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

THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS,

v.

JOHN DOE,
Taxpayer

No. XXXX
Account ID XXXX
Letter ID XXXX
Period 2/10/08

Ted Sherrod
Administrative Law Judge

RECOMMENDATION FOR DISPOSITION

Appearances: David Butbul, Esq. for John Doe; Paula Hunter, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter arose by way of a timely protest filed by the taxpayer in response to the Department’s Notice of Tax Liability for Form EDA-94, Auditor-prepared Use Tax Report issued by the Department on April 4, 2011. At issue is whether a specialized laser device used by physicians to treat skin diseases qualifies as a “medical appliance” under the provisions of 35 ILCS 105/3-10 of the Use Tax Act, and whether this device is exempt from tax under any other provision of this Act.
A secondary question is whether the taxpayer has shown sufficient “reasonable cause” to abate applicable penalties for failure to file and failure to pay tax when due.\(^1\)

On the basis of the evidence presented at hearing in this matter, it is my recommendation that this matter be decided in favor of the Department. In support of this recommendation, the following “findings of fact” and “conclusions of law” are made.

**Findings of Fact:**

1. The taxpayer is a resident of Illinois having his principal residence and place of business in Anywhere, Illinois. Department Ex. 1.

2. On February 10, 2008, the taxpayer purchased a laser beam machine (“laser”) used in the treatment of skin diseases which he subsequently leased to physicians for use in their medical practices. Tr. pp. 10-12. During the two years immediately following the taxpayer’s purchase of the laser, the taxpayer’s principal lessee was Dr. Jack Black (“Jack Black”), a physician having an office in Anywhere, Illinois. Tr. pp. 9-11. Subsequent to his purchase of the laser, the taxpayer agreed to lease it to Jack Black for a rental fee of $250 per week. Tr. pp. 10, 11. Upon the expiration of a lease term of two years, Jack Black purchased the laser from the taxpayer. Tr. pp. 11, 12. The laser was also leased to other physicians. Tr. p. 12.

3. The taxpayer purchased the laser outside of the US for use in this state for a purchase price of approximately $12,000. Tr. p. 11. At the time of this purchase, the taxpayer paid no customs duties on the laser. Tr. pp. 12, 13.

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\(^1\) While the taxpayer, in his protest, also disputes the cost price used by the Department in arriving at a tax liability in this case, the taxpayer has presented no testimony or documentary evidence disputing the accuracy of the Department’s cost price determination. Consequently, I find that the taxpayer has failed to contest this Department finding.

Conclusions of Law:

This case involves the application of section 3-10 of the Illinois Use Tax Act, 35 ILCS 105/3-10 (“section 105/3-10”) to a laser device the taxpayer purchased outside of the U.S. for use in Illinois on February 10, 2008. Tr. p. 9; Department Ex. 1. The taxpayer purchased the laser at issue for the purpose of leasing it in Illinois. Tr. pp. 5, 6. As a lessor of tangible personal property to entities within the State of Illinois, the taxpayer is deemed to be the ultimate user of the property and is thereby subject to the Use Tax Act. Philco Corporation et al v. Department of Revenue, 40 Ill. 2d 312 (1968).

Section 105/3-10 provides in pertinent part:

Unless otherwise provided in this Section, the tax imposed by this Act is at the rate of 6.25% of either the selling price or the fair market value, if any, of tangible personal property … With respect to … prescription and nonprescription medicines, drugs, medical appliances … and insulin, urine testing materials, syringes, and needles used by diabetics, for human use, the tax is imposed at the rate of 1%. (emphasis supplied)

35 ILCS 105/3-10

Both parties in this case have advanced the claim that the Use Tax Act provides a complete exemption for medical appliances. Tr. pp. 4-6, 16, 17. Medical appliances are not completely exempt under Illinois law, but are taxable at a reduced tax rate. Id. Accordingly even if the provision noted above pertaining to medical appliances is
applicable in this case, as the taxpayer contends, the taxpayer would remain liable for a portion of the tax due on the laser device in controversy.

The Department established its presumptively correct *prima facie* case when it introduced the Notice of Tax Liability at issue into the record.² See 35 ILCS 120/4 as incorporated into the Use Tax Act pursuant to 35 ILCS 105/12. The burden of going forward and rebutting the Department’s presumptively correct determination then shifted to the taxpayer. *A.R. Barnes & Co. v. Department of Revenue*, 173 Ill. App. 3d 826 (1st Dist. 1988); *Central Furniture Mart v. Johnson*, 157 Ill. App. 3d 907 (1st Dist. 1987); *Vitale v. Illinois Department of Revenue*, 118 Ill. App. 3d 210 (3d Dist. 1983). A taxpayer can overcome the Department’s *prima facie* case only by producing competent evidence closely identified with the taxpayer’s books and records. *Id.*

Section 105/3-10 noted above, which taxes medical appliances at the rate of 1%, does not define the term “medical appliances.” It only provides that they must be for human use. However, the Department has adopted a regulation that defines this term. The applicable regulation interpreting this statutory section is 86 Ill. Admin. Code, ch. I, section 130.310(c) which, as in effect for the period at issue, provides in relevant part as follows:

(c) Medicines and Medical Appliances

(2) A medical appliance is an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the human body. These items may be prescribed by licensed health care professionals for use by a patient, purchased by health care

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² Pursuant to 35 ILCS 120/4, the Department’s Notice of Tax Liability is entitled to a presumption of correctness. See *Balla v. Department of Revenue*, 96 Ill. App. 3d 293 (1981), wherein the Illinois Appellate Court states the following: “The Illinois legislature, in order to aid the Department in meeting its burden of proof ..., has provided that the findings of the Department concerning the correct amount of tax due are prima facie correct.” *Balla, supra* at 295.
professionals for the use of patients, or purchased directly by individuals. Purchases of medical appliances by lessors that will be leased to others for human use also qualify for exemption. Included in the exemption as medical appliances are such items as artificial limbs, dental prostheses and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines (including the dialyzer). Corrective medical appliances such as hearing aids, eyeglasses and contact lenses qualify for exemption. Diagnostic equipment shall not be deemed a medical appliance, except as provided in Section 130.310(d). Other medical tools, devices and equipment such as x-ray machines, laboratory equipment, and surgical instruments that may be used in the treatment of patients but that do not directly substitute for a malfunctioning part of the human body do not qualify as exempt medical appliances. Sometimes a kit of items is sold so the purchaser can use the kit items to perform treatment upon himself or herself. The kit will contain paraphernalia and sometimes medicines. An example is a kit sold for the removal of ear wax. Because the paraphernalia hardware is for treatment, it generally does not qualify as a medical appliance. However, the Department will consider the selling price of the entire kit to be taxable at the reduced rate when the value of the medicines in the kit is more than half of the total selling price of the kit.

86 Ill Admin. Code, Ch. I, section 130.310.3

In the case at hand, the taxpayer leased the laser at issue in this case to physicians for use in the treatment of skin diseases. Tr. pp. 10-12. As noted above, medical devices used for the treatment of patients do not fall within the definition of the term “medical appliance” contained in this regulation because the regulation express states that “[o]ther medical tools…that may be used in the treatment of patients but do not directly substitute for a malfunctioning part of the human body do not qualify as exempt medical appliances.” Moreover, a perusal of regulation 130.310(c) noted above indicates that

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3 Effective in 2010, the Department revised section 130.310 from one that addressed food, drugs and medical appliances to one that addressed only the types of property that would (or would not) be considered food subject to tax at the low rate. 34 Ill. Reg. 12935, 12946-71 (issue 36) (September 3, 2010)(effective August 19, 2010). It removed the medicine and medical appliance subsections that were previously included within section 130.310, and substantially rewrote those subsections within a newly numbered regulation section 130.311, bearing the heading, “Drugs, Medicines, Medical Appliances and Grooming and Hygene Products.” 86 Ill. Admin. Code, ch. I, section 130.311(2010); 34 Ill. Reg. 12963-71.
neither the laser device at issue nor any similar device is expressly mentioned in this regulation as falling within the Department’s definition of a “medical appliance.” The failure to specifically enumerate either the laser or any other device used for a similar purpose in the list of items that qualify for the reduced tax rate as “medical appliances” is additional and persuasive evidence that this device is not the type of item contemplated by section 105/3-10 or the regulation defining the terms “medical appliances” noted above for taxation at the low rate.

Moreover, notwithstanding the foregoing, the taxpayer introduced no evidence nor offered any expert opinion that the laser at issue substitutes for any malfunctioning human systems or body organs which is a prerequisite to coming within the definition of “medical appliance” under the aforementioned regulation. Although brief testimony was offered to explain what this laser device is and how it is used, there was no statement, medical conclusion or other indicative evidence that would establish a direct or inferential qualification of the laser under this criteria of the regulation. As a consequence, the taxpayer has not overcome the presumption of correctness with respect to the Department’s classification of the laser device at issue as taxable at the high rate. Accordingly the taxpayer’s attempt to qualify the taxpayer’s laser as a medical appliance must be denied.

While section 105/3-10 at issue in this case does not completely exempt medical appliances from use tax, some medical appliances and other medical devices are completely exempt pursuant to section 105/3-5 of the Use Tax Act, 35 ILCS 105/3-5. The foregoing measure exempts “equipment used in the diagnosis, analysis, or treatment of hospital patients purchased by a lessor who leases the equipment, under a lease of one
year or longer…to a hospital that has been issued an active tax exemption identification number…[.]” The record contains no indication that the taxpayer is relying on this exemption, and the taxpayer has produced no evidence demonstrating how or why it might apply to the facts presented in this matter. Consequently, I find that section 105/3-5 provides no basis for the taxpayer’s claim of exemption in the instant case.

**Taxpayer’s Request for Abatement of Penalties**

As a secondary issue in this case, the taxpayer argues that all applicable penalties imposed for his failure to file and to pay the tax when due should be abated. Tr. p. 18. This recommendation has determined that the taxpayer failed to establish that the laser device at issue qualifies for the low rate of tax prescribed at section 105/3-10, or that it is exempt from tax altogether pursuant to section 105/3-5. The laser is therefore subject to use tax at the full rate of taxation.

Section 4 of the ROTA provides, in pertinent part, as follows:

> If the tax computed upon the basis of the gross receipts as fixed by the Department is greater than the amount of tax due under the return or returns as filed, the Department shall … issue the taxpayer a notice of tax liability for the amount of tax claimed by the Department to be due, together with a penalty in an amount determined in accordance with Section 3-3 of the Uniform Penalty and Interest Act. Provided, that if the incorrectness of any return or returns as determined by the Department is due to negligence or fraud, said penalty shall be an amount determined in accordance with section 3-5 or section 3-6 of the Uniform Penalty and Interest Act as the case may be.

35 ILCS 120/4

As the text of section 4 makes clear, penalties pursuant to section 3-3 of the Uniform Penalty and Interest Act (“UPIA”) are automatically assessed whenever a correction of returns reveals a deficiency. *Id.*

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4 As previously noted, this section of the Retailers’ Occupation Tax Act is incorporated into the Use Tax Act pursuant to 35 ILCS 105/12.
The late filing penalty at issue in this case has been imposed by UPIA section 3-3 “for failure to file the tax return on or before the due date prescribed for filing …[.]” 35 ILCS 735/3-3(a-10). The late payment penalty at issue in this case has been imposed by UPIA section 3-3 “for failure to pay the tax shown due or required to be shown due on a return on or before the due date prescribed for payment of that tax …[.]” 35 ILCS 735/3-3(b-20).

The late payment and late filing penalties are penalties that may be abated for reasonable cause. 35 ILCS 735/3-8. The Department has adopted a regulation (at 86 Ill. Admin. Code, Ch. I, section 700.400) regarding reasonable cause which provides, in pertinent 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 made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion. 86 Ill. Admin. Code, ch. I, section 700.400(b).

This regulation further provides that, “[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. …[.]” 86 Ill. Admin. Cod, ch. I, section 700.400(c). The burden rests on the taxpayer to show that it acted with ordinary business care and prudence when filing its returns and paying the correct amount of tax when due. Hollinger International, Inc. v. Bower, 363 Ill. App. 3d 313 (1st Dist. 2005).

Significantly, the record contains no evidence that the taxpayer ever examined any regulations or asked for any specific information or rulings on the taxability of the
laser at issue from the state of Illinois. Indeed, it does not appear that the taxpayer ever checked the statutes of Illinois to ascertain how either lease transactions were handled or whether his laser was a “medical appliance” or was exempt within this state. Indeed, it is not even clear from the record whether he made any reasonable attempt to determine whether a use tax was relevant to his situation at all. Since the taxpayer offered no evidence or testimony at hearing regarding “reasonable cause” for penalty abatement, he has not shown that he exercised ordinary care and prudence when calculating and paying his tax liabilities. Therefore, the late payment and late filing penalties assessed should not be abated. Hollinger International, supra.

The taxpayer also objects to the assessment of a late payment penalty prior to the time that the taxpayer became aware of his unpaid use tax liability which was subsequent to the Department’s issuance of its Notice of Tax Liability on April 4, 2011. Tr. pp. 18, 19. This argument is expressly addressed by section 3-3(b-20)(3) of the UPIA, 35 ILCS 735/3-3(b-20)(3), which provides that the late payment penalty will be deemed assessed at the time the tax upon which the penalty is computed is assessed. Accordingly, the Department’s imposition of a late payment penalty based upon the date the taxpayer’s use tax was assessed (February 10, 2008) is expressly permitted by Illinois law.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department’s Notice of Tax Liability at issue in this case be upheld.

Ted Sherrod
Administrative Law Judge

Date: January 28, 2013