

**ST 12-08**

**Tax Type: Sales Tax**  
**Issue: Gross Receipts**

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

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

v.

**ABC Business,  
Taxpayer**

**No. XXXX**  
**Account ID XXXX**  
**Letter ID XXXX**  
**XXXX**  
**Period XXXX**

**Ted Sherrod**  
**Administrative Law Judge**

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**Appearances:** Special Assistant Attorney General John Alshuler on behalf of the Illinois Department of Revenue; John Doe, Esq. on behalf of ABC Business

**RECOMMENDATION FOR DISPOSITION**

**Synopsis:**

ABC Business (“taxpayer”) is an authorized agent of DEF Business Inc. (“DEF Business”) and is engaged in the sale of telephone service on DEF Business’s behalf. The taxpayer is also engaged in the sale of cellular phones provided to it by DEF Business, and prepaid telephone calling arrangements. The Illinois Department of Revenue (“Department”) audited the books and records of the taxpayer for the period January 1, 2004 through June 30, 2006. Based on this audit, the Department determined that payments the taxpayer received from DEF Business in connection with the taxpayer’s sale of cellular phones should have been included in the taxpayer’s gross receipts subject to Retailers’ Occupation Tax for the tax period

in question. The Department also determined that taxpayer should have collected and remitted tax on its sales of prepaid calling arrangements and that it also owed additional use tax on miscellaneous purchases it made during the tax period in controversy. On July 26, 2010 the Department issued Notices of Tax Liability for the period in question which the taxpayer promptly protested. A hearing in this matter was held before Administrative Law Judge John White.<sup>1</sup> During hearing proceedings, both the Department and the taxpayer introduced documentary evidence into the record, and the taxpayer presented the testimony of two witnesses on its behalf. At the commencement of the hearing, the taxpayer indicated that it was no longer objecting to the use tax liability indicated in the Department's Notices of Tax Liability but continued to disagree as to the remaining liabilities the Department determined.

Upon due consideration of the entire record in this case, including a review of all documentary evidence and testimony presented at hearing, I recommend that this matter be concluded in favor of the Department. In support of this recommendation, the following findings of fact and conclusions of law are made.

**Findings of Fact:**<sup>2</sup>

1. ABC Business ("taxpayer"), an Illinois corporation having its principal place of business in Anywhere, Illinois, is an authorized exclusive sales agent of XYZ Co. LLC and its affiliates a/k/a DEF Business ("DEF Business").<sup>3</sup> Tr. pp. 10, 15, 16; Taxpayer's Exhibit ("Ex.") A, F. Pursuant to its agreement with DEF Business, the taxpayer is only allowed to sell DEF

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<sup>1</sup> It is not a requirement that the Administrative Law Judge who heard and took evidence in this matter be the one to make the recommendation. American Welding Supply Co. v. Department of Revenue, 106 Ill. App. 3d 93 (5<sup>th</sup> Dist. 1982). The credibility of the witnesses that appeared at the hearing is not an issue in this matter.

<sup>2</sup> Unless otherwise noted, findings of fact apply to the tax period at issue in this case.

<sup>3</sup> Testimony in this case and a comparison of the taxpayer's exhibits indicates that XYZ Co. LLC and affiliates and U.S. Cellular are the same entity. See Tr. pp. 16, 17 (Taxpayer's contract with XYZ Co. described as a contract with U.S. Cellular); Department Ex. A, F.

Business products (including cellular phones DEF Business has contracted with the phone manufacturer to carry) and services. Tr. p. 15; Taxpayer's Ex. G.

2. The taxpayer purchases cellular phones exclusively from DEF Business and sells them to retail customers together with cellular telephone service from DEF Business. Tr. pp. 10, 15; Taxpayer's Ex. A, C, F.
3. By agreement between the taxpayer and DEF Business, the retail sales price of the cellular phones the taxpayer purchases from DEF Business is set by DEF Business and ranges from \$159.86 to \$499.95, depending upon the type of cellular phone being purchased. Taxpayer's Ex. B, F.
4. When the taxpayer purchases cellular phones from DEF Business, it pays DEF Business an amount per cellular phone that is between 10% and 50% less than the cellular phones' retail selling price. Tr. pp. 11, 12; Taxpayer's Ex. B.
5. Customers purchasing cellular phones from the taxpayer may purchase them with or without purchasing telephone service from DEF Business (i.e. entering into a two year service agreement for the provision of such service with DEF Business). Tr. pp. 10, 11. If a retail customer does not elect to enter into a service agreement with DEF Business, the taxpayer charges the customer the retail selling price of the cellular phone and collects Illinois sales tax on this retail selling price. Tr. p. 10. However, if the customer elects to enter into a service agreement with DEF Business to receive telephone service when it purchases a cellular phone from the taxpayer, the taxpayer charges the customer no more than 60% of the retail sales price of the cellular phone based upon a schedule of allowable discounts prescribed by DEF Business. Tr. pp. 10- 12; Taxpayer's Ex. B. Depending upon the type of

cellular phone the customer purchases, the customer's discount from the cellular phone's retail selling price can be as high as 99.9%. Taxpayer's Ex. B.

6. When the taxpayer sells cellular phones in a bundled transaction that also includes a sale of telephone service to the same customer, the taxpayer receives an equipment rebate from DEF Business which is based on the difference between the price charged the taxpayer for the cellular phone by DEF Business and the amount collected from the taxpayer's cellular phone customer. Tr. pp. 12, 13, 37.
7. DEF Business customers may cancel contracts for telephone service without charge within 30 days of signing up for such service; as a consequence, the taxpayer does not receive a rebate on cellular phone sales until this 30 day cancellation period has expired. Tr. pp. 12, 13, 20, 21, 37; Taxpayer's Ex. A, F.<sup>4</sup> Customers cancelling contracts for telephone service within 30 days are required to return cellular telephones to the taxpayer; the taxpayer then returns these cellular phones to DEF Business and receives a credit for the amount the taxpayer paid when the cellular phone was purchased from DEF Business for resale. Tr. pp. 14, 15, 23-25, 28, 29; Taxpayer's Ex. A, F.
8. During the tax period in controversy, the taxpayer collected sales tax on the actual sales price of the cellular phones it sold to its customers. Tr. pp. 10, 11. If a cellular phone having a retail sales price of \$169 was sold for \$9.95 in a bundled transaction together with the sale of telephone service, the taxpayer treated \$9.95 as its total gross receipt and collected and remitted tax on this amount. Tr. p. 11. When this \$169 cellular phone was sold for its retail sales price in a transaction that did not involve the purchase of telephone service, the

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<sup>4</sup> If a customer cancels its contract for telephone service with U.S. Cellular more than 30 days after entering into the contract for telephone service, the customer is required to pay a cancellation fee, but is allowed to keep the cellular phone it purchased. Tr. pp. 15, 24. Consequently, such customer cancellations after more than 30 days have no effect on the amount of the rebate from U.S. Cellular the taxpayer receives.

taxpayer treated the gross proceeds from the sale at the retail sales price as its total gross receipts and collected sales tax on this amount. Tr. pp. 10, 11.

9. During the tax period in controversy, the taxpayer remitted tax to the Department based upon the discounted sales price of each cellular phone sold in a bundled transaction that also involved the customer's purchase of telephone service. Department Ex. 2. In computing sales tax due, the taxpayer did not take into account the equipment rebate it received on each cellular phone sold in such bundled transactions that also involved the sale of telephone service. *Id.*
10. The Department conducted an audit of the taxpayer for the tax period in controversy, at the conclusion of which it assessed the taxpayer for underpayment of Retailers' Occupation Tax ("ROT") due on its sale of cellular phones that were sold at a discount when sold along with telephone service. Department Ex. 1, 2. This assessment was based upon the Department's determination that the taxpayer should have included in its gross receipts from cellular phone sales both the amount it collected from customers on cellular phone sales and the amount of the equipment rebate it received from DEF Business when it sold cellular phones at a discount. *Id.*
11. During the tax period in controversy, the taxpayer was also engaged in the sale of prepaid calling arrangements involving advance payments by customers for the right to receive future telephone service from XYZ, Inc. ("XYZ"), a third party telephone service provider. Tr. p. 38; Taxpayer's Ex. I. The taxpayer began collecting and remitting sales tax on these prepaid calling arrangements in June 2005. *Id.* Tax collections on these sales was undertaken pursuant to instructions the taxpayer received from DEF Business which were confirmed in

writing in a letter the taxpayer received from DEF Business dated July 28, 2005. Tr. pp. 38, 39, 42-44; Taxpayer's Ex. I.

12. During its audit of the taxpayer, the Department determined that the taxpayer owed ROT on its sales of prepaid calling arrangements for the portion of the tax period at issue commencing January 1, 2004 and ending May 31, 2005, the month before the taxpayer began collecting ROT on these sales. Tr. p. 56; Department Ex. 1, 2.
13. The taxpayer has filed a protest contesting the Department's assessment of tax indicated in the Department's Notices of Tax Liability on its sales of cellular phones at discount and on its failure to collect and remit sales tax on its sales of prepaid calling arrangements. Tr. p. 45.<sup>5</sup>

**Conclusions of Law:**

ABC Business ("taxpayer") is engaged in the sale of cellular phones, prepaid calling arrangements and telephone services as an exclusive agent for DEF Business, a telephone service provider. Tr. pp. 10, 15, 16. During the tax period in controversy, the taxpayer sold cellular phones and prepaid calling arrangements along with its sale of telephone services on DEF Business's behalf. Tr. pp. 10, 15, 16, 38; Taxpayer's Ex. A, B, C, F, I. In the instant case, the Department has assessed tax on the taxpayer's alleged underpayment of Retailers' Occupation Tax ("ROT") on its sales of cellular phones and on the taxpayer's failure to collect and remit sales tax on its sales of prepaid calling arrangements during the period January 1, 2004 through June 30, 2006. Department Ex. 1, 2. The taxpayer is contesting the foregoing tax assessments

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<sup>5</sup> The taxpayer has conceded the portion of the assessment pertaining to use tax due from the taxpayer during the tax period in controversy indicated in the Notices of Tax Liability at issue. This liability arises from the taxpayer's failure to self-assess use tax on its purchases of consumable supplies. Department Ex. 2. During the hearing, the taxpayer indicated that it is not contesting this portion of the Department's assessment determination. Tr. p. 5.

and avers that the Department's assessments are incorrect. For the reasons enumerated below, I find that the Department's assessments at issue in the instant case were proper.

### **Tax Due on Cellular Phone Sales**

This case involves the sale of tangible personal property, cellular phones, for a deeply discounted nominal price that was below the cost of the cellular phones to the taxpayer. Tr. pp. 10-12; Taxpayer's Ex. B. The record presented in this case indicates that the taxpayer sold cellular phones it purchased from DEF Business to its customers at a nominal price below the cost of cellular phones to the taxpayer when customers signed contracts for telephone service with DEF Business at the same time they purchased cellular phones. Tr. pp. 10-14. In effect, DEF Business provided cellular phones to customers at a discount through its agent, the taxpayer, as an incentive to customers to purchase telephone service from DEF Business. The taxpayer was able to sell the cellular phones it purchased from DEF Business below its cost for these cellular phones because it received payments from DEF Business, which were expressly designated as "rebates" to offset the loss the taxpayer would have otherwise incurred by selling cellular phones for less than it cost the taxpayer to buy them. Tr. pp. 12, 13, 37; Taxpayer's Ex. F.

The record indicates that the taxpayer collected Illinois sales tax on the nominal price it charged to customers purchasing cellular phones along with telephone service based on the amount paid for the cellular phones by these customers. Tr. pp. 10, 11. The Department contends that the measure of the Retailers' Occupation Tax ("ROT") used by the taxpayer on sales of cellular phones to customers at a discount was too low, because it did not reflect the total consideration the taxpayer received when it engaged in such sales. Department Ex. 2. It contends that a part of this consideration was the rebates the taxpayer received from DEF

Business. *Id.* Accordingly, the issue presented in this case is whether ROT was due from the taxpayer only on the discounted nominal amount it charged its customers for cellular phones when they also purchased telephone service or on a higher amount that included the rebates the taxpayer received from DEF Business when making such sales, as the Department alleges.

The Department has long expressed the position that the measure of ROT on the sale of cellular phones at deep discounts in connection with the sale of telephone service must include both the amount paid by the customer for the cellular phone, and any rebate that the cellular phone retailer receives from the cellular service provider to offset the loss the cellular phone retailer would otherwise suffer because it is selling cellular phones for less than the cellular phones' cost. See Illinois Department of Revenue General Information Letter No. ST 04-0114-GIL, 8/2/04; Illinois Department of Revenue General Information Letter No. ST 03-0149-GIL, 10/6/03. This Department position has recently been reaffirmed. See Illinois Department of Revenue General Information Letter No. ST-11-0046-GIL, 6/22/11. Consequently, the Department's expressed position is that tax can properly be imposed on amounts in addition to the nominal consideration the customer pays to the retailer at the time the customer purchases the cellular phone when the retailer also receives a rebate from the cellular phone supplier based upon its sale of these products.

The Department's position is succinctly summarized in Department of Revenue General Information Letter ST 04-0114-GIL dated August 2, 2004, wherein the Department, in replying to an inquiry from the taxpayer, states the following:

In your letter you have stated and made inquiry as follows:

...Taxpayer purchases cellular phones from its suppliers and since this is a transaction for resale, it pays no sales or use tax on the purchase. If a cellular phone is sold in a transaction that does not involve the customer signing a service contract (unbundled), it typically will be sold at more than its cost and

the appropriate sales tax will be collected. In certain promotional events, and when a customer agrees to enter into a contract with the third-party provider, a cellular phone will be ...sold at a very nominal price such as \$1.00 (Costs typically exceed \$100 per phone). In most cases, the cellular phone and maybe some accessories will be the only items that appear on the sales invoice.

QUESTION – What should be the basis ... for sales or use tax to be charged on the ...nominal charge phone? ...

**Department’s Response:** ... Your letter indicates that in some instances you receive at least some payment from the customer for the cellular phones. If you, as a retailer, sell cellular phones to your customers, then you incur Retailers’ Occupation Tax measured by the gross receipts from the sales. At the time you purchase cellular phones from your suppliers, you should supply a Certificate of Resale to the suppliers. Then, when you sell the cellular phones, you pay Retailers’ Occupation Tax based on the amount you receive from your customers. This amount represents the gross receipts received from the sale of the cellular phones. It is important, though, that retailers be very careful when computing the amount of gross receipts from the sales of their cellular phones. “Gross receipts” means “all the consideration actually received by the seller, except traded-in tangible personal property” from all sources. See 86 Ill. Admin. Code 130.401. If the money retailers receive from cellular service providers is the equivalent of a reimbursement for the discount offered to the customer, then this amount is included in gross receipts and is taxable. The retailers are required to collect a complimentary Use Tax liability from their customers when the sales of the cellular phones occur. The tax should be listed as a separate item from the selling price of the equipment and not as an administration or service charge. See 86 Ill. Admin. Code 150.135 ... [.]

An analysis of the Department’s stated position regarding whether tax is due on amounts exceeding the nominal charge to the customer when cellular phones are sold at a discount in connection with the sale of telephone services indicates that it is soundly based upon Illinois statutory and case law. Section 120/1 of the Retailers’ Occupation Tax Act contains the following definition of “gross receipts.”

“Gross Receipts” from the sale of tangible personal property means the total selling price or the amount of such sales, as hereinbefore defined.

35 ILCS 120/1

The term “selling price” referred to and used in the above definition of “gross receipts” is defined as follows:

“Gross receipts” means all the consideration actually received by the seller, except traded-in tangible personal property.  
86 Ill. Admin. Code, ch. I, section 130.401

It is clear from a plain reading of the above definitions that the Illinois General Assembly intended that all compensation received by a seller, including payments from third parties, be included in “gross receipts.” “Gross receipts” as defined in 35 **ILCS** 120/1 means “the total selling price” (emphasis added). The use of the word “total” here is certainly an indication that the General Assembly meant to include all consideration without limitation as to whether it was from one or more sources. Likewise, the General Assembly did not limit “gross receipts” in 35 **ILCS** 120/1 to compensation agreed to or paid only by the purchaser.

Additionally, 35 **ILCS** 120/1 defines “selling price” to mean the “consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property ... and service ...[.]” The definition does not require that the “cash, credits, property and service” be received solely from the purchaser. The only requirement of the definition is that the consideration be “received in money or otherwise” by the seller, without any limitation placed on whom or from what source the consideration is received.

Further, the Department’s regulations, which define “gross receipts” to include “all consideration actually received by the seller,” reflect the legislative intent and do not require that the consideration be agreed to or known to the purchaser (emphasis added). 86 Ill. Admin. Code, ch. I, section 130.140. Again, the only requirement of this definition is that the “consideration” be received “by the seller.”

The foregoing definitions of “selling price” and “gross receipts” are completely at odds with the taxpayer’s compliance in this case, pursuant to which the taxpayer included only the consideration that passed from the cellular phone purchaser to the taxpayer in its taxable gross

receipts. As is self evident from the foregoing, the definitions above do not support a finding that the taxpayer's compliance at issue in this case was proper. "Gross receipts" includes "all consideration" and there is obviously no requirement that the consideration included in the definition be limited to one source.

The focus of the statutory definitions noted above is how much consideration a seller receives from a particular sale. This consideration may consist of, and in many cases may total, the consideration tendered by the purchaser. However, the definitions cannot be read to require that consideration be limited to that tendered by the purchaser. The use of the word "total" in 35 **ILCS** 120/1 and "all" in the Department's definition of "gross receipts" would have no meaning or significance if consideration was limited to that received only from the purchaser. It is a basic premise of statutory construction that all words used in a statute must be considered in an interpretation of the provision, and it is improper to read out of or otherwise render meaningless any statutory words. Follett Corp. v. Illinois Department of Revenue, 344 Ill. App. 3d 388 (4<sup>th</sup> Dist. 2003); Central Illinois Light Company v. Department of Revenue, 335 Ill. App. 3d 412 (4<sup>th</sup> Dist. 2002).

The conclusion, that the "gross receipts" on which the taxpayer was required to collect tax should have included the equipment rebate received from DEF Business, is also supported by the Department's regulation 86 Ill. Admin. Code, ch. I, section 130.2125(b)(1),(2). This regulation covers situations in which a manufacturer reimburses a seller for the discounts given the seller's customers presenting coupons reducing the price paid by the purchaser. Consequently, it relates to transactions similar to those at issue in this case. This regulation provides, in part, as follows:

b) Discount Coupons

1) Where the retailer receives no coupon reimbursement:

If a retailer allows a purchaser a discount from the selling price on the basis of a discount coupon for which the retailer receives no reimbursement from any source, the amount of the discount is not subject to Retailers' Occupation Tax liability. Only the receipts actually received by the retailer from the purchaser, other than the value of the coupon, are subject to tax. For example, if a retailer sells an item for \$10 and the purchaser provides the retailer with a \$1 in-store coupon for which the retailer receives no reimbursement from the manufacturer of the item or any other source, the retailer's gross receipts of \$9 are subject to Retailers' Occupation Tax.

2) Where the retailer receives full or partial coupon reimbursement:

A) If a retailer allows a purchaser a discount from the selling price on the basis of a discount coupon for which the retailer will receive full or partial reimbursement (from a manufacturer, distributor or other source), the retailer incurs Retailers' Occupation Tax liability on the receipts received from the purchaser and the amount of any coupon reimbursement. For example, if a retailer sells an item for \$15 and the purchaser provides the retailer with a \$5 manufacturer's coupon for which the retailer receives full reimbursement from the manufacturer of the item, the retailer's gross receipts of \$15 are subject to Retailers' Occupation Tax. Technically, the coupon issuer (the manufacturer in this example) owes the corresponding Use Tax on the value of the coupon. However, in many cases, the coupon Issuer incorporates language into the coupon that requires the bearer (the purchaser in this example) to assume this Use Tax liability.

Pursuant to regulation section 130.2125(b)(2), noted above, if the manufacturer's coupon reduces the price paid by the purchaser, and the manufacturer reimburses the seller for the discount, the "total selling price" subject to ROT then includes the amount that the purchaser actually paid plus the amount of the proceeds received by the seller from the manufacturer. The "gross receipts" which "means all consideration actually received by the seller," subject to ROT, would include the amount paid to the seller from the purchaser and the amount paid to the seller from the manufacturer.

The Illinois Appellate Court's ruling in Ogden Chrysler Plymouth, Inc. v. Bower, 348 Ill. App. 3d 944 (2d Dist. 2004) also supports the Department's position in this controversy. In this case, the court sustained the application of the ROT to payments received by a car dealer from a

manufacturer pursuant to the manufacturer's employee/retiree purchase program, which entitled the manufacturer's present or former employees to purchase vehicles at a reduced price. The court found that sales pursuant to this purchase program involved a single transaction for which the dealer received payments from both the purchaser and the manufacturer. The court concluded that the dealers' gross receipt for such sales included payments from both the purchaser and the manufacturer. In explaining its rationale for reaching this conclusion, the court notes the following:

[E]ach transaction involves not only [the dealer] and the purchaser, but also [the manufacturer]. This is so because, but for [the dealer's] agreement to sell or lease vehicles under the program, [the dealer] would not receive the payments from [the manufacturer]. Thus, each [manufacturer] payment is a bargained-for element of every transaction, albeit between [the manufacturer] and [the dealer] and not between the purchaser and [the dealer]. This difference does not render the [manufacturer-dealer] side of each transaction irrelevant in determining ROT liability.  
Ogden Chrysler, *supra* at 801.

The taxpayer argues that the Appellate Court's ruling in Ogden Chrysler is not applicable in the instant case, stating as follows:

I reviewed the Chrysler case. This case is distinguishable and different.

DEF Business is having the customer sign long term contracts, so the phone is kind of incidental, but it's kind of a bundled package program what they're selling. It's not separable.

And the Chrysler case, as I mentioned before, I agree that rebate has to be included. If a retailer after receiving the rebate from the manufacturer discounted the amount to the customer, that discounted amount has to be included as a gross receipt in calculation of sales tax. I agree with that. I don't object to that.

But this case is different because the rebate amount is contingent upon, as I mentioned before, contingent upon DEF Business signing a contract, a long term contract with the customer.

Tr. p. 58

The taxpayer's argument raises the issue whether the taxpayer's cellular phone sales transactions, although treated as ROT transactions by both the Department and the taxpayer for compliance purposes, were in fact sales of tangible personal property that were merely incidental to sales of services and therefore not subject to the ROT. If the taxpayer's contention had merit, the Ogden Chrysler case would not be applicable since it only addresses the liabilities due from taxpayers that are engaged in ROT transactions.

Under Illinois law, taxpayers engaged in the sale of services involving transfers of tangible personal property that are treated for tax purposes as being merely incidental to their sales of services are subject to this state's Service Occupation Tax rather than to the ROT. The Illinois Service Occupation Tax ("SOT") is imposed "upon all persons engaged in the business of making sales of service (referred to as 'servicemen') on all tangible personal property transferred as an incident to the sale of service...[.]" 35 ILCS 115/3. A "sale of service" is defined as any transaction other than a retail sale or a sale for the purpose of resale. 35 ILCS 115/2. The tax is computed as a percentage of the cost price to the serviceman of the tangible personal property. 35 ILCS 115/3-10. Charges for services apart from the cost price of tangible personal property are not subject to this tax. *Id.* In the instant case, if the transactions at issue were subject to SOT, the taxpayer would not owe ROT on its cellular phone sales, but would owe tax on the cost price of cellular phones it purchased for resale in connection with its sale of telephone service.

The taxpayer's contention, implicit in the taxpayer's attempt to distinguish the Ogden Chrysler case noted above, by classifying the transactions at issue as involving transfers of tangible property that were merely incidental to its sales of services, fails when measured by the test that has been developed by the Illinois Supreme Court for determining whether a business is

subject to the SOT. In Colorcraft Corporation, Inc. v. Department of Revenue, 112 Ill. 2d 473 (1986), a case holding that photofinishing constitutes a service transaction rather than retailing, the court indicates this test:

If the article sold has no value to the purchaser except as a result of services rendered by the vendor and the transfer of the article to the purchaser is an actual and necessary part of the service rendered, then the vendor is engaged in the business of rendering service and not in the business of selling at retail. If the article sold is the substance of the transaction and the service rendered is merely incidental to and an inseparable part of the transfer to the purchaser of the article sold, then the vendor is engaged in the business of selling at retail. [citations omitted]  
Colorcraft, *supra* at 482. See also Spagat v. Mahin, 50 Ill. 2d 183, 189 (1971).

In amplifying upon the reasoning underlying the distinction drawn by this test, the court states as follows:

In Spagat, the issue was whether the sale and installation of custom wall-to-wall carpeting was a retail occupation or a service occupation. Thus the court held that “it is the carpeting which is the substance of the transaction, and the services involved in laying the carpeting wall-to-wall, no matter how skillfully performed, are ‘merely incidental to and an inseparable part of the transfer.’ ...We believe that the article sold in the instant case, the finished prints, have no value to the customer except as a result of the services rendered by Colorcraft. ...[A]lthough the transfer of prints ...is an actual and necessary part of the service rendered, it is the service of creating prints which is the essence of the transaction.”  
Colorcraft, *supra* at 483.

In the present case, the retail value of cellular phones the taxpayer sells is separated from the taxpayer’s charge for telephone service from DEF Business when cellular phones and telephone service are sold in a bundled transaction to a single purchaser. Tr. pp. 10, 11; Taxpayer’s Ex. B. The record in this case supports a finding that this retail value to customers exists whether or not they agree to purchase telephone service from DEF Business. This conclusion is dictated by the fact that the taxpayer, in addition to selling cellular phones along with telephone service, also sells the same cellular phones separately to customers that do not

elect to purchase telephone service from the taxpayer. Tr. pp. 10, 11; Taxpayer's Ex. B. These customers can elect to purchase service from a service provider other than DEF Business without diminishing in any way the retail value of the cellular phones they have purchased.

For the reasons enumerated in Colorcraft noted above, the fact that the telephone service the taxpayer sells adds no real value to the cellular phone the customer purchases from the taxpayer clearly indicates that the substance of the transactions at issue in this case is the customer's purchase of cellular phones, and not the purchase of telephone service. Consequently, under the test enumerated in Colorcraft, the taxpayer is properly subject to ROT on its cellular telephone sales.<sup>6</sup> Since the transactions at issue in this case are subject to ROT, I find that they are governed by Ogden Chrysler, which supports the Department's assessments.

As a general rule, the ROT applies to all sales at retail unless the taxpayer produces evidence in the form of books and records to show that the sales are not subject to ROT. H.D., Ltd. v. Department of Revenue, 297 Ill. App. 3<sup>rd</sup> 26, 34 (2d Dist. 1998). Section 4 of the Retailers' Occupation Tax Act provides that the certified copy of the notice of tax liability issued by the Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 ILCS 120/4. The burden shifts to the taxpayer to overcome this presumption of validity once the Department has established its *prima facie* case by submitting the notice into evidence. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 832 (1<sup>st</sup> Dist. 1988). To prove its case, a taxpayer must present more than its testimony denying

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<sup>6</sup> The taxpayer also contends that taxes other than ROT paid by U.S. Cellular must be credited against the taxpayer's ROT liability because they relate to the amount of revenues generated by the taxpayer's cellular phone sales. Tr. pp. 45-49. Specifically, the taxpayer claims that part of the amounts customers pay U.S. Cellular for telephone service should be treated as payments for the cellular phones the taxpayer sells at discount on U.S. Cellular's behalf. *Id.* However, the taxpayer has presented no records of U.S. Cellular tax payments, or any other evidence to support this claim. Consequently, I find that the taxpayer has failed to prove that it is entitled to the tax relief it espouses. Balla v. Department of Revenue, 96 Ill. App. 3d 293, 295 (1981) ("[W]hen a taxpayer claims that he is exempt from a particular tax, or where he seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer.")

the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1<sup>st</sup> Dist. 1991). The taxpayer must present sufficient documentary evidence to support its claim. *Id.*

For the reasons enumerated above, I find that the taxpayer has failed to present any factual or legal basis to support its claim that its ROT liability should be measured only by taxes it collected from customers when making sales of cellular phones at a discount in bundled transactions that also involved its receipt of rebates on cellular phone purchases for resale when its cellular phone sales to customers were coupled with sales of telephone services. Accordingly, I find that the Department properly assessed liability for underreporting and underpayment of sales tax on cellular phone sales during the tax period at issue in the instant case.

#### **Tax Due on Prepaid Calling Arrangements**

As indicated above, during the tax period at issue in this case, the taxpayer was engaged in the sale of prepaid calling arrangements. Tr. p. 38; Taxpayer's Ex. I. The record shows that the taxpayer failed to collect sales tax on these sales and did not remit ROT on its sales of prepaid calling arrangements during a portion of the tax period in controversy. These prepaid calling arrangements involved the sale of prepaid telephone usage time, including the replenishment of usage time after the initial usage time purchased by the taxpayer's customers expired. Taxpayer's Ex. I. The telephone service acquired through the purchase of these prepaid calling arrangements was provided by XYZ. *Id.*

Under Illinois law that became effective January 1, 2001, "prepaid telephone calling arrangements" are considered sales of tangible personal property subject to the Illinois ROT and are exempt for Illinois Telecommunications Excise Tax. 35 ILCS 120/2; 35 ILCS 105/3; 35 ILCS 630/3; 86 Ill. Admin. Code, ch. I, section 130.101. "Prepaid telephone calling

arrangements” are defined as the right to exclusively purchase telephone or telecommunications services in advance of their use, and enable the purchaser to originate intrastate, interstate, or international calls or other telecommunications using an access number or an authorization code. 35 ILCS 105/3-27; 35 ILCS 120/2-27; 86 Ill. Admin. Code, ch. I, section 130.101. These arrangements include the replenishment of “prepaid telephone calling arrangements” that have previously been acquired. *Id.*

At the time the law changed, making “prepaid telephone calling arrangements” subject to ROT, taxpayers were notified of this change by Illinois Department of Revenue Information Bulletin No. FY 2001-03, issued on August 1, 2000. This Information Bulletin stated in part as follows:

**To: Retailers who sell prepaid telephone calling cards and other prepaid telephone calling arrangements**

Beginning January 1, 2001, prepaid telephone calling arrangements, which are most commonly sold as prepaid telephone calling cards, and the recharges of these cards or other arrangements will be considered tangible personal property. The receipts from these sales will be subject to sales tax.

Prepaid telephone calling arrangements were previously taxed under the Telecommunications Excise Tax Act.

**What is a “recharge?”**

The term “recharge” means the purchase of additional prepaid telephone or telecommunications services. The purchaser may or may not acquire a different access number or authorization code.

**What is a “prepaid telephone calling arrangement?”**

- Your customer has paid you for telephone or telecommunications services in advance, and
- Those services enable the origination of one or more intrastate, interstate, or international telephone calls or other telecommunications, and
- Access to the service is by either manually or electronically dialing an access number, authorization code, or both ...[.]

In spite of the foregoing legislative mandate to pay ROT on “prepaid telephone calling arrangements”, the taxpayer contends that the ROT should not be applied to its sales of these

items during the period January 1, 2004 through May 31, 2005, all of which is subsequent to the effective date of the aforementioned legislation making “prepaid telephone calling arrangements” subject to sales tax. In explaining its failure to collect and pay ROT on such prepaid calling arrangements during the tax period at issue, the taxpayer states the following:

As to the prepaid minutes, I think it’s pretty much self-explanatory that up until June, the middle of June 2005, there was (*sic*) no instructions from DEF Business on what to do with this (*sic*) prepaid minutes.

And the Taxpayer was informed that all agents should collect the sales tax soon, so they started implementing as soon as they heard this announcement. They started implementing and collecting tax in the middle of June 2005. And then a month later this official letter came to the Taxpayer asking them to start collecting sales tax on these prepaid minutes beginning October 1, 2005.

The Taxpayer decided to collect sales tax anyway and then remit it to the Department from the middle of June through the end of September. And it is the Taxpayer’s understanding, it is my understanding, and it is what it says in the letter that prior to October 1, 2005, that XYZ, DEF Business’s designated third party carrier who does all of the prepaid minute arrangements, they’re the one responsible for paying the telecommunications tax on the prepaid minutes they received from the customer up to October 1, 2005.

Taxpayer has been charged, assessed sales tax on prepaid minutes they sold over the other period, which amounts to \$829,498.12. Based on the exhibits, based on the evidence and based on the testimony, telecommunications tax on this amount has been paid, which needs to be verified, by third party carrier, XYZ, as part of DEF Business.

So if, in fact, the same argument, if the Department tried to charge sales tax on this amount to DEF Business, they would be charging two different taxes on the same amount of dollars, which, I believe, that’s not equitable and cannot be justifiable.

Tr. pp. 49-50

As is evident from the above, the taxpayer’s only legally cognizable excuse for its failure to collect and pay over tax on its sales of prepaid calling arrangements is its claim that this liability was effectively offset by the Telecommunications Excise Tax (35 ILCS 630/1 *et seq.*) paid by XYZ, the company that actually provided the telephone services to which customers became entitled through the purchase of prepaid telephone usage time from the taxpayer.

Taxpayer's Ex. I. As a threshold matter, I find that, by the taxpayer's own admission, there is insufficient evidence in the record to support a claim that any Telecommunications Excise Taxes were paid by XYZ on the transactions at issue in this case. (The taxpayer states above that such payments by XYZ "needs to be verified"). This claim is based solely upon the unsubstantiated and undocumented averment of the taxpayer.

Moreover, even if the taxpayer could substantiate its claim that XYZ continued to collect and pay Telecommunications Excise Tax on the prepaid calling arrangements the taxpayer sold, in spite of the law change directing it not to do so, the taxpayer has provided no legal basis for its claim that it is entitled to offset the amounts it claims XYZ paid against its sales tax liability. Indeed, the legal premise of the taxpayer's argument, which is the taxpayer's claim that the tax paid by XYZ duplicated the taxpayer's ROT liability, is completely without merit.

The Telecommunications Excise Tax is imposed on consumers of telecommunications services in Illinois. 35 ILCS 630/3; 86 Ill. Admin. Code, ch. I, section 495.140. This tax only applies to service transactions involving the transmission of interstate and intrastate telephone messages. *Id.*

The ROT is an entirely different tax imposed upon taxpayers engaged in the business of making retail sales of tangible personal property. See 35 ILCS 120/2. The Telecommunications Excise Tax is not a duplicate ROT because, unlike the ROT, it is only imposed upon the sale of services which are exempt from ROT.<sup>7</sup> The ROT only applies to sales of tangible personal property, and therefore excludes services that are subject to the Telecommunications Excise Tax. *Id.*

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<sup>7</sup> As noted above, the legislature, in defining the sale of "prepaid telephone calling arrangements" as the sale of tangible personal property subject to the ROT, expressly exempted such sales from the Telecommunications Excise Tax. 35 ILCS630/3.

The Telecommunications Excise Tax and the ROT are imposed for different purposes, on different parties and on different types of transactions. Therefore, the taxpayer's failure to pay ROT on prepaid calling arrangements was not obviated by any Telecommunications Excise Tax the taxpayer speculates XYZ may have paid. Given the foregoing, the imposition of ROT for unpaid ROT taxes on prepaid calling arrangements is not impermissible or inequitable double taxation as the taxpayer implies. Clark Oil & Refining Corporation v. Thomas Johnson, 154 Ill. App. 3d 773 (1<sup>st</sup> Dist. 1987) ("Double taxation exists where two taxes are imposed for the same period of time, for the same purpose, upon the same property, by the same taxing authority[.]") (emphasis added)). For the foregoing reasons, I find that the taxpayer's objection to the imposition of the ROT on its sales of prepaid calling arrangements in this case is without merit.

In sum, the taxpayer has provided no factual or legal basis for its claim that it is entitled to offset against its ROT liability the Telecommunications Excise Tax it alleges was erroneously paid by XYZ on services provided in connection with the taxpayer's sale of prepaid calling arrangements prior to the taxpayer's commencement of sales tax collections on such sales in June 2005. For this reason, I find that the taxpayer has failed to prove that the Department's assessment of tax based upon its failure to collect and remit ROT on such sales during a portion of the tax period in controversy was erroneous.

## **Conclusion**

**WHEREFORE**, for the reasons stated above, it is my recommendation that the Department's assessments for unpaid ROT and Use Tax for the period January, 2004 through June, 2006 indicated in the Department's Notices of Tax Liability at issue in this case be affirmed in their entirety.

**Ted Sherrod**  
**Administrative Law Judge**

**Date: May 31, 2012**