

IT 12-08

Tax Type: Income Tax

Tax Issue: Replacement Tax Investment Credit/Property Used In Retailing

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

ANY BUSINESS, INC. & SUBSIDIARIES,)	Docket No.	XXXXXX
Taxpayer)	Tax Years	XXXXXX
v.)		
THE DEPARTMENT OF REVENUE)	John E. White,	
OF THE STATE OF ILLINOIS)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: John Doe appeared for Any Business, Inc. & Subsidiaries; Rickey Walton, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis: This matter involves amended returns/claims for refund that Any Business, Inc. & Subsidiaries (Taxpayer) filed to request refunds of Illinois replacement income tax claimed to have been paid in error regarding tax years ending (TYE) February 2000 through February 2003. Taxpayer's requests for refund are based on amounts it claims were eligible for Illinois replacement tax investment credits (RTIC) for the years at issue, which would have reduced its Illinois replacement tax liabilities for those tax years. The Department denied portions of Taxpayer's amended returns, and Taxpayer protested those denials.

In lieu of hearing, the parties submitted a stipulated record, which included the parties' Joint Stipulation of Facts (Stip.) and Joint Stipulation of Documents. The parties stipulate that the only issue is one of law, which is whether the statutory definition of retailing set forth in § 201(e)(1) of the Illinois Income Tax Act (IITA) includes "wholesale sales" or "sales for resale." If so, the parties stipulate that Any Business, Inc. is primarily engaged in retailing and is entitled

to the RTIC claimed on its 2002 Return and its Amended Returns. If not, the parties agree that Any Business, Inc. is not primarily engaged in retailing and would not be entitled to the RTIC claimed on its 2002 Return and its Amended Returns.

After considering the stipulated record and the parties' arguments, I am including in the recommendation findings of fact and conclusions of law. Based on the plain text of Illinois Income Tax regulation (IITR) § 100.2101, recommend that the legal issue be resolved in favor of the Department.

Stipulated Facts:

1. This case concerns the replacement tax investment credit Any Business, Inc. claimed on its combined Illinois Corporate Income and Replacement Tax Returns for investments made by eligible taxpayer members of its unitary group in "qualified property" which was placed in service in Illinois during Any Business, Inc.'s fiscal years ending February 26, 2000 through February 22, 2003. Stip. ¶ 1.
2. Any Business, Inc. is one of the largest companies in the United States grocery channel. Stip. ¶ 2.
3. Any Business, Inc. conducts its retail grocery operations under three principal store formats: extreme value food stores under the retail banner Any Business1; Blue superstores, under such retail banners as Any Business2, Any Business3, Any Business4, Any Business5; and supermarkets, under such retail banners as Any Business6, Any Business7 and Any Business8. Stip. ¶ 3.
4. Additionally, Any Business, Inc. provides supply chain services, primarily wholesale distribution, across the United States retail grocery channel. Stip. ¶ 4.

Facts Re: Any Business, Inc.'s Retail Food Operations

5. **Extreme Value Food Stores.** Any Business, Inc. operates extreme value food stores under the banner “Any Business1.” Stip. ¶ 5. Through this banner, Any Business, Inc. holds the number one market position in the extreme value grocery retailing sector. *Id.* Any Business1 stores typically are approximately 14,000 square feet in size, and stock approximately 1,250 high volume items that focus on a single size for each product sold. *Id.*
6. **Blue Superstores.** Any Business, Inc.'s Blue superstores hold the number one, two or three market position in most of their respective markets. Stip. ¶ 6. The Blue superstore focus is on providing everyday low Blues and product selection across all departments. *Id.* Most of Any Business, Inc.'s Blue superstores offer traditional dry grocery departments, along with strong perishable departments. In-store pharmacies are also operated in 187 locations. *Id.* Blue superstores carry over 30,000 items and generally range in size from 45,000 to 100,000 square feet with an average size of approximately 63,000 square feet. *Id.*
7. **Supermarkets.** Any Business, Inc.'s traditional supermarket format combines a grocery store that has a variety of specialty departments that may include floral, seafood, expanded health and beauty care, video rental, cosmetics, photo finishing, delicatessen, bakery, in-store bank, and a traditional drug store that includes a pharmacy. Stip. ¶ 7. The supermarket format offers traditional dry grocery departments along with strong fresh food departments. *Id.* A typical supermarket carries approximately 40,000 items and generally ranges in size from 30,000 to 65,000 square feet with an average size of approximately 50,000 square feet. *Id.*

Facts Re: Any Business, Inc.'s Food Distribution Operations

8. Any Business, Inc. also provides logistics and service solutions to retailers for food and non-food products. Stip. ¶ 8. Any Business, Inc.'s customers include single and multiple independent grocery store operators, regional and national chains, as well as mass merchants and the military. *Id.*
9. **Products Supplied.** Any Business, Inc. offers and supplies its distribution customers with a wide variety and selection of food and non-food products, including groceries, meats, dairy products, frozen foods, fresh fruits and vegetables, health and beauty aids, general merchandise, seasonal items and tobacco products. Stip. ¶ 9. Such products include national and regional brands and the company's own lines of private label products. *Id.*
10. **Logistics Network.** Any Business, Inc. has established a network of strategically located distribution centers utilizing a multi-tiered logistics system. Stip. ¶ 10. The network includes facilities that carry slow turn or fast turn groceries, perishables, general merchandise and health and beauty care products. *Id.* The network is comprised of 30 wholesale distribution facilities. *Id.* Deliveries to retail stores are made from Any Business, Inc.'s distribution centers by company-owned trucks, third party independent trucking companies or customer-owned trucks. *Id.* In addition, many types of meats, dairy products, bakery and other products purchased from the company are delivered directly by suppliers to retail stores under programs established by Any Business, Inc.. *Id.*
11. **Services Supplied.** In addition to supplying merchandise, Any Business, Inc. also offers its food distribution customers a wide variety of support services, including procurement, category management, promotional programs, internet marketing solutions, store management assistance, accounting, store design and construction, site selection, strategic and business planning, consumer and market research, and personnel training. Stip. ¶ 11. Certain Any Business, Inc. subsidiaries operate as insurance agencies and provide comprehensive insurance programs to the company's food distribution customers. *Id.*

Facts Re: Returns In Issue/Audit Adjustments

12. Any Business, Inc. filed an original combined unitary Illinois Corporation Income and Replacement Tax Return for TYE February 2000 (2000 Return) that included all of its subsidiaries, except for Yellow Holdings, Inc. (Yellow), Green Bakeries (Green), Orange Finance Company (Orange) and Any Business, Inc. Transportation (Transportation). Stip. ¶ 12.
13. Any Business, Inc. did not claim any RTIC on its 2000 Return. Stip. ¶ 13.
14. Any Business, Inc. filed an original combined unitary Illinois Corporation Income and Replacement Tax Return for TYE February 2001 (2001 Return) that included all of its subsidiaries, except for Yellow, Orange and Transportation. Stip. ¶ 14.
15. Any Business, Inc. did not claim any RTIC on its 2001 Return. Stip. ¶ 15.
16. Any Business, Inc. filed an original combined unitary Illinois Corporation Income and Replacement Tax Return for TYE February 2002 (2002 Return) that included all of its subsidiaries, except for Yellow, Orange and Transportation. Stip. ¶ 16.
17. Any Business, Inc. claimed an RTIC on its 2002 Return in the amount of \$186,049.98. Stip. ¶ 17.
18. Any Business, Inc. filed an original combined unitary Illinois Corporation Income and Replacement Tax Return for TYE February 2003 (2003 Return) that included all of its subsidiaries, except for Yellow, Orange and Transportation. Stip. ¶ 18.
19. Any Business, Inc. did not claim any RTIC on its 2003 Return. Stip. ¶ 19.
20. Orange filed separate Illinois Corporation Income and Replacement Tax Returns as a financial organization for each of the Tax Years at Issue apportioning its business income as provided for in 35 ILCS 5/304(c). Stip. ¶ 20.
21. Transportation filed separate Illinois Corporation Income and Replacement Tax Returns as a transportation company for each of the Tax Years at Issue apportioning its business income as provided for in 35 ILCS 5/304(d). Stip. ¶ 21.

22. For TYE February 2000, Green filed an Illinois Corporation Income and Replacement Tax Return to report its business activities through May 22, 1999, the date on which Any Business, Inc. sold Green to Pillsbury Company. Stip. ¶ 22.

23. Any Business, Inc. timely filed amended, combined Illinois Corporation Income and Replacement Tax Returns for each of its 2000 (2000 Amended Return), 2001 (2001 Amended Return) and 2003 (2003 Amended Return) tax years (the 2000 Amended Return, 2001 Amended Return and 2003 Amended Return sometimes collectively referred to as the Amended Returns) claiming an RTIC and seeking refunds of replacement tax previously paid in the following amounts:

<u>Tax Year</u>	<u>Refund Sought</u>
February 2000	\$ 275,328
February 2001	\$ 489,816
February 2003	\$ 453,368
TOTAL	\$1,218,512

Stip. ¶ 23.

24. During its audit of Any Business, Inc., the Department determined that Orange derived the majority of its business income from rentals (i.e., operating leases as opposed to financing leases). Stip. ¶ 24. As a result of its determination, the Department included Orange in Any Business, Inc.'s Illinois unitary business group for each of the Tax Years at Issue. *Id.*

25. During its audit of Any Business, Inc., the Department determined that Green was a member of Any Business, Inc.'s unitary business group and included Green in Any Business, Inc.'s Illinois unitary business group for TYE February 2000. Stip. ¶ 25.

26. The Department issued Notices of Claim Denial (Denials) denying the refunds Any Business, Inc. sought on its Amended Returns, and a Notice of Deficiency seeking the tax attributable to the RTIC claimed by Any Business, Inc. on its 2002 Return. Stip. ¶ 26; Stip. Ex. 1 (copy of Denial, dated October 29, 2009, regarding TYE February 2000 and February 2001); Stip. Ex. 2 (copy of Amended Denial, dated December 18, 2009, regarding TYE February 2002 and

February 2003); Stip. Ex. 3 (copy of NOD, dated December 18, 2009, regarding TYE February 2002).

Facts Re: The RTIC Claimed

27. On its 2002 Return and its Amended Returns, Any Business, Inc. reported the following amounts as investments made by eligible taxpayer members of its unitary business group in “qualified property” placed in service in the group’s business operations in Illinois during each of the Tax Years at Issue:

<u>Tax Years</u>	<u>Qualified Investments</u>
2000	\$28,645,730.00
2001	\$57,597,924.89
2002	\$18,604,990.57
2003	\$36,148,774.00

Stip. ¶ 28.

28. The property for which Any Business, Inc. claimed RTIC on its 2002 Return and its Amended Returns:

- a. Was tangible personal property;
- b. Was depreciable property pursuant to Section 167 of the Internal Revenue Code of 1986, as amended (IRC) and was other than 3-year property as defined in IRC Section 168;
- c. Was acquired by purchase as defined in IRC Section 179(d); and
- d. Was not previously used in Illinois in such a manner and by such a person that would otherwise qualify for the credit in 35 ILCS 5/201(e) or (f).

Stip. ¶ 29; Stip. Ex. 4 (copy of Department’s audit worksheet titled, Gross Receipts Test – Illinois Filers).

29. During TYE February 2000:

- a. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to individuals who were considered the ultimate consumers of such tangible

- personal property or services for their use and/or consumption reported gross receipts in the amount of \$1,428,148,771;
- b. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to persons for resale (not to the ultimate consumer) reported gross receipts in the amount of \$13,615,960,819;
 - c. The members of the Any Business, Inc. Illinois unitary business group reported total gross receipts of \$15,044,109,590;
 - d. The sum of gross receipts derived by members of the Any Business, Inc. Illinois unitary business group from the sale of tangible personal property or services rendered in conjunction with the sale of tangible personal property whether to the ultimate consumer of such tangible personal property or services or from the sale of such tangible personal property or services to persons for resale (\$15,044,109,590) represents 100% of the Any Business, Inc. Illinois unitary business group's total gross receipts.

Stip. ¶ 30; Stip. Ex. 4.

30. During TYE February 2001:

- a. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to individuals who were considered the ultimate consumers of such tangible personal property or services for their use and/or consumption reported gross receipts in the amount of \$1,300,869,024;
- b. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to persons for resale (not to the ultimate consumer) reported gross receipts in the amount of \$15,970,993,628;

- c. The members of the Any Business, Inc. Illinois unitary business group reported total gross receipts of \$17,871,710,629;
- d. The sum of gross receipts derived by members of the Any Business, Inc. Illinois unitary business group from the sale of tangible personal property or services rendered in conjunction with the sale of tangible personal property whether to the ultimate consumer of such tangible personal property or services or from the sale of such tangible personal property or services to persons for resale (\$17,271,862,652) represents 96.64% of the Any Business, Inc. Illinois unitary business group's total gross receipts.

Stip. ¶ 31; Stip. Ex. 4.

31. During TYE February 2002:

- a. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to individuals who were considered the ultimate consumers of such tangible personal property or services for their use and/or consumption reported gross receipts in the amount of \$4,229,231,824;
- b. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to persons for resale (not to the ultimate consumer) reported gross receipts in the amount of \$10,408,317,817;
- c. The members of the Any Business, Inc. Illinois unitary business group reported total gross receipts of \$15,159,742,955;
- d. The sum of gross receipts derived by members of the Any Business, Inc. Illinois unitary business group from the sale of tangible personal property or services rendered in conjunction with the sale of tangible personal property whether to the ultimate consumer of such tangible personal property or services or from the sale of such tangible personal

property or services to persons for resale (\$14,637,549,641) represents 96.56% of the Any Business, Inc. Illinois unitary business group's total gross receipts.

Stip. ¶ 32; Stip. Ex. 4.

32. During TYE February 2003:

- a. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to individuals who were considered the ultimate consumers of such tangible personal property or services for their use and/or consumption reported gross receipts in the amount of \$4,541,646,217;
- b. The members of the Any Business, Inc. Illinois unitary business group who sold tangible personal property or services rendered in conjunction with the sale of tangible personal property to persons for resale (not to the ultimate consumer) reported gross receipts in the amount of \$10,477,958,412;
- c. The members of the Any Business, Inc. Illinois unitary business group reported total gross receipts of \$16,446,955,225;
- d. The sum of gross receipts derived by members of the Any Business, Inc. Illinois unitary business group from the sale of tangible personal property or services rendered in conjunction with the sale of tangible personal property whether to the ultimate consumer of such tangible personal property or services or from the sale of such tangible personal property or services to persons for resale (\$15,019,604,629) represents 96.45% of the Any Business, Inc. Illinois unitary business group's total gross receipts.

Stip. ¶ 33; Stip. Ex. 4.

33. On the Form IL-477 attached to its 2001 Amended Return, Any Business, Inc. reported total available RTIC in the amount of \$575,979.26. Stip. ¶ 37; Stip. Ex. 8 (copy of 2001 Amended Return and attachments), pp. 4 (Part I, lines 5, 7), 5. On its 2001 Amended Return, Any Business, Inc. applied \$429,807.26 of its available RTIC against its replacement tax liability.

Stip. ¶ 37; Stip. Ex. 8, pp. 2 (Part IV, line 9), 4. Any Business, Inc. carried forward the remaining \$146,172 of its RTIC to its TYE February 2002. Stip. ¶ 37.

34. On or about December 16, 2002, Any Business, Inc. filed its 2002 Return for TYE February 2002. Stip. ¶ 38; Stip. Ex. 14 (copy of 2002 Amended Return and attachments). On the Form IL-477 attached to its 2002 Return, Any Business, Inc. reported an available RTIC in the amount of \$186,049.98. Stip. Ex. 14, pp. 2 (Part IV, line 10), 4 (Part I, lines 5, 7, 9). Any Business, Inc. claimed \$186,049.98 of its available RTIC against its replacement tax on its 2002 Return. Stip. ¶ 38; Stip. Ex. 14, p. 2.
35. During the audit of Any Business, Inc. for the Tax Years at Issue, the Department determined that certain members of Any Business, Inc.'s Illinois unitary business group were not engaged in retailing (within the meaning of the term “retailing” as set forth in 35 ILCS 5/201(e)(3)), and therefore denied the \$186,049.98 RTIC Any Business, Inc. claimed on its 2002 Return. Stip. ¶ 39; Stip. Ex. 1 (copy of Denial, dated October 29, 2009, regarding TYE February 2000 and February 2001), p. 2 (Statement); Stip. Ex. 2 (copy of Amended Denial, dated December 18, 2009, regarding TYE February 2002 and February 2003), p. 2 (Statement).
36. As a result of the denial of the RTIC Any Business, Inc. claimed on its 2002 Return, the Department determined that Any Business, Inc. underpaid its replacement tax by \$180,705 for the 2002 tax year. Stip. ¶ 40; *see also* Stip. Ex. 2, p. 2. Therefore, on December 18, 2009, the Department issued Any Business, Inc. a Notice of Deficiency (NOD), setting forth a deficiency of \$254,126, consisting of tax in the amount of \$180,705 and interest in the amount of \$73,421, computed through the date of the NOD. *Id.*; Stip. Ex. 3 (copy of NOD).¹
37. Subsequently, for TYE February 2002, Any Business, Inc. filed two amended returns claiming refunds. Stip. ¶ 42. On its first IL-1120X for TYE February 2002, filed on or about February 28, 2007, Any Business, Inc. claimed a refund in the amount of \$86,199. *Id.*; Stip.

¹ Any Business, Inc. paid the amount proposed in the NOD into the Protest Monies Fund and timely filed a complaint in the Circuit Court of Mountain County, Illinois. Stip. ¶ 41. The case involving the NOD is not part of the matter before the Department. *Id.*

Ex. 10 (copy of first amended return for TYE February 2002 and attachments). On the IL-477 attached to its first IL-1120X for TYE February 2002, Any Business, Inc. reported that it earned a RTIC of \$186,049.98 during that tax year and that it carried forward, from a prior tax year, a RTIC in the amount of \$146,172. Stip. ¶ 42; Stip. Ex. 10, p. 3 (Part I, line 8). Therefore, Any Business, Inc. reported total available RTIC in the amount of \$332,221.98 for TYE February 2002. Stip. ¶ 42; Stip. Ex. 10, p. 3 (Part I, line 9). On the same IL-477, Any Business, Inc. applied \$238,024 of its RTIC against its replacement tax on its IL-1120X for that tax year. Stip. ¶ 42. After applying \$238,024 of its RTIC to its 2002 tax year, Any Business, Inc. reported that it had a remaining RTIC balance of \$94,197.98, which it carried forward to its TYE February 2003. *Id.*

38. On its second IL-1120X for TYE February 2002, Any Business, Inc. claimed a refund in the amount of \$65,348. Stip. ¶ 43; Stip. Ex. 11 (copy of second amended return for TYE February 2002 and attachments). On the IL-477 attached to its second IL-1120X for TYE February 2002, Any Business, Inc. reported that it earned a RTIC of \$186,049.98 during the tax year and that it carried forward, from a prior tax year, a RTIC in the amount of \$146,172. Stip. ¶ 43. On its IL-477, Any Business, Inc. reported that it applied \$272,249 of its available RTIC against its replacement tax on its IL-1120X for that tax year. Any Business, Inc. reported that it carried forward the remaining \$59,972.98 of its RITC to TYE February 2003. *Id.*

39. On the IL-477 attached to its 2003 Amended Return, Any Business, Inc. reported that it earned an RTIC of \$361,488 and that it carried forward from a prior tax year an RTIC in the amount of \$94,198. Stip. ¶ 44. Therefore, Any Business, Inc. reported total available RTIC in the amount of \$455,686 for TYE February 2003, and applied \$453,368 of that amount for that tax year. (The \$2,318 difference between \$455,686 and \$453,368 represents a credit for replacement tax paid, not recapture amount). *Id.*

40. The Department conducted a corporate income tax audit of Any Business, Inc. for the Tax Years at Issue. Stip. ¶ 45. The Department made various adjustments to Any Business, Inc.'s 2002 Return and to its Amended Returns. *Id.* In particular, the Department, among other things, disallowed the RTIC Any Business, Inc. claimed on its 2002 Return and Amended Returns on the grounds that Any Business, Inc. and certain members of Any Business, Inc.'s Illinois unitary business group were not primarily engaged in retailing during such years. *Id.*; Stip. ¶¶ 30-33; Stip. Ex. 4.

41. The Department disallowed the following amounts of Any Business, Inc.'s RTIC:

	RTIC	
<u>Tax Year</u>		<u>Disallowed</u>
02-26-2000		\$275,328.00
02-24-2001		\$429,891.00
02-23-2002		\$197,203.00
02-22-2003		\$453,368.00

Stip. ¶ 46.

42. On October 29, 2009, the Department issued Any Business, Inc. a Notice of Denial (Denial) for TYE February 2000 and February 2001 denying and allowing the following amounts of RTIC:

<u>Tax Year</u>	<u>Amount of ITC Claimed</u>	<u>Amount Disallowed</u>	<u>Amount Allowed</u>
02-26-2000	\$275,328	\$275,328	\$0
02-24-2001	<u>\$429,891</u>	<u>\$429,891</u>	<u>\$0</u>
TOTAL	\$705,219	\$705,219	\$0

Stip. ¶ 47; Stip. Ex. 1 (copy of Denial).

43. For TYE February 2001, Any Business, Inc.'s total claim for refund was \$489,816. Stip. ¶ 48. The Department allowed Any Business, Inc. a refund in the amount of \$59,925, the amount of the claim for refund that was not related to Any Business, Inc.'s RTIC. *Id.*

44. On October 29, 2009, the Department issued Any Business, Inc. a Notice of Denial (Denial) for TYE February 2002 and February 2003 which denied RTICs in the amount of \$831,172. Stip. ¶ 49.

45. On December 18, 2009, the Department issued Any Business, Inc. an Amended Notice of Denial (Amended Denial), superseding the Notice of Denial, dated October 29, 2009, for TYE February 2002 and February 2003. Stip. ¶ 50; Stip. Ex. 2 (copy of Amended Denial).

The Amended Denial denied and allowed the following amounts of ITC:

<u>Tax Year</u>	<u>Amount of RTIC Claimed</u>	<u>Amount Disallowed</u>	<u>Amount Allowed</u>
02-23-2002	\$111,004	\$111,004	\$0
02-23-2002	\$ 86,199	\$ 86,199	\$0
02-22-2003	<u>\$453,368</u>	<u>\$453,368</u>	<u>\$0</u>
TOTAL	\$650,571	\$650,571	\$0

Stip. ¶ 50; Stip. Ex. 2.

46. For TYE February 2002, Any Business, Inc.'s total claim for refund was \$294,740. Stip. ¶ 51.

The Department allowed Any Business, Inc. a refund in the amount of \$183,736, the amount of the claim for refund that was not related to Any Business, Inc.'s RTIC. *Id.*

47. Any Business, Inc. asserts that the following entities were eligible to claim an RTIC for TYE February 2000 and February 2001:

- a. Any Business, Inc.;
- b. Any Business³ Warehouse Foods;
- c. Any Business, Inc. Holdings, Inc.;
- d. Juicy Foods.

Stip. ¶ 52.

48. The parties have stipulated that, if the term “retailing” as used in 35 ILCS 5/201(e)(3) which is defined to mean “the sale of tangible personal property or services rendered in conjunction with the sale of tangible consumer goods or commodities” includes “wholesale sales” or “sales for resale,” then Any Business, Inc. is primarily engaged in retailing and is entitled to the RTIC claimed on its 2002 Return and its Amended Returns. Stip. ¶ 34.

49. The parties also stipulated that, if the term “retailing” as used in 35 ILCS 5/201(e)(3) is defined to include only sales of tangible personal property for use or consumption and not for resale or services rendered in conjunction with the sale of tangible personal property for use or consumption and not for resale, then Any Business, Inc. would not be considered to be

primarily engaged in retailing and would not be entitled to the RTIC claimed on its 2002 Return and its Amended Returns. Stip. ¶ 35.

50. For TYE February 2000, Any Business, Inc. reported an available RTIC in the amount of \$286,458.00 on its Form IL-477 attached to its 2000 Amended Return. Stip. ¶ 36; Stip. Ex. 7, p. 3 (Part I, line 9). Any Business, Inc. also reported a RTIC recapture of \$11,130. Stip. ¶ 36; Stip. Ex. 7, p. 2 (Part IV, line 7b); 35 ILCS 5/201(f) (defining recapture). Therefore, the net available RTIC that Any Business, Inc. claimed for TYE February 2000 was \$275,328. Stip. ¶ 36. Any Business, Inc. applied \$275,328 of its net available RTIC against its replacement tax on its 2000 Amended Return. *Id.*; Stip. Ex. 7.

Conclusions of Law:

When a taxpayer seeks to take advantage of deductions, credits or other tax benefits allowed by statute, the burden of proof is on the taxpayer. Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981). Section 909 of the IITA authorizes the payment of refunds to a taxpayer that has overpaid its Illinois income tax liabilities. 35 ILCS 5/909. Here, Taxpayer claims that it was entitled to replacement tax investment credits for its use of qualified property in Illinois. Stip. ¶¶ 1, 28. Therefore, Taxpayer has the burden of proof. Balla, 96 Ill. App. 3d at 296, 421 N.E.2d at 238.

Section 201(c) of the IITA imposes a personal property replacement income tax (replacement tax) on every corporation, partnership and trust, for the privilege of earning or receiving income in or as a resident of Illinois. 35 ILCS 5/201(c). Section 201(e) grants a credit that may be applied against a person's replacement tax liability for investment in qualified property. 35 ILCS 5/201(e). During the years at issue, § 201(e) provided as follows:

(e) Investment credit. A taxpayer shall be allowed a credit against the Personal Property Tax Replacement Income Tax for investment in qualified property.

(1) A taxpayer shall be allowed a credit equal to .5% of the basis of qualified property placed in service during the taxable year, provided such property is placed in service on or after July 1, 1984.

(2) **The term "qualified property" means property which:**

(A) is tangible, whether new or used, including buildings and structural components of buildings and signs that are real property, but not including land or improvements to real property that are not a structural component of a building such as landscaping, sewer lines, local access roads, fencing, parking lots, and other appurtenances;

(B) is depreciable pursuant to Section 167 of the Internal Revenue Code, except that "3-year property" as defined in Section 168(c)(2)(A) of that Code is not eligible for the credit provided by this subsection (e);

(C) is acquired by purchase as defined in Section 179(d) of the Internal Revenue Code;

(D) is used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing; and

(E) has not previously been used in Illinois in such a manner and by such a person as would qualify for the credit provided by this subsection (e) or subsection (f).

(3) For purposes of this subsection (e), "manufacturing" means the material staging and production of tangible personal property by procedures commonly regarded as manufacturing, processing, fabrication, or assembling which changes some existing material into new shapes, new qualities, or new combinations. For purposes of this subsection (e) the term "mining" shall have the same meaning as the term "mining" in Section 613(c) of the Internal Revenue Code. **For purposes of this subsection (e), the term "retailing" means the sale of tangible personal property or services rendered in conjunction with the sale of tangible consumer goods or commodities.**

35 ILCS 5/201(e) (emphasis added).

The statutory definition of qualified property, highlighted above in § 201(e)(2)(D), was changed as a result of the Illinois General Assembly's passage of Public Act 88-141, which became effective in 1994. P.A. 88-141, § 5; 86 Ill. Admin. Code § 100.2101; 19 Ill. Reg. 1844. That statutory amendment changed the definition of qualified property from one that depended on how certain property was used by a taxpayer — that is, by *any* taxpayer — to one that depended upon the primary business of the taxpayer that owned and used such property. P.A. 88-141, § 5 (effective January 1, 1994); *see also* 19 Ill. Reg. 1844. Specifically, before the statutory

amendment, the text of § 201(e)(2) provided, in part: “(2) The term ‘qualified property’ means property which: *** is used in Illinois by the taxpayer in manufacturing operations or in mining coal or fluorite, or in retailing” 35 ILCS 5/201(e)(2); American Stores Co. v. Illinois Department of Revenue, 296 Ill. App. 3d 295, 298, 694 N.E.2d 644, 646 (1st Dist. 1998). After the amendment, that same section provided: “(2) The term ‘qualified property’ means property which: *** is used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing” P.A. 88-141, § 5 (effective January 1, 1994).

The Illinois General Assembly gave the Department the authority to make, promulgate and enforce reasonable rules and regulations relating to the administration and enforcement of the IITA. 35 ILCS 5/1401. Pursuant to that authority, the Department adopted regulations in which it has announced how it will administer and enforce the RTIC. Section 100.2100, originally titled, Investment Credit, was first adopted in 1985, and was based on the text of IITA § 201 as it existed at that time. 86 Ill. Admin. Code § 100.2100 (1985); 10 Ill. Reg. 685 (effective December 31, 1985). Shortly after P.A. 88-141 became law, the Department adopted amendments to § 100.2100 and, at the same time, adopted new § 100.2101. 19 Ill. Reg. 1839, 1844 (effective February 6, 1995). The Department’s amendments to § 100.2100, and its addition of new § 100.2101, were the direct result of the Illinois General Assembly’s 1994 change to the definition of qualified property. P.A. 88-141, § 5; 86 Ill. Admin. Code § 100.2101; 19 Ill. Reg. 1844.

Prior to, and for a short time after P.A. 88-141 became effective, IITR § 100.2100 provided, in pertinent part, as follows:

Section 100.2100 Investment Credit

c) Qualified property. In order to qualify for the investment credit, property must be tangible; depreciable pursuant to Internal Revenue Code Section 167, except that “3-year property” as defined in IRC Section 168(c)(2)(A) is not eligible; and acquired by purchase as defined in Internal Revenue Code Section 179(d). In addition to the above requirements, property must be used in Illinois, by the taxpayer, in manufacturing, retailing, coal mining or fluorite mining in order to qualify for the IITA Section 201(g) credit against the replacement tax. ***

(9) Retailing. Retailing is defined as the sale of tangible personal property. It is not required that such tangible personal property be finished goods, or that the property be sold to its ultimate consumer. For example, sales of tangible personal property for resale are included in the definition of retailing. Also included in the definition of retailing for these purposes are any services rendered in conjunction with the sale of tangible consumer goods or commodities such as uncrating, cleaning, assembling, delivery or installation, provided such services are in conjunction with a specific sale. For example, a delivery truck would qualify for the Section 201(g) credit as it is used in conjunction with specific sales but a company jet used by the president of the company for general or personal purposes would not. Similarly, equipment used by the payroll division of a company would not be used in a retailing operation or in a service rendered in conjunction with the sale of tangible consumer goods. The following activities are not considered retailing operations:

- A) The construction, reconstruction, alteration, remodeling, or improvement of real estate;
- B) The operation of a hotel or motel or other institution providing only lodging facilities;
- C) Other service professions which do not involve the transfer of tangible personal property other than as an incident to the service performed. For guidance in distinguishing service professions from retailing professions, the Department will rely on rules promulgated under the Service Occupation Tax Act at 86 Ill. Adm. Code 140.101 et seq.;
- D) Farming operations related to crop and livestock production do not constitute retailing. However, the marketing of such products would constitute a retailing operation and otherwise qualifying property used in marketing farm produce would qualify for the Section 201(h) credit.

86 Ill. Admin. Code § 100.2100(c)(9), (d) (1985). After February 5, 1995, the title of IITR § 100.2100 was changed to “Replacement Tax Investment Credit Prior to January 1, 1994 (IITA 201(e)).” 86 Ill. Admin. Code § 100.2100 (1995); 19 Ill. Reg. 1844.

When announcing that the 1995 amendments to § 100.2100 and new § 100.2101 had been adopted, the Department wrote the following description of the summary and purpose of the pertinent amendments:

15) Summary and Purpose of Amendment(s):

Rulemaking #1 amends existing Section 100.2100 which at present sets forth the Department’s rules on the Replacement Tax Investment Credit and the Investment Credit for Enterprise Zones. The Department decided that it would enhance the clarity of its rules, if rules concerning each credit is [*sic*] contained in a separate Section of Part 100. In addition, P.A. 88-141 amended the Replacement Tax Investment Credit effective January 1, 1994. The focus of the credit was shifted as a result of this statutory change.

Rulemaking #1 contains two rules concerning the Replacement Tax Investment Credit. Section 100.2101 sets forth the rule in effect for periods commencing with January 1, 1994.

19 Ill. Reg. 1844.

Effective February 5, 1995, new regulation § 100.2101 provided, in pertinent part:

Section 100.2101 Replacement Tax Investment Credit (IITA 201(e))

e) Qualified property. In order to qualify for the investment credit, property must be tangible; depreciable pursuant to Internal Revenue Code Section 167, except that “3-year property” as defined in IRC Section 168(c)(2)(A) is not eligible; and acquired by purchase as defined in Internal Revenue Code Section 179(d). In addition to the above requirements, property must be used in Illinois by the taxpayer who is engaged primarily in manufacturing, retailing, coal mining or fluorite mining, in order to qualify for the IITA Section 201(e) credit against the replacement tax. Qualified property can be new or used, but cannot have been previously used in Illinois, in such a manner and by such a person as would qualify for the investment credit, or for the Section 201(f) Enterprise Zone Investment Credit, and includes buildings and structural components thereof.

9) Retailing. Retailing is defined as *the sale of tangible personal property or services rendered in conjunction with the sale of tangible consumer goods or commodities* (IITA Section 203(e)(3)). It is required that such tangible personal property be finished consumer goods, and the property be sold to its ultimate consumer. For example, sales of tangible personal property for resale are not included in the definition of retailing. ***

f) To qualify for the credit, property must be used in Illinois by a taxpayer who is primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing. It is not required that the property be used exclusively in manufacturing, mining of coal or fluorite or in retailing. So long as the taxpayer is primarily, more than 50%, engaged in one of these operations, all qualified property is eligible for the credit, even if the property is not actually used in an exempt manufacturing, coal or fluorite mining or retailing process. The taxpayer must engage primarily in one or more of the operations. In other words, a taxpayer that is engaged 30% of the time in retailing and 40% of the time in manufacturing will qualify for the credit, because the taxpayer is engaged primarily in one or more of the operations. In determining whether a taxpayer is primarily engaged in an activity the Department will look to the gross receipts of the taxpayer received in the ordinary course of business by that taxpayer. For example, if more than 50% of the taxpayer's gross receipts are from manufacturing, the taxpayer is primarily engaged in manufacturing, or if more than 50% of the gross receipts are from retailing, the taxpayer is primarily engaged in retailing. The taxpayer (and the Department) will look to the gross receipts received by the taxpayer in the ordinary course of business. Therefore, if, for example, the taxpayer suffers a casualty loss and that is compensated for by an insurance payment, the

amount of money so received will not be deemed gross receipts received in the ordinary course of business, and disqualify the taxpayer from eligibility and perhaps result in the recapture of credits granted in prior years.

EXAMPLE 1: Corporation A manufactures CD ROM Units for personal computers, which are sold to others for resale. Corporation A also engages in the retail sale of canned computer software. Finally, Corporation A develops and sells custom computer software to various clients. Corporation A receives 20% of its gross receipts from the manufacturing of CD ROM Units, 40% of its gross receipts from retail sales of canned software, and 40% of its gross receipts from its custom computer software development and sales operations. Corporation A is eligible for the credit. Corporation A is engaged primarily in manufacturing and retailing, because the total of its manufacturing and retailing operations is 80% of its gross receipts. Therefore, the Corporation is eligible for the credit.

EXAMPLE 2: Corporation B operates a hotel. 80% of the gross receipts of Corporation B are from the renting of rooms, 5% of the gross receipts are from the operation of a gift shop in the hotel and the remaining 15% of the gross receipts are from the operation of a restaurant and lounge in the hotel. The renting of rooms is not retailing. Therefore, Corporation B is ineligible for the credit because it is not engaged primarily in retailing, even though it does, through the operation of the gift shop, restaurant and lounge, engage in some retailing activities.

86 Ill. Admin. Code § 100.2101(e)-(f) (1995); 19 Ill. Reg. 1854. But for minor changes, not relevant here, the text of IITR § 100.2101 had remained unchanged from 1995 through the years at issue.

Public Act 88-141 changed the statutory definition of qualified property from one that depended on how a taxpayer/owner used a particular item of tangible personal property to one that depended on the primary business of the taxpayer owner. Before the statutory amendment, the credit applied to *any* taxpayer who used certain property in retailing. After the statutory amendment, the credit applied to certain property that was owned and used by persons who were primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing. Another way to say this is that the credit applied *only* to persons who were primarily engaged in manufacturing, or in mining coal or fluorite, or in retailing.

Regarding the last category in this list, different parts of newly adopted IITR § 100.2101(e) announced the Department's determination that the legislature's change to the definition of qualified property meant that a person who was not, itself, primarily engaged in

retailing would no longer be entitled to claim the statutory credit. 86 Ill. Admin. Code § 100.2101(e) (“In addition to the above requirements, property must be used in Illinois by the taxpayer who is engaged primarily in manufacturing, retailing, coal mining or fluorite mining, in order to qualify for the IITA Section 201(e) credit against the replacement tax.”), (f) (“The taxpayer must engage primarily in one or more of the operations.”). Reading revised § 100.2100 together with new § 100.2101 reflects the Department’s determination that the legislature’s change to the definition of qualified property was intended to narrow the class of property to which the credit would apply. 19 Ill. Reg. 1844 (“The focus of the credit was shifted as a result of this statutory change.”).

But while the General Assembly changed the statutory definition of qualified property when it passed P.A. 88-141, the newly amended text of IITA § 201(e) did not provide any specific method for determining whether a taxpayer was primarily engaged in one of the three qualifying occupations. As a consequence of that ambiguity, that process was left to the Department. *See* Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 104 S.Ct. 2778, 81 L.Ed.2d 694 (1984);² Church v. Department of Professional Regulation, 164 Ill. 2d 153, 646 N.E.2d 572 (1995) (“Where the legislature expressly or implicitly delegates to an agency the authority to clarify and define a specific statutory provision, administrative

² The pertinent dicta from Chevron is:

When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. [footnotes omitted] If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.

Chevron U.S.A., Inc., 467 U.S. at 842-43, 104 S.Ct. at 2781-82, 81 L.Ed.2d 694.

interpretations of such statutory provisions should be given substantial weight unless they are arbitrary, capricious, or manifestly contrary to the statute.”) (*citing Chevron*).

Before P.A. 88-141 became law, the Department had previously announced that certain activities would not be included within the statutory definition of retailing. 86 Ill. Admin. Code § 100.2100(c)(3)(C) (1994). It did so, in part, by expressly stating that, “The following activities are not considered retailing operations: *** Other service professions which do not involve the transfer of tangible personal property other than as an incident to the service performed. For guidance in distinguishing service professions from retailing professions, the Department will rely on rules promulgated under the Service Occupation Tax Act at 86 Ill. Adm. Code 140.101 et seq.” *Id.* After P.A. 88-141 became law, the Department devised a method to use to determine whether a taxpayer was primarily engaged in one of the three qualifying occupations. 86 Ill. Admin. Code § 100.2101(f) (1995). The Department’s revised distinction between retailing and non-retailing activities, as set forth in IITR § 100.2101(e)(9), takes into account the statutory credit’s new focus on the primary business of the property’s owner.

The text of IITR § 100.2101(e)(9) expressly provides that “sales of tangible personal property for resale *are not included* in the definition of retailing.” 86 Ill. Admin. Code § 100.2101(e)(9) (1995) (emphasis added). But the context of that regulatory text is just as important as its text. Specifically, for years after P.A. 88-141 became law, when measuring a taxpayer’s comparative gross receipts, the text of IITR § 100.2101(e)(9) means that the Department would not include, as gross receipts from retailing, those receipts realized from sales of tangible personal property or services rendered in conjunction with the sale of tangible personal property to persons for resale and not to the ultimate consumer. 86 Ill. Admin. Code 100.2101(e)(9), (f) (1995). That is the process used in this case. Stip. ¶¶ 30-33; Stip. Ex. 4.

When taking into account the Department’s summary and purpose for new § 100.2101 with the plain text of that section and of amended § 100.2100, it is clear that the Department considered the statutory amendment effected by P.A. 88-141 as requiring it to change its prior

interpretation of the scope of the credit. 19 Ill. Reg. 1844. (“P.A. 88-141 amended the Replacement Tax Investment Credit effective January 1, 1994. The focus of the credit was shifted as a result of this statutory change. Rulemaking #1 contains two rules concerning the Replacement Tax Investment Credit. Section 100.2101 sets forth the rule in effect for periods commencing with January 1, 1994.”). Moreover, an administrative agency is not required to adhere to a certain policy or practice forever. Greer v. Illinois Housing Development Authority, 122 Ill. 2d 462, 506, 524 N.E.2d 561, 581 (1988). The Illinois General Assembly’s amendment to the statutory definition of qualified property provided a rational basis for the Department to change its interpretation of the statutory definition of retailing, to effect the new statutory obligation to determine whether a taxpayer claiming the credit was primarily engaged in retailing. P.A. 88-141, § 5; 86 Ill. Admin Code § 100.2101(e)-(f).

On this point, while I acknowledge the parties’ stipulations regarding the issue to be resolved (Stip. ¶¶ 34-35), I do not agree with their construction of the issue. That is, the issue here is not so much what the text of IITA § 201(e)(3) says or means, but whether new IITR § 100.2101 describes a rational process for determining whether the members of Taxpayer’s unitary business group were — or whether *any* taxpayer claiming RTIC is — primarily engaged in retailing. Stip. ¶¶ 30-33; Stip. Ex. 4; 86 Ill. Admin. Code § 100.2101. If it does, it is a permissible exercise of the Department’s statutory authority “to make, promulgate and enforce reasonable rules and regulations relating to the administration and enforcement of the IITA.” 35 ILCS 5/1401; Chevron U.S.A., Inc., 467 U.S. at 842-43, 104 S.Ct. at 2781-82, 81 L.Ed.2d 694; Greer, 122 Ill. 2d at 506, 524 N.E.2d at 581 (“The standard is one of rationality.”).

Finally, I acknowledge here that one of Taxpayer’s two principal arguments is that IITR § 100.2101 is invalid because it adds a limitation to the definition of retailing that is not included within the text of IITA § 201(e)(3). Taxpayer’s Brief, pp. 21-28. But my understanding of Illinois administrative law requires an agency fact finder to be bound by the agency’s own applicable regulations. 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 its rules. *Id.* While an administrative regulation does not bind a court charged with reviewing an agency's application of an administrative regulation to a particular set of facts (*see, e.g., Wesko Plating Inc. v. Department of Revenue*, 222 Ill. App. 3d 422, 584 N.E.2d 162 (1st Dist. 1991)), the regulation at issue here binds me, an administrative law judge, on the precise question at issue. Again, that precise issue is whether, when determining if a taxpayer is primarily engaged in retailing, one may include, as gross receipts from retailing, gross receipts from sales of tangible personal property or services rendered in conjunction with the sale of tangible personal property to persons for resale. Stip. ¶¶ 30-33; Stip. Ex. 4. With regard to that question, the text of the applicable regulation is unambiguous. 86 Ill. Admin. Code § 100.2101(e)(9), (f).

Moreover, given the legislature's 1994 change in the statutory definition of qualified property, and thereby, in the scope of the credit (*see* P.A. 88-141, § 5), the Department's 1995 change to its prior interpretation of the statutory definition of retailing is, in all respects, reasonable. If the Department had *not* created a procedure for making the "primarily engaged" determination, there would have been no difference between how the credit was administered after the P.A. 88-141 changed the statutory definition of qualified property.

Conclusion

For all of the reasons stated above, I recommend that the Director finalize the Denial and Amended Denial as issued.

Date: November 2, 2012

John E. White, Administrative Law Judge

