

ST 08-13

Tax Type: Sales Tax

Issue: Sales v. Service Issues

Reasonable Cause on Application of Penalties

Amnesty Eligibility

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

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE d/b/a
ABC MONUMENT CO.**

Taxpayer

Docket # 06-ST-0000

IBT # 0000-0000

NTL # 00 00000000000000

NTL # 00 00000000000000

RECOMMENDATION FOR DISPOSITION

Appearances: Shepard K. Smith, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Anthony J. DelGiorno of Rammelkamp Bradney, P.C. for John Doe d/b/a ABC Monument Co.

Synopsis:

The Department of Revenue (“Department”) conducted an audit of John Doe d/b/a ABC Monument Company (“taxpayer”) for the period of July 1, 2002 to November 30, 2004. The Department concluded that the taxpayer owed additional tax and issued two Notices of Tax Liability, which were timely protested by the taxpayer. The parties agreed to waive their right to an evidentiary hearing and have the case decided based on the Stipulation of Facts and exhibits that they filed along with their supporting briefs.

According to the pretrial order, the primary issue in this case is whether the taxpayer is liable for \$21,319, plus interest and penalty, in retailers' occupation tax ("ROT") and related taxes for the audit period. The sub-issues were listed as follows: (1) whether the taxpayer is entitled to a deduction for the labor expense he claims was incurred during the installation and engraving of the monuments he sells, and as a result does not owe \$17,517 in tax; (2) whether the interest should be doubled because the taxpayer failed to pay the tax during the amnesty period; and (3) whether the late payment penalty should be abated due to reasonable cause. In its brief, the Department agreed that the audit period began the day after the amnesty period ended, and therefore, the interest should not be doubled. After reviewing the documents and briefs concerning the remaining issues, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer is a sole proprietor who operates a funerary monument business in Anywhere, Illinois. (Stip. #2)
2. The taxpayer makes retail sales of funerary stones, monuments and accessories. The taxpayer also installs those funerary stones and monuments and makes alterations to them. (Stip. #2)
3. On the taxpayer's invoices, the amount for the installation or alteration labor was not separately stated as a line item. The amount of the sales tax also was not separately stated. (Dept. Ex. #2, p. 2; #3)
4. On the taxpayer's sales tax returns, he included a deduction for the installation and alteration labor. (Dept. Ex. #2, p. 2)

5. The taxpayer employed the accounting firm of Smith & Jones, Ltd. to prepare its sales tax returns, and all of the taxpayer's returns were timely filed. (Dept. Ex. #2, p. 2)
6. The audit period in this matter is from July 1, 2002 to November 30, 2004. (Stip. #1)
7. As a result of the audit, the primary adjustment was to deny the taxpayer's labor (installation and alteration) deduction that amounted to \$17,517 in tax. (Stip. #3)
8. On May 8, 2006, the Department completed a corrected return for the taxpayer that shows additional tax due in the amount of \$21,319, plus a late payment penalty. A copy of the corrected return was submitted under the certificate of the Director of the Department. (Dept. Ex. #1; Stip. #4)

CONCLUSIONS OF LAW:

The Department's regulation concerning vendors of memorial stones and monuments provides in part as follows:

For information concerning the taxability or exemption of the seller's receipts from additional special service charges, such as lettering or installing the item for the purchaser, see Section 130.450 of this Part. (86 Ill. Admin. Code §130.2150(b)).

Section 130.450 provides in part as follows:

Section 130.450 Installation, Alteration and Special Service Charges

a) When Taxable

Where the seller engages in the business of selling tangible personal property at retail, and such tangible personal property is installed or altered for the purchaser by the seller (or some other special service is performed for the purchaser by the seller with respect to such property), the gross receipts of the seller on account of his charges for such installation, alteration or other special service must be included in the receipts by which his Retailers' Occupation Tax liability is measured, if

such installation, alteration or other special service charges are included in the selling price of the tangible personal property which is sold. This is true whether the charge for the property which is sold and the charge for installation, alteration or other special services are billed by the seller to his customers as separate items (except when the purchaser signs an itemized invoice so as to make it a contract reflecting the intention of both the seller and the purchaser), or whether both items are included in a single billed price.

b) When Not Taxable

On the other hand, where the seller and the buyer agree upon the installation, alteration or other special service charges separately from the selling price of the tangible personal property which is sold, then the receipts from the installation, alteration or other special service charge are not a part of the "selling price" of the tangible personal property which is sold, but instead such charge is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability. (86 Ill. Admin. Code §130.450(a), (b)).

The auditor in the present case explained in the audit report that the deduction for labor was disallowed because the invoice included a lump sum due; the taxpayer did not separately contract for the labor amount, and the amount was not included on the invoice.

(Dept. Ex. #2, p. 4)

The taxpayer concedes that the Department properly applied the regulations in this case. The taxpayer contends, however, that his accountant relied on the instructions in ST-19, Retailer's Tax Booklet, which was revised and issued by the Department in April 2002. (Taxpayer Ex. #1) ST-19 provides in part as follows;

Item 1a General merchandise retail sales

Write the amount of tax you collected on your retail sales of general merchandise. This includes food sold for immediate consumption, such as food sold at a restaurant.

If you do not know the amount of tax you collected, follow these steps:

- 1) Figure your taxable receipts by subtracting your receipts for exempt retail sales of general merchandise from your total receipts for all retail sales of general merchandise.
- 2) Divide your taxable receipts by [1 + the sales tax rate]. (This rate is preprinted in Line 4a/4b of Form ST-1 or Form ST-2.)
- 3) Multiply the result (tax base) by the general merchandise sales tax rate. This is the amount of tax you collected. [example omitted]

Item 1b General merchandise service sales

If you charge and collect Service Occupation Tax on sales of service, write the amount of tax you collected on general merchandise transferred or sold in the performance of that service.

Note: If you are not required to charge Service Occupation Tax on your sales of service and you owe Service Occupation Tax on purchases, report the tax here as a tax collected.

If you do not know the amount of tax you collected, follow these steps:

- 1) Figure your taxable receipts by subtracting your receipts for exempt service sales of general merchandise from your total receipts for all service sales of general merchandise.
- 2) Divide your taxable receipts by [1 + the sales tax rate]. (This rate is preprinted in Line 4a/4b of Form ST-1 or Form ST-2.)
- 3) Multiply the result (tax base) by the general merchandise sales tax rate. This is the amount of tax you collected. (Taxpayer Ex. #1, *emphasis added*)

Because the taxpayer did not separately calculate the amount of sales tax due, his accountant calculated the amount of the tax collected and to be paid by relying on the part of the instructions in ST-19 that are to be followed if the taxpayer does not know the amount of tax he collected. His accountant took the total taxable receipts and subtracted what he believed were exempt retail sales from the total receipts to determine the amount of sales tax collected.

The taxpayer argues that the ST-19 instructions contradict the regulations. The taxpayer believes the instructions are not in conformity with the regulations, and they misguided the taxpayer as to the appropriate way to report his ROT. The taxpayer notes

that the distinction concerning separately contracted labor charges is not in the ST-19. The taxpayer states that the audit report indicates that his accountants based their actions on the instructions in the ST-19, and the taxpayer believes that at a minimum, the ST-19 instructions were ambiguous compared to the regulations.

In addition, the taxpayer argues that the Department should be estopped from collecting the tax because of the error or ambiguity of its instructions. The taxpayer notes that in Austin Liquor Mart, Inc. v. Department of Revenue, 51 Ill. 2d 1 (1972), the court indicated the general rule, which is that “the State cannot be estopped in the exercise of its power of taxation or the collection of revenue unless necessary to prevent fraud and injustice.” *Id.* at 6. Furthermore, courts have acknowledged that “extraordinary circumstances” could warrant estoppel based on “basic concepts of right and justice.” See Mr. Car Wash, Inc. v. Department of Revenue, 27 Ill. App. 3d 931, 934 (4th Dist. 1975). The taxpayer asserts that relying on the erroneous instruction is an extraordinary circumstance that warrants an estoppel to prevent injustice to the taxpayer.

Finally, the taxpayer claims that he has shown reasonable cause to abate the late payment penalty. The taxpayer diligently and timely filed his returns and relied on the advice of his accountant. The taxpayer believes the record indicates that his accountant reasonably applied the instructions issued by the Department. The taxpayer contends that because the instructions were, at worst, unclear, confusing, or incomplete, this supports a finding of reasonable cause.

In response, the Department contends that because the taxpayer has agreed that he is not entitled to the labor deduction, he should be liable for the tax related to it. The Department believes that the instructions are not contrary to the regulations, and the ST-

19 sheds no light on claiming a labor deduction. The instructions only mention exempt retail sales. In the Department's view, it cannot be estopped from collecting the tax because the ST-19 is not contrary to the regulations. The Department also states that the taxpayer did not exercise ordinary business care and prudence that would warrant abating the penalty.

The taxpayer's argument that the ST-19 instructions are ambiguous, erroneous, or contradict the regulations is not persuasive. First, the instructions state, "If you do not know the amount of tax you collected, follow these steps." Because the taxpayer's invoices did not separately indicate the amount of the tax, as well as the labor charges, it was necessary for the taxpayer to follow these instructions to determine the amount of tax collected, and they accurately explain how to do it. The instructions do not make any reference to the taxability of labor charges or whether labor charges should be deducted from gross receipts.

Second, the instructions continue by stating that the "receipts for exempt retail sales of general merchandise" are to be subtracted from the total receipts for all retail sales. Labor charges are not "exempt retail sales." Exempt retail sales include, for example, sales to organizations that are tax-exempt. See 35 ILCS 120/2-5(11). As the regulations clearly explain, if the labor charges are included in the selling price of the merchandise, then they must be included in the gross receipts by which the ROT liability is measured and no deduction would be necessary. If the labor charges are contracted for separately, then the total amount of retail sales would not include the labor charges, and again, no deduction would be necessary. Because the taxpayer failed to accurately account for the labor charges, the taxpayer erroneously attempted to claim that the labor

charges were exempt retail sales. The ST-19 instructions do not mislead the taxpayer and are not a justification for the taxpayer's mistake. Furthermore, the instructions are general ones, and the ST-19 does not indicate in any way that it is an exhaustive summary of the relevant tax laws.

In addition, the Department should not be estopped from collecting the tax because nothing in the record indicates that an injustice will occur if the taxpayer is held liable for the tax. The facts in the present case are certainly not as compelling as those in Philger, Inc. v. Department of Revenue, 208 Ill. App. 3d 1066 (5th Dist. 1991), where the Department was estopped from collecting the tax. In Philger, Inc., the taxpayer purchased a restaurant and paid approximately \$7,000 to the Department for taxes still owed by the restaurant. Despite the Department's assurances to the contrary, nearly one year after the closing of the sale of the restaurant, the Department sought to recover additional taxes from the taxpayer in amounts in excess of \$20,000. *Id.* at 1071. The court found that it would have been an injustice for the taxpayer to be required to pay the additional amount because the taxpayer "did all that it could prior to the sale" to ensure the Department was paid the tax it was due. *Id.* The tax was on sales made by the former owners of the restaurant, and if the Department had demanded the money prior to the closing, the amount could have been deducted from the purchase price. *Id.* at 1072. In the present case, the record does not disclose that the taxpayer made an effort to find instructions concerning whether his labor charges were taxable. Instead, he relied on a general instruction booklet that explained how to determine the amount of tax collected. The instructions were accurate, and requiring the taxpayer to pay the assessment does not amount to an injustice.

An argument similar to the one raised by the taxpayer was addressed by the court in McLean v. Department of Revenue, 184 Ill. 2d 341 (1998). The taxpayer in that case argued that it had detrimentally relied upon erroneous documents published by the Department. The court found that one of the documents (a public release) that the taxpayer had relied upon was “rife with advice that could be easily construed as contradictory to the Act.” *Id.* at 363. Due to the misinformation published by the Department, the court required the Department to abate the assessment for the period in which the document was in effect.¹ *Id.* Unlike the document in McLean, the ST-19 is not rife with information that is contradictory to the ROT Act and does not provide a basis for abating the assessment.

Finally, the late payment penalty should not be abated due to reasonable cause. The Department imposed the penalty for the late payment of the taxes pursuant to section 3-3 of the Uniform Penalty and Interest Act (UPIA) (35 ILCS 735/3-1 et seq.) Section 3-8 of the UPIA provides a basis for the abatement of the section 3-3 penalty and states in part as follows:

The penalties imposed under the provisions of Sections 3-3, 3-4, and 3-5 of this Act shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department. (35 ILCS 735/3-8).

The Department’s regulation concerning reasonable cause provides in part as follows:

b) The determination of whether a taxpayer acted with reasonable cause shall be made on a case by case basis taking into account all pertinent facts and circumstances. The most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer

¹ The court based its decision on section 4(c) of the Taxpayers’ Bill of Rights Act (20 ILCS 2520/4(c)) rather than equitable estoppel.

made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion.

c) A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return. (86 Ill. Admin. Code §700.400(b), (c)).

Although the taxpayer relied on an accountant to prepare his tax returns, it is not clear from the record that the taxpayer exercised ordinary business care and prudence to determine how to account for labor charges. The accountant claims to have relied upon ST-19, but that booklet accurately instructs how to calculate the amount of tax collected. It does not provide instructions concerning labor charges. If the taxpayer, during the operation of his business, had accounted for these charges correctly, then his accountant would have had accurate information upon which to prepare the returns. Without evidence of an effort on the part of the taxpayer to determine how to properly account for labor charges, an abatement of the penalty is not warranted.

Recommendation:

For the foregoing reasons, it is recommended that the assessment and penalty be upheld. The interest, however, should not be doubled.

Linda Olivero
Administrative Law Judge

Enter: February 25, 2008

