

ILLINOIS DEPARTMENT OF REVENUE
TAX PRACTITIONERS MEETING
OCTOBER 28, 2016

2016 Court Decisions

I. Sales Tax

A. Manufacturing Equipment

Brandenburg Industrial Service Co. v. Hamer, No. 2013 MR 001292, (Cir. Ct. DuPage County Sep. 15, 2016)

Brandenburg is both a manufacturer of steel and metal products and a provider of demolition, environmental remediation and site clean-up services. Brandenburg uses much of the demolished materials, scrap and waste products as materials for its manufacturing operations. The issue in dispute is whether equipment used at Illinois job sites qualifies for the manufacturing, machinery and equipment exemption. The circuit court of DuPage County ruled that the equipment qualified for exemption.

The Department appealed. The primary basis of the appeal was that Brandenburg's evidence contained insufficient documentation that the equipment in Illinois was used primarily for manufacturing rather than for demolition. Brandenburg's evidence was testimony and documentation based upon Brandenburg's study of its overall operations and the percentages that certain equipment was used for manufacturing. The Department's position is that these studies were merely general information about overall operations and lacked the specificity needed to prove that the actual equipment used in Illinois was used primarily in an exempt manner.

On appeal, the court held that there are issues of fact precluding summary judgment. The court distinguished a prior Cook County decision relied on below because there was no evidence that the same equipment was at issue or that it was used in the same manner, and because that decision was issued after trial with a more extensive evidentiary record. The court also determined that an affidavit submitted by Brandenburg opining that the equipment was used primarily in its manufacturing process was insufficient to rebut the Department's *prima facie* case because it was not supported by any documentary evidence.

Following remand, the circuit court conducted a three day bench trial. In addition to evidence previously presented, Brandenburg offered time cards indicating the amount of time per day the machinery was utilized. Although these documents did not indicate how the machinery was utilized, the judge nonetheless determined that the equipment at issue was used more than 50% of the time in manufacturing. Accordingly, she ruled that Brandenburg was entitled to the manufacturing, machinery and equipment exemption.

B. Nexus/Exhaustion of Administrative Remedies

Airris Aviation and Marine, Inc. v. Beard, 2016 IL App (1st) 152834-U (Sep. 30, 2016)

Plaintiff Airris Aviation and Marine purchased a 2013 Ford Flex from Napleton Ford Libertyville. The dealer filed a sales tax return indicating that Airris was a nonresident buyer and thus no tax was collected. The Department sought additional information from the dealer and discovered that although a 30-day drive away permit was issued, the vehicle continued to be serviced in Libertyville several months after the purchase. Thereafter, the Department initiated a sales and use tax audit of the claimed exemption. Airris objected to several requests for information, arguing that it had no nexus with Illinois and thus could not be subjected to Illinois tax laws. After the Department issued a Notice of Proposed Liability, Airris filed a declaratory judgment action seeking a declaration that it did not have sufficient nexus to be subject to Illinois tax laws, and an injunction from collecting the tax. While this action was pending, the Department finalized its audit and issued a Notice of Tax Liability. Airris then filed a protest and requested an administrative hearing.

The circuit court denied the Department's motion to dismiss for failure to exhaust administrative remedies and granted summary judgment in favor of Airris. The court enjoined the Department from continuing proceedings to collect tax with respect to the purchase of the vehicle and ordered the Notice of Tax Liability be dismissed.

On appeal, the appellate court reversed the judgment and vacated the injunction in an unpublished Rule 23 order. The court held that Airris was required to exhaust its administrative remedies. With respect to Airris' argument that the Department could not even audit the issue, the court stated that "the Department has jurisdiction and a duty to inquire, investigate and impose a use tax." It further noted that all of Airris' arguments "are appropriately made to the Department and, if unsuccessful, they can be presented to the special competence of an administrative body and, if necessary, thereafter on administrative review in the circuit court pursuant to the Act."

C. Statute of Limitations

Illinois Bell Telephone Co. v. Illinois Dep't of Revenue, No. 2015 L 50313 (Cook County July 1, 2016)

On Administrative Review, the court upheld the denial of Illinois Bell's refund claims as untimely. The Department had audited Illinois Bell's Illinois Telecommunications Excise Tax and Infrastructure Maintenance Fee returns for 1997 through 2002. Illinois Bell paid its audit liabilities in November 2003 under amnesty. In 2005, the City of Chicago audited Illinois Bell

for the municipal versions of the same taxes, and discovered that Illinois Bell had erroneously paid those taxes to the Department, rather than the City, from July 2000 to December 2002. Illinois Bell filed claims for credit on June 13, 2006, which the Department denied as untimely and barred by the 2003 amnesty regulations.

The Department argued, and the ALJ agreed, that the erroneous payments occurred from July 2000 through December 2002. Illinois Bell argued that the erroneous payments occurred in November 2003 when the Department failed to offset its overpayments against its underpayments. The circuit court rejected this argument and concluded that the date of accrual for the credit claims is when the taxes were erroneously remitted to the Department from July 2000 through December 2002. Because the credit claims were filed in June 2006, they were barred by the 3 year statute of limitations.

D. Taxable Motor Fuel

Waste Management of Illinois, Inc. v. Illinois Dep't of Revenue, Illinois Independent Tax Tribunal No. 15-TT-130 (Oct. 3, 2016)

Waste Management provides waste collection, transfer, recycling and resource recovery, and disposal services. Waste Management operates motor vehicles, including its waste hauling trucks, on Illinois' public highways. During the tax period at issue, Waste Management had some of its motor vehicles operate using compressed natural gas ("CNG"). The Department determined that Waste Management was liable for Motor Fuel Tax on its use of CNG.

Waste Management's main argument in the Tax Tribunal was that under the Motor Fuel Tax Law ("MFTL"), 35 ILCS 505/1, *et seq.*, CNG is not a taxable "Motor Fuel." Specifically, because the definition of "Motor Fuel" discusses "liquids," Waste Management argued that its use of CNG, which was only used in a gaseous state, was not taxable under the MFTL. Waste Management also argued that the Department's regulations providing motor fuel gallon-equivalency rates for gaseous substances, including CNG, were invalid as beyond the scope of the MFTL. Finally, Waste Management argued that the taxability of CNG under the MFTL was not valid under the Illinois Constitution because the Department did not have the authority to tax CNG and make related regulations.

The Tribunal ruled that CNG is a taxable "Motor Fuel" because the definition of "Motor Fuel" is unambiguous and broad in its application. The Tribunal further stated that whether the definition of "Motor Fuel" was ambiguous or not, an interpretation of taxable motor fuel to include CNG is entirely consistent with the MFTL statute. Then, the Tribunal examined the other provisions of the MFTL, including the primary legislative intent section and other definitional sections, and stated that these provided further support that CNG is taxable. Additionally, the Tribunal held that under the doctrine of *in pari materia*, since the taxability of CNG as a motor fuel was discussed in a ROTA regulation, this provided additional support that CNG was a taxable "Motor Fuel" under the MFTL. Given the above analysis, the Tribunal also ruled that the MFTL

regulations were valid because they did not expand beyond the scope of the MFTL. Finally, the Tribunal ruled that the taxing of CNG was constitutional as applied because the Department was entitled to administer and enforce the MFTL by its issuance of regulations, and noted that in any event the Tribunal lacked the authority to declare a statute or rule unconstitutional.

II. Income Tax Litigation

A. Administrative Hearings

1. 15-06 Taxpayers were confused on whether or not certain pension income was taxable. Taxpayers did not file amended return timely SOL prevents refund.
2. 15-07 Responsible officer case. Fact intensive, looking at check signing authority, signing of the REG-1, managing of the day to day activities. Taxpayer did not prevail.
3. 16-01 Taxpayer had a federal negative adjusted gross income due to NOLs carried forward. For Illinois, line 1 cannot be less than zero, in essence Taxpayer would be getting a double deduction
4. 16-02 Individual credit for taxes paid in other states, was denied as the Taxpayer's base of operations was Illinois and all income is considered paid in Illinois
5. 16-03 Taxpayer was a resident of Iowa, Illinois employer had incorrectly been withholding in Illinois for five years. Iowa determined that Taxpayer should have been paying tax in Iowa. Taxpayer allowed claim for refund for years still in statute and denied for those not in statute.
6. 16-04 Taxpayers' AGI was increased due to debt cancellation, NOD issued to the Taxpayers. NOD upheld Taxpayers presented no documentary evidence and Department had documentation to support cancellation of debt income.
7. 16-05 Taxpayer received refunds on two previously filed amended returns for the same tax year. Department denied third amended return for that same year.
8. 16-06 Taxpayers were a responsible officer for withholding purposes; Remanded to Administrative Hearings twice based on procedural dismissals; third addresses substantive issues and criminal convictions regarding same tax liability.
9. 16-07 Husband and wife were deemed responsible officers for withholding tax assessment, even though divorce court gave business to the husband who claimed he did not know that withholding was not being paid over.
10. 16-08 Taxpayer filed amended return to report final federal change untimely, and refund was denied.
11. 16-09 Taxpayer's amended returns increased the amount of nonbusiness income. Department disallowed the nonbusiness deduction

12. 16-10 During an audit the Department determined that an S corp had underreported its receipts. Taxpayer also argued he had no opportunity to contest sales tax case. The ALJ held business was represented by an attorney, it was too late to contest underlying sales tax liability and upheld tax on shareholder for additional income for those receipts.

B. Tax Tribunal

1. Innophos Holdings v. Illinois Department of Revenue, 14-TT-214 (November 17, 2015)

The Tribunal held that the audit properly threw sales back to Illinois. The Taxpayer in this case was a manufacturer of phosphates with manufacturing facilities and distribution center in Illinois. Under audit, the auditor determined that the sales from the Illinois distribution facility were not being taxed in some other states and were also not being included in the Taxpayer's Illinois sales factor. The Taxpayer asserted that IITA Section 304(f) precluded an automatic adjustment for throwback. Additionally, the Taxpayer argued that the Department did not meet its burden of proving that these specific sales indicate the Illinois market for the Taxpayer's products. Taxpayer also argued that if throwback is allowed, then the retroactive application of the 2013 amendment to IITA Section 304(f) to 2009 and 2010 tax returns violated due process. Tribunal held that the 2013 changes regarding market based sourcing did not have an effect on the throw back language in IITA Section 304(a)(3)(B)(ii). Also, the Department does not have the burden of proof on throwback, it is up to the Taxpayer to show and prove gross distortion, and the Taxpayer could have filed a 304(f) petition requesting alternate apportionment, but did not.

2. Matthew S. May v. Illinois Department of Revenue, 14 TT 135 (Dec. 28, 2015)

The Tribunal held that the Taxpayer was responsible for unpaid withholding for one quarter at issue. The quarters at issue were the last three quarters of 2011 and the first quarter of 2012. Taxpayer has listed as an officer of a construction company. Taxpayer helped run jobs, prepared reports for hours employees worked and on occasion signed a paycheck. Salient facts the Tribunal considered that the Taxpayer never objected to being named an officer, had no reason to suspect bills were being unpaid in 2011, his payroll check was returned ISF in January of 2012 and March of 2012 and the Taxpayer did not make an inquiries into this. Tribunal concluded the Taxpayer was not willful because he had no knowledge of any returned checks in 2011, however the Taxpayer was willful in 2012 because he was clearly on notice that there were insufficient funds to cover checks and took no action.

3. Security Life of Denver Insurance Company v. Illinois Department of Revenue, 14 TT 89
(April 11, 2016)

The issue in this case was the proper apportionment of unitary business income, assessment of interest and penalty. The Taxpayer was part of group that had insurance and non insurance companies. On audit, the losses at issue were divided up between both groups using taxable income. In ICB, a decision was made that the losses should be allocated between the two groups by using gross receipts. Taxpayer had previously made a decision to not participate in the Amnesty Program beginning October 1, 2010. The Tribunal found that it had no statutory authority to eliminate interest, however there was reasonable cause penalty abatement as there was internal disagreement within the Department as to how to allocate the losses.

C. Hot topics

- Personal service income deduction
- Occasional sale exception