

ST 97-25

Tax Type: SALES TAX

Issue: Audit Methodologies and/or Other Computational Issues

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

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS,)	
)	
v.)	No.
)	
)	IBT:
TAXPAYER,)	NTL:
)	
Taxpayer)	

FINAL ADMINISTRATIVE DECISION

Appearances: Mr. Michael R. Collins of Collins & Collins, for TAXPAYER; Mr. Mark Dyckman, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to the Department of Revenue's denial of TAXPAYER's Claim and Request for Review of Audit for Retailers' Occupation and Related Taxes. Taxpayer was assessed Use Tax for the audit period of September 1988 through December 1993. At issue are the questions 1) whether the taxpayers have "used" the tangible personal property purchased from suppliers so as to subject the transaction to the provisions of the Use Tax Act, 2) whether some of the materials taxed are exempt as temporary storage under the multistate exemption, 3) whether the sampling techniques done during

the audit are representative and 4) whether the taxpayer is entitled to the governmental exemption.

On September 14, 1990 taxpayer contracted with the United States Department of Energy ("USDOE") to provide research and development services and reports on the production of a multicarbonate fuel cell. This contract provided that the title to all goods purchased by the taxpayer in fulfillment of the governmental contract passed to the USDOE upon delivery to the taxpayer. Among other contentions, the taxpayer maintains these activities do not constitute a "use" under the Illinois statute because although the taxpayer uses the property in fulfillment of its contractual obligations, title rests with the USDOE.

I have thoroughly reviewed the record and with particularity all evidence admitted of record as well as the ALJ's Findings of Facts and Conclusions of Law. As a result of that review, I determine that the ALJ's recommendation that the transactions involved are not subject to the Use Tax Act is contrary to Illinois law and I cannot adopt it as the final determination of this matter.

In furtherance of my decision to reject part of the ALJ's recommendation, I adopt his findings of facts and make additional findings based upon the evidence of record. The additional findings concern other matters at issue herein. These findings are made as I have determined that the ALJ's findings are incomplete. As I do not concur with his analysis of the law, the following conclusions of law form the basis of my decision to finalize the Department's denial of taxpayer's claim for credit. I have also included in my conclusions, further discussion regarding other matters at issue.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Tentative Determination of the Claim for \$92,665.00 for taxes paid. Dept. Ex. Nos. 1, 2.

2. The Department of Revenue ("Department") conducted an audit of TAXPAYER Corporation ("Taxpayer" or "TAXPAYER") for the audit period September, 1988 through December, 1993. Dept. Ex. No. 2.

3. In connection with the audit the auditor prepared a Global Taxable Exceptions table. The Global Taxable Exceptions represent the detail of the personal property for certain test periods. The Department annualized these test periods and assessed Use Tax against the taxpayer based thereon (hereinafter referred to as the "Assessment"). Stip ¶ 2

4. At the completion of the audit the taxpayer paid the full amount of tax contained in the assessment, that being \$139,749.00. Stip. ¶ 3. Thereafter, taxpayer filed a Claim and Request for Review of Audit for Retailers' Occupation and Related Taxes. Stip. ¶ 5.

5. On September 14, 1990 the taxpayer entered into a contract with the U.S. Department of Energy Morgantown Energy Technology Center ("DOE Contract"). Stip. ¶ 8. At all relevant times the USDOE was a governmental body statutorily exempt from sales tax for tangible personal property pursuant to tax exemption identification number. Stip. ¶ 6.

6. Taxpayer's principal performance obligation under the DOE Contract was to conduct research and prepare reports for a Simulated

Coal Gas Molten Carbonate Fuel Cell Power Plant System Verification.
Stip. ¶ 10.

7. The DOE Contract provides that the USDOE and taxpayer will each perform based upon a Cost-Participation arrangement. Stip. ¶ 11.

8. The DOE contract contains the following clause with regards to passage of title:

Clause 63. Dear 952.245-5 on page 26 of the Contract Clauses (DOE SET 304) Cost Reimbursement Service Contracts of the Contract ("Clause 63") provides in relevant part:

(c) Title.

(1) The Government shall retain title to all Government furnished property.

(2) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a

direct item of cost under this contract shall pass to and vest in the Government upon the vendor's delivery of such property.

(3) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon

(i) Issuance of the property for use in contract performance;

(ii) Commencement of processing of the property or use in contract performance; or

(iii) Reimbursement of the cost of the property by the Government, whichever occurs first;

(4) All Government-furnished property and all property acquired by the Contractor, title to which vests in the Government under this paragraph (collectively referred to as "Government property"), are subject to the provisions of this clause. Title to Government property shall not be affected by its incorporation into or attachment to any property not owned by the Government, nor

shall Government property become a fixture or lose its identity as personal property by being attached to any real property.

(d) Use of Government property

The Government property shall be used only for performing this contract, unless otherwise provided in this contract or approved by the Contracting Officer.

Stip. ¶ 13.

9. TAXPAYER is engaged in the business of developing for commercial application a device known as a mult carbonate fuel cell. Tr. p. 16. TAXPAYER's principal performance obligations under the contract with the USDOE were to conduct research and prepare reports for a Simulated Coal Gas Molten Carbonate Fuel Cell Power Plant System and Verification and to provide incidental materials in connection therewith. Stip. ¶ 17. Upon completion of its performance under the contract TAXPAYER provides USDOE with a written report. Stip. ¶ 18.

10. This research is sponsored by the U.S. Department of Energy (USDOE). The contract between the taxpayer and the USDOE is a cost type contract, that is, the contractor incurs costs and then is reimbursed by the USDOE. Tr. pp. 17, 18.

11. TAXPAYER is a privately owned corporation. Tr. pp. 29, 30.

12. TAXPAYER's day to day operations are not controlled by the USDOE. Tr. p. 30.

13. Taxpayer hires its own employees to conduct operations. Tr. p. 30.

14. TAXPAYER directly enters into sales contracts with its vendors. Tr. pp. 71, 72.

15. The vendors ship the materials and supplies, purchased to fulfill the obligations under the USDOE contract, to the TAXPAYER

facilities in Illinois. Tr. p. 72. Many of the materials are incorporated into fuel cell stacks. Tr. p. 42. These fuel cell stacks are used for research and testing and are never transferred to the USDOE. Tr. p. 72.

16. Vendors are directly paid by taxpayer. TAXPAYER receives invoices from the vendors and issues payment checks from its own bank account to the suppliers. Tr. p. 30.

17. Upon the vendor's delivery of the property, the taxpayer immediately tags the property with U.S. Government tags and segregates the property on its premises. Taxpayer prepares and delivers to the USDOE a monthly Property Report showing all USDOE owned property. Stip. ¶¶ 15, 16.

18. None of the materials and supplies in question were ever shipped to the USDOE facilities in West Virginia, either directly from the vendor or from TAXPAYER. Tr. p. 72.

19. The auditor reviewed invoices from the test period of September 1992 through August 1993. Tr. p. 76. Exceptions were listed on the Global Taxable Exceptions list. From this list the auditor calculated what tax should have been assessed for that test period. A percentage of error was developed and the exceptions were projected to the remaining years during the audit period. Tr. pp. 75-77.

20. TAXPAYER did not provide any resale certificates to their vendors. Tr. p. 78.

21. TAXPAYER was not registered as a reseller during the audit period. Tr. p. 78.

Conclusions of Law:

The first issue to be addressed is whether the taxpayer has "used" the tangible personal property purchased from suppliers so as to subject the transaction to the provisions of the Use Tax Act. Section 2 of the Use Tax Act ("UTA") provides the definition of use and states in pertinent part:

"Use" means the exercise by a person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased, and does not include the use of such property by its owner for demonstration purposes: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. "Use" does not mean the demonstration use or interim use of tangible personal property by a retailer before he sells that tangible personal property. ... "Use" does not mean the physical incorporation of tangible personal property, to the extent not first subjected to a use for which it was purchased, as an ingredient or constituent, into other tangible personal property (a) which is sold in the regular course of business or (b) which the person incorporating such ingredient or constituent therein has undertaken at the time of such purchase to cause to be transported in interstate commerce...

35 ILCS 105/2. (formerly, Ill. Rev. Stat. 1991, ch. 120, ¶ 439.2).

Taxpayer asserts that its conduct with regards to the property at issue does not constitute a "use" under the statute. Taxpayer focuses

on the language "incident to the ownership of that property" in Section 2 of the UTA and contends that the government, the eventual legal title holder, is the "user" of the property within the meaning of the Use Tax Act. Taxpayer maintains it cannot be the "user" of the property since TAXPAYER is not the owner and does not possess any control incident to ownership over that property. Taxpayer Brief p. 8.

The taxpayer's contention that the government, as the title holder, is necessarily the "user" of the tangible personal property is predicated on Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305 (1976) and Philco Corp. v. Dept. of Revenue, 40 Ill. 2d 312 (1968). In both Telco Leasing and Philco the Court affirmed the imposition of the use tax on the lessor, as the owner of the property and the party exercising dominion and control, rather than upon the lessee who was merely using the property and had no powers incident to ownership.

In Telco, the lessor sought to avoid the assessment of use tax on property leased to not-for-profit institutions. Telco (the lessor), purchased the equipment only after the not-for-profit institution placed an order. The lessor never actually took physical possession of the equipment, as it was delivered directly to the not-for-profit lessee. The lease also provided that the lessee bore the burden of all use taxes. In spite of these factors, the court found that based upon a statutory analysis of the definition of "use" the owner and lessor of the property was the "user" within the meaning of the Use Tax Act. Telco, at 309. The Telco court observed: "[T]he right or power exercised by the plaintiff incident to its ownership of the

property in question is the right or power to lease the property in an attempt to make a profit." *Id.* at 310.

In Philco, *supra*, another case where the Court affirmed the imposition of the use tax on the lessor, the Court looked to the Supreme Court of California's holding in Union Oil Co. v. State Board of Equalization, 386 P. 2d 496, (1964), appeal dismissed, 377 U.S. 404, a case which presented the same issue and where the California court said: "[O]wnership is not a single concrete entity but a bundle of rights and privileges as well as of obligations. It finds expressions through multiple methods. One such method is the lease. ... *Id.* at 500.

The case at hand is not analogous to the facts present in either Telco Leasing, or Philco. Both of these cases deal with lessor/lessee relationships. Taxpayer tries to align itself with the lessee in this situation and thus, escape liability. However, several important facts distinguish the cases cited from the case at hand. In fact, when examined closely, they show that TAXPAYER's dominion and control more closely reflect that of the lessor, the party the courts in both Telco and Philco found to have properly borne the use tax burden.

TAXPAYER contracts directly with the suppliers to purchase goods, as do the lessors. The items are directly invoiced to TAXPAYER and TAXPAYER buys the goods with its own funds. The same is true as to the lessors in Telco and Philco. TAXPAYER exercises its dominion and control by choosing to contract directly with the USDOE and agreeing to transfer legal title to the Government. Aside from taxpayer's physical use of the property, its power to transfer legal title is

akin to the lessor's power to lease and constitutes a use incident to ownership under the statute.

Taxpayer asserts that title passes directly to the government and it is, therefore, never the owner of the property in question. The record reflects, however, that it is even the taxpayer's secretary and general counsel's own understanding that under the property clause of the contract the contractor purchased the property and subsequently resold it to the U.S. Government. Tr. pp. 24, 25. The mere fact that the taxpayer chose to enter into a contract with the government to subsequently transfer title does not change the substance of the initial transaction. Looking to the realities of the transaction, the consideration for the purchase of goods by the taxpayer ran from the taxpayer to the vendors, not the government to the vendors. TAXPAYER, issued the purchase orders, paid the vendors with its own funds and consequently had the unlimited right to take title to the goods purchased. Taxpayer purchased these supplies from the vendors directly to fulfill its own contractual obligations.

The taxpayer notes that the government ultimately bears the burden of the use tax. However, this is of little significance because there is no indication that the legislative intent was to exempt a corporation from payment of the use tax merely because the taxpayer might pass this financial obligation on to the USDOE. See, Telco Leasing, *supra* at 311. (Court did not find evidence that the legislative intent was to exempt corporations from the imposition of use tax even when the burden of the use tax was passed on to a charitable institution.) When tangible personal property is sold and directly invoiced to the government it is put to an exclusively exempt

purpose. Here, that is not the case. Taxpayer 1) directly purchased goods it needed to satisfy its contractual obligations; 2) these goods were directly invoiced to the taxpayer, not the government and TAXPAYER, an independent, private corporation, used the property pursuant to its own considerations of how to fulfill its contract to conduct testing and providing these results to the government.

The fact that the taxpayer chose to limit its right by transferring title to the USDOE and thereafter subjecting itself to inventory control and regulation by the USDOE is also of little importance. TAXPAYER contracted directly with its suppliers and received the privilege of using the tangible personal property in Illinois without limit. The fact that it chose to subsequently transfer title is not relevant to the taxability of the initial transaction. Furthermore, when contracting with its vendors, taxpayer exercised its power to use the property of its own choice for its benefit. Taxpayer's benefit was his ability to enter into contracts with regards to the materials and supplies in question to ultimately carry on its business operations.

Taxpayer's second argument that a sale for resale has occurred is also without merit. Section 120/1 of the Retailers' Occupation Tax Act defines a sale at retail as any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration:" 35
ILCS 120/1.

It is well established in Illinois that a contractor uses or consumes the materials purchased to satisfy a contractual obligation and does not make a sale at retail. Modern Dairy Co. v. Department of Revenue, 413 Ill. 55 (1952). In Modern Dairy, the court stated:

Considering the purpose of the Retailer's Occupation Tax Act, it is reasonable to assume the legislature intended the term "use" to include any employment of a thing which took it off the retail market so that it was no longer the object of a tax on the privilege of selling it at retail.

Id. at 67.

The Illinois Supreme Court has also established that a construction contractor is the user of tangible personal property when it takes materials off the market as tangible personal property and converts them into real estate. G.S. Lyon & Son Lumber and Manufacturing Company v. Department of Revenue, 23 Ill. 2d 177 (1961). This principle was recently affirmed by the Fourth Appellate District in Craftmasters v. Department of Revenue, 269 Ill. App. 3d 934 (4th Dist. 1995). Although the taxpayer herein does not actually incorporate materials into real estate, the basic principle that a use of the materials takes the item off the retail market and precludes a sale at retail still holds true.

Further, the object of the contract between the USDOE and the taxpayer was not to build property for resale to the government. The USDOE has no interest in securing possession of the actual materials and supplies in question. At the time of purchase, the taxpayer's intent is to purchase materials to enable it to fulfill its contractual obligations to the USDOE. It conducts research and

development pursuant to the contract, compiles the results into a report and hands this report over to the USDOE. It is these testing reports which are of value to the government, not the actual materials and supplies. The record reflects that the taxpayer never gives up possession of the tangible personal property to the USDOE. Nor does the contract even address in detail what should be done with the property after the testing is completed, in fact, many of the items are consumed during the testing process itself. Thus, it is quite clear that the USDOE's objective is not to acquire the materials or supplies.

Taxpayer's argument that a sale for resale has occurred is further undermined by two important points: 1) taxpayer is registered as a business/professional service corporation, not a retailer, and 2) no resale certificates were provided by the taxpayer to its suppliers as required pursuant to statute. See, 35 **ILCS** 120/2c.

Another issue to be addressed is whether some of the materials taxed qualify under the temporary storage exemption. The temporary storage exemption provides:

The temporary storage, in this State, of tangible personal property that is acquired outside this state and that, after being brought into this State and stored here temporarily, is used solely outside this State or is physically attached to or incorporated into other tangible personal property that is used solely outside this state, or is altered by converting, fabricating, manufacturing, printing, processing, or shaping, and, as altered, is used solely outside this State.

35 **ILCS** 105/3-55(e).

Taxpayer argues that this exemption applies because the purchased materials were eventually shipped to California and incorporated into multicarbonate fuel cell stacks for research and testing and, therefore, were only temporarily stored in Illinois.

Taxpayer has failed to rebut the *prima facie* correctness of the tentative determination of the claim with respect to proving such items fall under the temporary storage exemption. Pursuant to Illinois statute and case law, the Claim Denial is *prima facie* correct and constitutes *prima facie* evidence of the correctness of tax due as shown therein. 35 **ILCS** 120/6b; A.R. Barnes and Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988). The record reflects that the stacks were constructed in Illinois. Tr. p. 26. Taxpayer has failed to present documentary evidence showing that these goods were shipped to California and, thereafter, were never returned to Illinois for further testing. Merely asserting that these items were shipped to California without further proof is insufficient to rebut the *prima facie* correctness of the Department's determinations. A.R. Barnes and Co., *supra*.

Taxpayer also raised the issue of whether the sampling techniques used during the audit were representative. As discussed above, the Correction of Returns and the Claim Denial are *prima facie* correct. See, 35 **ILCS** 120/4; 35 **ILCS** 120/6b; A.R. Barnes, *supra*. The taxpayer's mere assertion that these sampling techniques are not representative of the population is insufficient to rebut the *prima facie* correctness of the Department's proposed adjustments. Simply questioning the correctness of the Department's determination or denying its accuracy does not shift the burden back to the Department.

Quincy Trading Post, Inc v. Department of Revenue, 12 Ill. App. 3d 725 (1973). The Department's determinations are rebutted only after a taxpayer introduces evidence which is consistent, probable and identified with taxpayer's books and records, showing that the Department's determination is incorrect. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). A taxpayer's oral testimony, without sufficient corroborative evidence, will not rebut the Department's *prima facie* case. A. R. Barnes, supra.

Taxpayer did not present sufficient evidence to prove that the audit methodology was incorrect and/or unreasonable. Although the taxpayer questioned the auditor regarding sampling methods, the record does not reflect any evidence which proves that the sampling method was unreasonable or that the sample was not sufficiently representative of the population.

The transaction in the case at hand does not fall within the purview of the Service Occupation Tax Act ("SOTA"). The Department's regulations provide that:

A serviceman making a sale of service in which the cost price of tangible personal property transferred as an incident to the sale of service is less than 35% (75% in the case of servicemen transferring prescription drugs, or servicemen engaged in graphic arts production as the term graphic arts production is defined in Section 2-30 of the Retailers' Occupation Tax Act) of the total gross receipts from the transaction is not subject to Service Occupation Tax. However, the purchase of such tangible personal property by the serviceman shall be subject to tax under the Retailers' Occupation Tax and Use Tax and should be paid by the serviceman to his supplier or self-assessed and paid to the Department. ...

86 Admin. Code ch. I, Sec. 140.101; See also, 35 **ILCS** 115/2(g).

A serviceman who transfers tangible personal property with a cost price of less than 35% of the total gross receipts from the transaction is not subject to the service occupation tax. As clearly stated in the Department regulations, that serviceman is subject to the Retailers' Occupation Tax and Use Tax Act and should be paying tax to its supplier or self-assessing use tax and remitting it to the Department directly. If the tangible personal property's cost price was greater than 35% of the gross receipts from the transaction, the taxpayer must file returns reflecting its total receipts and indicate any receipts from exempt transactions and remit SOT to the Department. It was determined in audit that the taxpayer fell under the 35% threshold and that use tax was properly due. Taxpayer has not presented any documentary evidence which proves that its annual cost of tangible personal property is over 35% of its annual aggregate receipts from the sale of service, nor does it file returns reflecting total receipts from its sales of service and remit Service Occupation Tax ("SOT"). Thus, taxpayer has not successfully rebutted the *prima facie* correctness of the Department's determination that use tax was properly due. A.R. Barnes, *supra*.

Taxpayer, in his opening statement, also argued that the Service Use Tax ("SUT") under 35 **ILCS** 110 would preclude assessment of tax on a service provided incident to a contract with the government. In the case at hand, taxpayer is an Illinois business purchasing supplies from out of state vendors. Service Use Tax is inapplicable, in that it is a complementary tax to the SOT, and is imposed upon the privilege of using in this State property acquired as an incident to the purchase of service from a serviceman. See, 35 **ILCS** 115/1;

115/2. It is unclear from the record why the taxpayer argues the service use tax would be applicable under these circumstances. As discussed above, the taxpayer is not subject to SOT, rather the taxpayer should be paying tax to its supplier or self-assessing and remitting use tax to the Department. The record does not provide evidence to prove that the taxpayer should be subject to SOT or that it should be collecting SUT from its customers, thus, taxpayer has failed to meet its burden and rebut the Department's *prima facie* case.

Taxpayer also proposes that because title passes to the USDOE upon delivery of the tangible personal property to the taxpayer, the exemption pertaining to government entities applies. Section 105 of the UTA provides: "Exemptions. Use of the following tangible personal property is exempt from the tax imposed by this Act: ... (4) Personal property purchased by a government body" 35 **ILCS** 105/3-5

The United States Supreme Court, faced with similar facts and circumstances, has upheld the taxing authority of the State in United States v. New Mexico, 455 U.S. 724 (1982), wherein a government contractor and the United States Department of Energy entered into a series of management contracts to manage certain Government-owned atomic laboratories.

In New Mexico, the contracts provided that title to all tangible personal property purchased by the contractors passed directly from the vendor to the Government. The Government bore the risk of loss for property procured by the contractors. Taxpayer submitted an annual voucher of expenditures for Government approval, and the agreements gave the Government control over the disposition of all

property purchased under the contracts, as well as over each contractor's property management procedures. In addition, all work done by the contractors was performed at Government facilities and the Government reimbursed the taxpayer for all state taxes paid by the contractor. Further, one of the contractor's purchase orders stated that it made purchases "for and on behalf of the Government." The contractors placed the orders with suppliers in their own names and identified themselves as the buyers. The taxpayers controlled day-to-day operations and the hiring and direct supervision of employees.

The contract in the present case is in all relevant respects identical to the ones discussed in U.S. v. New Mexico, *supra*. In one respect, however, the contracts differ. In New Mexico, the parties used an "advanced funding" procedure to pay the vendors. Creditors were paid with federal funds which had been deposited in a special account, upon which the contractors could issue a draft. Thus, only federal funds were expended when the contractors purchased supplies. In the instant case, the taxpayer writes its own checks and uses its own funds to purchase the goods. Therefore, the case at hand presents an even stronger scenario in favor of upholding the State's ability to levy the use tax.

The Supreme Court in holding that federal contractors are not immune from use tax liability stated: "[W]hereas the Government is absolutely immune from direct taxes, it is not immune from taxes merely because they have an "effect" on it, or "even because the Federal Government shoulders the entire economic burden of the levy." *Id.* at 734. In fact, it is "constitutionally irrelevant that the United States reimburses all the contractor's expenditures, including

those going to meet the tax." *Id.* (citing Alabama v. King v. Boozer, 314 U.S. 1, 62 S. Ct. 43 (1941)). Tax immunity is "appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities." U.S. v. New Mexico, *supra* at 1383.

The Use tax statute in New Mexico and Illinois are similar in purpose and intent.¹ The New Mexico statute levies a use tax equivalent in amount to New Mexico's gross receipts tax, "[f]or the privilege of using property in New Mexico." N.M. Stat. Ann. § 72-16A-7. New Mexico's tax is not imposed on the "receipts of the United States or any agency or instrumentality thereof," or on the "use of property by the United States or any agency or instrumentality thereof." N.M. Stat. Ann. §§ 72-16A-12.1, 72-16A-12.2.

TAXPAYER at no time became an "instrumentality" of the United States. Courts have considered the requisite factors in determining whether a company should be considered a federal instrumentality and have described the relationship as "virtually ... an arm of the Government." Department of Employment v. United States, 385 U.S. 359, 360 (1942), 87 S.Ct. 467. "To resist the State's taxing power, a private taxpayer must actually "stand in the Government's shoes."

¹. New Mexico levies a use tax "[f]or the privilege of using property in New Mexico." §72-16A-7. Property acquired out-of-state in a "transaction that would have been subject to the gross receipts tax had it occurred within [New Mexico]". §72-16A-7(A)(2). Thus, like the use tax in Illinois it serves as an enforcement mechanism for the correlating gross receipts or the Illinois Retailers' Occupation Tax Act. In addition, like the Illinois use tax, New Mexico's Use Tax statute is not imposed on the "... use of property by the United States or any agency or instrumentality thereof." §§ 72-16A-12.1, 72-16A-12.2.

City of Detroit v. Murray Corp., 355 U.S. 466, 503 (1958), 78 S. Ct. 474, 467.

The record reflects that TAXPAYER is in a position almost identical to that of the contractor in U.S. v. New Mexico, *supra*, wherein the United States Supreme Court declined to find the contractor a federal agent or instrumentality of the U.S. Government. The taxpayer, an independent, privately owned company conducted its business operations in its private facilities, purchased its supplies directly from vendors with its own funds all to fulfill its contractual obligation to the USDOE. The similarity in facts between the case at hand and U.S. v. New Mexico, is unmistakable and provides clear and thoughtful insight into why the government exemption is not applicable to TAXPAYER.

A summary breakdown of the protested items on Exhibit A of the Stipulation of Facts is as follows:

Protested - (I) Incorporated into material	\$507,094.00
Protested - (U) Used up during R & D	\$ 607.00
Protested - (O) for "Other" reasons	\$ 70,877.00

Obviously, any item which is used up in the research and development cannot be properly classified as a sale for resale. These items are consumable supplies which the taxpayer admittedly "consumes" in the testing and, therefore, can never be returned to their original condition or used again for its intended purpose. Thus, taxpayer is necessarily the "end user" of these items. Therefore, I find all items designated with a "U" on the Global Exceptions List (taxpayer's abbreviation for "used up") taxable. See, Stipulation of Facts, Exhibit A.

Some materials and supplies which the taxpayer has classified as being incorporated into the testing stacks are actually used up or consumed during the taxpayer's performance of his contractual obligations. The items are more properly classified as supplies or are tools or equipment which are used and never actually incorporated into the testing stacks. Although, both the items marked "I" for incorporated into and "U" for used up are deemed taxable, the following are technically used up or consumed in the process and are listed separately below for clarity:

ITEMS WHICH WERE MARKED AS INCORPORATED BUT WERE ACTUALLY USED UP OR CONSUMED DURING THE TESTING PROCESS:

<u>DATE</u>	<u>NO.</u>	<u>VENDOR</u>	<u>ITEM</u>	<u>AMOUNT</u>
3/5/93	30595	ABBEON CAL, INC.	PAINT PEN	7.00
8/7/92	325781	ALDRICH CHEMICAL	SODIUM PELLETS	80.00
3/2/93	007521	AUBURN MANUF	AMI-GLAS TAPE	59.00
5/5/93	52702	COOL-AMP	PLATING POWDER	288.00
3/1/93	100015456	COMPRESSOR ENG. CO.	ELEMENT, FILTER	31.00
2/9/93	100014708	COMPRESSOR ENG. CO.	FILTER, OIL	29.00
7/10/92	1193	DELTA RESOURCES	BLACK EPOXY POWDER	96.00
1/8/93	0009002	EXMET	PRODUCT: 5AL7-1/OF	1000.00
7/19/93	57286	SCOTT SPEC. GASES	CARB. MONO/NITROGEN	430.00
5/3/93	20673	JOHN DUSENBERY	RAZOR BLADE	50.00
4/20/93	20241	JOHN DUSENBERY	RAZOR BLADE	260.00
<u>TOOLS AND/OR EQUIPMENT</u>				
3/1/93	856340	TRAVERS TOOL Co.	DIE, HAND TAP	120.00
5/21/93	909760	TRAVERS TOOL Co.	BALL/PLUNGER	90.00
7/14/93	20101	MARTIN THIELE Co.	SOCKET CAP	18.00
5/12/93	18529	MARTIN THIELE	SOCKET CAP	57.00
10/22/92	10357	MARTIN THIELE	SOCKET CAPSCREW	525.00
12/8/92	15834	ULTRAFAB, INC.	STATIC ELIM BRUSH	210.00
12/22/93	03120	CONTAQ	LD1000-V10	1514.00

Stipulation of Facts, Exhibit A; Tr. pp. 64-71.

Other materials which were incorporated into the fuel cell stacks are taxable for the reasons discussed above. Thus, all the remaining items designated with a "I" on the Global Exceptions List (taxpayer's abbreviation for "incorporated") are taxable. See, Stipulation of Facts, Exhibit A.

Of the "O" property the following item was protested because tax was paid:

3/22/93	OUCO41	Premier Refrac. Flat Plate	\$13,408.00
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A review of the invoice indicates tax was paid and thus this item should be deleted from the taxable exceptions list. See, Stipulation of Facts, Exhibit G.

"O" Items protested because taxpayer claims they are service invoices and do not involve tangible personal property:

4/8/93	522206	Aurora Area Express	\$ 30.00
3/4/93	122166	Ideal Tool & Mfg.	\$35,094.00
6/8/93	4583	McKey Perf. Nickel	\$ 1,927.00
6/8/93	4584	McKey Perf. Nickel	\$ 1,323.00
6/8/93	4585	McKey Perf. Nickel	\$ 1,477.00

A review of the invoices indicates that the first item is freight and is therefore not taxable. See, Stipulation of Facts, Exhibit G. The remaining items are labor charges and are also not taxable. *Id.* Thus, all of the above items should be deleted from the taxable exceptions list.

Some remaining items marked "O" were as follows:

11/30/92	92324012801	ASTM	\$	117.00
11/04/92	923042009801	ASTM	\$	12.00
11/06/92	2242	AQA CI	\$	88.00
11/02/92	PO 004309	Amer. Nat'l Stnds	\$	50.00
11/18/92	991925	ASQC	\$	45.00

A review of these invoices and the explanation given in the transcript does not provide adequate documentation to allow these exceptions. It is unclear whether the items in question are books or periodicals. Thus, because taxpayer has not sufficiently rebutted the *prima facie* correctness of the Department's determinations, all of the remaining five invoices listed above should remain on the taxable exceptions list. See, Stipulation of Facts, Exhibit G.

The remaining items marked "0" on the Global Taxable Exceptions List are as follows:

12/15/92	505672	Corralloy Inc.	Alloy Sheet	7298.00
7/15/93	313-66229	Pckg Co. of Amer	Cardboard	621.00
2/8/93	12124-001	Seton Name Plate	Labels	241.00
1/5/93	10982	U.S. Corrulite	Corrulite	22187.00
12/4/92	663979	Consol. Plastics	Steel Grad	367.00

The first three items listed above are taxable for the reasons discussed in this decision. The last two items are measuring equipment which are also taxable for the reasons discussed above. The taxpayer has not offered any basis under which this equipment would qualify for an exemption nor have I found any basis in the record. Stipulation of Fact, Exhibit G.

Wherefore, for the reasons stated herein, the Department's denial of the Claim for Credit should be finalized as revised by this decision.

Date

Kenneth E. Zehner, Director
Illinois Department of Revenue