Sales Tax – 2019 Court Decisions

A. Statute of Limitations

Redbox Automated Retail, LLC v. Illinois Dep't of Revenue, 2019 IL App (5th) 180489-U (Oct. 30, 2019) (2019 WL 5636966)

Redbox purchased licensing agreements which allowed it to provide movies and video games to customers via self-service kiosks located throughout Illinois. From January 2007 to June 2010 use tax was paid on the licensing agreements. The Department audited this period and extended the statute of limitations through waivers to June 30, 2013. In October 2013 the Department initiated a second audit for the subsequent period of July 2010 through June 2014. During the course of this second audit, in April 2016, the Department agreed that the use tax Redbox had been paying on the licensing agreements was not due. Consequently, in July 2016, the Department issued a refund for the amounts paid during the second audit period. Redbox had also sought, in February 2016, a refund for the amount of use tax erroneously paid during the first audit period. However, the Department denied this claim as untimely.

Redbox filed a petition with the Tax Tribunal challenging the denial of its refund claim. The Tax Tribunal upheld the Department's denial, rejecting Redbox's claim that the statute of limitations should be calculated as three years from the conclusion of the first audit. Redbox then appealed to the Fifth District Appellate Court.

The Appellate Court affirmed the judgment of the Tax Tribunal. First, the Court rejected Redbox's argument that its payment of an additional amount of tax at the conclusion of the first audit in February 2013 extended the statute of limitations to seek a refund of amounts paid during the audit period (prior to July 2010.) Second, the Court rejected Redbox's contention that the Department's audit implicitly tolled or restarted the limitations period, citing the strict interpretation of refund statutes and statute of limitations provisions. Finally, the Court rejected Redbox's uniformity argument, noting that the applicable statute of limitations provisions do not create multiple classifications of taxpayers other than those who timely file a refund claim and those who do not.

B. Construction Contractors

Best Buy Stores, L.P. v. Illinois Dep't of Revenue, 2017-L-050591(Cook County) (July 29, 2019)

Best Buy designates sales of appliances that coincide with delivery and installation services of those appliances as construction contracts. Under this designation, Best Buy self-assesses Illinois Use Tax, instead of ROT, on the cost of appliances that it considers "permanently affixed" to real estate. Best Buy considers certain installed appliances, including built-in dishwashers, over-the-range microwaves, wall ovens, cooktops installed on counters, range hoods, built-in refrigerators, and gas range/gas dryers to be incorporated into, and permanently affixed to, real estate. The Department issued a Notice of Tax Liability assessing ROT on the sales at issue on the grounds that Best Buy was acting as a retailer, not a construction contractor and that its installation services are incidental to the retail sales, not the other way around. Best Buy paid the liability under protest and challenged the assessment in Circuit Court.

On July 29, 2019, Judge Otto granted the Department's Motion for Summary Judgment, denied Best Buy's Motion for Summary Judgment, and found that Best Buy was acting as a retailer, not a construction contractor. Therefore, the sales at issue are not exempt from ROT. The Court also found that the appliances at issue are not "materials and fixtures" which are "incorporated into a structure as an integral part thereof' once installed (86 Ill. Admin Code 130.1940(c)). The Court found that the appliances at issue are "connected to and operated from a building's electrical, plumbing or other specialized system, but which is not actually a part of any such system and is considered to remain personal property when installed" (86 Ill. Admin Code 130.1940(b)(2)). In addition, the Court rejected Best Buy's Uniformity Clause argument.

This case is currently on appeal to the First District Appellate Court.

C. Gross Receipts

Martin Equipment v. Illinois Dep't of Revenue, No. 18-TT-86 (Aug. 23, 2019)

The Department issued a Notice of Tax Liability to Martin Equipment (a construction equipment dealer) following an audit, finding that certain credits provided by John Deere should have been included in Martin's taxable gross receipts and thus subject to ROT. Martin challenged the assessment in the Tax Tribunal and moved for summary judgment on the grounds that the discounts it realized from the credits should not have been included in its gross receipts.

The Tax Tribunal distinguished the credits received by Martin from the rebates received by the dealer in *Ogden Chrysler Plymouth, Inc. v. Bower*, 348 Ill. App. 3d 344 (2d Dist. 2004) because the credits Martin received did not increase its revenue from individual sales but rather only lowered its costs, and Martin, unlike the dealer in *Ogden Chrysler*, was not required to pass on any savings to its customers. Thus, the Tribunal concluded that "[t]he key factors found in *Ogden Chrysler Plymouth* – cost reduction to the retail purchaser coupled with reimbursement to the retailer – are not present here." Accordingly, the Tribunal granted Martin's motion for summary judgment and vacated the Notice of Tax Liability.

The Department did not appeal the Tribunal's decision.

D. Prima Facie and Minimum Standard of Reasonableness

Chak Fai Hau (Joye Chop Suey) v. Illinois Dep't of Revenue, 2019 IL App (1st) 172588 (Feb. 27, 2019) (2019 WL 983595)

This matter involved a cash business audit of a Chinese restaurant. The taxpayer did not keep proper books and records, so a markup method could not be used in the audit. Instead, the auditor used the "container method" in which the auditor used the different sized containers used in a sample period and the average of prices for items sold within those containers to derive an amount of underreporting. At the administrative hearing at the Department, the Department's attorney submitted the relevant portions of the audit file and the Notices of Tax Liability with the Director's certification. The auditor did not testify. Among other arguments, the taxpayer argued that the audit file documents should not have been admissible and that the auditing method was unreasonable and did not meet the required minimum standard of reasonableness. The Administrative Law Judge, Department's Director, and Circuit Court upheld the admissibility and methodology as appropriate.

The Appellate Court upheld the lower court's decision as to the reasonableness of the auditing methodology and admissibility of the audit file. In particular, the Court held that "the auditor was working with limited information, which was due to the actions or inactions of the taxpayer himself, and engaged in a calculated effort to obtain the best reconstruction possible." The Court also re-affirmed that under Department statutes the Department auditor's in-court testimony is not required to prove up the Department's *prima facie* case. Further, a taxpayer needs to rebut the Department's *prima facie* case with documentary evidence. In other words, it is not enough for a taxpayer to merely state that its own return is correct.

E. Property Tax

Midwest Palliative Hospice and Care Center v. Illinois Dep't of Revenue, 125 N.E.3d 1196 (1st Dist. Feb. 25, 2019)

In this case a hospice care center filed an application for tax-exempt status on the basis that it was a charitable institution. The Department denied a property tax exemption to the care center finding that the taxpayer failed to meet its burden to demonstrate by clear and convincing evidence that the property was being put to an exclusively charitable use. The Circuit Court affirmed.

The Appellate Court laid out how an entity seeking a charitable property tax exemption must demonstrate that it is both owned by a charitable institution and put to a charitable use. The Court examined the 6 *Korzen* factors, from *Methodist Old Peoples Home v. Korzen*, 39 Ill.2d 149 (1968). The *Korzen* factors are: 1) the organization is set up for the benefit of an indeterminate number of people, 2) the organization has no capital, capital stock or shareholders and earns no profits or dividends, 3) it derives its funds primarily from public and private charity and holds those funds in trust for the objectives and purposes expressed in its charter, 4) it dispenses charity to all who need and apply for it, does not provide gain or profit in a private sense to any person connected with it, and does not appear to place obstacles of any character in the way of those who need and would avail themselves of the charitable benefits it dispenses, 5) the property is actually and factually used exclusively for the charitable purpose, regardless of any intent expressed in the organization's charter or bylaws, and 6) charitable use is the primary purpose for which the property is used and not a second or incidental purpose.

Although some of these factors were met, the Court found that the vast majority of Midwest's revenue came from non-charitable services. Also, the patients who used Midwest's services were primarily paying customers. Finally, by taking in Medicare and Medicaid payments, Midwest was not relieving the government of a burden, as many charitable organizations may do. In sum, the Court held that "just because an institution is a non-profit and performs good deeds does not mean that the institution is using its real property exclusively for charitable purposes as that term is used in the Illinois Constitution."