

ST 08-4

Tax Type: Sales Tax

Issue: Gross Receipts

Tangible Personal Property

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

ABC'S MOTORS, INC.,	)	Docket No.	07-ST-0000
ABC'S CHRYSLER PLYMOUTH,	)	Reg. Nos.	0000-0000
INC., ABC'S CHRYSLER JEEP	)		0000-0000
OF ANYWHERE, INC, ABC'S	)		0000-0000
OF EVERYWHERE, INC.	)		0000-0000
Taxpayers	)	Claim Periods	7/03 — 3/06
v.)		
THE DEPARTMENT OF REVENUE	)	John E. White,	
OF THE STATE OF ILLINOIS,	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Peter Larsen, Akerman Senterfitt, appeared, *pro hac vice*, for Taxpayers; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

The matter involves the Illinois Department of Revenue's (Department) denial of amended returns that ABC's Motors, Inc., ABC's Chrysler Plymouth, Inc., ABC's Chrysler Jeep of Anywhere, Inc., and ABC's of Everywhere, Inc. filed to claim a refund of taxes paid regarding transactions undertaken during the months of July 2003 through and including March 2006. For convenience I will refer to all taxpayers collectively as either ABC or Taxpayer.

In lieu of hearing, the parties submitted a Joint Stipulation of Facts (Stip.), which included exhibits. The issue is whether ABC is entitled to a partial refund of the tax it paid when it sold certain motor vehicles to customers for use in Illinois, where the

customers to those sales obtained financing from DaimlerChrysler Financial Services Americas LLC, a third party, and where such customers later defaulted on their contract with the third party financier. I am including in this recommendation findings of fact and conclusions of law. I recommend the denials be finalized as issued.

Findings of Fact:

1. Each Taxpayer is a registered Illinois retailer and each sold motor vehicles in Illinois through their respective retail locations. Stip. ¶ 1.
2. Most of ABC's customers financed their purchases of vehicles with assistance of DaimlerChrysler Financial Services Americas LLC (DCF), a third party financing source. The customers entered into retail installment contracts (the "Contracts") with ABC. ABC assigned the Contracts to DCF and, therefore, the customers were obligated to repay DCF the purchase price of the vehicles and the related tax over time. Stip. ¶ 2.
3. In exchange for the assignments, DCF paid ABC the amount financed under the Contracts, which included the purchase price of the vehicles and all applicable tax due on the vehicles. Stip. ¶ 3.
4. Pursuant to Illinois law, at the time of each of the installment sales, each Taxpayer paid or remitted the full amount of the retailers' occupation tax (ROT) to the Department on the entire sales price of each of the sales. Stip. ¶ 4.
5. In some cases, the customers defaulted on the Contracts and the defaulted portion of the sales price was not collected from the customers. Stip. ¶ 5.
6. Once it was reasonably determined that the debts for these Contracts were worthless and uncollectible, and legal action to enforce payment would in all probability not result in the satisfaction of execution on a judgment, the Contracts became bad debts (which included ROT attributable to the amount of unpaid taxable charges) and were charged off by DCF as worthless and were deducted as bad debts by DCF for federal income tax purposes. Stip. ¶ 6.

7. DCF is not a registered retailer, has not paid the taxes in issue over to the Department, and has not sought refunds of taxes paid over to the Department by ABC on the Contracts that ultimately became worthless and uncollectible and were deducted as bad debts by DCF for federal income tax purposes. Stip. ¶ 7.
8. On or about August 17, 2006, each Taxpayer filed a claim for refund or credit of ROT with the Department for the amount of ROT paid on the sales for which Contracts were made, and which ultimately became DFC's bad debts for the period July 1, 2003 through March 31, 2006. Stip. ¶ 8; Stip. Exs. A-D (copies of, respectively, each Taxpayer's amended return for the period).
9. On November 7, 2006, the Department denied Taxpayer's amended returns. Stip. ¶ 10; Stip. Exs. E-H (copies of, respectively, the Notice of Tentative Denial of Claim for Sales Tax issued to each Taxpayer).
10. On January 5, 2007, each Taxpayer timely filed a protest regarding the Department's denials of such claims for refund. Stip. ¶ 12.

Conclusions of Law:

The parties included a copy of the Department's denials within their stipulated exhibits. Stip. Exs. E-H. Section 6b of the Retailers' Occupation Tax Act (ROTA) provides that the Department's denial of a taxpayer's claim for credit constitutes prima facie proof that the taxpayer is not entitled to a credit. 35 ILCS 120/6b. The Department's prima facie case is a rebuttable presumption. The presumption is overcome, and the burden shifts back to the Department to prove its case, only after a taxpayer presents evidence that is consistent, probable and identified with its books and records, to show that the Department's determinations are wrong. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 156-57, 242 N.E.2d 205, 206-07 (1968); A.R.

Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 832, 527 N.E.2d 1048, 1052 (1st Dist. 1988).

There are certain sections of the ROTA that provide a helpful background to the issue in this contested case. Section 1 of the ROTA provides statutory definitions for terms used within the Act, including the term “gross receipts.” The definition of gross receipts is as follows:

“Gross receipts” from the sales of tangible personal property at retail means the total selling price or the amount of such sales, as hereinbefore defined. In the case of charge and time sales, the amount thereof shall be included only as and when payments are received by the seller. Receipts or other consideration derived by a seller from the sale, transfer or assignment of accounts receivable to a wholly owned subsidiary will not be deemed payments prior to the time the purchaser makes payment on such accounts.

35 ILCS 120/1.

I first point out that the sales the parties describe in their Stipulation are not charge and/or time sales as that term is used in the ROTA’s definitions section. As Taxpayer has stipulated, at the time of each sale, DCF paid to ABC “the amount financed under the Contracts, which included the purchase price of the vehicles and all applicable tax due on the vehicles.” Stip. ¶ 3. ABC then used those proceeds, at least in part, to pay its own tax liability regarding that particular sale. Stip. ¶ 4.

Next, § 3 of the ROTA provides for a refund to retailers where the property it previously sold at retail is returned to the retailer by a customer. Specifically, § 3 provides, in pertinent part:

Refunds made by the seller during the preceding return period to purchasers, on account of tangible personal property returned to the seller, shall be allowed as a deduction under subdivision 5 of his monthly or quarterly return, as the case may be, in case the seller had theretofore

included the receipts from the sale of such tangible personal property in a return filed by him and had paid the tax imposed by this Act with respect to such receipts.

35 ILCS 120/3. The Department has the authority to promulgate reasonable regulations to interpret and/or administer the provisions of the ROTA (35 ILCS 120/12)), and it has promulgated a ROT regulation (ROTR) regarding ROTA § 3's express grant of a refund of taxes that a retailer has paid regarding property a purchaser has returned to the retailer.

86 Ill. Admin. Code § 130.401. That regulation provides, in pertinent part:

Section 130.401

b) Returned Merchandise and Cancellations

Any seller may deduct from his gross receipts any refunds made by him during the preceding return period to purchasers, on account of tangible personal property returned to the seller, in case the seller had theretofore included the receipts from the sale of such tangible personal property in a return made by him, and had paid the tax imposed by the Retailers' Occupation Tax Act with respect to such receipts. However, if the seller collected the Use Tax on such a sale, he should refund such tax to his customer to whom he makes a refund of the selling price. When the seller makes a charge for restocking or reshelving returned merchandise, the receipts retained by the seller to cover the restocking or reshelving fee are not considered taxable gross receipts. When customers return merchandise, sellers should refund all of the sales tax to the customer, even though they will not be refunding all of the purchase price because of the restocking or reshelving policy. Cancellation fees should be handled in the same manner.

86 Ill. Admin. Code § 130.401(b) (2000).

Section 6 of the ROTA provides a further credit for tax paid by a retailer of motor vehicles regarding a return of a motor vehicle. That section provides, in pertinent part:

Credit memorandum or refund. If it appears, after claim therefor filed with the Department, that an amount of tax or penalty or interest has been paid which was not due under this Act, whether as the result of a mistake of fact or an error of law, except as hereinafter provided, then the Department shall issue a credit memorandum or refund to the person who made the erroneous payment or, if that person died or became a person under legal disability, to

his or her legal representative, as such. For purposes of this Section, the tax is deemed to be erroneously paid by a retailer when the manufacturer of a motor vehicle sold by the retailer accepts the return of that automobile and refunds to the purchaser the selling price of that vehicle as provided in the New Vehicle Buyer Protection Act. When a motor vehicle is returned for a refund of the purchase price under the New Vehicle Buyer Protection Act, the Department shall issue a credit memorandum or a refund for the amount of tax paid by the retailer under this Act attributable to the initial sale of that vehicle. Claims submitted by the retailer are subject to the same restrictions and procedures provided for in this Act. ***

35 ILCS 120/6 (2001).

These ROT sections authorize the credit at issue, which is published at 86 Ill. Admin. Code § 130.1960. Before being amended in 2000, the credit now described within ROTR § 1960(d) as the bad debt credit was called the repossession credit. *See* 24 Ill. Reg. 11599 (August 4, 2000) (first notice of proposed amendment to 86 Ill. Admin. Code § 130.1960); 24 Ill. Reg. 18376 (adopted amendment to 86 Ill. Admin. Code § 130.1960(d) (eff. December 1, 2000)). The current regulation provides:

Section 130.1960 Finance Companies and Other Lending Agencies -- Installment Contracts -- Bad Debts

a) Lending Agencies -- When Liable For Tax

Finance companies and other lending agencies are not relieved from liability for tax in cases in which they engage in the business of selling to users or consumers tangible personal property to which they hold or acquire title. Except as provided in subsection (b) of this Section, when a lending agency transfers title to a repossessed car to a user, the lending agency is engaging in the business of selling tangible personal property at retail and incurs Retailers' Occupation Tax liability on its receipts from such sales. It should be registered as a retailer under the Retailers' Occupation Tax Act and should file returns and otherwise comply with that Act.

b) Lending Agencies -- When Not Liable For Tax

1) Finance companies and other lending agencies are engaged primarily in the business of financing or acquiring the promissory notes given by purchasers of automobiles, furniture, refrigerators or other items of tangible personal property.

2) To guarantee payment of such notes, they sometimes take as security chattel mortgages upon such tangible personal property. In cases where the purchaser of the automobile or other tangible personal

property fails to meet his obligation, the lending agency repossesses the property and sells it to satisfy the obligation evidenced by the notes. In connection with such sales, the lending agency acts as agent for the owner of the repossessed property if such owner is known or disclosed to the purchaser, and if the lending agency does not take title to the property; the lending agency, under such circumstances, is not liable for payment of any Retailers' Occupation Tax with respect to the proceeds from such sales.

3) Even if the lending agency does title a repossessed motor vehicle in its name, if the original buyer, after the expiration of the redemption period provided for in the Retail Installment Sales Act [815 ILCS 405], is granted permission to redeem and to resume possession of the vehicle and to continue performance under his original installment contract without any change in the terms of such contract, and the lending agency re-endorses the repossession title to such original buyer, the transaction is not regarded as a sale and so is not taxable.

c) Installment Sales

1) When a retailer of tangible personal property sells an installment contract or "paper" to a third party, the difference between the selling price of the tangible personal property and the selling price of the installment contract or "paper" is a cost of doing business and is therefore not deductible in computing Retailers' Occupation Tax liability. Retailers' Occupation Tax is measured by the total selling price of the tangible personal property purchased from the retailer for use or consumption. Upon sale of the installment contract or "paper" to a third party, Retailers' Occupation Tax becomes due based on the entire selling price to the purchaser of the tangible personal property, with credit allowed for any tax already remitted to the Department based on the receipts from the sale of the tangible personal property. As an illustration, a computer vendor enters into an installment sales contract with a business for a computer system. The selling price of the computer system is \$120,000 and the contract requires monthly installment payments of \$10,000 for one year. After the business makes the first payment, the computer vendor sells the installment contract to a bank for \$90,000. Upon the sale of the installment contract to the bank, the computer vendor incurs Retailers' Occupation Tax on \$120,000 (the entire selling price to the original purchaser), with credit allowed for tax that was remitted on the first \$10,000 payment made by the business.

2) For purposes of this Section, "paper" means any instrument of indebtedness which was acquired by the retailer from the purchaser of the tangible personal property. Sales of "paper" to a third party includes the sale of accounts receivable as well as assignments or sales of the actual instruments of indebtedness themselves.

d) Bad Debts

1) In case a retailer repossesses any tangible personal property and subsequently resells such property to a purchaser for use or

consumption, his gross receipts from such sale of the repossessed tangible personal property are subject to Retailers' Occupation Tax. He is entitled to a bad debt credit with respect to the original sale in which the default has occurred to the extent to which he has paid Retailers' Occupation Tax on a portion of the price which he does not collect, or which he is not permitted to retain because of being required to make a repayment thereof to a lending agency under a "with recourse" agreement. Retailers of tangible personal property other than motor vehicles, watercraft, trailers and aircraft that must be registered with an agency of this State may obtain this bad debt credit by taking a deduction on the returns they file with the Department for the month in which the federal income tax return or amended return on which the receivable is written off is filed, or by filing a claim for credit as provided in subsection (d)(3) of this Section. Because retailers of motor vehicles, watercraft, trailers and aircraft do not pay Retailers' Occupation Tax to the Department on retail sales of motor vehicles, watercraft, trailers, and aircraft with monthly returns, but remit the tax to the Department on a transaction by transaction basis, they are unable to take a deduction on the returns that they file with the Department, but may file a claim for credit with the Department, as provided in subsection (d)(3), on any transaction with respect to which they desire to receive the benefit of the repossession credit.

2) Retailers who incur bad debt on any tangible personal property that is not repossessed may also obtain bad debt credit as provided in subsections (d)(1) and (3).

3) In the case of tax paid on an account receivable that becomes a bad debt, the tax paid becomes a tax paid in error, for which a claim for credit may be filed in accordance with Section 6 of the Retailers' Occupation Tax Act, on the date that the Federal income tax return or amended return on which the receivable is written off is filed.

86 Ill. Admin. Code § 130.1960 (2000); 24 Ill. Reg. 18376 (eff. December 1, 2000).

To briefly summarize the effect of ROTR § 1960(d) on this matter,¹ the first subparagraph does a few different things. First, it provides that a retailer that repossesses

¹ The most significant difference between the old and new versions of ROTR § 1960(d) is that within newly amended ROTR § 1960(d)(2), the Department, for the first time, extended the credit that had previously been allowed only where there had been a repossession of the property that a retailer had sold at retail, to instances where there was no repossession of such property by either the retailer or by the third party to whom the retailer sold or assigned an installment sale agreement. 86 Ill. Admin. Code § 130.1960(d)(2) (2000). But since all of the claims here involve vehicles that were repossessed, *see* Stip. Exs. A-D, this matter does not require any further discussion of that aspect of amended ROTR § 1960(d)(2).

property that it previously sold will incur ROT on its subsequent sale of the property, if that sale is a sale at retail. 86 Ill. Admin. Code § 130.1960(d)(1). Second, it provides that the retailer is entitled to a bad debt credit with respect to the original sale of the property later repossessed, to the extent that it does not receive a portion of the original selling price of that property, or to the extent it is not permitted to retain the original selling price of the property because of being required to make a repayment thereof to a lending agency under a “with recourse” agreement. *Id.* Next, it distinguishes between the two ways that retailers may claim the credit, depending on whether the retailer is selling motor vehicles, watercraft, trailers and aircraft that must be registered with an agency of this State property, or whether it is selling other property. *Id.* Each is entitled to a credit where the retailer actually incurs a bad debt regarding the original sale of the repossessed property; the only difference being the manner by which the retailer reports the credit. The former reports the credit by filing an amended return, whereas the latter reports the credit as a deduction against the next month’s taxable gross receipts. *Id.*

In turn, subparagraph 3 of ROTR § 1960(d) describes when an amount of gross receipts that remains unpaid by a customer may be considered to be an amount paid in error, and creditable against the retailer’s prior payment of tax. 86 Ill. Admin. Code § 130.1960(d)(3). It provides that, “[i]n the case of tax paid on an account receivable that becomes a bad debt, the tax paid becomes a tax paid in error ... on the date that the Federal income tax return or amended return on which the receivable is written off is filed. *Id.*

Considering that subparagraphs (d)(1) and (d)(3) are part of a single paragraph within a larger regulatory section, it is reasonable to assume that a careful reader would

take into account the text and context of all of the related subparagraphs when reading any particular subparagraph. Antunes v. Sookhakitch, 146 Ill. 2d 477, 484, 588 N.E.2d 1111, 1115 (1982) (language of a statute must be read as a whole, considering each part or section in connection with every other part or section). That is, when reading ROTR § 1960(d)(3)'s description of an unpaid "account receivable that becomes a bad debt", a reasonable person would understand that, consistent with the plain text of ROTR § 1960(d)(1), the "account receivable that becomes a bad debt" refers either to the retailer's own unpaid account receivable, or to an unpaid account receivable of the third party that purchased the retailer's retail installment contract under a "with recourse" agreement. 86 Ill. Admin. Code § 130.1960(c), (d)(1).

But ABC does not favor a consistent reading of the interrelated parts of ROTR § 1960(d). Instead, it argues that "the language of the Bad Debt Regulation does not require that the party that claims the sales tax bad debt deduction be the same party that wrote off the bad debt for federal income tax purposes." Taxpayer's Post-Hearing Brief, p. 6. Of course it does. Again, ROTR § 1960(d)(1) provides that "[A retailer] ... is entitled to a bad debt credit with respect to the original sale in which the default has occurred to the extent to which he has paid Retailers' Occupation Tax on a portion of the price which he does not collect, or which he is not permitted to retain because of being required to make a repayment thereof to a lending agency under a 'with recourse' agreement." 86 Ill. Admin. Code § 130.1960(d)(2). The function of the text following the phrase "to the extent ..." is to describe the circumstances where a customer's default becomes a bad debt *of the retailer*. It takes a wholly unreasonable reading of ROTR § 1960(d)(3), and a purposefully isolated one at that, to infer that the Department intended

to administer the credit provisions of the ROTA so as to allow a credit to a retailer that did not incur any loss of receipts from a customer that defaulted on his promise to make payments to a third party for property purchased from the retailer, and which retailer had already received all of the proceeds of that sale. To construe ROTR § 1960(d)(3) in the way ABC desires is to nullify § (d)(1)'s express provision that a retailer is entitled to the credit "to the extent" that the retailer has, in fact, incurred a bad debt as a result of the customer's default. In re County Collector of Kane Co., 132 Ill. 2d 64, 72, 547 N.E.2d 107, 110 (1989) ("In construing a statute or an ordinance, a court should not adopt a construction which renders words or phrases in a statute superfluous.").

ABC's own stipulations establish that it did not incur any bad debt as a result of its customers' failure to make all of their loan payments to DCF. At the time of the sale, and as a result of ABC's assignment of retail installment contracts to DCF, DCF paid ABC the amount financed under such contracts, which included the purchase price of the vehicles and all applicable tax due on the vehicles. Stip. ¶ 3. ABC then paid the full amount of ROT to the Department on such sales. Stip. ¶ 4. Under the first pertinent clause of ROTR § 1960(d)(1) then, ABC has not paid ROT on a portion of the selling price for the vehicles that it did not, in fact, collect. 86 Ill. Admin. Code § 1960(d)(1). It has conceded that it collected the entire selling price, and all applicable tax due on the vehicles. Stip. ¶ 3.

In the alternative, under the second pertinent clause of ROTR § 1960(d)(1), ABC might have still shown that it incurred a bad debt from its customers' failure to pay DCF all of the amounts they owed it, if ABC established that it had assigned the retail installment contracts to DCF pursuant to a "with recourse" agreement. 86 Ill. Admin.

Code § 1960(d)(1). Had ABC's assignment to DCF been pursuant to a "with recourse" agreement, it would have had to repay to DCF some part of the monies that DCF had loaned to customers, and previously given to ABC, but which ABC's customers later failed to pay to DCF. Under those circumstances, ABC would have established that it was "not permitted to retain because of being required to make a repayment [of] ..." such funds. *Id.* But nothing in the parties' Stipulation establishes that fact, and ABC has not offered the pertinent contracts or assignments into evidence. In sum, there is no evidence that ABC realized a bad debt as a result of its customers' default on contracts with a third party. Instead, ABC stipulates that DCF took the bad debt deduction on its federal returns. Stip. ¶ 6. Since ABC did not realize a bad debt on the sales at issue, it is not entitled to the credit actually authorized by § 3 of the ROTA, and described within ROTR § 130.1960(d)(1).

Here, the Department notified ABC that its claims for credit were being denied because the Department had "not established that this tax was paid in error or that issuing a credit memorandum would not result in unjust enrichment to you." Stip. Exs. E-H. The Department's denials were, in both instances, correct. First, ABC did not pay the tax in error. It sold the cars at retail to customers for use in Illinois, and it received its entire selling price for those cars, together with the amounts of tax due on such sales. Stip. ¶ 3-4. Since ABC has not shown that it has incurred any bad debt from any of the sales at retail it made, it not entitled to a refund of taxes correctly paid regarding those sales. 86 Ill. Admin. Code § 1960(d)(1).

Second, giving ABC a credit where it has realized no loss from its customers' failure to pay DCF all of the monies DCF agreed to lend to those customers would

unjustly enrich ABC. By its own admission, ABC has collected the full amount of the selling price for each car plus the amount of tax due on each sale for which it now seeks a partial refund or credit. Stip. ¶ 4. But ABC does not once suggest that it has returned to its customers, or that it intends to turn over, any portion of the tax that it collected from them (using monies DCF loaned to those customers) as use tax regarding such sales. Central Illinois Light Co. v. Department of Revenue, 117 Ill. App. 3d 911, 916, 453 N.E.2d 1167, 1170 (3d Dist. 1983) (“a retailer may be granted a claim for credit or refund where it appears that the claimant has unconditionally repaid to the purchaser any amount collected from the purchaser.”); *see also* 86 Ill. Admin. Code § 130.401(b) (“When customers return merchandise, sellers should refund all of the sales tax to the customer, even though they will not be refunding all of the purchase price because of the restocking or reshelving policy.”). Nor has it established that its agreement to assign to DCF the retail installment contracts it made with customers oblige it to pay over to DCF the amounts that its customers failed to make to DCF on such contracts. *See* Stip., *passim*; 86 Ill. Admin. Code § 130.1960(c), (d)(1).

Finally, ABC argues that if its claims are not allowed, the State will have received a windfall. Taxpayer’s Brief, pp. 7-9. But here, ABC ignores that just as its obligation to pay taxes can only be justified by a statute, its right to a credit for taxes paid exists only because of a statute. People ex rel. Eitel v. Lindheimer, 371 Ill. 367, 371, 21 N.E.2d 318, 320 (1939). Credits, exemptions and deductions from tax are “privileges created by statute as a matter of legislative grace.” Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981) (*citing* Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305, 347 N.E.2d 729 (1976); Bodine Electric Co. v. Allphin, 81 Ill. 2d 502, 410

N.E.2d 828 (1980)). “Statutes granting such privileges are to be strictly construed in favor of taxation.” Balla, 96 Ill. App. 3d at 296, 421 N.E.2d at 238. Section 3 of the ROTA provides for a credit for property returned to a retailer by a customer, and ROTR § 130.1960(d) sets forth in detail the scope of the credit allowed for property that is returned to a retailer via repossession. No section within the ROTA, and nothing within ROTR § 130.1960(d), authorizes a credit to be given to a retailer under the circumstances described within the parties’ Stipulation. It is not unjust to apply a statute or regulation as written. Village of Chatham v. County of Sangamon, 216 Ill. 2d 402, 429, 837 N.E.2d 29, 45 (2005) (when statutory language is clear, it must be given effect). Considering that ABC: (1) correctly paid ROT on its sales, (2) incurred no bad debt from its customers’ failure to make all payments to a third party that financed those sales, and (3) has not repaid to its customers or to DCF the tax it collected from them regarding those sales, the only enrichment that might properly be deemed unjust would be occasioned by granting ABC’s claims.

Conclusion:

I recommend the Director finalize the Department’s denial as issued.

March 6, 2008
Date

John E. White, Administrative Law Judge