

ST 98-23

Tax Type: SALES TAX

Issue: Nexus (Taxable Connection With Or Event Within The States)

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

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	Case No.
)	IBT
v.)	NTL
)	
XYZ COMPANY)	Administrative Law Judge
)	Mary Gilhooly Japlon
Taxpayer)	

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorney General Richard A. Rohner, on behalf of the Illinois Department of Revenue; Paul J. Bargiel, P.C., by Paul J. Bargiel, on behalf of XYZ COMPANY.

SYNOPSIS:

This matter comes on for hearing pursuant to the timely protest by JOHN AND JANE DOE, dba, XYZ COMPANY, and XYZ COMPANY Sales and Service, Inc. (hereinafter "taxpayer") of the assessments of Use Tax, interest and penalty issued by the Illinois Department of Revenue (hereinafter "Department") on the taxpayer's sale of tangible personal property in the form of appliances and repair parts to Illinois customers. The taxpayer protested the assessments and requested a hearing thereon.¹

¹ It is noted at the outset that although two forms of business ownership are involved (sole proprietorship/partnership for the period of January 1, 1988 through June 30, 1989; corporation for the period of July 1, 1989 through December 31, 1992), the owners of both business entities are the same:

At hearing, JOHN AND JANE DOE testified on behalf of the taxpayer. Subsequent to the hearing, the parties filed memoranda of law in support of their respective positions.

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

FINDINGS OF FACT:

1. The Department's prima facie case, inclusive of all jurisdictional elements, was established by the admission into evidence of a certified copy of the Correction of Returns, showing a liability due and owing by JOHN AND JANE DOE, d/b/a XYZ COMPANY in the amount of \$2,827 for Use Tax delinquencies, and penalty in the amount of \$848, for a total due of \$3,675 for the period of January 1, 1988 through June 30, 1989. (Dept. Ex. No. 1; Tr. p. 6).
2. The Department further established its prima facie case by the admission into evidence of a certified copy of the Correction of Returns showing a liability due and owing by XYZ COMPANY Sales & Service, Inc. in the amount of \$32,043 for Use Tax delinquencies, plus a penalty in the amount of \$9,613, for a total due of \$41,656 for the period of July 1, 1989 through December 31, 1992. (Dept. Ex. No. 1; Tr. p. 6).

JOHN AND JANE DOE. Therefore, when the word "taxpayer" is used in this Recommendation, it refers to either or both entities, differentiated solely by the liability period.

Furthermore, it is to be noted that throughout the direct examination of JOHN AND JANE DOE, their counsel referred to the audit period as the period June 1989 to December 1992. This is not an accurate rendition of either audit period, as the period relating to the sole proprietorship/partnership is January 1, 1988 through June 30, 1989, and the period corresponding to the corporation's liability is July 1, 1989 through December 31, 1992. Therefore, the inclusive audit period is January 1, 1988 through December 31, 1992; that is the period at issue herein.

3. In 1988, JOHN AND JANE DOE moved their appliance repair business out of their home in FICTITIOUS CITY, Indiana, and into a 2500 square foot warehouse in FICTITIOUS CITY, Indiana. (Tr. pp. 13-14).
4. The business expanded beyond appliance service and repair to actually selling major appliances, such as washers, dryers, dishwashers, ranges, microwaves, etc. (Tr. pp. 13, 30).
5. The business was a sole proprietorship or a partnership when it was initially formed; the witness, JOHN DOE, which form of business was operative. (Tr. p. 14).
6. JOHN AND JANE DOE incorporated the business within two years after its inception under the name of XYZ COMPANY & Service. (Tr. p. 15).
7. JOHN DOE is the president and owns 50 percent of the stock; JANE DOE is the Secretary and Treasurer and owns the other 50 percent of the stock. (Tr. pp. 15, 16).
8. During the period of June 1989 through December 1992, the taxpayer advertised in FICTITIOUS CITY and FICTITIOUS CITY, Indiana newspapers, as well as through a flier that was inserted in the FICTITIOUS CITY Times. (Tr. pp. 17, 41).
9. The taxpayer did not advertise on television during the above-mentioned period. (Tr. p. 17).
10. However, the taxpayer did advertise on a FICTITIOUS CITY radio station, WJOB, during this period. (Tr. p. 18).
11. During the period of June 1989 to December 1992, the taxpayer did not advertise at all in Illinois. (Tr. pp. 18, 41).

12. During the above-mentioned period, the taxpayer did not have an office or store in Illinois, nor did it have any sales persons or any kind of sales force in Illinois. (Tr. pp. 18-19, 42).
13. During this time frame, the taxpayer did not have a registered agent in Illinois, nor did it own any real or personal property in Illinois. (Tr. pp. 19, 42).
14. During this time the taxpayer did not have any lawsuits pending against anyone in Illinois. (Tr. pp. 19, 42).
15. During the period of 1989 to 1992, some sales were made to Illinois customers. (Tr. p. 41).
16. Prior to and throughout the period of 1989 to 1992, the taxpayer was not registered with the Department of Revenue to collect Use Tax, nor did it collect Use Tax on sales made to Illinois customers. (Tr. p. 19).
17. The taxpayer did not register with the Department or collect Illinois Use Tax on sales made to Illinois residents during this time period because it did not believe it had to do so. (Tr. p. 20).
18. The taxpayer bases this belief on JOHN DOE's past experience working for ABC APPLIANCE in FICTITIOUS CITY, Indiana. (Tr. p. 20).
19. While working for ABC APPLIANCE prior to the period at issue, JOHN DOE testified that he was instructed to not charge tax on parts inserted in appliances for Illinois customers. (Tr. pp. 21, 44).
20. In order to remain competitive with other Indiana retailers, the taxpayer did not register to collect tax, nor did it collect Use Tax from Illinois customers during the taxable period. (Tr. p. 24).

21. During late summer 1994, the taxpayer first became aware of a potential obligation to collect Use Tax due to a telephone call from Revenue Auditor Deborah Hicks-Hill of the Illinois Department of Revenue. (Tr. pp. 24-25).
22. The taxpayer was audited by the auditor, with a Notice of Tax Liability a result thereof. (Tr. p. 27).
23. The taxpayer provided the Department with the names and addresses of its Illinois customers to whom it made sales during the audit period. (Tr. p. 29).
24. The auditor informed the DOES about the amnesty program; however, they were told that they could not qualify for it because it was too late, and because they had not voluntarily contacted the Department about their liability. (Tr. pp. 28-29, 43).
25. The assessment is based upon sales to Illinois customers. (Tr. p. 29).
26. During the audit period, the taxpayer sometimes delivered the appliances to Illinois customers via its own trucks. (Tr. pp. 30-31, 46).
27. Other times, the Illinois customer picked up the appliance from the store. (Tr. pp. 30, 47).
28. Some of the appliances sold to Illinois residents required installation and/or repair service. (Tr. pp. 31-32, 46-47).
29. The taxpayer also performed repair work on appliances in Illinois. (Tr. p. 32).
30. During the audit period the taxpayer's business was located in a 5,000 square foot facility next door to the original location. (Tr. p. 34).
31. During the taxable period, the taxpayer had seven employees, including JOHN AND JANE DOE. (Tr. p. 39).

32. Two of the employees were sales people who worked in the showroom. (Tr. pp. 39-40).

33. The taxpayer hired an accountant to prepare its year end tax returns; he never suggested that the taxpayer should collect Illinois Use Tax. (Tr. p. 41).

CONCLUSIONS OF LAW:

The Department prepared corrected returns for JOHN AND JANE DOE, dba, XYZ COMPANY, and for XYZ COMPANY Sales and Service, Inc. for Use Tax delinquencies pursuant to section 5 of the Retailers' Occupation Tax ("ROT") Act (35 ILCS 120/5). Section 5 of the ROT Act is incorporated into the Use Tax Act via section 12 thereof (35 ILCS 105/12). Section 5 of the Act provides in relevant part as follows:

In case any person engaged in the business of selling tangible personal property at retail fails to file a return, the Department shall determine the amount of tax due from him according to its best judgment and information, which amount so fixed by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown in such determination. ... Proof of such determination by the Department may be made at any hearing before the Department or in any legal proceeding by a reproduced copy or computer print-out of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue. ... Such certified reproduced copy or certified computer print-out shall, without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax due, as shown therein. (35 ILCS 120/5).

The Department prepared the corrected returns and issued the Notices of Tax Liability based upon its determination that the taxpayers, JOHN AND JANE DOE, dba, XYZ COMPANY, and XYZ COMPANY Sales & Service, Inc., businesses located in

Indiana, made taxable sales to Illinois customers and failed to collect Use Tax. The facts are not in dispute. Rather, the issue is whether the taxpayer had nexus with the state of Illinois substantial enough to subject it to the Use Tax Act.

Section 3 of the Use Tax Act imposes a tax “upon the privilege of using in this State tangible personal property purchased at retail from a retailer... .” (35 ILCS 105/3). As the court stated in Klein Town Builders, Inc. v. Dept. of Revenue, 36 Ill.2d 301, at 303 (1966), the purpose of the Use Tax is “primarily to prevent avoidance of the [Retailers’ Occupation] tax by people making out-of-State purchases, and to protect Illinois merchants against such diversion of business to retailers outside Illinois.”

The taxpayer herein takes the position that its activities do not bring it within the ambit of the Use Tax Act. Section 2 of the Use Tax Act defines a “retailer maintaining a place of business in this State” as follows:

A retailer having or maintaining within this State, directly or by a subsidiary, ... any agent or other representative *operating* within this State under the authority of the retailer or its subsidiary, irrespective of whether such ... agent or other representative is located here permanently or temporarily, or whether such retailer or subsidiary is licensed to do business in this State. (Emphasis added). (35 ILCS 105/2).

It is the operation of DOE employees within this State that brings the taxpayer within the purview of the Act. According to the testimony elicited at the hearing, during the audit period the taxpayer made sales to Illinois customers. The taxpayer delivered appliances to Illinois customers via its own trucks. The taxpayer also performed installation work and repair services on appliances in the homes of Illinois residents. JOHN AND JANE DOE testified that during the audit period they did not advertise in Illinois, nor did the taxpayer maintain an office or store in Illinois. Furthermore,

according to the testimony the taxpayer did not have any sales people or any kind of sales force in Illinois, nor did it have a registered agent in Illinois during the taxable period. Lastly, the taxpayer did not own any real or personal property in Illinois, or have any litigation pending against anyone in Illinois.

In order for a state to impose a tax that affects interstate commerce, the state tax must satisfy the four-part test set forth in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). One of the components is that the tax must be applied to an activity with a substantial nexus with the taxing state. In the case of Brown's Furniture v. Wagner, 171 Ill.2d 410 (1996), the Illinois Supreme Court discusses "substantial nexus" by referring to the U.S. Supreme Court case of Quill Corp. v. North Dakota, 504 U.S. 298 (1992). The holding in Quill determines that an out-of-state seller must be physically present within a state in order for the substantial nexus prong of the four-part Complete Auto test to be met. Furthermore, the Quill court decided that more than the "slightest" physical presence within a state is necessary to establish substantial nexus. However, left unclear is exactly how much physical presence is required to constitute substantial nexus, and thus allow a state to impose Use Tax collection obligations upon an out-of-state retailer.

In Brown's Furniture, *supra*, the Illinois Supreme Court adopts the rule regarding substantial nexus as stated by the Court of Appeals of New York in Orvis Co. v. Tax Appeals Tribunal, 654 N.E.2d 954 (1995):

While a physical presence of the vendor is required, it need not be substantial. Rather, it must be demonstrably more than a 'slightest presence' [citation]. And it may be manifested by the presence in the taxing State of the vendor's property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf. (654 N.E.2d at 960-61).

In the case at bar there is scant evidence regarding the taxpayer's operation within Illinois. The only activities in which the taxpayer engaged during the audit period in the State of Illinois were some deliveries of appliances via its own trucks, as well as some repair and installation services. There is no evidence of how many times the taxpayer made deliveries or engaged in installation and/or repair services.

The taxpayer argues that the Department is required to prove that the taxpayer is obligated to collect Use Tax on its sales to Illinois customers due to its substantial nexus. According to the taxpayer, the prima facie correctness of the corrected returns attaches only to the amount of liability, not the application of the Act to the taxpayer. That is, the taxpayer contends that the Department has the burden of proving that the taxpayer had presence in Illinois sufficient to subject it to the Use Tax Act. Only then can the corrected return be deemed prima facie evidence of the correctness of the amount of tax due.

This argument is logically unsound. The facts in evidence are certainly sufficient to support the issuance of a Notice of Tax Liability; i.e., the taxpayer admittedly made sales to Illinois residents, made deliveries of the tangible personal property to Illinois using its own trucks, and performed installation and repair services in Illinois. The prima facie correctness of the corrected returns assumes the application of the Use Tax Act to the taxpayer. It is the taxpayer who has control over its own books and records. These documents would presumably indicate the degree to which the taxpayer operated in Illinois. Furthermore, it is well settled law in Illinois that in order to overcome the presumption of validity accorded a corrected return, a taxpayer must produce competent evidence, identified with its books and records, showing that the Department's return is

incorrect. (Masini v. Department of Revenue, 60 Ill.App. 3d 11 (1st Dist. 1978). Oral testimony alone is insufficient to overcome the prima facie correctness accorded the corrected return. (A.R. Barnes and Co. v. Department of Revenue, 173 Ill.App.3d 826 (1st Dist. 1988). Herein, it is the taxpayer's burden to prove with its books and records that the degree of its presence in Illinois was so diminimus as to result in a lack of nexus with this State. This the taxpayer failed to do.

Certainly, as the case stands, the application of the substantial nexus rule set forth in Orvis, *supra*, and adopted by the court in Brown's Furniture, *supra*, results in the determination that the taxpayer had sufficient presence in the State of Illinois to subject it to Use Tax collection obligations. The taxpayer argues that in the case of Brown's Furniture, *supra*, the Illinois Supreme Court relied upon a reciprocal Missouri law requiring the collection of tax by out-of-state vendors selling to Missouri residents as its basis for determining that Brown's Furniture was obligated to collect Illinois Use Tax. I concur with the Department that that the Brown's Furniture court did not base its holding upon the reciprocal Missouri statute, but rather, upon the fact that Brown's Furniture had substantial nexus with Illinois.

The taxpayer herein also posits the argument that based upon fundamental fairness this case should be decided upon the circuit court's determination in Brown's Furniture which held in favor of that taxpayer. At the time of the audit, the circuit court was the only Illinois court to rule regarding an Indiana taxpayer's obligation to collect Illinois Use Tax. Due to the confusion that the lower court decision generated as to the application of the law to certain taxpayers, and because that ruling supports the taxpayer's

belief that it was not obligated to collect Use Tax, the lower court decision in favor of the taxpayer should be applicable herein, according to the taxpayer.

There is no evidence of record that the taxpayer either knew about or relied upon the circuit court's decision in Brown's Furniture. Even if the taxpayer had relied on that decision, it would not be entitled to an abatement of tax as that decision is not the law in Illinois. Rather, any taxpayer's reliance on this lower court decision might be considered for penalty relief, only. However, this was not raised as an issue, herein. The corrected returns, therefore, remain unrebutted.

RECOMMENDATION:

Based upon the foregoing, the Notices of Tax Liability at issue herein are affirmed in their entirety.

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Administrative Law Judge