UT 96-3
Tax Type: **USE TAX**
Issue: **Machinery and Equipment Exemption - Manufacturing**

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

THE DEPARTMENT OF REVENUE)		
OF THE STATE OF ILLINOIS)	Case No.	
	)	NTL
v.	)	
	)	Administrative Law Judge
TAXPAYER,	)	Mary Gilhooly Japlon
Taxpayer	)	

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General John Alshuler, on behalf of the Illinois Department of Revenue; ATTORNEY, on behalf of TAXPAYER

SYNOPSIS:

This matter comes on for hearing pursuant to the timely protest by TAXPAYER (hereinafter "taxpayer") of Notice of Tax Liability XXXXX issued by the Department of Revenue (hereinafter "Department") on October 15, 1993 for Use Tax on the taxpayer's purchases of sausage casings and carbon dioxide gas. Prior to hearing, the Department agreed that the sausage casings qualify for the manufacturing machinery and equipment exemption, and that 10 percent of the carbon dioxide gas purchased by the taxpayer is incorporated into the sausage that is subsequently resold, thereby qualifying as nontaxable sales for resale.

At issue is the remaining 90 percent carbon dioxide gas. The taxpayer contends that the shipping charges included in the selling price of the carbon dioxide gas should be deducted before applying the tax to the purchases. The Department claims that the transportation charge should not be deducted because it was neither separately stated on the purchase invoices, nor separately contracted for as required by statute.

Testifying at hearing were WITNESS A, business manager for INDUSTRY carbon dioxide division, and PRESIDENT, president of the corporate taxpayer.

Following the submission of all evidence and a review of the record, it is recommended that this matter be resolved in favor of the taxpayer.

FINDINGS OF FACT:

1. The Department's prima facie case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Correction of Returns, showing a total liability due and owing in the amount of $230,916.00. (Dept. Grp. Ex. No. 1).

2. The audit period at issue is January 1990 through December 1991. (Dept. Grp. Ex. No. 1).

3. During the taxable period, the taxpayer purchased carbon dioxide gas from two different suppliers, SUPPLIER A (INDUSTRY, being the successor corporation) and SUPPLIER B. (Tr. pp. 8, 13).

4. Each of the two carbon dioxide suppliers sold TAXPAYER 50 percent of the gas it needed based upon oral agreements until January 1994. (Tr. pp. 12, 13).

5. The taxpayer did not want written contracts with its suppliers because it played one against the other on a weekly basis in order to negotiate favorable terms. (Tr. p. 24).

6. In January 1994, the taxpayer first entered into a written contract with INDUSTRY regarding the purchase of carbon dioxide on an exclusive basis. (Tr. p. 13, 14).

7. The terms in the written contracts were the same or similar to the conditions in the oral agreements that INDUSTRY had with the taxpayer in 1990 and 1991. (Tr. p. 14).

8. Specifically, INDUSTRY negotiated with PRESIDENT at TAXPAYER for the purchase of the carbon dioxide. (Tr. p. 11).

9. TAXPAYER and INDUSTRY separately negotiated the price of the product and the cartage costs during the taxable period. (Tr. p. 19).

10. TAXPAYER insisted on the separation between product cost and cartage cost when negotiating terms with INDUSTRY in the event the taxpayer wanted to pick up the product itself. (Tr. pp. 11, 12).

11. During the taxable period, 47 percent of the total invoice amounts were for transportation charges; 53 percent of the total invoice amounts were for the actual product purchases. (Tr. pp. 25-27).

12. The rail charges as reflected in Taxpayer's Exhibit No. 2 are similar to the prices in effect during the audit period. (Tr. p. 16).

13. When negotiating the terms of the carbon dioxide purchases, INDUSTRY supplied the taxpayer with the actual price of the product, as well as the transportation charges, per the taxpayer's request. (Tr. p. 17).

14. The actual cost to INDUSTRY to transport the product from its production plant in XXXXX, Iowa, to the rail depot in XXXXX, Illinois, plus the trucking costs from the depot to the taxpayer, was the amount charged to the taxpayer for delivery of the gas. (Tr. p. 16).

15. INDUSTRY provided the taxpayer with the name of a contract hauler of cryogenic gases per taxpayer's request. (Tr. p. 17).

16. However, the taxpayer did not retain the contract hauler, but rather, had INDUSTRY deliver the product. (Tr. p. 17).

17. During the taxable period, INDUSTRY did not have the computer capability to separate cartage cost from product cost on its invoices; however, the transportation costs and product costs were separately negotiated. (Tr. pp. 18, 19, 24).

18. During the period at issue, when the taxpayer purchased carbon dioxide it did not pay Use Tax on its purchases because it believed that all of the gas was incorporated into the final product and ultimately resold. (Tr. p. 25).

19. Subsequently, the Department agreed that 10 percent of the gas is incorporated into the product and ultimately resold. (Tr. p. 25).

CONCLUSIONS OF LAW:

The Department prepared corrected returns (admitted into evidence as Department's Group Exhibit No. 1) for Use Tax liability pursuant to section 4 of the Retailers' Occupation Tax (hereinafter ROT) Act (35 **ILCS** 120/4). Said section is incorporated into the Use Tax Act via section 12 thereof (35 **ILCS** 105/12). Section 4 of the ROT Act provides in pertinent part as follows:

> As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return

> according to its best judgment and information, which return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown therein.
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> Proof of such correction by the Department may be made at any hearing before the Department or in any legal proceeding by a reproduced copy ... in the name of the Department under the certificate of the Director of Revenue. ... Such certified reproduced copy ... shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax due, as shown therein.

The Department maintains that as there is no documentary proof that the transportation and delivery charges associated with the taxpayer's carbon dioxide purchases were separately contracted for and not included in the price of the gas, then the total invoice price must be taxed. The taxpayer, on the other hand, claims that delivery and transportation charges were in fact negotiated apart from the price of the product. Evidence was presented in support of the taxpayer's assertions.

Section 130.415(c) of 86 Illinois Administrative Code states that if transportation or delivery charges are included in the selling price of the product which is sold, these expenses are an element of cost and may not be deducted by the seller in computing ROT liability. However, section 130.415(d) provides as follows:

> On the other hand, where the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property which is sold, but instead is a service charge, separately contracted for and need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability. ... The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price, is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge will suffice. (86 Ill. Admin. Code, Ch. 1, sec. 130.415 (d)).

In the instant cause, during the audit period there was no written documentation to evidence the separate negotiation of transportation and delivery charges from the price of the product. Several reasons were offered in explanation. The carbon dioxide supplier testified that its computers were incapable of

making such a distinction during the time period at issue. However, at present invoices issued by INDUSTRY do make this differentiation. Furthermore, testimony on behalf of the taxpayer indicates that during the audit period, the taxpayer believed that all of the gas was incorporated into the final product and ultimately resold to the end user. Therefore, the taxpayer saw no need for the breakdown of product cost from transportation charges.

Beginning in January 1994, the taxpayer and INDUSTRY entered into written contracts delineating product cost from cartage costs. By way of parol evidence adduced by one of its two suppliers during the audit period, the taxpayer presented proof that the terms as reflected in the written contracts were the same terms as orally negotiated during the audit period. The taxpayer did not employ written agreements during the years in question because he did not want to be bound to one product supplier. The taxpayer was able to attain the best deals possible by alternating orders between his two suppliers.

INDUSTRY substantiates the taxpayer's assertion that cartage costs were in fact separately negotiated. The taxpayer did not want to be bound to its supplier for delivery of the product. In fact, INDUSTRY provided the taxpayer with the name of a hauler of cryogenic gases upon its request.

Based upon the evidence adduced at the hearing and the application of the applicable law thereto, it is my determination that the taxpayer has successfully rebutted the Department's prima facie case. The testimony of a supplier of 50 percent of the taxpayer's product during the audit period supports the taxpayer's position that delivery and transportation costs were separately bargained for. A written contract entered into at the time when the taxpayer dealt with only one supplier evidences the separate agreement regarding cartage and product cost. Testimony also indicates that 45 percent of total invoice amounts is attributable to transportation charges, and 55 percent of total invoice amounts is attributable to the product price. Based upon the foregoing, the Notice of Tax liability at issue should be revised to reflect the assessment of tax on only that portion of invoice amounts attributable to product cost.

RECOMMENDATION:

Based upon the foregoing, it is my recommendation that Notice of Tax Liability No. XXXXX be revised and that tax be assessed on 55 percent of total invoice amounts.

Enter:

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Administrative Law Judge