ST 13-08
Tax Type: **Sales Tax**
Tax Issue: **Applicability of Tax – Sale or Lease**
Gross Receipts

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No.** XXXX
v.	**Account ID** XXXX
	Letter ID XXXX
	XXXX
	Period 10/04-12/06
ABC BUSINESS,	**Ted Sherrod**
Taxpayer	**Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General John Alshuler on behalf of the Illinois Department of Revenue; Michael Wynne, Adam Beckerink and Jennifer Warylas of Reed Smith on behalf of ABC Business

Synopsis:

This matter is before the Illinois Department of Revenue ("Department") Office of Administrative Hearings as the result of a timely protest by ABC Business ("ABC Business" or "taxpayer") of two Notices of Tax Liability ("NTLs") issued to the taxpayer on October 12, 2010 assessing additional taxes due for amounts collected but not remitted to the Department. The taxpayer sells and leases motor vehicles, and the taxes at issue were assessed with regard to sales the taxpayer made during the period from October 1, 2004 through December 31, 2006. The issue presented in this case is whether the taxpayer overcollected taxes when it collected taxes on

sales of vehicles in connection with lease transactions in excess of amounts the taxpayer remitted to the Department as tax collections on its sales tax returns.

At the hearing on this matter, both parties presented documentary evidence, and the taxpayer presented testimony by Jack Black, the taxpayer's controller and by James Skrna, a Department of Revenue auditor. The record in this case also includes briefs submitted by both the Department and the taxpayer. Following the submission of all evidence and a review of the record in this case, it is recommended that the Department's assessment be affirmed and finalized.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, is established by the admission into evidence of the SC-10-K, the Department's Audit Correction and/or Determination of Tax Due showing a proposed liability of $XXXX for the period October 1, 2004 through December 31, 2006. Department Exhibit ("Ex.") 1.[1]

2. ABC Business, a corporation registered with the Department to do business in Illinois located in Anywhere, Illinois, is engaged in the operation of a new and used automobile dealership and leasing agency. Tr. p. 18; Department Ex. 1. It acquires some of the automobiles it sells from Business X a/k/a Business Z ("BUSINESS X"). Tr. pp. 25, 26. ABC Business also sells automobiles to BUSINESS X. Tr. pp. 19, 25-28, 32, 33; Taxpayer's Group Exhibit ("Ex.") 3.[2] These sales relate to lease transactions pursuant to

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

which ABC Business enters into lease agreements with customers and then assigns the lease and sells the vehicle under lease to BUSINESS X. Tr. pp. 18, 19, 25; Taxpayer's Ex. 2, 3.

3. ABC Business is required to file, and does file, ST-556 forms reporting its gross receipts from selling tangible personal property on a transaction by transaction basis. Tr. p. 127; Taxpayer's Group Ex. 3. That is, for each sale it makes, ABC Business files a separate return. *Id*.[3]

4. An "advance trade-in credit" against taxes due on motor vehicle sales is a credit that is earned when a motor vehicle is acquired by a dealer from a purchaser that is contractually obligated to make a purchase of a vehicle from that dealer no more than nine months after the dealer acquires the motor vehicle from the purchaser. 86 Ill. Admin. Code, ch. I, section 130.455. In effect, the acquired vehicle is treated as a "trade-in" for the vehicle the purchaser subsequently purchases from the dealer. *Id*.

5. The Department audited ABC Business regarding the period from October 1, 2004 through and including December 31, 2006. Department Ex. 1. This audit included an examination of ABC Business's advance trade-in credits reported in section 6 of ABC Business's forms ST-556. Tr. pp. 27, 28, 34, 122.

6. The tax assessed as a result of the audit was based upon the Department's determination that ABC Business collected taxes from BUSINESS X in connection with sales of vehicles to

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[2] Taxpayer's Group Ex. 3 relates to an audit period preceding the audit period in controversy. However, the documents contained in this group exhibit are identical to documents used by ABC Business in connection with its automobile sales and leasing activities during the period at issue in this case. Taxpayer's Brief, p. 2 ("…ABC Business has been doing business with Business X in excess of 50 years … and (has) documented BUSINESS X SmartLease Transaction [credits] in the same manner since at least 1995 through June of 2010."). Because these documents have been admitted without objection, I accept them as evidence of the contents of documents prepared during the tax period in controversy.

[3] See 35 **ILCS** 120/3.

BUSINESS X that exceeded the amount of taxes remitted to the Department on each separate ST-556 form filed by the taxpayer to report these transactions. Tr. pp._122, 123. This determination was based upon the auditor's finding that the gross receipts shown on the taxpayer's ST-556 returns were not reflected in the sales prices charged to BUSINESS X as shown on the "Smartlease" lease agreement and the "Smartlease" lease agreement worksheet prepared in connection with ABC Business's sales of automobiles to BUSINESS X. *Id* ; Taxpayer's Group Ex. 3.

7. In arriving at an audit determination, the Department's auditor reviewed the following:

I. An example of "Advance Trade-In Credit Agreements" entered into between ABC Business and BUSINESS X which provided in pertinent part as follows: "The undersigned, Business X Corporation (Purchaser) hereby agrees to purchase from ABC Business Cadillac (Dealer) one or more vehicles within nine months of the date of this transaction. In exchange, Purchaser is submitting a 2001 Cadillac Seville … to be used as a trade-in against purchase price of the vehicle(s) referred to above. Dealer represents that it will provide Purchaser a credit (Advance Trade-In Credit) … for the vehicle traded. The Amount of the Advance Trade-In Credit will be allowed to reduce, for purposes of the Illinois sales tax, the amount of taxable sales price of the vehicle(s) to be purchased from the Dealer within the time period specified above. … The Trade-In Credit is valid only for the Purchaser named above, and is not transferable." Tr. pp. 27, 28; Taxpayer's Group Ex. 3.

II. Various documents prepared in connection with leases of the vehicles ABC Business sold to BUSINESS X including examples of the typical lease entered into between BUSINESS X and vehicle lessees (the so-called "BUSINESS X

Smartlease"), and worksheets used to compute the lessee's monthly rental payment (the so-called "Smartlease Worksheet"), both of which indicate that sales and use taxes are included in the cost price of the vehicle under lease that is sold by ABC Business to BUSINESS X as part of the lease transaction. Tr. pp. 122, 123; Taxpayer's Group Ex. 3.

III. ST-556 forms prepared to report transactions documented by the aforementioned documentation reflecting as a "trade in credit" the cost or value of a previously acquired vehicle being traded in. *Id.*

Conclusions of Law:

The issue in this case is whether taxes, reflected as amounts paid by BUSINESS X to the taxpayer in the taxpayer's books and records that exceeded amounts reported as collected from BUSINESS X on the taxpayer's ST-556 sales tax returns, are required to be remitted to the Department under provisions of the Illinois sales and use tax laws.[4] For the reasons enumerated below, I conclude that amounts shown as tax collections in the taxpayer's books and records exceeding amounts reported as tax collections on the taxpayer's returns constitute amounts due and owing to the Department.

Statutory Burden of Proof

The admission into evidence of the corrected returns by the Department under the certification of the Director at a hearing before the Department or in any legal proceeding establishes the Department's *prima facie* case. 35 **ILCS** 120/4; Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968); Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st Dist.

[4] The pre-trial order entered in this case states that "[T]he issue to be decided at the aforementioned hearing is whether the taxpayer overcollected Illinois Use Tax from purchasers of vehicles during the audit period."

1987). Thus, when the Department introduced its corrected return into the record, the Department's *prima facie* case was established.

Once the Department has established its *prima facie* case, the burden of proof shifts to the taxpayer. To overcome the Department's *prima facie* case, the taxpayer must present consistent, probable evidence identified with its books and records. Copilevitz, *supra*; Central Furniture Mart, *supra*. Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991); A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988). The record in this case establishes that the taxpayer has failed to submit sufficient evidence to overcome the Department's *prima facie* case.

Summary of Applicable Law Regarding Trade-Ins

The tax at issue in this matter is imposed by the Retailers' Occupation Tax Act (the "ROTA"), 35 **ILCS** 120/1 *et seq.* It is a tax upon persons engaged in the business of selling tangible personal property that is measured by the gross receipts from such sales. 35 **ILCS** 120/3; Norton Co. v. Illinois Department of Revenue, 340 U.S. 534 (1951). The amount of Retailers' Occupation Tax imposed on a purchase is determined by multiplying the "gross receipts" from the sale of tangible personal property by the prescribed rate. 35 **ILCS** 120/2-10. The term "gross receipts" is defined as follows:

> " (G)ross receipts" from the sales of tangible personal property at retail means the total selling price of the amount of such sales, as hereinbefore defined." 35 **ILCS** 120/1.

The term "selling price" is defined in the ROTA as follows:

> "Selling price" or the "amount of sale" means the consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property, other than as hereinafter provided, and services, but not including the value of or credit given for traded-in tangible personal property where the item that is traded-in is of like kind and character as that which is being sold … [.]" (emphasis added)

35 **ILCS** 120/1

The foregoing definition, when read *in pari materia* with the definition of "gross receipts" provides for the reduction of taxable "gross receipts" by the value of or credit given for trade-ins.

By regulation, trade-ins for which credit can properly be given include "Advance Trade Credits." 86 Ill. Admin. Code, ch. I, section 130.455(a), (b). "Advance Trade Credits" are credits earned when a motor vehicle is traded to a dealer for a future purchase of a vehicle where the purchaser is contractually obligated to make a purchase within nine months after the advance trade. *Id*. An "Advance Trade Credit" is established when a value is assigned to the motor vehicle being traded. *Id*. A credit that is unused after nine months expires. *Id*.

Summary of Facts

The facts at issue in this case are essentially undisputed. ABC Business is engaged in two types of businesses: 1) the sale of new and used vehicles; and 2) leasing new vehicles to customers. Tr. p. 18; Taxpayer's Group Ex. 3. Business X a/k/a Business Z ("BUSINESS X") is also engaged in two types of business related to this case, namely: 1) the sale of vehicles; and 2) leasing vehicles to customers. Tr. pp. 25, 32, 33; Taxpayer's Ex. 2; Taxpayer's Group Ex. 3.

In the conduct of its leasing business, ABC Business would solicit potential lease customers interested in leasing new vehicles that ABC Business had in its inventory of vehicles at its dealership. Tr. pp. 18, 19. Once a vehicle was selected by the customer, ABC Business would enter into a lease agreement with the customer pursuant to which ABC Business, as lessor, agreed to lease the vehicle to the customer for the term of the lease. *Id*. After entering into the lease, ABC Business would routinely assign the lease it entered into to BUSINESS X. Tr. pp. 18, 19, 25; Taxpayer's Ex. 2; Taxpayer's Group 3. BUSINESS X thus assumed the role of lessor. In connection with the transfer of the lease to BUSINESS X, ABC Business also sold

the vehicle under lease to BUSINESS X. *Id.* Since ABC Business also purchased motor vehicles from BUSINESS X, it was both a seller to and purchaser from BUSINESS X. Tr. pp. 21, 25.

Regulation 86 Ill. Admin. Code, ch. I, section 130.455 noted above is applicable to transactions in which an automobile dealer is selling vehicles to and purchasing vehicles from a vehicle supplier. Specifically, this regulation states as follows:

> 130.455. Motor Vehicle Leasing and Trade-In Allowances.
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> a) Definitions.
> Advance Trade Credit means a trade-in credit earned as the result of the trade-in of a vehicle on the future purchase of a vehicle where the purchaser is contractually obligated to make a purchase within 9 months after the advance trade …
> b) Use of Trade-In Credits
> 1) A dealer may reduce his gross receipts by the value or credit given for a traded-in motor vehicle where: …
> C) A lessor trades a motor vehicle he owns on the purchase of a new or used motor vehicle for subsequent lease.
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> 86 Ill. Admin. Code, ch. I, section 130.455

As indicated above, an "Advance Trade In Credit" is a type of trade-in deduction. It involves two transactions. In order to qualify for this deduction, a purchaser must first sell or transfer an old car to a dealer. In a second separate transaction, the purchaser must then purchase a new car from the dealer to whom the old car was sold. This purchase must take place within 9 months of the sale or transfer of the old car. When the new car is purchased from the dealer within 9 months, the purchaser gets a deduction or "credit" for the value of the old car previously tendered to the dealer.

As indicated by the title and content of regulation 130.455 quoted above, the use of "advance trade credits" typically involves a dealer's repurchase of vehicles whose leases have expired from a leasing company. These repurchased vehicles are typically allowed as credits

against the purchase price of purchases of new vehicles by the leasing company from a dealer. The Illinois courts have stated that such credits for purchased old vehicles against the purchase price of new vehicles sold by a dealer is a part of the "whole scheme of transactions … intended [as] a trade-in" under Illinois law. McCoy Inc. v. Department of Revenue, 60 Ill. App. 3d 429, 431 (4th Dist. 1978) (affirming the legality of "advance trade ins" but holding that the transactions at issue in that case did not meet the requirements for qualification as "advance trade ins").

In order to avail itself of the trade-in credit benefit noted above, ABC Business entered into agreements with BUSINESS X regarding this credit. Taxpayer's Group Ex. 3. An example of such an agreement is the Advance Trade-In Credit Agreement entered into between ABC Business and BUSINESS X in connection with a transaction involving the lease of a vehicle to a Mr. John Doe. *Id*. This transaction relates to a period prior to the tax period in controversy, but has been admitted and implicitly accepted by the Department as an accurate reflection of the documentation used in connection with transactions that took place during the tax period at issue here. See footnote 2. This Advance Trade-In Credit Agreement states in part as follows:

> The undersigned Business X Corporation (Purchaser) hereby agrees to purchase from ABC Business Cadillac (Dealer) one or more vehicles within nine months of the date of this transaction. In exchange, Purchaser is submitting a 2001 Cadillac Seville … to be used as a trade-in against the purchase price of the vehicles(s) referred to above. Dealer represents that it will provide Purchaser a credit (Advance Trade-In Credit) … for the vehicles traded. The Amount of the Advance Trade-In Credit will be allowed to reduce, for purposes of Illinois sales tax, the amount of taxable sales price of the vehicles(s) to be purchased from the Dealer within the time period specified above … The Trade-In Credit is valid only for the Purchaser named above, and is not transferable.
> *Id*.

Pursuant to this agreement, ABC Business was entitled to apply a trade-in as a credit in determining the amount of gross receipts to be collected from BUSINESS X on sales of vehicles

to BUSINESS X in connection with lease transactions when reimbursing itself through the collection of use tax to offset its sales tax liability pursuant to section 8 of the Use Tax Act, 35 **ILCS** 105/8.[5] However, rather than applying the credit and reducing the amount of gross receipts it collected from BUSINESS X by the amount of the available trade-in credit, ABC Business charged BUSINESS X the full amount of tax due on the purchase of vehicles ignoring any available trade-in credit. The "Smartlease" and "Smartlease Worksheet" contained in the record clearly demonstrate this. *Id*. So, even though ABC Business was entitled to apply trade-in credits, the documents of record do not show that it did so, on the sales of vehicles to BUSINESS X at issue in this case.

Despite having ignored available trade-in credits in its documentation of sales to BUSINESS X, and despite having shown in these records collections of tax on gross receipts without reflecting any such credits, the trade-in credits at issue in this case were claimed on ST-556 returns filed regarding these transactions. *Id*. On its ST-556 returns reporting the aforementioned transactions, the taxpayer treated the vehicles acquired from BUSINESS X as trade-ins for vehicles sold to BUSINESS X. *Id*. The Department's auditor computed the taxpayer's liability by allowing these trade-ins as deductions for purposes of determining taxes due on ABC Business's sale of vehicles to BUSINESS X. Department Ex. 1. However, he determined that the discrepancy between tax amounts paid by BUSINESS X as purchaser and shown in the "Smartlease" and "Smartlease Worksheet" and tax reported on the taxpayer's ST-556 returns, resulted in a collection of tax by the taxpayer that was not properly reported, and, accordingly, the auditor assessed a liability for excess taxes collected. Tr. pp. 122, 123.

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[5] Under the terms of the Retailers' Occupation Tax Act, a retailer is liable for tax on an item when the retailer sells it. On the same transaction, the buyer is separately liable for use tax, which the retailer must collect and remit under the terms of the Use Tax Act. However, pursuant to section 8 of the Use Tax Act, 35 **ILCS** 105/8, the use tax that the retailer collects need not be remitted if, on the same transaction, the retailer pays a retailers' occupation tax.

Analysis

Section 3-45 of the Use Tax Act ("UTA"), 35 **ILCS** 105/3-45 provides as follows:

> § 3-45. Collection. The tax imposed by this Act shall be collected from the purchaser by a retailer maintaining a place of business in this State or a retailer authorized by the Department under Section 6 of this Act, and shall be remitted to the Department … [.] … If a seller collects use tax measured by receipts that are not subject to use tax, or if a seller, in collecting use tax measured by receipts that are subject to tax under this Act collects more from the purchaser than the required amount of the use tax on the transaction, the purchaser shall have the legal right to claim a refund of that amount from the seller. If, however, that amount is not refunded to the purchaser for any reason, the seller is liable to pay that amount to the Department.

The applicability of this provision to retailers collecting use tax as reimbursement for retailers' occupation taxes due from customers is indicated in section 130.901(g) of the Department's sales tax regulations. This section provides as follows:

> If a seller collects an amount (however designated) that purports to reimburse the seller for Retailers' Occupation Tax liability measured by receipts that are not subject to retailers' occupation tax, or if a seller, in collecting an amount (however designated) that purports to reimburse the seller for Retailers' Occupation Tax liability measured by receipts that are subject to tax under the Act, collects more from the purchaser than the seller's Retailers' Occupation Tax liability on the transaction, the purchaser shall have a legal right to claim a refund of that amount from the seller. If, however, that amount is not refunded to the purchaser for any reason, the seller is liable to pay that amount to the Department.
> 86 Ill. Admin. Code, ch. I, section 130.901

Section 3-45 of the UTA provides that any collection of tax from a purchaser over and above that due must either be refunded or paid to the State. Based upon a plain reading of section 3-45, the Department contends that the amount added to the taxpayer's bill when no tax was actually due must be paid to the State. Department's Brief pp. 9, 10.

The identical issue presented in the instant case has previously been adjudicated by the parties to this proceeding. Taxpayer's Ex. 4 (Department of Revenue v. ABC Business, Administrative Hearing Decision No. 06-ST-0159, Ill. Dept. of Revenue, Office of Admin. Hearings, Sept. 16, 2008). In the prior case, the Department prevailed because the evidence contained in the record indicated that BUSINESS X was not given the benefit of the advance trade in credits it earned when it traded in used vehicles and therefore was, in effect, "overcharged" tax when it purchased vehicles from ABC Business in connection with its acquisition of leases from ABC Business, as noted above. In effect, this Tribunal ruled that there was insufficient evidence to support a finding that BUSINESS X did receive the benefit of these credits.

In the instant case, the taxpayer seeks to present additional support for its claim that ABC Business was not unjustly enriched as a result of the transactions at issue in this and the previous case. Specifically, the taxpayer contends that events subsequent to the decision in ABC Business Cadillac, *supra* have produced evidence that supports a finding that no unjust enrichment to the taxpayer resulting from the transactions at issue. In support of this conclusion, the taxpayer avers that BUSINESS X did not agree with this Tribunal's finding, which is based on facts identical to the facts presented in this case. At pages 3 through 5 of its brief, the taxpayer chronicles BUSINESS X's reaction to this Tribunal's earlier ruling as follows:

> ABC Business's decision to not appeal the circuit court decision affirming the ALJ's First Hearing Decision left it with two choices under the law: (a) to pay the amount finally assessed as an overcollection to BUSINESS X, or, in lieu of that, (b) to pay the amount finally assessed to the Department. *Tr. 43:4-13.* ABC Business chose to pay to BUSINESS X the $623,240 final assessment amount, which it did on December 30, 2010 by electronic funds transfer on BUSINESS X's system designated for use by dealers. *Tr. 43: 14-20.* As the ALJ may appreciate, the implications of allowing the First Hearing Decision to become final and of making payment to BUSINESS X potentially

were far more damaging to ABC Business than the financial hit of disgorging $XXXX to BUSINESS X.

In making payment to BUSINESS X on December 31, 2010 of the final assessment amount ABC Business was disclosing to BUSINESS X that the Department, and now a court, had concluded that ABC Business had overcollected taxes from BUSINESS X from January of 2002 through September of 2004 on *every* transaction involving an ATC. *Tr. 44: 19-24, 45:1-11*. Worse yet, ABC Business disclosed to BUSINESS X, its finance lending partner of more than 50 years, that ABC Business had engaged in a systematic multi-million dollar overcollection of tax from BUSINESS X on *all* BUSINESS X Smartlease transactions involving an ATC *for at least 9 years*, from 1995 through September of 2004. BUSINESS X's reaction to these disclosures was unpredictable, and it could have been catastrophic for ABC Business. The BUSINESS X reaction is telling.

With respect to the funds BUSINESS X received from ABC Business on December 31, 2010, the testimony indicated that two-years later the $XXXX remains in suspense in an account and has not been applied. *Tr. 46; 16-24, 47:1-8, 50:2-22*. The written communications from BUSINESS X's legal counsel on December 5, 2011, indicated that even a year after payment from ABC Business, BUSINESS X desired to return the $XXXX to ABC Business but was uncertain of the Department's and the Attorney General's posture and suggested some affirmative statement from them is needed for BUSINESS X to return the $XXXX to ABC Business. *Tr. 49:12-24, 50:1; 51:10-24; 52:1-3; Exhibit No. 6.* From the testimony that the funds were still in suspense and unapplied as recently as the day prior to the second hearing, the ALJ may correctly assume that both the Attorney General's office and the Department have made no representation to BUSINESS X on what their position would be if BUSINESS X returned the funds to ABC Business.

Equally, if not more telling, are the reactions BUSINESS X did not have but which it could or should reasonably be expected to have upon the disclosure that a business partner of more than 50 years has been found by a tax authority to have overcollected and pocketed excess taxes on vehicle sales to BUSINESS X for at least a nine-year period. BUSINESS X could or should have sought to recover similar overcollections from ABC Business for all other periods preceding ABC Business's notification, but it did not do so. *Tr. 52: 20-24, 53:1-7*. BUSINESS X could or should have ceased to conduct further business with ABC Business, but it did not do so. In fact, BUSINESS X continued to transact business with ABC Business and it continues to do so to this day, as Business Z Bank.

Either of the foregoing anticipated reactions, or others, including legal actions we have not contemplated, could have imperiled the viability of ABC Business as a business. Instead, BUSINESS X's reaction was to ask ABC Business to procure assurances from the tax and legal authorities of the State that BUSINESS X could return the funds to ABC Business without legal consequence to BUSINESS X, and to not apply the $XXXX to its own account, which is the *status quo* today.

Taxpayer's Brief pp. 3-5.

While BUSINESS X's reaction to this Tribunal's earlier decision is evidence that BUSINESS X believed it paid the correct amount of tax on its purchases from the taxpayer and therefore was not overcharged, it does not support the conclusion that unjust enrichment did not result from the taxpayer's failure to afford BUSINESS X the benefit of the advance trade-in credit. As noted previously, under the terms of the Retailers' Occupation Tax Act ("ROTA"), a retailer is liable for tax on an item when the retailer sells it. On the same transaction, the buyer is separately liable for use tax, which the retailer must collect and remit under the terms of the UTA. 35 **ILCS** 105/8. The Illinois courts have determined that unjust enrichment pursuant to section 3-45 of the UTA occurs whenever a seller collects a tax amount from a purchaser to reimburse the seller for the seller's retailers' occupation tax that exceeds the amount of retailers' occupation tax that is due from the seller. Acme Brick and Supply Company v. Department of Revenue, 133 Ill. App. 3d 757 (2d Dist. 1995); Adams v. Jewel Companies, Inc., 63 Ill. 2d 336 (1976). See also 86 Ill. Admin. Code, ch. I, section 130.901, noted above. Since the amounts collected by the taxpayer shown by the taxpayer's records (i.e. the "Smartlease" and "Smartlease Worksheet" contained in Taxpayer's Group Ex. 3) clearly exceeded the retailers' occupation tax the taxpayer, as seller, reported as due on its ST-556 returns (Taxpayer's Group Ex. 3), the evidence supports a finding that the taxpayer's actions constituted "unjust enrichment" as that concept has been defined by the courts.

As previously noted, the lease, and the revenue stream it generated, was assigned to BUSINESS X immediately after it was entered into between the taxpayer and the lessee. This revenue stream included a "capitalized cost" which was paid by the lessee. A component of this "capitalized cost" the lessee paid was the cost of sales taxes BUSINESS X paid to the taxpayer

when BUSINESS X purchased the vehicle being leased from the taxpayer. Taxpayer's Group Ex. 3. Consequently, while BUSINESS X paid sales tax to the taxpayer without receiving the benefit of the advance trade in credit, it suffered little if any detriment as a consequence of doing so because it passed this tax cost to the lessee. Indeed, the taxpayer, in its brief, admits that overcollection of sales tax from the lessee occurred in this case. This acknowledgement is contained at page 8 of the taxpayer's brief wherein the taxpayer states as follows:

> …[T]he Department's auditor testified very clearly that the overcollection he had identified and assessed was <u>from the lessee</u>, and that it occurred on the BUSINESS X Smartlease upon the inclusion of the capitalized cost of the "Sales Tax" designated [as] an amount to be paid by the lessor in the absence of any ATC.
>
> In pertinent part, the auditor's testimony was as follows:
>
> Q. What do you understand unjust enrichment to be?
>
> A. In basic terms, when a taxpayer collects tax, sales tax, from a customer and does not submit that sales tax to the Illinois Department of Revenue.
>
> Q. And in the transactions you examined who are you referring to as a customer?
>
> A. I'm referring in this instance to the person that comes in and leases the automobile and makes the monthly payments on the lease.
>
> Q. So is that the customer you are referring to when you say there has been unjust enrichment?
>
> A. What I'm saying is that the customer has lease payments that includes sales tax that's capitalized into the lease. The customer makes those payments that include sales tax and that sales tax that's included and capitalized in the lease is not included on the ST-556 return that corresponds to the lease deal.
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> Taxpayer's Brief pp. 3-5.

However, the fact that BUSINESS X passed the financial detriment of the taxpayer's overcollection to a third party and therefore suffered no financial ill effects from the taxpayer's overcollection does not negate evidence that taxes the taxpayer collected from BUSINESS X exceeded the retailers' occupation tax due that these collections were designed to offset. As a consequence, irrespective of the financial impact of the taxpayer's overcollection on BUSINESS X, a finding of unjust enrichment to the taxpayer is warranted by the facts presented in this case. Because the record shows that the very overcollection section 3-45 of the UTA is designed to

prohibit did occur in the instant case, I do not find persuasive evidence to the contrary arising from BUSINESS X's denial that any overcollection occurred as a result of the taxpayer's use of trade in credits on its tax returns reducing its retailers' occupation tax that BUSINESS X never benefited from when it paid use tax offsetting the taxpayer's retailers' occupation tax to the taxpayer.

Based upon the aforementioned evidence of overcollection from the lessee noted above, the taxpayer also contends that the overcollection that occurred in this case resulted from tax collections by BUSINESS X from its lessee rather than from the taxpayer's sales tax charges to BUSINESS X. Taxpayer's Brief pp. 7-12. In support of this contention it indicates, as noted above, that the lessee actually bore the burden of the overcollection and notes that the lease payments by the lessee were made to BUSINESS X after the lease was assigned by the taxpayer to BUSINESS X. It contends that overcollection by a lessor from a lessee does not violate section 3-45 of the UTA because leases are not subject to Illinois' sales and use tax. *Id.*

The taxpayer's argument is premised on the assumption that the assessment at issue arises from amounts paid by lessees to BUSINESS X. However, the SC-10-K Audit Correction and/or Determination of Tax Due contained in the record clearly shows that the amount assessed is based on the amount the taxpayer collected from BUSINESS X on its sales of motor vehicles to BUSINESS X, and is not based upon amounts BUSINESS X collected from its lessees. Department Group Ex. 1. Since the transactions giving rise to the assessment were clearly taxable sales, I must reject the taxpayer's claim that the overcollection at issue relates to non-taxable transactions and therefore did not violate any provision of the Illinois sales or use tax.

Moreover, even if the evidence in the record supported a finding that no over collection in violation of section 3-45 of the UTA occurred as the taxpayer alleges, the taxpayer would still

be required to pay over the full amount of tax collected as "sales tax" to the Department by section 8 of the UTA.

Section 8 of the UTA, 35 **ILCS** 105/8 provides as follows:

> § 8. Any retailer required to collect the tax imposed by this Act shall be liable to the Department for such tax, whether or not the tax has been collected by the retailer, except when the retailer is relieved of the duty of remitting the tax to the Department by virtue of having paid a tax imposed by the Retailers' Occupation Tax Act upon his or her gross receipts from the same transaction. <u>To the extent that a retailer required to collect the tax imposed by this Act has actually collected that tax, such tax is held in trust for the benefit of the Department.</u> (emphasis added)

Even accepting the taxpayer's argument that it has not been unjustly enriched, it is clear that the taxpayer collected use tax to reimburse itself for retailers' occupation tax imposed by the ROTA by virtue of its charges to BUSINESS X showing state use taxes due. This is evident from the manner in which such tax charges are reflected on the "Smartleases" and "Smartlease Worksheets" prepared to show the cost of vehicles under lease to BUSINESS X. Taxpayer's Group Ex. 3.

Pursuant to section 8 of the UTA, if a seller collects use taxes due the Department (including amounts intended to reimburse the seller for retailers' occupation tax) the amounts collected become the property of the State. Upon collection of such amounts, the taxpayer becomes a "fiduciary" holding the State's funds in trust. As a consequence of section 8, the Illinois sales and use tax law simply does not permit a taxpayer to collect a tax amount without remitting it to the State.

The taxpayer further contends that the evidence of record in this case does not support a finding that the amount invoiced to BUSINESS X failed to credit BUSINESS X for the advance trade in credit taken on the taxpayer's sales tax returns. In reaching his conclusion that the

taxpayer overcollected tax in the instant case, the Department's auditor relied upon amounts shown in BUSINESS X's "Smartlease" and "Smartlease" lease worksheet documentation showing an amount as "sales tax" on the vehicle BUSINESS X purchased from the taxpayer for lease to its lessees. Tr. pp. 122, 123. However, the taxpayer, at pages 12 through 17 of its brief, argues that this lease documentation was never intended to reflect the actual amount of sales tax paid, and that the "invoice" reflecting the amounts actually due from BUSINESS X was the sales tax ST-556 return it filed for each transaction wherein an advance trade in credit is shown. The taxpayer bases this conclusion on the Department's sales and use tax regulation 130.540, which provides, in part, as follows:

> (b) Function and Contents of Transaction Reporting Returns
> 1) The transaction reporting return prescribed and supplied to retailers by the Department not only shall serve as such return (for both the buyer and the seller), but also may serve as the dealer's invoice to the purchaser. …
> 86 Ill. Admin. Code, ch. I, section 130.540

A review of the lease documentation contained in the record indicates that the sales tax shown in this documentation is identified as an <u>actual cost</u> BUSINESS X incurred which it "capitalized" on its books and records. Taxpayer's Group Ex. 3. Specifically, Jack Black, the taxpayer's controller testified, with respect to this sales tax cost, as follows:

> Question. Now, on the first page of this, which is the motor vehicle lease agreement, in your previous answer you referred to something called a cap cost reduction.
> Can you explain what that is, what that term was?
> Answer. Cap cost reduction is the customer is buying the vehicle. To get a certain payment sometimes if they come in and lease a car the advertised payment might be 299 a month. He wants to get that payment reduced a bit, so he comes in and puts the money down to just to kind of lower his payment a little bit.
> Question. In the middle of the page there is a section in the first page called itemization of gross capitalized cost, what does that section accomplish on this document? …
> Answer. Basically it's the agreed upon value of the vehicle, BUSINESS X administration fee, a sales tax number determination which comes to the gross

> capitalized cost, add it all up, you add those numbers in there and then the gross capitalized cost to determine the customer's payment.
> Question. Now, this is the cost to whom? The gross capitalized cost is whose cost?
> Answer: That's BUSINESS X's cost. (emphasis added)
> Tr. pp. 35, 36.

Jack Black's testimony, noted above, constitutes an admission that the tax component of the "capitalized cost" shown on BUSINESS X's "Smartlease" and "Smartlease" worksheet accurately reflects the sales taxes charged to BUSINESS X by the taxpayer when the taxpayer sold vehicles for lease to BUSINESS X. Consequently, even if the ST-556s filed in this case constituted invoices to BUSINESS X from the taxpayer, the aforementioned testimony negates any inference arising from the ST-556s that the ST-556s accurately reflect the sales tax actually collected from BUSINESS X.

With the exception of the ST-556 returns reporting the "Advance Trade Credits" at issue in this case, the records of the transactions audited by the Department are consistent with sales in which no "Advance Trade Credits" were utilized by BUSINESS X when it paid sales tax to the taxpayer. This is clearly indicated by the "Smartlease" and the "Smartlease" worksheet contained in the record wherein sales tax is shown as a component of the "capitalized cost" identified in these documents. As Jack Black clearly testified, this "capitalized cost" included an actual tax charge to BUSINESS X which BUSINESS X paid. Accordingly, I find the evidence contained in the record consistent with a sale wherein no available trade-in credits were taken into account when the taxpayer collected tax from BUSINESS X rather than with a transaction in which trade-in credits were utilized by BUSINESS X to reduce the amount of the taxpayer's gross receipts or the amount of BUSINESS X's sales tax due.[6]

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[6] The record indicates that, subsequent to the tax period in controversy, the Department ceased to assess the taxpayer for overcollection of taxes based upon changes to documentation to show that a lower amount of sales tax is being

In sum, based upon the evidence contained in the record, I conclude that the taxpayer collected taxes exceeding its ROT liability and therefore over collected the amount of taxes due, by failing to allow BUSINESS X the benefit of the advance trade in credits BUSINESS X earned by trading in vehicles for vehicles it purchased from the taxpayer. I further conclude that the taxpayer collected taxes from BUSINESS X as reimbursements for its Retailers' Occupation Tax liability, and therefore was required to remit these taxes to the Department pursuant to section 8 of the UTA.

WHEREFORE, for the reasons stated above, it is my recommendation that the Notices of Tax Liability at issue in this case be affirmed and finalized.

Ted Sherrod
Administrative Law Judge

Date: March 11, 2013

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collected from BUSINESS X on transactions that are in all other respects identical to those at issue in this case. Taxpayer's Brief p. 9; Tr. pp. 57-72. I do not find that this subsequent tax treatment supports an inference that the assessment for overcollection in the instant case was incorrect because the record shows that the documentation upon which the assessment at issue was based (the "Smartlease" and the "Smartlease" worksheet) was subsequently changed to show that BUSINESS X received the benefit of the advance trade in credit it earned and paid sales tax on an amount that took into account this credit. See Taxpayer's Ex. 8-12. I find that these changes in documentation were not mere changes to the form of the transactions at issue as the taxpayer infers in its brief (at page 9), but rather changed their legal substance in a manner conforming the transactions being reported to the ST-556 forms the taxpayer filed reporting them.