doe, the record does not include bills of sale or other verification (such as bills of lading), that show that the vehicles were either resold, qualified for another exemption, or were exempt from tax on the basis that the tax would violate the Commerce Clause. These vehicles were not included on Taxpayers' Exhibit #1. (Taxpayer Ex. #1, 5)

CONCLUSIONS OF LAW:

Under the Vehicle Code ("Code") (625 ILCS 5/1-100 *et seq.*), Illinois imposes a tax on the privilege of using in Illinois any motor vehicle acquired by gift, transfer, or purchase. 625 ILCS 5/3-1001. In the administration of the vehicle use tax, the Department and the taxpayers "have the same rights, remedies, privileges, immunities, powers and duties, and [are] subject to the same conditions, restrictions, limitations, penalties and definitions of terms, and employ the same modes of procedure, as are prescribed in the Use Tax Act." 625 ILCS 5/3-1003.

Under the Use Tax Act ("UTA") (35 ILCS 105/1 *et seq.*), Illinois imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. The use tax is a corollary to the retailers' occupation tax ("ROT"), which is a tax on persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. The use tax is imposed at the same rate as the ROT. 35 ILCS 105/3-10; 120/2-10. The purpose

of the use tax is to prevent avoidance of the ROT by people who make purchases in states that do not impose the ROT and to protect Illinois merchants from the diversion of business to retailers outside Illinois. Brown's Furniture, Inc. v. Wagner, 171 Ill. 2d 410, 418 (1996). Credit is given for taxes paid to another state. 35 ILCS 105/3-55(d); 86 Ill. Admin. Code §150.310(a)(3). The use tax complements the ROT in that an Illinois retailer who collects the use tax as an agent of the State is correspondingly relieved of his ROT liability on the transaction. Chicago Tribune Company v. Johnson, 119 Ill. App. 3d 270, 273 (1st Dist. 1983). If the person who uses the property does not pay the use tax to the retailer, it must be paid directly to the Department. 35 ILCS 105/3-45.

Prima Facie Case

Section 12 of the UTA incorporates by reference sections 4 and 5 of the Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*), which provide that the Department shall determine the amount of tax due "according to its best judgment and information." 35 ILCS 105/12; 120/4, 5. A certified copy of the Department's determination of the amount of tax due "shall, without further proof, be admitted into evidence… and shall be prima facie proof of the correctness of the amount of tax due, as shown therein." *Id.*

The taxpayers argue that the Department's certified copies of the NTLs in this case are legally insufficient to create a *prima facie* case because there is no statutory authority or case law to support the assessments. The taxpayers believe that the provisions that the Department applied (regulations 130.605(b)(3)-(g), 150.705, 151, 520.101, the RUT-25 instructions, and the UPIA) do not allow a basis for assessing the use tax. In addition to the lack of authority for the assessments, the taxpayers claim that the Department's assessments include several mistakes because they indicate the vehicles were brought into Illinois when many of them were not. The

taxpayers contend that they provided the Department with all the information to compile Taxpayers' Exhibit #1, but the Department ignored most of the information on the exhibit. In the taxpayers' view, the Department's assessments are not *prima facie* evidence of the correctness of the amount of tax due, and they are an abuse of the Department's *prima facie* privilege.

Sections 4 and 5 of the ROTA provide that the certified copy of the corrected returns 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. The Department's corrected return is only *prima facie* proof if the Department has met a minimum standard of reasonableness in preparing the corrected return. Vitale v. Department of Revenue, 118 Ill.App.3d 210, 212 (3rd Dist. 1983). This reasonableness standard is based on the statutory requirement that the Department correct the tax return according to its "best judgment and information." 35 ILCS 120/4. 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).

The Department's method of correcting the returns in this case meets a minimum standard of reasonableness. When the taxpayers purchased vehicles from Illinois dealers, the taxpayers did not pay tax because Mr. John Doe, on behalf of the LLCs, marked the box next to "Non-resident." The state of residency was indicated as Alaska. The non-resident exemption for purchases of motor vehicles is found under subsections (h) and (h-1) of section 3-55 of the UTA and provide, in part, as follows:

> Sec. 3-55. Multistate exemption. To prevent actual or likely multistate taxation, the tax imposed by this Act does not apply to the use of tangible personal property in this State under the following circumstances:
>
> …
>
> (h) Except as provided in subsection (h-1), the use, in this State, of a motor vehicle that was sold in this State to a nonresident, even though the motor vehicle is delivered to the nonresident in this State, if the motor vehicle is not to be titled in this State, and if a drive-away permit is issued to the motor vehicle as provided in Section 3-603 of the Illinois Vehicle Code or if the nonresident purchaser has vehicle registration plates to transfer to the motor vehicle upon returning to his or her home state. The issuance of the drive-away permit or having the out-of-state registration plates to be transferred shall be prima facie evidence that the motor vehicle will not be titled in this State.
>
> (h-1) The exemption under subsection (h) does not apply if the state in which the motor vehicle will be titled does not allow a reciprocal exemption for the use in that state of a motor vehicle sold and delivered in that state to an Illinois resident but titled in Illinois. …
>
> 35 ILCS 105/3-55(h), (h-1).

The record in this case contains no evidence that the taxpayers had drive-away permits or out-of-state registration plates at the time that they purchased the vehicles. These specific requirements must be met in order for the non-resident exemption to apply. In addition, all of the vehicles purchased by the LLCs were titled in Alaska, and Alaska does not have a state sales tax. Under subsection (h-1), the non-resident exemption does not apply because Alaska "does not allow a reciprocal exemption for the use in that state of a motor vehicle sold and delivered in that state to an Illinois resident …" 35 ILCS 105/3-55(h-1).

When the Department conducted the audit and reviewed the transactions in this case, it determined that this non-resident exemption does not apply. One of the taxpayers' witnesses, who previously worked for the Department, agreed that this non-resident exemption does not apply in this case. (Tr. II pp. 30, 49, 62) During the audit, the taxpayers did not provide documentation to support any other exemption. (Tr. I pp. 12-17) The Department's method of

correcting the returns in this case certainly meets a minimum standard of reasonableness because the taxpayers' purchases did not qualify for the exemption that they were claiming. The NTLs, therefore, are *prima facie* proof of the correctness of the amount of tax due.

Use Tax

Once the Department has established its *prima facie* case by submitting the certified copies of the Department's determinations into evidence, the burden shifts to the taxpayers to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773, 783 (1st Dist. 1987). To prove their case, the taxpayers must present more than testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990). The taxpayers must present sufficient documentary evidence to support their claim. *Id*.; Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1st Dist. 1981).

The Department argues that the taxpayers have not met their burden of overcoming the Department's *prima facie* case because the taxpayers used the vehicles in Illinois, and therefore, they owe use tax on all of the vehicles. The Department notes that the UTA defines "use" 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. The Department believes that under this definition, all of the taxpayers' activities that took place in Illinois (*i.e.*, the execution of contracts and bills of sale, the payment of money, the receipt of titles and licenses, and the subsequent sales of the vehicles as "used") constitute use in Illinois. The Department claims that although the taxpayers rely on the fact that the vehicles were titled in Alaska, the taxpayers have not shown that the vehicles were ever physically present in Alaska. In addition, the Department argues that because "the evidence strongly suggests that the taxpayers' use of the vehicles consisted only of the purchase and taking of title…," the taxpayers' use, regardless of physical

presence, was predominantly in Illinois. (Dept. brief p. 22) According to the Department, the taxpayers' use of the vehicles was more in Illinois than in any other State, and Illinois is the only State with the power to tax the purchases. The taxpayers did not provide documentation that they paid taxes to another State.

The Department states that although the LLCs were organized in the State of Alaska, all of their business activities were conducted in Illinois. The offices, telephones, bank accounts, mailing addresses, computers, employees, and assets were all located in Illinois. None of the taxpayers maintained an office or bank account in Alaska or Montana, and no funds were ever "wired" there. Mr. John Doe did not travel to Alaska or Montana during the time period in question.

The Department states that the Illinois Vehicle Code requires new and used car dealers to be licensed (see 625 ILCS 5/5-101, 5-102). The Department contends that the Illinois legislature determined that certain requirements must be met in order to protect the citizens of Illinois as well as ensure a level of compliance with Illinois laws, including the ROTA and UTA. In order to enforce the licensure requirements, the legislature determined that any individual or entity that sells a vehicle without the required license would be guilty of a Class A misdemeanor. 625 ILCS 5/5-801. The Department claims that it is clear that the Illinois legislature did not intend for unlicensed dealers to operate in Illinois or take advantage of the exemptions provided for dealers and other brokers or resellers of vehicles regulated by the Illinois Vehicle Code. The Department claims that Mr. John Doe organized the LLCs to gain a competitive advantage over licensed dealers. In addition, the Department argues that the Illinois legislature anticipated that dealers may attempt to avoid the requirements of the Illinois Vehicle Code and required certain licenses for off-site sales. 625 ILCS 5/5-102.1.

The Department argues that Mr. John Doe set up the numerous LLCs to do the same business as licensed dealers in the State of Illinois, but these taxpayers have avoided complying with Illinois laws relating to licensure (including insurance, disclosures, training, and compliance with Illinois tax laws). The taxpayers have also avoided the requirement of filing ST-556s and the payment of taxes.

The Department argues that the taxpayers' business activities involved purchasing new cars at retail, putting the title in the name of the taxpayers, and then selling the cars as "used" vehicles. The Department believes that the taxpayers exercised sufficient incidents of ownership to subject the vehicles to use tax. The taxpayers took title to the new vehicles and registered the vehicles in the taxpayers' names and "changed the character of the vehicles so that they could be exported." (Dept. brief p. 21) In the Department's view, because the taxpayers owned the vehicles, the taxpayers owe use tax on the vehicles.

The taxpayers argue that if it is assumed that the Department established a *prima facie* case, then the taxpayers have presented sufficient evidence to rebut the presumption of correctness. The taxpayers first claim that the Department's assessments are unconstitutional because they violate the Commerce Clause. In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the court applied the following four-pronged test to determine whether a state tax will withstand scrutiny under the Commerce Clause. It will if "the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id*. at 279. In the taxpayers' view, the purchase and sale of vehicles in interstate commerce over the internet from a residential location in Illinois does not create a "substantial nexus" to Illinois as required under the Complete Auto Transit, Inc. case. The taxpayers also believe that there is no

apportionment of the tax, and any application of the use tax puts too great a burden upon interstate commerce, especially for the transactions where the vehicles were not physically present in the State of Illinois. For the transactions where the vehicles were purchased in Illinois, the taxpayers contend that the interstate exemption applies.

The taxpayers claim that the tax is unconstitutional because the use tax clearly does not apply to the vehicles that were never in Illinois, and all of the vehicles were immediately sold and delivered to customers outside of Illinois. Neither Mr. John Doe nor an employee of the taxpayers ever drove the vehicles for a purpose other than for transportation during the selling process. The taxpayers claim that the interim purchasers (*i.e.*, the LLCs) were not residents of the State of Illinois because they were all incorporated outside of Illinois. The taxpayers, therefore, claim that the non-resident exemption applies even for the vehicles that were initially purchased from an Illinois dealer.

The taxpayers contend that if it is found that the non-resident exemption does not apply, then the resale exemption would apply because all the vehicles were purchased for resale. The sales were arranged prior to the taxpayers' purchase of the vehicles. Section 7 of the ROTA states that the tax is not imposed on the sale of tangible personal property for which the purchaser intends to resell. 35 ILCS 120/7. The fact that the taxpayers were not registered does not invalidate this exclusion. Although the taxpayers did not have a Certificate for Resale, section 2c of the ROTA allows the taxpayers to present other evidence that the purchases are for resale. See 35 ILCS 120/2c; 86 Ill. Admin. Code §130.1415(a). The taxpayers claim that under Section 2c of the ROTA, they have rebutted the presumption that the sales were not for resale. The only reason for purchasing nearly 400 vehicles was to resell them. A company that is essentially a wholesaler rather than a retailer need not obtain resale certificates. See Illinois

Cereal Mills, Inc. v. Department of Revenue, 99 Ill. 2d 9 (1983). The taxpayers contend that the same reasoning applies to the present case. The taxpayers did nothing with the vehicles that was not related to selling them.

The taxpayers argue that the property was never subject to a "use" in Illinois for which it was purchased. The taxpayers contend that "it is a vast overreach" for the Department to claim that Mr. John Doe' location of his computer constitutes "use" in Illinois and an "exercise of right or power." (Taxpayers' Reply, p. 6) The taxpayers believe that the activity that the Department contends was use in Illinois (*i.e.*, office, telephone, paperwork, etc.) is not sufficient to constitute use in Illinois for the use tax to be imposed. In addition, the fact that Mr. John Doe' income tax returns did not show inventory or depreciation for the vehicles substantiates the taxpayers' claim that the vehicles were purchased because of pre-arranged sales, and the purchases do not create an Illinois use tax liability.

The taxpayers agree that the Vehicle Code has provisions that apply to the taxpayers, and the Illinois Secretary of State may assess penalties against the taxpayers for their failure to comply with the Vehicle Code. 625 ILCS 5/5-801. The taxpayers state that Mr. John Doe "may have inadvertently violated the Illinois Vehicle Code," but there is no evidence that penalties were assessed by the Secretary of State. (Taxpayers' Reply, p. 7) The taxpayers claim that there is no authority for the Department to assess use tax for any alleged violations of the Vehicle Code, and the taxpayers currently have a dealer's license.

The taxpayers contend that the only "logical" tax that might apply in this case is the retailer's occupation tax on the ultimate sale of the vehicles. (Taxpayers' brief, p. 13) The taxpayers state, however, that the ROT would not apply because the vehicles were sold to out-of-state customers, and the interstate commerce exemption would apply.

Finally, the taxpayers claim that the Department is liable for costs and attorney's fees pursuant to 20 ILCS 2520/7. According to the taxpayers, they are entitled to receive costs and fees because there was no reasonable cause to assess liability, the taxpayers fully cooperated with the Department, the Department used the information that the taxpayers provided as the basis for issuing the NTLs, and the Department has been aggressive in pursuing the alleged liability.

As the Department indicated in its brief, at the time of the hearing there was essentially no dispute as to the underlying facts of this case. (Dept. brief p. 20, #37) The "dispute is solely whether the taxpayers exercised sufficient incidences of ownership in Illinois to subject them to Illinois use taxes." *Id*. For the following reasons, I believe that although the taxpayers had ownership of the vehicles for a brief period of time, the record includes sufficient evidence to find that the vehicles that were purchased by the LLCs and X of the vehicles purchased by Mr. John Doe are exempt from the use tax because they were purchased for resale.

As previously mentioned, under the UTA Illinois imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. The definition of the word "use" includes, in relevant part, the following:

> "Use" means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, **except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased,** and does not include the use of such property by its owner for demonstration purposes: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. "Use" does not mean the demonstration use or interim use of tangible personal property by a retailer before he sells that tangible personal property … (Emphasis added); 35 ILCS 105/2.

The term "purchase at retail" means “the acquisition of the ownership of or title to tangible personal property through a sale at retail.” *Id*. The term “sale at retail” is defined, in relevant part, as follows:

> "Sale at retail" means any transfer of the ownership of or title to tangible personal property to a purchaser, **for the purpose of use, and not for the purpose of resale** in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. … **"Sale at retail" includes any such transfer made for resale unless made in compliance with Section 2c of the Retailers' Occupation Tax Act,** as incorporated by reference into Section 12 of this Act. … (Emphasis added); *Id*.

Under these provisions, the use tax does not apply to tangible personal property that is purchased for resale, but the resale must be made in compliance with section 2c of the Retailers' Occupation Tax Act. Section 2c provides, in relevant part, as follows:

> If the purchaser is not registered with the Department as a taxpayer, but claims to be a reseller of the tangible personal property in such a way that such resales are not taxable under this Act or under some other tax law which the Department may administer, such purchaser (except in the case of an out-of-State purchaser who will always resell and deliver the property to his customers outside Illinois) shall apply to the Department for a resale number. Such applicant shall state facts which will show the Department why such applicant is not liable for tax under this Act or under some other tax law which the Department may administer on any of his resales and shall furnish such additional information as the Department may reasonably require.
>
> Upon approval of the application, the Department shall assign a resale number to the applicant and shall certify such number to him. …
>
> Except as provided hereinabove in this Section, a sale shall be made tax-free on the ground of being a sale for resale if the purchaser has an active registration number or resale number from the Department and furnishes that number to the seller in connection with certifying to the seller that any sale to such purchaser is nontaxable because of being a sale for resale.
>
> Failure to present an active registration number or resale number and a certification to the seller that a sale is for resale creates a presumption that a sale is not for resale. **This presumption may be rebutted by other evidence that all**

of the seller's sales are sale [sic] for resale, or that a particular sale is a sale for resale. (Emphasis added); 35 ILCS 120/2c.

The taxpayers in this case did not have an active registration number or resale number, and they did not present a certification to the seller that the sales were for resale. The taxpayers cited the case of Illinois Cereal Mills, Inc., *supra*, and indicated that a company that is essentially a wholesaler rather than a retailer need not obtain resale certificates. In that case, the court found that Section 2c of the ROTA did not apply to the taxpayer because the taxpayer was not in the business of making retail sales, and the few retail sales that it made were only occasional. Illinois Cereal Mills, Inc., at 18-19. In the present case, the record is not clear as to whether and how often the taxpayers made retail sales of the vehicles. Although a large number of the sales were to entities that were reselling the vehicles (*e.g.*, Busy Cars and Fast Motors), it is not clear from the record how many, if any, of the taxpayers' sales were actually retail sales. Without that information, it cannot be determined whether the taxpayers would have been required to register or obtain a resale number. Nevertheless, with the exception of 2 of the vehicles purchased by Mr. John Doe himself, the record includes sufficient evidence to find that the taxpayers have rebutted the presumption that use tax is owed on the basis that the purchases were for use and not for resale.

During the hearing, the Department agreed that all of the vehicles that were titled in the name of the LLCs were resold. (Tr. II p. 79) The record indicates that the resale was to pre-determined customers; the resale was arranged prior to the purchase by the LLCs, and the resale took place relatively quickly after the purchase. The paperwork for each transaction was not started until all the parties agreed on the price of the vehicle. When some of the vehicles were brought to Mr. John Doe' home to await a transporter, they usually did not remain there longer than 7 days.

Considering the large number of vehicles that were purchased, the taxpayers are clearly in the business of buying and selling motor vehicles. Mr. John Doe advertised his business, and the subsequent sale happened in such a short time period after the purchase that Mr. John Doe, as the sole member of the LLCs, did not include the vehicles in a sales inventory account and did not depreciate the vehicles on his tax returns. The evidence supports a finding that the vehicles were purchased with the intent to quickly resell them.

It is clear from the record as a whole that, with the exception of X of the vehicles purchased by Mr. John Doe himself, the remaining vehicles were purchased for the purpose of resale, and the transitional use of the vehicles was incidental. The Department admitted that "the evidence strongly suggests that the taxpayers' use of the vehicles consisted only of the purchase and taking of title…" (Dept. brief p. 22) The transfer of title is generally indicative that a "sale at retail" has taken place. Weber-Stephen Products, Inc. v. Department of Revenue, 324 Ill. App. 3d 893, 899 (1st Dist. 2001). The taxpayers, however, have rebutted the presumption that a sale at retail took place because the record includes sufficient evidence to conclude that the purchases were for resale. The vehicles were not acquired for a purpose other than for resale.

The Department correctly states that motor vehicles are considered to be "used" once they are titled, but this "use" does not automatically trigger the use tax. Under the UTA, the purchase of tangible personal property for the purpose of resale is a "use" that is expressly excluded from the definition of a taxable "use." The resale exemption applies to all tangible personal property; it does not distinguish between titled and untitled property.

Many years ago the Supreme Court provided an explanation of the word "use" for purposes of the ROTA that is still pertinent today. The court stated as follows:

> 'Use' means a long-continued possession and employment of a thing to the purpose for which it is adapted, as distinguished from a possession and

> employment that is merely temporary or occasional. Revzan v. Nudelman, 370 Ill. 180, 185 (1938).

The resale exemption exists because it is consistent with this definition.

Because the taxpayers are clearly in the business of buying and selling motor vehicles, the most compelling reason for why the use tax should not be assessed on their purchases is to prevent possible double taxation. If the use tax assessments are upheld in this case, and if the taxpayers were to make a sale at retail of a vehicle to an Illinois resident, then there would be two taxes on the same vehicle: a use tax at the time the taxpayers purchase the vehicle and a retailer's occupation tax when the vehicle is sold. This result would not further the purpose of the UTA "but would instead have the contrary effect of discriminating against Illinois retailers by the imposition of two taxes." Illinois Road Equipment Co. v. Department of Revenue, 32 Ill. 2d 576, 580-581 (1965). The UTA was not meant for this result.

The Department has argued that unlicensed dealers are not allowed to take advantage of the exemptions that are allowed for dealers, brokers, or resellers of vehicles, but there is no legal authority to support this contention. Although the taxpayers should have been registered as dealers as required by sections 5-101 and 5-102 of the Illinois Vehicle Code (625 ILCS 5/5-101, 5/5-102), nothing in the statute or case law indicates that a violation of the Vehicle Code precludes qualifying for an exemption under the UTA.

Finally, for X of the X vehicles purchased by Mr. John Doe himself, the record does not include bills of sale, bills of lading, or other verification that they were either resold or qualified for another exemption. These vehicles were not included on Taxpayers' Exhibit #1. The NTL Letter IDs for these two vehicles are as follows: XXXX and XXXX. The dates that these vehicles were allegedly brought into Illinois are January 22, 2007 and September 10, 2007.

Although Mr. John Doe is clearly in the business of buying and selling motor vehicles, there is no evidence that these vehicles were purchased for resale instead of for his own personal use.

Section 4 of the UTA provides as follows:

> Evidence that tangible personal property was sold by any person for delivery to a person residing in this State shall be *prima facie* evidence that such tangible personal property was sold for use in this State. 35 ILCS 105/4.

Mr. John Doe was residing in Illinois at the time of these purchases, and the record does not include bills of lading to show where the vehicles were delivered or a bill of sale to show that they were resold. Mr. John Doe has the burden of overcoming the Department's *prima facie* case with documentary evidence. The Department agreed during the hearing that all of the vehicles that were titled in the name of the LLCs were resold (Tr. II p. 79), but the Department did not make the same stipulation with respect to the vehicles purchased by Mr. John Doe. The record simply does not include documentary evidence to support Mr. John Doe's contention that these purchases are exempt from the use tax. The Department's determination, therefore, must be upheld with respect to these X vehicles.

In summary, the taxpayers have presented sufficient evidence to show that nearly all of the vehicles that were purchased are exempt from the use tax because they qualify for the resale exemption. With respect to X of the vehicles purchased by Mr. John Doe, the record does not include bills of sale to show that the purchases were for resale. In addition, there is no documentation in the record to determine whether the X vehicles were purchased out-of-state and sold out-of-state without being in Illinois. Without this documentation, it is not necessary to consider the taxpayers' arguments that the assessments in this case violate the Commerce Clause.

Attorney's Fees and Costs

Section 7 of the Taxpayers' Bill of Rights Act provides as follows:

> §7. Costs. The fees for an attorney or accountant to aid a Taxpayer in an administrative hearing relating to the tax liability or in court shall be recoverable against the Department of Revenue if the Taxpayer prevails in an action under the Administrative Review Law and the Department has made an assessment or denied a claim without reasonable cause. 20 ILCS 2520/7.

To be eligible to receive attorney's fees pursuant to this section, the taxpayers must "prevail in an action under the Administrative Review Law…[.]" The Administrative Review Law (735 ILCS 5/3-101 *et seq.*) pertains to judicial review of the actions of the Department in the circuit or appellate court. Section 7, therefore, does not authorize attorney's fees where the taxpayers prevail in an administrative hearing proceeding as has been conducted in the instant case.

Recommendation:

For the foregoing reasons, it is recommended that the Notices of Tax Liability be cancelled except for the following 2 Notices: Letter ID XXXX and Letter ID XXXX. The taxpayers' request for attorney's fees should be denied.

Linda Olivero
Administrative Law Judge

Enter: October 29, 2015