

ST 10-15

Tax Type: Sales Tax

Issue: Enterprise Zone (Exemptions)

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

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

v.

ABC, LLC d/b/a ABC HOTEL

Taxpayer

Docket # 09-ST-0000

Acct ID: 0000-0000

Reporting Periods: 1/04 thru 6/06

RECOMMENDATION FOR DISPOSITION

Appearances: Matthew Crain, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Dwight O’Keefe of Brown, Hay & Stephens, LLP for ABC, LLC d/b/a ABC Hotel

Synopsis:

The Department of Revenue (“Department”) conducted an audit of ABC, LLC d/b/a ABC Hotel (“taxpayer”) for the period of January 2004 to June 2006. At the conclusion of the audit, the Department issued two Notices of Tax Liability (“NTL’s”) to the taxpayer for additional retailers’ occupation tax (“ROT”) and use tax. The taxpayer timely protested the NTL’s, and an evidentiary hearing was held. The taxpayer concedes that it owes a portion of the assessment; the amount that the taxpayer believes it does not owe is use tax that was assessed on items that the taxpayer claims qualify for the enterprise zone exemption because they were fixed assets that were purchased for

incorporation into real estate in an enterprise zone. The Department contends that these items were purchased before a Certificate of Eligibility was issued for the enterprise zone, and the taxpayer owes use tax on these items. In addition, the taxpayer argues that if it is found that the taxes were properly assessed on these purchases, then the penalties and interest that are attributable to these purchases should be abated. After reviewing the record, it is recommended that this matter be resolved partially in favor of the taxpayer.

FINDINGS OF FACT:

1. The taxpayer operates a hotel, restaurant, and lounge in Anywhere, Illinois. (Dept. Ex. #2, p. 2; Tr. p. 10)
2. Beginning in April 2004, the taxpayer made substantial renovations to the hotel and purchased various fixed assets that were incorporated into the real estate. (Dept. Ex. #2, pp. 4, 33-37)
3. On April 22, 2004, the administrator of the enterprise zone from the Illinois Department of Commerce and Economic Opportunity (“DCEO”) sent a letter to the City of Anywhere stating that the DCEO certified the Ordinance that expanded the Anywhere enterprise zone. The letter included a “Certification” dated April 21, 2004 that states that pursuant to the Illinois Enterprise Zone Act, the DCEO certifies the expansion of the Anywhere enterprise zone. The letter states that a certified copy of the Ordinance was sent to the Department of Revenue. (Dept. Ex. #3, pp. 7-8)
4. On May 27, 2004, the taxpayer sent a letter to its vendors stating that the DCEO approved and certified the expansion of the enterprise zone to include the

- taxpayer's hotel. The letter states that sales tax should not be charged on the taxpayer's purchases. (Dept. Ex. #3, p. 6)
5. On August 18, 2004, a Certification of Eligibility for Sales Tax Exemption ("Certificate of Eligibility") was issued from the administrator of the enterprise zone where the hotel is located. The Certificate of Eligibility indicates that the taxpayer's hotel is located within the Anywhere Enterprise Zone and the project is eligible for an exemption from sales taxes on the purchase of building materials associated with the project. (Dept. Ex. #3, p. 2)
 6. On July 23, 2007, Jane Doe, who is a Development Specialist for the City of Anywhere, sent a letter to the taxpayer's president stating that in 2004 the City of Anywhere expanded its enterprise zone to include the taxpayer's hotel. Ms. Doe states in the letter that the Illinois DCEO approved the expansion in April 2004, but "due to a mix-up" the Certificate of Eligibility was not completed until August 2004. (Taxpayer Ex. #1)
 7. The Department conducted an audit of the taxpayer for the time period of January 2004 to June 2006. The auditor, *inter alia*, determined that the taxpayer owes use tax on the purchase of fixed assets that were incorporated into real estate prior to August 18, 2004. (Dept. Ex. #2)
 8. On April 30, 2009, the Department issued two Notices of Tax Liability that assess ROT and use taxes, plus penalties and interest, as a result of the audit. The Department's determination was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1)

CONCLUSIONS OF LAW:

Under the Use Tax Act (“Act”) (35 ILCS 105/1 *et seq.*), Illinois imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 12 of the Act incorporates by reference section 5k of the Retailers’ Occupation Tax Act (“ROTA”) (35 ILCS 120/1 *et seq.*), which provides, in relevant part, as follows:

Building materials exemption. Each retailer who makes a qualified sale of building materials to be incorporated into real estate in an enterprise zone established by a county or municipality under the Illinois Enterprise Zone Act by remodeling, rehabilitation or new construction, may deduct receipts from such sales when calculating the tax imposed by this Act. For purposes of this Section, "qualified sale" means a sale of building materials that will be incorporated into real estate as part of a building project for which a Certificate of Eligibility for Sales Tax Exemption has been issued by the administrator of the enterprise zone in which the building project is located. To document the exemption allowed under this Section, the retailer must obtain from the purchaser a copy of the Certificate of Eligibility for Sales Tax Exemption issued by the administrator of the enterprise zone into which the building materials will be incorporated...35 ILCS 120/5k; 105/12.

The Department’s regulation concerning enterprise zones provides, in relevant part, as follows:

Effective August 6, 2002, there is still no requirement that the retailer be located in a municipality or county that created the enterprise zone into which the materials will be incorporated. However, restrictions on the deduction contained in the ordinance in effect at the retailer’s location no longer control the sale. Rather, the purchaser must obtain a Certificate of Eligibility for Sales Tax Exemption from the administrator of the enterprise zone into which the materials will be incorporated. That Certificate of Eligibility for Sales Tax Exemption will certify that the building project identified therein meets all the requirements of the enterprise zone ordinance of the jurisdiction in which the building project is located. In order to purchase building materials for that project tax-free, the purchaser must provide a copy of that Certificate to the retailer along with the purchaser’s own certification that the materials will be incorporated into the building project identified in the Certificate of Eligibility for Sales Tax Exemption. 86 Ill. Admin. Code §130.1951(a)(5).

Section 12 of the Act also incorporates by reference section 5 of the ROTA, which provides that the certified copy of the Department's determination of the amount of tax due is *prima facie* correct and is *prima facie* proof of the correctness of the amount of tax due, as shown therein. 35 ILCS 105/12; 120/5. Once the Department has established its *prima facie* case by submitting the certified copy of the Department's determination into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. Clark Oil & Refining Corp. v. Johnson, 154 Ill. App. 3d 773, 783 (1st Dist. 1987). To prove its case, a taxpayer must present more than testimony denying the Department's assessment. Sprague v. Johnson, 195 Ill. App. 3d 798, 804 (4th Dist. 1990). The taxpayer must present sufficient documentary evidence to support its claim for an exemption. *Id.*; Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1st Dist. 1981).

It is well-established under Illinois law that tax exemption provisions are strictly construed in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill. 2d 576, 579 (1975). The party claiming the exemption has the burden of clearly proving that it is entitled to the exemption. *Id.* Whenever doubt arises, it must be resolved in favor of requiring the tax to be paid. *Id.*; Quad Cities Open, Inc. v. City of Silvis, 208 Ill. 2d 498, 508 (2004).

The taxpayer argues that under the Illinois Enterprise Zone Act (20 ILCS 655/1 *et seq.*), the enterprise zone is effective upon the issuance of a certificate by the DCEO, and that is the certificate upon which the taxpayer relied in this case. The relevant section of the Illinois Enterprise Zone Act provides, in part, as follows:

Certification of Enterprise Zones; Effective date.

- (a) Approval of designated Enterprise Zones shall be made by the Department [of Commerce and Economic Opportunity] by

certification of the designating ordinance. The Department shall promptly issue a certificate for each Enterprise Zone upon its approval...

- (b) An Enterprise Zone shall be effective upon its certification. The Department shall transmit a copy of the certification to the Department of Revenue, and to the designating municipality or county.

Upon certification of an Enterprise Zone, the terms and provisions of the designating ordinance shall be in effect, and may not be amended or repealed except in accordance with Section 5.4....20 ILCS 655/5.3.

The taxpayer claims that under the statute, the enterprise zone was effective on April 21, 2004, which is the date that the DCEO issued the Certification. The taxpayer contends there was a “horrible misunderstanding” with respect to the Certificate of Eligibility, and the mix up was on the part of the City of Anywhere, not the taxpayer. Under the statute, the Department of Revenue had notice of the enterprise zone in April 2004, and the taxpayer, therefore, believes that it does not owe use tax on fixed assets that were incorporated into the hotel after April 21, 2004.

The Department argues that the Certificate of Eligibility was not issued until August 18, 2004, and the taxpayer owes use tax on the purchases made prior to that date. The Department contends that this matter is analogous to a 16-year-old who has failed to go and get his driver’s license because turning 16 does not automatically authorize the legal right to drive; certain administrative requirements must be completed before receiving the benefit of driving. The Department believes that the taxpayer in the present case is similarly not entitled to the benefit of the enterprise zone exemption prior to August 18, 2004 because the taxpayer failed to obtain the proper document that is necessary for the exemption prior to that date.

Although the taxpayer claims that the mix up concerning the Certificate of Eligibility was on the part of the City of Anywhere and not the taxpayer, this has not been clearly established. The Department's regulation states that "the purchaser must obtain a Certificate of Eligibility for Sales Tax Exemption from the administrator of the enterprise zone into which the materials will be incorporated." 86 Ill. Admin. Code §130.1951(a)(5). In the auditor's narrative that was completed after the audit, the auditor stated as follows: "When I asked Mr. XXXX [the taxpayer's accountant] why the previous manager, Mr. XXXX had gotten the certificate of eligibility so late in the construction he said that Mr. XXXX just didn't get himself down there to obtain the proper paperwork." (Dept. Ex. #2, p. 8) The Certificate of Eligibility is signed by Mr. XXXX, and he dated it August 14, 2004, which is four days before the same document was signed by the zone administrator. (Dept. Ex. #3, p. 2) It is not clear from the record what process is necessary in order to obtain the Certificate of Eligibility and whether that process must be initiated by the taxpayer. Because the Certificate of Eligibility was signed by the taxpayer's representative four days prior to the date it was signed by the zone administrator, it is possible that it was the taxpayer's responsibility to initiate the process, and the taxpayer's procrastination was the reason for the delay.

In addition, the letter from the City of Anywhere stating that there was a "mix-up" is not signed by the Anywhere enterprise zone administrator; it is signed by Jane Doe, who is a Development Specialist. She is not the person who signed the Certificate of Eligibility as the zone administrator. Furthermore, the letter does not explain the mix up and does not specifically indicate that the mix up was on the part of the City of Anywhere. The letter was written on July 23, 2007, in response to the audit, and nothing

in the letter explains the cause of the delay other than that there was a “mix-up.” The taxpayer did not provide any further explanation during the hearing as to why the Certificate of Eligibility was issued so late.

The parties do not dispute the fact that certain items the taxpayer purchased prior to August 18, 2004 would qualify for the enterprise zone exemption but for the fact that a Certificate of Eligibility had not been issued prior to that date. If the Certificate of Eligibility was issued at the same time that the DCEO issued its Certification, then various items that were purchased between April 21, 2004 and August 18, 2004 would qualify for the exemption. The relevant question, therefore, is whether the Certificate of Eligibility must be issued prior to the date of purchase in order for the purchase to qualify for the exemption.

Under section 5k, a retailer who makes a “qualified sale” is entitled to the exemption. The term “qualified sale” is defined in the statute as “a sale of building materials that will be incorporated into real estate as part of a building project for which a Certificate of Eligibility for Sales Tax Exemption has been issued by the administrator of the enterprise zone in which the building project is located.” 35 ILCS 120/5k. Although the statute does not specifically state that the Certificate of Eligibility must be obtained prior to the purchase date, it does say that a qualified sale is one for which a Certificate of Eligibility “has been” issued. In addition, in two of the Department’s General Information Letters that concern the enterprise zone exemption, ST 06-0173-GIL and ST 08-0110 GIL, the Department’s response indicates that a purchaser must obtain a Certificate of Eligibility “[p]rior to making a purchase of qualifying building materials.” As previously mentioned, exemption provisions are to be strictly construed, and all

doubts are resolved in favor of taxation. Heller, *supra*. A strict reading of the statute results in the conclusion that the Certificate of Eligibility should have been obtained prior to the purchase of the building materials. Because the Certificate of Eligibility was not issued until August 18, 2004, the taxpayer owes use tax on the purchases prior to that date.

Nevertheless, under these circumstances, the penalties attributable to the purchase of building materials between April 21, 2004 and August 18, 2004 should be abated due to reasonable cause. The Department imposed the late filing and late payment penalties 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 these penalties if the taxpayer shows that its failure to pay the tax at the required time was due to reasonable cause. 35 ILCS 735/3-8. Reasonable cause is determined on a case by case basis. 86 Ill. Admin. Code §700.400(b). Because the DCEO issued a certification in April 2004 and the taxpayer relied on that certification, the penalties attributable to these purchases should be abated.

The interest, however, may not be abated. An agency only has authority given to it by the legislature through the statute. Davis v. Chicago Police Board, 268 Ill. App. 3d 851, 856 (1st Dist. 1994). Because this tribunal has no statutory authority to reduce the interest in this case, it cannot be recommended that the interest be abated.

Recommendation:

For the foregoing reasons, it is recommended that the penalties attributable to the purchase of fixed assets that were incorporated into real estate from April 21, 2004

through August 18, 2004 should be abated. The remainder of the assessment should be upheld.

Linda Olivero
Administrative Law Judge

Enter: October 8, 2010