

UT 11-16

Tax Type: Use Tax

Issue: Medicines & Medical Appliance Exemption (Low Rate)

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

THE DEPARTMENT OF REVENUE)	Docket No.	XXXXX
OF THE STATE OF ILLINOIS)	Reg. No.	XXXXX
)	NTL No.	XXXXX
ABC BUSINESS,)	John E. White,	
Taxpayer)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: John Argoudelis, Law Offices of John Argoudelis LLC, appeared for ABC Business; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose when ABC Business (Taxpayer) protested a Notice of Tax Liability (NTL) the Illinois Department of Revenue (Department) issued to it following an audit of Taxpayer's business. The primary issue involves the Department's determination that Taxpayer's returns improperly reported its sales and use of certain items of tangible personal property as being subject to tax at the low statutory rate of 1%, because they were medical appliances, instead of at the higher statutory rate.

The hearing was held at the Department's Office of Administrative Hearings in Chicago. Taxpayer offered documents into evidence, as well as the testimony of one of its officers, John Doe. After considering the evidence adduced at hearing, I am including in this recommendation findings of fact and conclusions of law. I recommend the NTL be revised to eliminate the tax attributable to certain types of property that Taxpayer established were medical appliances, to abate the late payment penalties assessed, and that it thereafter be finalized as so revised.

Findings of Fact:

1. The Department conducted an audit of Taxpayer for the period from January 2006 through March 2008. Department Ex. 2 (copy of report titled, Audit Narrative), p. 1. James Skrna (Skrna) conducted the audit. *Id.*
2. During the audit period, Taxpayer conducted business as a retailer and construction contractor. Department Ex. 2, p. 1. John Doe (John Doe) was an officer of Taxpayer. Department Ex. 2, p. 8; Hearing Transcript (Tr.), 31-32 (John Doe). Taxpayer ceased doing business in December 2008. Department Ex. 2, p. 2.
3. John Doe is a medical doctor who, prior to a 1996 auto accident that rendered him a paraplegic, practiced as a podiatrist in Illinois. Tr. p. 32 (John Doe).
4. Approximately 96% of Taxpayer's gross receipts were realized from its sales as a construction contractor, and 4% from its sales at retail. Department Ex. 2, p. 7.
5. The Department concluded its audit after Taxpayer ceased doing business. Department Ex. 1, pp. 2-3 (copies of, respectively, the Department's Correction of Returns form (dated January 22, 2010), and the NTL).
6. Skrna's audit narrative provides as follows:

B. AUDIT TAX LIABILITY – BACKGROUND INFORMATION

The tax liability assessed in this audit results from medical appliances that were sold over-the-counter at retail at the low rate instead of the correct high rate. *** The liability found in the Consumable Supplies portion of the audit relates to medical equipment and building materials installed at the customer's home. (described as "Job Materials") ***

The following list of medical equipment was assessed at the high rate of tax in the audit. The Taxpayer disagreed with this assessment.

1. Ceiling Lifts
2. Wheel Chair Inclined Lifts
3. Lift Chairs
4. Stair Lifts

- 5. Vertical Platform Lifts
- 6. Hoyer/Floor Transfer Lifts w/sling

The Regulations state that a medical appliance is defined as an item which is intended by the manufacturer for use in directly substituting for a malfunctioning part of the body. See 86 Ill. Adm. Code 130.310(c).

X. AUDIT RESULTS

Total liability is as follows:

<u>TAX TYPE</u>	<u>TOTAL</u>
ROT	\$2,245
UT	23,320
PENALTIES	5,156
INTEREST	3,777
TOTAL	\$34,498

Department Ex. 2, pp. 5, 9.

- 7. Although only six types of property are identified in Skrna's audit narrative report (Department Ex. 2, p. 5), Skrna also prepared a schedule on which he listed all of the items Taxpayer sold at retail, and/or transferred to customers as an incident of selling services as a construction contractor, and which Taxpayer considered to be medical appliances. Taxpayer Ex. 2 (copy of Skrna's audit schedule).
- 8. The six types of property that Skrna identified in his audit narrative report are also included within Skrna's schedule, which was admitted as Taxpayer Exhibit 2. *Compare* Department Ex. 2, p. 5 *with* Taxpayer Ex. 2. In his schedule, Skrna noted that those six types of property were taxable at the high rate. Taxpayer Ex. 2; *see also* Department Ex. 2, p. 5.
- 9. In the schedule admitted as Taxpayer Exhibit 2, Skrna listed twenty-three different items, and then noted whether each specific item was taxable at either the high or low rate. Taxpayer Ex. 2. Skrna determined that all but six types of items listed on his audit schedule (Taxpayer

Exhibit 2) were subject to tax at the rate of 6.25%. *Id.* The only types of property Skrna determined were subject to tax at the low rate of 1% were: crutches, canes, scooters, walkers, wheelchair cushions, and slings. *Id.*

10. Skrna noted and gave Taxpayer credit for the 1%, or low rate, of retailers' occupation tax Taxpayer charged to customers when it made over-the-counter sales of property Taxpayer treated as medical appliances. Department Ex. 2, p. 7. He also noted, and gave Taxpayer credit for, the 1% use tax rate Taxpayer self assessed and reported when it installed such property at customer's homes. *Id.*

11. John Doe described the function of each of the six items listed in Skrna's audit narrative report, in summary, but not verbatim, as follows:

- A ceiling lift is a battery powered crane that is affixed to a ceiling near a bed or a bath. Tr. pp. 44-45. The component parts include the lifting mechanism and a track, along which a metal bar (that extends downward from the ceiling) may be moved. The bottom of the bar holds a sling that is wrapped around a person whose legs, or whose legs and arms, are not functioning. The crane then lifts the sling, and the person, to allow the person to move, or be moved, from a wheelchair or other device into and out of the bed and/or bath. Tr. pp. 44-45.
- A Hoyer lift performs the same purpose and function as a ceiling lift, except it is a free standing unit that moves on four wheels. Tr. p. 45. That is, it allows person whose legs (or whose legs and arms) are not functioning to move, or be moved, from a wheelchair or other device into and out of the bed and/or bath. *Id.*
- A wheelchair inclined lift is a mechanical device consisting of a track that is attached to one side of a stairway and along which a moveable platform may be raised or lowered.

The platform folds down to allow a wheelchair to be placed on it. It allows a person in a wheelchair, whose legs (or whose legs and arms) are not functioning, to move from one floor of a home to another. Tr. pp. 49-50.

- A lift chair is a chair with motors that work to lift the seat of the chair so as to allow a person whose legs (or whose legs and arms) do not function well enough to allow the person to stand up from a seated position. Tr. pp. 50-53.
- A stair lift is similar to the wheelchair inclined lift. Tr. pp. 53-54. That is, it consists of a track that is attached to one side of a stairway and along which a chair or stool is raised or lowered. It allows a person with limited mobility, but whose legs, or legs and arms, do not function well enough to allow the person to climb a set of stairs, to move from one floor of a home to another. *Id.*
- A platform lift is a small outdoor elevator. Tr. pp. 54-55. It is used where the physical structure of a wheelchair-bound person's home does not allow him to use ramps to get from the sidewalk, or street-level, into his home. *Id.* It allows a person whose legs do not function, or do not function well enough to get out of a wheelchair or to climb stairs, to move from the sidewalk into a higher floor of a building. *Id.*

12. The Department determined that Taxpayer's sales or transfers of slings, which are used with the ceiling and Hoyer lifts that Taxpayer sold and/or installed, should be taxed at the low rate. Taxpayer Ex. 2; Tr. pp. 45-48 (John Doe).

13. But for the six types of property Skrna identified in his audit narrative report (Department Ex. 2, p. 5), Taxpayer did not offer evidence sufficient to establish that the items of property that Taxpayer sold or used, and which Skrna determined were taxable at the high rate (Taxpayer Ex. 2), were medical appliances. *See* Tr. *passim*.

Conclusions of Law:

This matter involves the Department's assessment of both retailers' occupation tax (ROT) and use tax (UT) to Taxpayer. Department Exs. 1-2. Section 4 of the Retailers' Occupation Tax Act (ROTA) authorizes the Department to examine a taxpayer's returns and, if necessary, to correct such returns according to its best information and information. 35 ILCS 120/4. Section 12 of the Use Tax Act (UTA) incorporates several sections of the complementary ROTA, including ROTA § 4. 35 ILCS 105/12. Section 4 of the ROTA further provides that, "In the event that [a taxpayer's] return is corrected for any reason other than a mathematical error, any return so corrected 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 therein." 35 ILCS 120/4.

The Department introduced a copy of the correction of Taxpayer's returns and a copy of the NTL into evidence under the certificate of the Director. Department Ex. 1. Pursuant to ROTA § 4, those documents constitute the Department's prima facie case in this matter. 35 ILCS 120/4; 35 ILCS 105/12. The Department's prima facie case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968). A taxpayer cannot overcome the statutory presumption merely by denying the accuracy of the Department's assessment. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833, 527 N.E.2d 1048, 1053 (1st Dist. 1988). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217, 577 N.E.2d 1278, 1287 (1st Dist. 1991).

During the audit period, ROTA § 2-10 provided, in pertinent part:

Rate of tax. Unless otherwise provided in this Section, the tax imposed by this Act is at the rate of 6.25% of gross receipts from sales of tangible personal property made in the course of business.

With respect to ... medical appliances ... for human use, the tax is imposed at the rate of 1%. ***

35 ILCS 105/2a.

The Illinois General Assembly did not define the phrase medical appliance in either the ROTA or the UTA, but the Department has, in a regulation that, during the audit period, provided as follows:

Section 130.310 Food, Drugs, Medicines and Medical Appliances

c) Medicines and Medical Appliances

2) A medical appliance is an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the human body. These items may be prescribed by licensed health care professionals for use by a patient, purchased by health care professionals for the use of patients, or purchased directly by individuals. Purchases of medical appliances by lessors that will be leased to others for human use also qualify for the exemption. Included in the exemption as medical appliances are such items as artificial limbs, dental prostheses and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines (including the dialyzer). Corrective medical appliances such as hearing aids, eyeglasses and contact lenses qualify for exemption. Diagnostic equipment shall not be deemed to be a medical appliance, except as provided in Section 130.310(d). Other medical tools, devices and equipment such as x-ray machines, laboratory equipment, and surgical instruments that may be used in the treatment of patients but that do not directly substitute for a malfunctioning part of the human body do not qualify as exempt medical appliances. Sometimes a kit of items is sold so the purchaser can use the kit items to perform treatment upon himself or herself. The kit will contain paraphernalia and sometimes medicines. An example is a kit sold for the removal of ear wax. Because the paraphernalia hardware is for treatment, it generally does not qualify as a medical appliance. However, the Department will consider the selling price of the entire kit to be taxable at the reduced rate when the value of the medicines in the kit is more than half of the total selling price of the kit.

3) Supplies, such as non-sterile cotton swabs, disposable diapers, toilet paper, tissues, towelettes, and cosmetics such as lipsticks, perfume and

hair tonics do not qualify for the reduced rate. Sterile dressings, bandages and gauze do qualify for the reduced rate. Diapers for incontinent adults, as well as undergarments for incontinent adults, qualify for the low rate of tax.

86 Ill. Admin. Code § 130.310 (2008). The Department made non-substantive changes to § 130.310(c) during the audit period. 31 Ill. Reg. 14091-92, 14106-07 (issue 40) (October 7, 2007).

Effective in 2010, the Department revised § 130.310 from one that addressed food, drugs, and medical appliances to one that addressed only the types of property that would (or would not) be considered food subject to tax at the low rate. 34 Ill. Reg. 12935, 12946-71 (issue 36) (September 3, 2010) (effective August 19, 2010). It removed the medicine and medical appliance subsections that were previously included within § 130.310, and substantially rewrote those subsections within a newly numbered regulation, § 130.311, bearing the heading, “Drugs, Medicines, Medical Appliances and Grooming and Hygiene Products”. 86 Ill. Admin. Code § 130.311 (2010); 34 Ill. Reg. 12963-71.

At hearing, Department counsel argued that new § 130.311 applies to this matter (Tr. pp. 80-81), whereas Taxpayer argued that former § 130.310(c)(2) should apply. Tr. pp. 69-72, 76. In Allegis Realty Investors v. Novak, 223 Ill. 2d 318, 860 N.E.2d 246 (2006), the Illinois Supreme Court provided a clear guide to follow when considering whether an amendment to a statute should be applied prospectively or retroactively. And since the rules for construing statutes is the same for construing administrative regulations (Heifner v. Board of Ed. of Morris Community High School Dist. No. 101, 32 Ill. App. 3d 83, 87, 335 N.E.2d 600, 603 (3d Dist. 1975)), the Allegis guidelines apply here. Specifically, the Allegis Court held:

*** In assessing whether a statute applies retroactively, this court has adopted the approach set forth by the United States Supreme Court in *Landgraf v. USI Film Products*, 511 U.S. 244, 114 S.Ct. 1483, 128 L.Ed.2d 229 (1994). *Commonwealth Edison Co. v. Will County Collector*, 196 Ill. 2d 27, 37-39, 255 Ill.Dec. 482, 749 N.E.2d 964 (2001). The *Landgraf* analysis

consists of two steps. First, if the legislature has expressly prescribed the statute's temporal reach, the expression of legislative intent must be given effect absent a constitutional prohibition. Second, if the statute contains no express provision regarding its temporal reach, the court must determine whether the new statute would have retroactive effect, keeping in mind the general principle that prospectivity is the appropriate default rule. ***

After adopting the *Landgraf* framework, our court considered the effect of section 4 of the Statute on Statutes (5 ILCS 70/4 (West 1998)) on our retroactivity analysis. ***

Our court has recognized section 4 as a clear legislative directive as to the temporal reach of statutory amendments and repeals when none is otherwise specified: those that are procedural may be applied retroactively, while those that are substantive may not. *Caveney v. Bower*, 207 Ill. 2d 82, 92, 278 Ill.Dec. 1, 797 N.E.2d 596 (2003). This principle applies to civil as well as criminal enactments. *Caveney v. Bower*, 207 Ill. 2d at 92-93, 278 Ill.Dec. 1, 797 N.E.2d 596. In light of the statute, we have held that an Illinois court need never go beyond step one of the *Landgraf* test. *People v. Atkins*, 217 Ill. 2d 66, 71, 298 Ill.Dec. 50, 838 N.E.2d 943 (2005). That is because the legislature will always have clearly indicated the temporal reach of an amended statute, either expressly in the new legislative enactment or by default in section 4 of the Statute on Statutes. *Caveney v. Bower*, 207 Ill. 2d at 95, 278 Ill.Dec. 1, 797 N.E.2d 596.

Because it is a *default* standard, section 4 of the Statute on Statutes is inapplicable to situations where the legislature has clearly indicated the temporal reach of a statutory amendment. Whenever a court is called upon to assess the applicability of a statutory change, the court must therefore still make an initial determination as to whether the legislature has clearly indicated the amended statute's temporal reach. If it has, there is no need to invoke section 4 of the Statute on Statutes. Rather, in accordance with *Landgraf*, the expression of legislative intent must be given effect absent constitutional prohibition. *Caveney v. Bower*, 207 Ill. 2d at 94, 278 Ill.Dec. 1, 797 N.E.2d 596.

Allegis Realty Investors, 223 Ill. 2d at 330-32, 860 N.E.2d at 252-53 (emphasis original).

No text within § 130.311 contains the Department's clear expression of the temporal reach of that newly amended regulation. 86 Ill. Admin. Code § 130.311 (2010). Since it does not, the intent must be inferred from § 4 of Illinois' Statute on Statutes. Allegis Realty Investors, 223 Ill. 2d at 331-32, 860 N.E.2d at 253.

Additionally, new § 130.311 made a substantive change to the Department's definition of a medical appliance. During the audit period, § 130.310(c)(2) provided that, "A medical appliance is an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the human body." 86 Ill. Admin. Code § 130.310(c)(2) (2008). In new § 130.311, the definition was changed to, "A medical appliance is an item that is used to directly substitute for a malfunctioning part of the human body." 86 Ill. Admin. Code § 130.311(d) (2010). Thus, the new regulatory definition makes the manufacturer's intent irrelevant to an issue of whether a manufactured item is used to directly substitute for a malfunctioning part of the body. Further, new § 130.311 removes specific items of tangible personal property from the list of items that the Department had previously said were subject to tax at the low rate. *Compare* 86 Ill. Admin. Code § 130.310(c)(2)-(3) (2008) (lip balms and adult diapers classified as products subject to the lower, 1%, tax rate) *with* 86 Ill. Admin. Code § 130.311(c)(2)(G), (P) (2010) (lip balms and adult diapers classified as hygiene products subject to tax at the rate of 6.25%) *and* 86 Ill. Admin. Code § 130.311(d) (2010) (lip balms and adult diapers removed from products classified as medical appliances or supplies). Assuming, as I must, that the Department's changes were reasonable (Springwood Assoc. v. Lumpkin, 239 Ill. App. 3d 771, 606 N.E.2d 733 (4th Dist. 1992) ("The actions of an administrative agency are presumed to be correct unless evidence is introduced to the contrary.")), it is clear that by changing the regulatory text, the Department changed the law regarding the property that is included within the class of medical appliances that are taxable at 1%. Department of Corrections v. Illinois Civil Service Commission, 187 Ill. App. 3d 304, 308, 543 N.E.2d 190, 194 (1st Dist. 1989) ("Rules adopted by an administrative agency pursuant to statutory authority have the force of law and the administrative agency is bound by the rules."). Courts have recognized the Department's power

to do so, where the Department exercises its rulemaking authority consistent with legislative intent. *See, e.g., Travenol Laboratories, Inc. v. Johnson*, 195 Ill.App.3d 532, 553 N.E.2d 14 (1st Dist. 1990) (invalidating a 1985 amendment to § 130.310, which disqualified medical appliances used by health care professionals from the reduced rate of tax, because it was inconsistent with ROTA § 2-10).

Since the Department did not express the temporal reach of new § 130.311 within the text of the new regulation itself, and since the amended text made substantive changes to the old regulation, the new regulation should be given prospective application only. *Allegis Realty Investors*, 223 Ill. 2d at 330-31, 860 N.E.2d at 253. New § 130.311 was not in effect during the audit period (86 Ill. Admin. Code § 130.311; 34 Ill. Reg. 12963-71), and it is not applicable to this dispute. *Allegis Realty Investors*, 223 Ill. 2d at 330-31, 860 N.E.2d at 253.

Taxpayer argues that the items at issue were intended for use in directly substituting for a malfunctioning part of the human body. Tr. pp. 69-72 (closing argument). Taxpayer also asserted that the regulatory definition of a medical appliance cannot be given a strict construction, since the different items the Department expressly included within the class of medical appliances do not necessarily directly substitute for a malfunctioning part of the human body. Specifically, Taxpayer reasoned that a wheelchair is not a prosthetic or brace, yet the Department expressly included wheelchairs within the class of items considered to be a medical appliance. Tr. pp. 73-74. Taxpayer contends that each of the items at issue is like a wheelchair, in that it helps a person whose legs are not functioning get into and out of bed, or into and out of a shower, or into and out of a chair. *Id.* at 74. In each case, the item directly substitutes for the person's malfunctioning body parts. *Id.*

The Department responded that Taxpayer did not offer any evidence of the intent of any of the entities that manufactured the items at issue. Tr. pp. 80-81. The Department also argued that some of the types of property described in Skrna's audit narrative do not directly substitute for a malfunctioning body part. Tr. p. 82.

With regard to the Department's first argument, however, this is not a case in which there is some fact dispute over the intended use of the property at issue. The Department has not challenged Dr. John Doe's medical training, or why his description of the intended uses of the six types of property referred to in Skrna's audit narrative should be considered incompetent or inadequate. Dr. John Doe's training and knowledge are reasonably related to Taxpayers' business of identifying and guiding customers toward specific devices that would be appropriate for a customer's unique needs. *See* Department Ex. 2, p. 2 ([Taxpayer] concentrated in selling and installing products for the disabled and elderly community"). Neither Skrna nor Department counsel disputed the use to which Taxpayer, or its customers, put the six types of property at issue. Instead, both Skrna and the Department determined that they did not constitute medical appliances. Department Ex. 1; Department Ex. 2, pp. 5, 9. I had the opportunity to observe Dr. John Doe while testifying, and his testimony was clear, measured and credible. Dr. John Doe's specialized knowledge as a physician, his personal knowledge of the nature of a paraplegic's disabilities, and of the functions of the six types of property described in Skrna's audit narrative, made his testimony regarding the intended use of such property uniquely competent.

After considering the credible, competent evidence admitted at hearing, I agree with Taxpayer's arguments that the six types of property described in Skrna's audit narrative were medical appliances. 86 Ill. Admin. Code § 130.310(c)(2) (2008). That the Department expressly included a wheelchair within the class of medical appliances means that the Department

considered a wheelchair to be property “intended by its manufacturer for use in directly substituting for a malfunctioning part of the human body.” *See id.* A non-powered wheelchair allows a person whose legs do not function, or do not function well enough, to be mobile without the use of the person’s legs. A powered wheelchair allows a person to be mobile even though his arms and legs do not function, or do not function well enough to move without the wheelchair.

But functioning arms and legs do more than just enable a person to move along a straight plane or path. Functioning legs also allow people to climb up and down stairs, to climb into and out of a bed or shower or bathtub, to bend downward to sit down, and to stand from a sitting position. Each of the six types of property is intended to be used by persons with malfunctioning body parts. Those six types of property allow such persons to perform the regular, essential movements that functioning body parts would allow them to perform. Each such item supports and moves a person with malfunctioning body parts — as does a wheelchair — while the item is in direct contact with the person. The six types of property at issue perform the same function as a wheelchair does, by directly supporting and moving a person with malfunctioning body parts in ways that are slightly different from yet still analogous to the support and mobility provided by a wheelchair.

The express text of the applicable regulation provides that, “[i]ncluded in the exemption as medical appliances are such items as artificial limbs, dental prostheses and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines (including the dialyzer).” 86 Ill. Admin Code § 130.310(c)(2) (2008). By placing the exact words in a slightly different order, that sentence means that items such as artificial limbs, dental prostheses and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines (including the dialyzer) are included in the exemption as medical appliances.

See id. Taxpayer has persuaded that the six types of property specified in Skrna’s audit narrative are, by their function, items “such ... as ... wheelchairs ...”, and therefore should be “[i]ncluded in the exemption as medical appliances.” *Id.* Finally, none of the six types of property function to diagnose or treat, which types of property are excluded from the regulatory definition of a medical appliance. *E.g.*, North Shore MRI Centre v. Illinois Department of Revenue, 309 Ill. App. 3d 895, 723 N.E.2d 726 (1st Dist. 1999); 86 Ill. Admin Code § 130.310(c)(2) (2008).

In the parties’ pre-hearing order, the issue was identified as follows: “The parties agree that the issue to be decided at hearing is whether the sale at retail of certain items of tangible personal property qualify for application of the low-rate of tax as medical appliances pursuant to 35 ILCS 120/2-10.” Pre-hearing Order. Based on the documentary evidence admitted at hearing, and Dr. John Doe’s competent, credible testimony, Taxpayer has borne its burden of showing that the six types of property identified in Skrna’s audit narrative qualify for the low rate of tax. Taxpayer did not, however, show that the other items that are listed within Skrna’s audit schedule (Taxpayer Exhibit 2) qualify for the low rate of tax. These types of property include, for example, grab bars, hospital beds, ramps, etc. Taxpayer Ex. 2. Taxpayer has offered no competent, credible evidence showing that such items are intended to directly substitute for a malfunctioning body part. 86 Ill. Admin Code § 130.310(c)(2) (2008). Thus, the NTL should be revised to eliminate the amount of ROT assessed that is attributable to the six types of property that are specified in Skrna’s audit narrative, and that Taxpayer sold, over-the-counter, at retail. Similarly, the NTL should be revised to eliminate the amount of UT assessed on Taxpayer’s cost price of such six types of property, which it transferred to customers as an incident of performing services as a construction contractor. *See* Sinclair Refining Co. v. Department of Revenue, 50 Ill. 2d 201, 207-09, 277 N.E.2d 858, 861-62 (1971).

The record also supports a determination that Taxpayer exercised good faith and ordinary business care and prudence when timely filing its monthly returns during the months at issue, and when attempting to properly determine and timely pay the correct amount of tax due. 86 Ill. Admin. Code § 700.400(b)-(c). This conclusion is based, in part, on the fact that Taxpayer has supported its claim that certain items of property that it sold or used should be included within the definition of medical appliances. *See* Pre-hearing Order. Further, Skrna's audit narrative reflects that Taxpayer kept complete books and records, and timely filed its returns throughout the audit period, and timely paid the amounts of tax shown due on its returns. Department Ex. 2, pp. 2-4; 86 Ill. Admin Code § 700.400(d).

Under the circumstances, moreover, I am unable to conclude that John Doe's determination of the correct amount of tax due, even though mistaken regarding other types of property, was not made in good faith. 86 Ill. Admin Code § 700.400(b)-(c). The phrase medical appliance is not defined by statute, and the Department's regulatory definition does not provide an exhaustive list of property that is either included within, or excluded from, the class of property described as being medical appliances. 86 Ill. Admin Code § 130.310(c)(2) (2008). Further, the property at issue does not come within the regulation's description of the types of property that are excluded from the class of medical appliances. *See id.* Finally, the applicable regulation has gone through substantive and other changes before (North Shore MRI Centre, 309 Ill. App. 3d at 898-99, 723 N.E.2d at 729 (referring, in 1999, to the Department's 1992 amendment to § 130.310(c)(2)), during (31 Ill. Reg. 14091-92, 14106-07 (issue 40) (October 7, 2007)), and after the audit period. 34 Ill. Reg. 12935, 12946-71 (issue 36) (September 3, 2010) (effective August 19, 2010). Based on this record, I recommend that the late payment penalties assessed on the NTL be abated.

Conclusion:

For all of the foregoing reasons, I recommend the Director revise the NTL to eliminate the amount of tax that is attributable to the six types of property identified in Skrna's audit narrative report. I recommend that the NTL be further revised to abate the late payment penalty assessed. Finally, I recommend that the NTL be finalized as so revised, with interest to accrue pursuant to statute.

September 20, 2011

John E. White
Administrative Law Judge