

UT 02-4

Tax Type: Use Tax
Issue: Tangible Personal Property
Use Tax On Purchases of Building Materials & Supplies
Commerce Clause (U.S. Const.) Controversy

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

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

v.

ABC INC.,
Taxpayer

No. 01-ST-0000
IBT No. : 0000-0000
Audit periods: 3/94 thru 5/99

Charles E. McClellan
Administrative Law Judge

RECOMMENDATION FOR DECISION

Appearances: George Foster, Special Assistant Attorney General, for the Department of Revenue; James M. Murray, for ABC, Inc.

Synopsis:

This matter arose from a protest filed by ABC, Inc. (“taxpayer”) to a Notice of Tax Liability issued by the Department for Illinois use tax liabilities during the periods March 1994 through May 1999. The issue in this matter is whether the taxpayer, located in Wisconsin, is liable under the Illinois Use Tax Act¹ for tax on prefabricated wooden trusses it manufactured and sold to contractors located in Illinois during the audit periods. The parties filed a stipulation of facts, and the taxpayer waived its right to an evidentiary hearing. Both parties filed briefs.

¹ Unless otherwise noted, all statutory references are to 35 ILCS 120/1, *et seq.*, the Retailers’ Occupation Tax Act. (ROTA) or 35 ILCS 105/1, *et seq.*, the Illinois Use Tax Act. (UTA).

I recommend that the Notice of Tax Liability be made final.

Finding of Facts:

1. The taxpayer is a Wisconsin corporation that was voluntarily dissolved in 1999. It was never qualified by the Illinois Secretary of State to conduct business in Illinois. Stip. ¶ 1.²
2. The taxpayer's only place of business was located at Anywhere, Wisconsin. The taxpayer had no office or other place of business in Illinois. Stip. ¶ 2.
3. The taxpayer engaged in the business of manufacturing prefabricated wooden trusses used in the construction of buildings. The taxpayer employed 20 to 25 people at the Anywhere, Wisconsin facility. The trusses were sold primarily to contractors. Stip. ¶ 3.
4. The Department of Revenue audited the taxpayer for the months of March 1994 through May 1999. Stip. ¶ 4.
5. During the audit period, the taxpayer had no business locations in Illinois, owned no property in Illinois and had no employees in Illinois. Stip. ¶ 6.
6. During the audit period, the taxpayer had no salespersons in Illinois. It did have an unwritten arrangement with a self-employed structural engineer to pay the engineer a commission of ten percent for business he referred to the taxpayer. The engineer referred to the taxpayer approximately three to five new customers mostly located in Illinois during each year of the audit period. In any given year, the engineer received \$10,000 to \$20,000 in commissions from the taxpayer. Stip. ¶ 7
7. The taxpayer's usual procedure for doing business began with the receipt in Anywhere, Wisconsin of a proposal from a customer by mail, telephone or fax. The taxpayer

² In this recommendation, citations to the stipulation will be identified by paragraph number as Stip. ¶ n.

would then prepare a cost estimate and mail or fax the proposal to the customer from its facility in Anywhere, Wisconsin. Stip. ¶ 8.

8. All contracts for the purchase of the taxpayer's trusses were accepted and signed by the taxpayer at its Anywhere, Wisconsin office. Stip. ¶ 9.

9. When completed, the trusses were loaded on trucks and delivered to the job site F.O.B. the job site. Stip. ¶ 10.

10. The only contacts with Illinois that the taxpayer had during the audit periods were the following:

- (1) General advertising in national or regional trade journals that were distributed to customers in Illinois and other states and some direct mail advertising to customers in Illinois as well as in other states.
- (2) Delivery of the trusses to the job site by taxpayer owned truck or unrelated hauler. Most of the trusses were delivered in company owned trucks and were unloaded onto the ground at the job site.
- (3) For small jobs, the taxpayer would sometimes install the truss at the job site using its own crane mounted on the truck. Otherwise, the customer would normally be responsible for installing the trusses.
- (4) The taxpayer's president, who lived in Illinois, would occasionally pick up drawings for the convenience of the customer on his way to or from work in Anywhere, Wisconsin.
- (5) Approximately twice a month the taxpayer's president would visit a job site in Illinois to investigate a problem. Infrequently, a designer employed by the taxpayer in Wisconsin would visit a job site in

Illinois to solve problems or to get information from the customer that the taxpayer needed. Stip. ¶ 11.

11. No employee of the taxpayer ever visited a potential customer in Illinois for sales purposes. *Id.*
12. The taxpayer collected sales tax on sales in Wisconsin but did not collect any sales or use tax from any customer located in Illinois. Stip. ¶ 12.
13. Taxpayer's contracts with its customers specifically state that, "Deliveries outside Wisconsin are not subject to the Wisconsin Sales Tax. Any taxes that may apply are the responsibility of the purchaser." Stip. ¶ 14.
14. The Department of Revenue prepared a corrected return and a Notice of Tax Liability that it sent to the taxpayer showing an assessment of tax, interest and penalties for a total amount of \$130,271. Stip. ¶ 4, Stip. Ex. No. 1.

Conclusions of Law:

The tax at issue in this case is the UTA. The UTA imposes a tax "upon the privilege of using in this State tangible personal property purchased at retail from a retailer . . ." 35 ILCS 105/3. The statute provides that a "retailer" is any person having . . . any agent or other representative operating within this State under the authority of the retailer . . ." 35 ILCS 105/2. The UTA requires that the tax be collected by a retailer maintaining a place of business within the state. 35 ILCS 105/3-45. The statute does not define the term "operating" as used in the statute, however, given its common and ordinary meaning, it has been held to include delivering products to a customer by a retailer. *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, 419; 665 N.E.2d 795, 800 (1996) ("When Brown's Furniture made deliveries in Illinois during the 10-month audit period, they were

‘operating’ within the State as that term is ordinarily understood. Thus, Brown’s Furniture’s deliveries in Illinois bring it within the ambit of the Act.”).

In this case the taxpayer delivered the majority of its prefabricated trusses to its customers in Illinois on its own trucks. It delivered the remainder by hiring independent haulers. In some cases, taxpayer’s employee installed the trusses at the customer’s building site. All of taxpayer’s sales were conducted F.O.B. (free on board) point of delivery. That means that the seller, the taxpayer, assumed all responsibility for the shipments to the place of delivery.³ In those cases in which the taxpayer delivered the trusses on its own trucks, and in those cases in which the taxpayer’s employee installed the trusses using the truck mounted crane, the taxpayer was operating directly in Illinois. In addition, the visits by the taxpayer’s president and its designers to customers or their building sites in Illinois were additional business contacts in Illinois. By delivering the trusses on its own trucks to its customers in Illinois, the taxpayer was operating in Illinois as a retailer within the meaning of the UTA as the term “operating” is defined in *Brown’s Furniture, supra*, so it is within the ambit of the Act and had a statutory obligation to collect the Illinois use tax on the sales made to customers in Illinois.

The UTA makes numerous sections of the Retailers’ Occupation Tax Act (120 ILCS 120/1 *et seq.*) applicable to the Use Tax, including §§ 120/4 and 120/8, 35 ILCS 105/12. Accordingly, the admission into evidence of the records of the Department under the certification of the Director at a hearing before the Department or any legal proceeding establishes the Department’s *prima facie* case. 35 ILCS 120/4, 120/8; Copilevitz v. Department of Revenue, 41 Ill.2d 154, 242 N.E.2d 205 (1968); Central Furniture Mart v.

³ ‘When the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them . . .’ 810 ILCS 5/2-319(b).

Johnson, 157 Ill.App. 3d 907 (1st Dist. 1987). Thus, when the Department introduced the corrected return and Notice of Tax Liability under the certificate of the Director by attaching them as exhibits to the stipulation, the Department's *prima facie* case was established.

To overcome the Department's *prima facie* case the taxpayer must present consistent, probable evidence identified with his books and records. Copilevitz v. Department of Revenue, *supra*; Central Furniture Mart v. Johnson, *supra*. Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203, (1st Dist. 1991), A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34 (1st Dist. 1988), 86 Admin. Code ch. I, § 130.1405 (a). I find that the taxpayer has failed to provide sufficient proof to overcome the Department's *prima facie* case.

The taxpayer in this case relies incorrectly on the Department's regulations to support its opinion that it is not liable for the tax. Taxpayer quotes a portion of 86 Ill. Admin. Code § 130.2075(c) that provides, "If the purchaser buys such materials outside Illinois from an unregistered seller, the purchaser should pay the Use Tax directly to this Department." Taxpayer argues that since the truss sales were made outside of Illinois from an out of state seller the burden of paying the tax was on the Illinois purchasers. Taxpayer has taken this language out of context. The regulation in relevant part reads as follows:

If the purchaser buys such materials outside Illinois from an unregistered seller, the purchaser should pay the Use Tax directly to this Department. No local Retailers' Occupation Tax is applicable in this situation. 86 Ill. Admin. Code § 130.2075(c).

This section of the regulation obligates the purchaser to pay the use tax if it is not collected by the retailer, and it makes it clear that the ROTA does not apply to the

transaction. It does not relieve an out of state vendor whose activities in Illinois bring it within the ambit of the UTA from its statutory obligation to collect the use tax. Taxpayer also quotes language from a regulation that provides, that the ROTA does not apply, “where the purchaser sends an offer or counteroffer to purchase directly to the seller outside Illinois and the seller accepts the offer or counteroffer outside Illinois.” 86 Ill. Admin. Code § 130.610(d)(1)(C)⁴. This section also refers to the ROTA, so it does not relieve an out of state vendor whose activities in Illinois bring it within the ambit of the UTA from the statutory obligation to collect the use tax.

The taxpayer also argues that it should not be held liable for the uncollected use tax because it did not collect the tax from its Illinois customers, so it is not holding money that belongs to someone else, and the taxpayer’s contract specifically advised its Illinois customers that no tax would be collected and that any tax due on the transactions was the responsibility of the purchaser. Taxpayer argues further that the Department knows who the customers are and it should collect the tax from them.

These arguments fail for two reasons. First, an individual cannot contract away an obligation imposed on him or her by statute. *Hertz Corp. v. Garrott*, 238 Ill.App.3d 231, 238; 606 N.E. 2d 219, 223 (1st Dist. 1992) (a disclaimer of liability in a car rental agency’s rental agreement cannot negate the agency’s statutory obligation to provide liability insurance coverage.) Second, the obligation to collect the use tax was placed on the out-of-state retailer because of the impracticality of collecting the tax from individual purchasers. *Brown Furniture*, 171 Ill.2d at 418, 665 N.E.2d at 800. The Department has no obligation to pursue purchasers for the use tax in cases where the statute places the obligation to collect it on the retailer.

⁴ Taxpayer incorrectly cites this provision in it’s brief as being in § 610(b)(1).

Next, the taxpayer argues that the Commerce Clause in the United States Constitution bars the Department from collecting the tax from the taxpayer. The taxpayer argues that the Commerce Clause, which generally prohibits states from taxing interstate commerce, requires that an out-of-state taxpayer must have a significant presence in Illinois before Illinois can require it to collect use tax from sales to Illinois customers for delivery in Illinois. The taxpayer argues that it did not have a significant physical presence in Illinois, so by assessing the use tax at issue, the Department is violating the Commerce Clause prohibition against states taxing interstate commerce.

Taxpayer cites a number of decisions of the United States Supreme Court dealing with the nexus issue in support of its argument that the Commerce Clause bars the Department from collecting the tax assessed. Each of these cases involve the issue of nexus, *i.e.*, the connection or link, between the out-of-state vendor and the taxing state, required for the tax to pass constitutional muster.

The U. S. Supreme Court has long held that the states can impose a tax on interstate commerce to require it to bear its fair share of the tax burden. *National Bellas Hess, Inc. v. Dept. of Revenue*, 386 U.S. 753, 756; 878 S. Ct. 1389, 1391 (1967). The issue has always been how much of a connection or link must there be between the taxing state and the out-of-state vendor. In *National Bellas Hess*, the Court held that the vendor located in Kansas could not be required to withhold Illinois use tax from customers in Illinois because the only contact the vendor had with customers in Illinois was by common carrier delivering goods purchased from catalogs it sent to its Illinois customers once or twice a year.

More recently, on March 7, 1977, the U.S. Supreme Court decided *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 97 S.Ct. 1076. In that case the Court promulgated a

four-prong test to determine if a state tax passes constitutional muster. It held that a tax will sustain a Commerce Clause challenge if the activity to which it is applied has a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State. 430 U.S. at 279, 97 S.Ct. at 1078.

On April 7, 1977, one month after the Supreme Court decided *Complete Auto*, it decided *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 97 S.Ct. 1386. In that case, the Court rejected the principle adopted by the California Supreme Court that where an out-of-state seller utilizes only the mail and common carriers to serve its customers in a state, the slightest physical presence in the state of the out-of-state seller provides sufficient nexus to justify requiring the out-of-state seller to collect use tax on sales to customers within the state. However, the Court held that the two sales offices that the Society maintained on a continuing basis in California provided enough nexus to justify California's imposition of the obligation to collect use tax on sales of maps, globes and similar items solicited from the California offices but completed by shipment by common carrier from the Society's facility in the District of Columbia.

The most recent Supreme Court case involving the nexus issue cited by the taxpayer is *Quill Corp. v. North Dakota*, 504 U.S. 298, 112 S.Ct. 1904 (1992). In that case, North Dakota attempted to require Quill, an out-of-state mail order seller, to collect and pay use tax on goods it sold to customers in North Dakota through its mail order operation even though Quill had no facilities, sales or other personnel located in the state. The North Dakota Supreme Court upheld the assessment concluding that the physical presence requirement promulgated in *Bellas Hess* was no longer appropriate because of changes in

the economy and the law since it was decided in 1967. The U.S. Supreme Court reviewed the long line of cases it had decided involving the nexus issue under the Due Process Clause of the 14th Amendment and under the Commerce Clause and agreed that physical presence is no longer a requirement under the Due Process Clause. It then reviewed the cases it had decided regarding nexus required under the Commerce Clause and concluded that the *Bellas Hess* rule requiring physical presence is a bright-line test that has provided guidance to taxpayers over the years so it remains good law. It also reiterated the four-prong test set forth in *Complete Auto*. Thus, under *Quill*, an out-of-state seller must still have a physical presence in a state for the state to impose an obligation on the seller to collect use tax and the tax must satisfy the other three tests set forth in *Complete Auto*. *Quill* did not specify how much physical presence was required, however.

Taxpayer argues that it had insufficient nexus with Illinois because it only made infrequent and incidental visits to Illinois. The record does not support this allegation. The record shows that taxpayer had three to five customers referred to it per year by the structural engineer during the audit periods. However, the record does not establish that those were the only sales to Illinois customers during the audit periods. Figures disclosing the total number and dollar amount of taxpayer's sales and the number and amount that was derived from Illinois are not set forth in the record. Also, most of taxpayer's deliveries to job sites in Illinois were made using its own trucks, but the record doesn't show the number of trips made to Illinois, or the number of deliveries it made in total.

The record states that a designer infrequently visited job sites in Illinois during the audit periods, but the record does not show how often "infrequently" is. In addition, taxpayer's president visited job sites in Illinois approximately twice each month during the

audit period. The deliveries made in Illinois by the taxpayer's trucks and the fact that in some cases it installed the trusses on site for the customer together with the visits by its president and its designer bring it within the statutory definition of being a retailer as set forth in *Brown's Furniture, Inc. v. Wagner, supra*. Thus, the record shows that taxpayer had a physical presence in Illinois during the audit periods. The burden of proof is on the taxpayer, and the taxpayer has failed offer sufficient evidence to show that the tax assessed failed the first of the *Complete Auto Transit* tests.

The tax assessed by the Department is assessed only with respect to trusses shipped to taxpayer's customers at Illinois sites. The taxpayer stipulated that it did not charge Wisconsin tax on these sales, so the only tax being imposed on these transactions is the Illinois tax and it is assessed at the same rate as is assessed on any other retailer doing business in Illinois. Because there is no double taxation imposed on the sales to Illinois customers, the tax does not discriminate against interstate commerce, and it is fairly apportioned. Therefore, the tax assessed in this case passes the second and third *Complete Auto Transit* tests.

Taxpayer also argues that it received no benefit from Illinois because it is a Wisconsin corporation, and it has all of its employees in Wisconsin. However, when the taxpayer's president and designer visited job sites in Illinois, and when the trusses were delivered in Illinois on taxpayer's trucks and sometimes installed by the taxpayer's employees at job sites in Illinois, taxpayer and its personnel benefited from the use of Illinois roads and fire and police protection. There is nothing in the record to show that the tax assessed is not fairly related to the services rendered by Illinois, so taxpayer has failed to show that the assessed tax violates the fourth *Complete Auto Transit* test.

In its reply brief, the taxpayer cited two additional cases in support of its position. These cases are *Miller Bros.Co. v. Maryland*, 347 U.S. 340, 74 S.Ct. 535 (1954) and *In re Laptops Etc. Corp. v. District of Columbia*, 164 B.R. 506 (Dist. Ct., Maryland, 1993). The facts in *Miller Bros.* are that the State of Maryland assessed use tax against Miller Brothers Co., a Delaware corporation, for sales made to Maryland customers. Miller Brothers had no property or sales personnel or agents soliciting sales in Maryland. It did send circulars to customers in Maryland and advertised over the radio but did not specifically solicit Maryland customers. Miller Brothers delivered furniture to its customers in Maryland either on its own trucks or by common carrier. The Court held that there was insufficient nexus between Maryland and Miller Brothers to satisfy the U.S. Constitution's Due Process requirements. The Court did not address the nexus requirement under the Commerce Clause. Because of the U.S. Supreme Court's decision in *Quill, supra*, holding that a physical presence is no longer required under the Due Process clause, it is doubtful if the Court's decision in *Miller Bros.* is still authoritative. *Brown's Furniture*, 171 Ill.2d at 426, 665 N.E.2d at 803.

The facts in *In re Laptops Etc. Corp. v. District of Columbia*, are that the District of Columbia assessed sales tax on sales made by Laptops Etc. to residents of the District of Columbia. Laptops Etc. was a Virginia corporation with its principal place of business located in Maryland. It had a secondary location in Falls Church, Virginia, which is very close to the District of Columbia. At the Falls Church location, Laptops Etc. maintained a retail establishment from which it sold, leased and repaired laptop computers. It maintained no facilities in the District of Columbia. Sales at the Falls Church outlet were made in three ways: (1) a customer would buy or lease a laptop computer and then, after

payment of the price or the rental fee and the Virginia sales tax, the customer would take the computer with him or her; (2) a customer would visit the Falls Church store, and after purchasing or contracting to purchase a computer, the computer would be shipped tax free to the customer by common carrier; (3) a customer would mail or fax an order to the Falls Church store and the computer would be shipped tax free to the customer by common carrier.

The District of Columbia auditor assessed sales tax on all orders he found with a purchaser's address in the District of Columbia, without regard to whether a Virginia tax had been paid or not, unless it was clear from the documentation that the computer had been picked up in Virginia. The court found that the only contacts Laptops Etc. personnel had with the District of Columbia were on rare occasions when they would accompany the common carrier into the District for public relations purposes.

On this finding, the court held that there was sufficient nexus to satisfy the Due Process Clause, but not enough connect to allow the sales tax to be assessed under Commerce Clause nexus standards as set forth in *Complete Auto* and *Quill, supra*.

Although decisions from other states are not binding on courts in Illinois, they should be examined if they are relevant for whatever value they may offer. *Kroger Company v. Department of Revenue*, 284 Ill.App.3d 473, 481. (1st Dist. 1996). Accordingly, the bankruptcy court's decision in *In re Laptops Etc. Corp. v. District of Columbia, supra*, is not binding in this case. In addition, it is distinguishable from this case because it involved an attempt to assess a sales tax, not a use tax, as is the case at issue here.

In summary, the taxpayer has failed to overcome the Department's *prima facie* case. Therefore, I recommend that the Notice of Tax Liability be made final.

ENTER: October 22, 2002

Charles E. McClellan
Administrative Law Judge