UT 06-1
Tax Type: Use Tax
Issue: Use Tax On Out-Of-State Purchases Brought Into Illinois

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No. 00-ST-0000**
	IBT# 0000-0000
v.	**NTL# 00 0000000000000**
JOHN DOE,	**Ted Sherrod**
Taxpayer	**Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Anthony Packard and Bradley McCann of Nisen & Elliott for John Doe; Marc L. Muchin, Special Assistant Attorney General for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to John Doe's ("Doe " or "taxpayer") protest of Notice of Tax Liability No. SF 0000000000000 issued June 24, 2004. The basis of the assessment was the Department's determination that the taxpayer failed to pay use tax due to the Department on a boat the Department contends the taxpayer purchased on or about July 3, 2000. Doe protested this assessment claiming that he neither owned the boat in controversy, nor used it in Illinois. An evidentiary hearing was held in this matter on October 21, 2005 with Doe and Joe Blow, a business associate of Doe, testifying. Following a review of the testimony and the evidence submitted by the

taxpayer, it is recommended that the Notice of Tax Liability be cancelled. 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 000000000000, and the Department's SC-10-K Audit Correction and/or Determination of Tax Due covering the period 7/1/00 through 7/31/00, which shows use tax due of $2,147, plus penalty and interest. Department ("Dept.") Exhibit ("Ex.") 1.[1]

2. John Doe ("Doe"), a resident of Indiana (Tr. pp. 31, 36-42; Taxpayer Group Ex. 2), is the owner of ABC Services (Tr. p. 84), which is located in Chicago, Illinois (Tr. p. 43), and is engaged in the business of providing marketing and advertising services (Tr. p. 44). He also has been actively engaged in sailboat racing for thirty-five years. Tr. p. 64. Joe Blow, an employee of ABC Services, and Doe's former boat racing coach, participated in races with Doe during 2000. Tr. pp. 75, 83, 84.

3. During July 2000, Doe acquired possession of a Soling Class sailboat for the purpose of participating in a boat race held in Wisconsin. Tr. pp. 48, 50, 54, 55.

4. In a report of transactions for the third quarter of 2000, Doe was enumerated as the consignee of a boat and trailer on a customs declaration filed with the United States Customs Service. Tr. pp. 5, 6, 95, 96; Dept. Ex. 2. The declaration showed a delivery of a "floating structure" or boat, having a total value of $34,350 which entered the United States from a foreign country on or about July 3, 2000 under Tariff

[1] Unless otherwise noted, findings of fact apply to the tax period in controversy.

No.: 00 and Entry No. 00000000000 and showed Doe's business address in Chicago, Illinois. Dept. Ex. 3.

5. On June 24, 2004, the Illinois Department of Revenue assessed use tax on Doe based upon the delivery and use in Illinois of the boat described in the customs declaration filed with the United States Customs Service. Tr. pp. 5-13, 95, 96; Dept. Ex. 1-4. On the basis of this customs report, the Department determined that the cost and use tax base for this boat was $34,350, and assessed use tax in the amount of $2,147. Dept. Ex. 1, 3, 4. Doe timely protested the Department's determination of use tax due. Tr. pp. 96, 97.

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 June 24, 2004, the Department of Revenue issued a Notice of Tax Liability ("NTL") 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 NTL issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due. Once the Department establishes its *prima facie* case by submitting the NTL into evidence, the burden shifts to the taxpayer to overcome the presumption of validity. 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 NTL, the taxpayer must produce competent evidence, identified with its books and records showing that the NTL is 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).

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 Doe's alleged use of the boat indicated in the customs declaration 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 tangible property in this state that is attendant to ownership of the property constitutes a taxable use of the property in this state. Time,

Inc., *supra*. The taxpayer contends that his acquisition of the boat at issue is 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. He bases this claim upon his contention that he borrowed the boat at issue and never had an ownership interest in this property. Tr. pp. 6, 24, 103-105. The taxpayer was unable to produce any boat registration information or other documentation establishing the identity of the owner of the boat in controversy. Doe contends that he does not possess such information because he is not the owner. Tr. p. 104. The only evidence proffered by the taxpayer concerning ownership was a letter from a boat retailer the taxpayer contends was the owner of the boat at issue during the tax period in controversy. Tr. p. 23. The letter was not admitted into the record, but was referenced in testimony by the taxpayer. Tr. pp. 24-27, 62-64.

The taxpayer testified that he borrowed the boat in controversy from Mr. Smith, owner of Smith Inc., a boat manufacturer and retailer located in Ontario (Canada). Tr. pp. 49-51. He further testified that, prior to taking possession, Mr. Smith, the alleged owner of the boat, and the taxpayer reached an agreement allowing the taxpayer to elect to either purchase the boat or return it to Smith after a short period of interim use by the taxpayer during July 2000. Tr. p. 50. After using the boat to participate in a boat race held during July 2000, the taxpayer testified that he elected to return the boat at issue to its owner and not to buy it. Tr. pp. 48-50. While this testimony is consistent with a letter from Mr. Smith tendered for admission into the record at trial, since Mr. Smith, the purported author of this letter, did not testify, the letter was excluded from the record as

hearsay. Tr. pp. 24-27. Consequently, this letter could not be used as documentary evidence necessary to corroborate the taxpayer's testimony and rebut the Department's *prima facie* case under Illinois case law. Since the taxpayer presented no other documentary evidence concerning ownership of the boat in controversy, the Department contends that the taxpayer failed to prove that it was not the owner of the boat at issue and therefore failed to rebut the Department's *prima facie* case. Tr. pp. 96-99.

While the Department's Notice of Tax Liability was *prima facie* evidence of the tax due, and was presumed to be correct without further evidence, the Department chose to present documentation upon which the NTL was based. The only document relied upon for this purpose was an excerpt from an abstract of a customs declaration filed in connection with the transfer of possession of the boat at issue, designating John Doe as the "consignee" of this boat.[2] Tr. pp. 95, 96; Dept. Ex. 2. Neither the taxpayer nor the Department claims that this abstract in any way mischaracterizes the customs declaration upon which it is based or that it erroneously categorizes the taxpayer as a "consignee." The Department indicated that this document was the sole basis for its determination that the taxpayer was the owner of the boat at issue. *Id.* Indeed, the Department concedes that the NTL at issue is based entirely upon its belief that this customs document, which designates the taxpayer as a "consignee" conclusively demonstrates that the taxpayer obtained ownership rights to the boat in controversy for tax purposes. Tr. pp. 95, 96.

[2] A complete abstract of the customs declaration was shown to the administrative law judge *in camera*, but was not included in the record because it revealed the identity of other taxpayers, information the Department is prohibited from publicly disclosing by 35 **ILCS** 120/11 as incorporated by reference into the Use Tax Act at 35 **ILCS** 105/12.

However, Illinois case law addressing the legal effect of a consignment does not support the Department's conclusions.

A review of the voluminous case law in Illinois addressing the legal effect of a consignment of property indicates that the hallmark of a consignment is the absence of any transfer of title by the consignor to the consignee. Chicago Budget Rent-A-Car Corp. v. Maj, 5 Ill. App. 3d 265 (2d Dist. 1972); Country Mutual Insurance Co. v. Waldman Mercantile Co., 103 Ill. App. 3d 39 (5th Dist. 1981); Mori v. Chicago National Bank, 3 Ill. App. 2d 49 (1st Dist. 1954); F.F. Ide Manufacturing Co. v. Sager Manufacturing Co., 82 Ill. App. 685 (2d Dist. 1898); W.O. Dean Company v. Lombard, 61 Ill. App. 94 (3d Dist. 1895); Lewis v. Springville Banking Co., 166 Ill. 311 (1897); Berry v. W.D. Allen & Co., 59 Ill. App. 149 (2d Dist. 1894). As a consequence of this absence of a transfer of title, a consignment is also characterized by the non-existence of any absolute obligation on the part of the consignee to pay for the goods being transferred. Pease v. Rand & Leopold Desk Co., 100 Ill. App. 244 (1st Dist. 1902); W.O. Dean Company, *supra*. The case law indicates that the consignee is not a buyer but only an agent of the buyer. F.F. Ide Manufacturing Co., *supra* at 685. ("Consign … is to send goods to an agent, commission merchant, correspondent or factor to be sold, stored.").

Where a consignment involves a title transfer, title does not move to the consignee or through it. Berry v. W.D. Allen, *supra*. Accordingly, "[A] consignment of goods for sale does not pass title at any time, nor does it contemplate that it should be passed." Hawkland, Consignment Under the Uniform Commercial Code, 67 Commercial L.J. 146, 147 (1962). Rather "[T]he very term implies an agency, and that title is in the consignor, the consignee being his agent." *Id*.

Under Illinois case law, the essence of the status of consignee is that of one who is given custody or possession for some limited purpose while title itself is withheld and remains with the consignor. The taxpayer testified that he obtained temporary custody of the boat in controversy for the purpose of using it prior to deciding whether to purchase it. This testimony is exactly the type of transaction falling within the meaning of the term "consignee" as enumerated by the extensive case law on the subject of consignment in this state.

Recent changes to the Uniform Commercial Code enacted in Illinois and other states have eradicated much of the distinction between sales conferring transferable rights of ownership and consignments. See e.g. 810 **ILCS** 5/2-326, as amended by P.A. 91-893, § 10, eff. July 1, 2001. Nevertheless, the Uniform Commercial Code treatment of consignors obtaining possession for use rather than for resale comports with the traditional notion of a consignment as being a transfer of possession only, and not title. *Id.* Specifically, Section 2-326 of the Uniform Commercial Code (810 **ILCS** 5/2-326) as currently in effect in Illinois provides in part as follows:

> § 2-326. Sale on approval and sale or return; rights of creditors.
> (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is
> a) a "sale on approval" if the goods are delivered primarily for use, and
> b) a "sale or return" if the goods are delivered primarily for resale.
>
> (2) Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

The Department has conceded that the taxpayer's acquisition of the boat at issue was for the taxpayer's personal use rather than for resale, and does not allege that the taxpayer

was a boat dealer or reseller. Tr. pp. 5, 98. [3] Consequently, the type of consignment evidenced by the abstract of the customs declaration submitted into the record in this case constitutes a "sale on approval" rather than a "sale or return" as defined in section 2-326 of the Uniform Commercial Code (810 **ILCS** 5/2-326) noted above. As noted above, Section 2-326 expressly provides that a consignee acquiring goods for personal use (i.e. pursuant to a "sale on approval") rather than for resale cannot pass title to the consigned goods to creditors of the consignee. *Id.* In contrast, a creditor of a consignee who has possession and has acquired the consigned goods for resale (i.e. pursuant to a "sale or return") can acquire title to such property from the consignee. *Id*. The clear import of this distinction is that a consignee acquiring goods pursuant to a "sale on approval" does not acquire incidents of title or ownership when it takes possession. Rather, in such situations, a title transfer is consummated only when the consignee approves the sale. *Id.*

In describing a "sale on approval" as used in 2-326 of the Commercial Code, the official commentary to this section states the following:

> A "sale on approval," sometimes also called a sale "on trial" or "on satisfaction," deals with a contract under which the seller undertakes a risk in order to satisfy its prospective buyer with the appearance or performance of the goods that are sold. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell."
> See 2004 Uniform Laws Annotated, Uniform Commercial Code, section 2-326.

[3] The Department relies upon the statutory presumption that the taxpayer acquired the boat in controversy for "use" in this state (Tr. pp. 5, 98). See 35 **ILCS** 105/4. The term "use" is defined to exclude "the sale of 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." 35 **ILCS** 105/2.

In the instant case, the taxpayer testified that it took custody of the boat at issue while it decided whether to purchase the boat or return it to its alleged owner, Mr. Smith. What is described in this testimony is the paradigm of a "sale on approval" transaction described in the commentary to section 2-326 of the Uniform Commercial Code. Given Illinois case law defining the term "consignment" as a concept divorced from a transfer of title, and the treatment of the type of consignment transaction at issue in this case under the Uniform Commercial Code as one not conferring transferable ownership rights, I find that the taxpayer's testimony is wholly consistent with, and corroborated by, the abstract of the customs declaration contained in the record designating the taxpayer as the "consignee" of the boat in controversy.

In sum, the basis for the Department's NTL is its assumption that the customs declaration, an abstract of which is contained in the record, evidenced a transfer of rights attendant to ownership of the boat in controversy to the taxpayer. However, since the taxpayer is designated as consignee in this customs declaration, this document only is evidence that the taxpayer was transferred possession of the boat at issue. It does not connote a right of ownership or make the taxpayer a purchaser of the boat as the Department contends.

The taxpayer claims that he did not own the boat in controversy. I find this claim is wholly consistent with the designation of the taxpayer as a "consignee" on the summary of customs documentation contained in the record and which the Department admits accurately reflects the customs documentation upon which it is based. Tr. pp. 8-14. Accordingly, I find that the record affords more than "mere testimony" (Mel-Park Drugs, *supra*) to support the taxpayer's claim since it contains documentation that

corroborates the taxpayer's assertions. Given the introduction of testimony and corroborating documentation into the record in this case indicating that the taxpayer was not the owner of the boat in controversy, I find that the taxpayer has presented sufficient evidence to rebut the Department's *prima facie* case.

Once the taxpayer rebuts the Department's *prima facie* case, the burden shifts to the Department to prove its claim by competent evidence. 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 boat 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 Notice of Tax Liability number 00 0000000000000 be cancelled.

Ted Sherrod
Administrative Law Judge

Date: January 4, 2006