ILLINOIS INDEPENDENT

TAX TRIBUNAL

KISHWAUKEE AUTO CORRAL, INC., Petitioner,	)	
v.	)	15 TT 234
	)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT OF REVENUE, Respondent.	)	

DECISON ON SUMMARY JUDGMENT MOTIONS

Kishwaukee Auto Corral, Inc. operates a used car dealership in Rockford Illinois. Kishwaukee filed multiple refund claims on Forms ST-557 (Claim for Credit for Repossession of Motor Vehicles, Watercraft, Aircraft, Trailers, and Mobile Homes) for sales tax totaling approximately $61,000 with the Illinois Department of Revenue. The basis for Kishwaukee's claims is that Kishwaukee initially paid 100% of sales tax when it sold certain cars on installment that Kishwaukee self-financed and the buyers/borrowers of those cars ultimately defaulted on the installment contracts they had with Kishwaukee. Kishwaukee filed a refund claim for the per centage of sales tax it never received from an individual customer following a default as Kishwaukee had paid the entire sales tax up front to the Department. In October of 2015, the Department issued a Notice of Tentative Denial of Claim as it rejected Kishwaukee's multiple refund claims for sales tax.

Kishwaukee argues that because it bore the burden of paying the full amount of sales tax, a portion of which became uncollectible from each customer when they defaulted on their installment loans, Kishwaukee is entitled to having its claims for refunds for the uncollected sales tax recognized and granted by the Department pursuant to 35 ILCS 120/6 (Credit Memorandum or Refund). Kishwaukee also argues that the language of 35 ILCS 120/6d (Deduction for uncollectible debt)

(enacted in 2015) can be read to allow cash basis taxpayers, like Kishwaukee, to claim a refund without having to take a bad debt deduction on its federal tax return and, alternatively, that relatively new statute section does not apply to titled property transactions. Kishwaukee further argues that the Department's regulation, 86 Ill. Adm. Code 130.1960(d)(3)(A) (Bad Debt Claimed by Retailers on or after July 31, 2015), was not published until 2018 and therefore is not applicable, and the regulation violates the Illinois Constitution's uniformity clause.

The Department states that it is without authority to grant Kishwaukee's claims for refunds as the Illinois legislature in 2015 enacted section 6d which limits refunds to retailers who charge off uncollectible accounts on their books and records as well as claim a corresponding bad debt deduction on their federal income tax returns. The Department argues, *inter alia*, that because Kishwaukee is a cash-basis taxpayer which is unable to claim any bad debt deduction on its federal income tax return, the Department cannot grant Kishwaukee's claims for refunds. The Department also contends that the distinctions between cash basis and accrual basis of accounting provide a rational basis for allowing only accrual basis taxpayers a refund and its regulation does not violate the Illinois Constitution's uniformity clause.

As explained below, Kishwaukee's summary judgment motion is denied and the Department' s summary judgment motion is granted.

1. Background

The Illinois Retailers' Occupation Tax Act ("ROTA") imposes a tax ("ROT") upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 86 Ill. Adm. Code 150.101. Taken together, those taxes comprise "sales tax" in Illinois.

Retailers in Illinois who sell property that must be titled by an agency of Illinois are to report sales and pay sales tax to the Department on Form ST-556 (Sales Tax Transaction Return (For Sale of Vehicles, Watercraft, Aircraft, Trailers and Mobile Homes). Used car dealerships, like Kishwaukee, fall into that category of retailers.

A. Kishwaukee Car Sales Transactions

As part of its used car dealership operations, Kishwaukee offers financing to its prospective customers. Many of Kishwaukee's customers have less than stellar credit and the default rate on financed car transactions is high. Revised Stipulations of Fact and Other Matters ("Stip.") at ¶2.[1]

Kishwaukee self-finances automobile loans so its customers do not have to seek outside lenders. Once a customer is approved for a loan, the customer executes a retail installment contract with Kishwaukee. *Id*. The contract sets out the terms of the car sale and the installment loan including amounts for the sales price of the car, credits for any cash down payment or trade-in, interest charged on the loan, the number of monthly loan payments, and the monthly amount due from the customer to Kishwaukee.

After a customer purchases a car and enters into an installment contract, Kishwaukee files a form ST-556 Sales Tax Transaction Return for that car sold with the Department. Stip. at ¶3. The total sales tax on the sale must be and is reported and paid by Kishwaukee at that time despite the fact that the customer only pays Kishwaukee a portion of the full sales price which includes sales tax in the form of a down payment, and not full payment, on the car. *Id*.

B. Kishwaukee's Method of Accounting

As a general matter, corporations are prohibited on the federal level from using the cash receipts and disbursements method of accounting, resulting in corporations using the accrual method of accounting to record income and expenses on the company's internal books and records and to report income and expenses on the company's federal income tax returns. 26 U.S.C. §481. That is also true for all taxpayers who hold inventory for sale for customers. 26 U.S.C. §471. Normally, Kishwaukee would be required to use the accrual method of accounting, but Kishwaukee voluntarily avails itself of an exclusion found under both Internal Revenue Code sections which provides that a business which has less than $25,000,000 in average annualized gross receipts over the prior three-year period is allowed to use the cash receipts and disbursements method. §471(c)(1) and §481(c)(1). Stip. at ¶4. During the tax periods at issue in this case, Kishwaukee elected to report its income and expenses under the cash basis method of accounting

[1] The agreed Revised Stipulation of Fact and Other Matters are attached as Exhibit 1 to Petitioner's Supplemental Brief in Support of its Motion for Summary Judgment.

as opposed to the accrual method of accounting on its federal income tax returns. *Id*.

C. Uncollectible Car Loans

In the case of a car purchaser defaulting on an installment loan, Kishwaukee will proceed to repossess the car and attempt to re-sell the car. Stip. at ¶6. In that instance, Kishwaukee has paid the entire sales tax due on the original sales price of the repossessed car even though it will not collect the entire sales price from the defaulting customer. The following example, stipulated to by the parties, reflects such a transaction.

If Kishwaukee sells an automobile for $5,000, Kishwaukee pays sales tax on the transaction of $350 (assuming a 7% sales tax rate). If the buyer later defaults after paying only $2,000, Kishwaukee received only 40% of the initial sales price. After the default, Kishwaukee would file a refund claim with the Department to try to recover the sales tax portion on the sales amount that will not be paid to Kishwaukee, or, in this case, 60% of $350, or $210. It is only the percentage of sales tax it paid in that will not be recovered from its car buyers that Kishwaukee is attempting to recover from the Department on Form ST-557 (Claim for Credit for Repossession of Motor Vehicles, Watercraft, Aircraft, Trailers, and Mobile Homes). Stip. at ¶5.

Because Kishwaukee voluntarily elected to use the cash basis method of accounting, it was unable to claim a business bad debt deduction pursuant to Internal Revenue Code §166 on its federal income tax return when a car customer/borrower defaulted as cash basis taxpayers, as opposed to accrual basis taxpayers, are not able to claim bad debt deductions.

D. Kishwaukee's Claims for Refunds Prior to July 31, 2015

Prior to July 31, 2015, the Department's regulation 86 Ill. Adm. Code 130.1960 (Finance Companies and Other Lending Agencies-Installment Contracts-Bad Debts) presumptively created the right to tax refunds or credit for sales tax paid by retailers, like Kishwaukee, which were ultimately not paid the full purchase price on an item sold on which the retailer paid the sales tax up front. The general refund statute for ROT, 35 ILCS 120/6 (Credit Memorandum or Refund) reads, in part:

> If it appears, after claim therefor filed with the Department, that an amount of tax or penalty or interest has been paid which was not due under this Act, whether as a result of a mistake of fact or an

> error of law, except as hereinafter provided, then the Department shall issue a credit memorandum or refund to the person who made the erroneous payment….No credit may be allowed or refund made for any amount paid by or collected from any claimant unless it appears (a) that the claimant bore the burden of such amount and has not been relieved thereof nor reimbursed therefor…
>
> 35 ILCS 120/6 (West 2012).

Accordingly, refunds under Section 6 must be predicated on a mistake of fact or an error of law.

The Department's regulation relating to bad debts prior to July 2015, 86 Ill. Adm. Code 130.1960 read, in part:

> In case a retailer repossesses any tangible personal property and subsequently resells such property to a purchaser for use or consumption, his gross receipts from such sale of the repossessed tangible personal property are subject to Retailers' Occupation Tax. He is entitled to a bad debt credit with respect to the original sale in which the default has occurred to the extent to which he has paid Retailers' Occupation Tax on a portion of the price which he does not collect, or which he is not permitted to retain because of being required to make a repayment thereof to a lending agency under a 'with recourse' agreement….Because retailers of motor vehicles, watercraft, trailers and aircraft do not pay Retailers' Occupation Tax to the Department on retail sales of motor vehicles, watercraft, trailers, and aircraft with monthly returns, but remit the tax to the Department on a transaction by transaction basis, they are unable to take a deduction on the returns that they file with the Department, but may file a claim for credit with the Department, as provided in subsection (d)(3), on any transaction with respect to which they desire to receive the benefit of the repossession credit.
>
> 86 Ill. Adm. Code 130.1960(d) (2000).

Before July 31, 2015, when a customer defaulted on a car loan and Kishwaukee repossessed the car, Kishwaukee would file a form ST-557 Claim for Credit for Repossession of Motor Vehicles, Watercraft, Aircraft, Trailers and Mobile Homes with the Department seeking a refund for the portion of the sales tax Kishwaukee paid at the time of the sale but did not receive from the customer. Stip. at ¶8.

Those types of pre-July 31, 2015 claims were generally honored by the Department for the sales tax paid on the defaulted portion of the installment contract. *Id.* The Department characterized those claims as either "bad debt

credits" or, alternatively, "repossession credits." Stip. at ¶12. *See also* ST-96-0154-GIL; ST 00-0029-GIL.

E. Bad Debt Write-off Prerequisite for Sales Tax Refunds after July 31, 2015

In 2015, the Illinois legislature enacted 35 ILCS 120/6d-Deduction for Uncollectible Debt. New section 6d provides, in part:

> (a) A retailer is relieved from liability for any tax that becomes due and payable if the tax is represented by amounts that are found to be worthless or uncollectible, have been charged off as bad debt on the retailer's books and records in accordance with generally accepted accounting principles, and have been claimed as a deduction pursuant to Section 166 of the Internal Revenue Code on the income tax return filed by the retailer. A retailer that has previously paid such a tax may, under rules and regulations adopted by the Department, take as a deduction the amount charged off by the retailer. If these accounts are thereafter, in whole or in part, collected by the retailer, the amount collected shall be included in the first return filed after the collection, and the tax shall be paid with the return.

35 ILCS 120/6d(a) (West 2016).

The Illinois Supreme Court provided an explanation as to why 35 ILCS 120/6d was enacted when it reviewed that statute section in *Citibank v. Illinois Department of Revenue*, 2017 IL 121634. "Section 6d of the ROTA not only confirms an element of the Department's regulation that some might say sought to resolve a matter of statutory ambiguity—whether, for purposes of section 6, a "tax paid on an account receivable that becomes a bad debt *** becomes a tax paid in error" (see 86 Ill. Adm. Code 130.1960(d)(3)(2000))—it also makes abundantly clear that all refund or credit claims—whether on a bad debt or otherwise—go through the retailer, the original remitter of the tax." *Id*. at ¶68. Therefore, the legislature enacted new section 6d(a) to presumably allow for ROT refunds arising from bad debts without taxpayers having to rely on the dubious stretch of the Department's pre-July 2015 regulation that facially expanded Section 6 to include ROT amounts paid on receivables that become bad debts as tax paid in error.

In 2018, the Department amended its bad debt regulation, 86 Ill. Adm. Code 130.1960, to incorporate and to emphasize the limiting language of 35 ILCS 120/6d(a) for bad debts claimed by retailers on or after July 31, 2015 by adding new regulation sub-section (d)(3). That sub-section does not include the prior language of the regulation specifically referencing retailers of motor vehicles and allowing those retailers to obtain "bad debt credits" or "repossession credits." [2]

86 Ill. Adm. Code 130.1960 (Finance Companies and Other Lending Agencies-Installment Contracts-Bad Debts) reads, in part:

> d) Bad Debts
>
> …
>
> 3) Bad Debt Claimed by Retailers on and after July 31, 2015
>
> A) On and after July 31, 2015, a *retailer is relieved from liability for any tax that becomes due and payable if the tax is represented by amounts that are found to be worthless or uncollectible, have been charged off as bad debt on the retailer's books and records in accordance with generally accepted accounting principles, and have been claimed as a deduction pursuant to section 166 of the Internal Revenue Code on the income tax return filed by the retailer. A retailer that has previously paid such a tax may, under rules and regulations adopted by the Department, take as a deduction the amount charged off by the retailer. If these accounts are thereafter, in whole or in part, collected by the retailer, the amount collected shall be included in the first return filed after the collection, and the tax shall be paid with the return.* [35 ILCS 120/6d(a)] For purposes of computing the deduction or refund, payments on the accounts or receivables shall be prorated against the amounts outstanding on the accounts or receivables (e.g., any penalties, interest and fees).
>
> B) Because retailers of motor vehicles, watercraft, trailers and aircraft do not pay ROT to the Department on retail sales of motor vehicles, watercraft, trailers and aircraft with monthly returns, but remit the tax to the Department on a transaction-by-transaction basis, they are unable to take a deduction on the returns that they file with the Department, but may file a claim for credit with the

[2] Similarly, the Illinois legislature, having knowledge of the Department's pre- July 2015 regulation, nevertheless chose not to include any language in Section 6d referencing "repossession credits" thereby evidencing an intent to limit any refund claim for retailers of motor vehicles, *inter alia*, to only those that fulfill the new requirements of subsection 6d(a).

> Department, as provided in subsection (d)(5)(B), on any eligible transaction.
>
> …
>
> 5) Bad Debt Procedural Requirements – Record Keeping – Limitations Period on and after July 31, 2015
>
> A) *The retailer and lender shall maintain adequate books, records or other documentation supporting the charge off of the accounts or receivables for which a deduction was taken or a refund was claimed under Sections 6 or 6d of the Retailers' Occupation Tax Act,* including, but not limited to, a copy of the federal return on which the deduction was claimed. *For purposes of computing the deduction or refund, payments on the accounts or receivables shall be prorated against the amounts outstanding on the accounts or receivables.*
>
> B) If a retailer or lender does not charge off an account receivable that is found to be worthless or uncollectible as a bad debt in its books and records and claim a deduction pursuant to section 166 of the Internal Revenue Code on its federal income tax return or amended return, the tax paid on that bad debt or receivable will not be considered a tax paid in error and, thus, the retailer will not be able to file a deduction or claim for credit in accordance with Sections 6 or 6d of the Retailers' Occupation Tax Act. Retailers or lenders that file federal returns on a cash basis and cannot claim a deduction pursuant to section 166 of the Internal Revenue Code are not eligible for the bad debt deduction.

86 Ill. Adm. Code 130.1960(d)(3)(A) and (B) and (5)(A) and (B) (eff. July 31, 2015).

The new regulation specifically provides that a cash basis taxpayer which cannot claim a bad debt deduction on its federal income tax return is not entitled to claim refunds under 35 ILCS 120/6d and the new related Department regulation section, 86 Ill. Adm. Code 130.1960(d). Stip. at ¶13.

2. Analysis

Summary judgment is proper when "the pleadings, depositions and admissions on file, together with affidavits, if any, show there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Performance Marketing Assoc., Inc. v. Hamer*, 2013 IL 11496, ¶12 (2013) (quoting 735 ILCS 5/2-1005(c) (2010)). In the present case, Kishwaukee filed a Motion for Summary Judgment, the Department filed its own Motion for Summary Judgment, Kishwaukee filed a Response to the Department's Motion for Summary Judgment, and the Department filed a Reply brief. Following a change in Petitioner's counsel, Kishwaukee filed a Supplemental Brief and a Supplemental Reply Brief and the Department filed a Supplemental Reply Brief. Following oral argument on the summary judgment motions, Kishwaukee filed a Supplemental Filing and the Department filed another Supplemental Reply Brief. When both parties file motions for summary judgment, they agree that no material facts are in dispute and invite a decision as a matter of law. *Irwin Indus. Tool Co. v. Ill. Dep't. of Revenue*, 238 Ill. 2d 332, 340 (2010).

At this juncture, the findings contained in the tentative denial of claims issued by the Department are considered to *prima facie* correct and are *prima facie* evidence that the denial of claims are correct. 35 ILCS 505/21; 35 ILCS 120/6b. *See Copilevitz v. Dep't of Revenue*, 41 Ill. 2d. 154, 156-157 (1968).

A. A Federal Bad Debt Deduction Must Be Taken to Claim a Refund of Previously Paid ROT.

Kishwaukee argues that the requirement found in the Department's new regulation sub-section, 86 Ill. Adm. Code 130.1960(d)(3), that a taxpayer, *inter alia*, must first take an Internal Revenue Code §166 bad debt deduction on its federal income tax return before claiming a refund from the Department for Illinois ROT previously paid is contrary to the underlying statutory language of 35 ILCS 120/6d(a) which it claims allows for a refund without first taking a bad debt deduction. Pet'r Supp. Br. in Supp. of Mot. for Summ. J. at 6. The operative language in 35 ILCS 120/6d(a) that Kishwaukee refers to is:

> Sec. 6d. Deduction for uncollectible debt.
>
> (a) A retailer is relieved from liability for any tax that becomes due and payable if the tax is represented by amounts that are found to be worthless or uncollectible, have been charged off as

> bad debt on the retailer's books and records in accordance with generally accepted accounting principles, and have been claimed as a deduction pursuant to Section 166 of the Internal Revenue Code on the income tax return filed by the retailer. A retailer that has previously paid such a tax may, under rules and regulations adopted by the Department, take as a deduction the amount charged off by the retailer….

35 ILCS 120/6d(a) (West 2016)

Kishwaukee argues that the second sentence in section 6d(a) should be read as to be describing a different situation than described in that section's first sentence and one which does not require a bad debt deduction, but simply a "charge off" on its internal books and records. Pet'r Supp. Br. in Supp. of Mot. for Summ. J. at 7. Its argument is premised on the fact that the first sentence refers to tax that "becomes due and payable" while the second sentence refers to tax "previously paid."

"The fundamental rule of statutory interpretation is to determine and give effect to the intent of the legislature, and the statutory language is the best indicator of the legislature's intent." *Quality Saw & Seal, Inc. v. Ill. Commerce Comm'n,* 374 Ill. App. 3d 776, 781 (2nd Dist. 2007). "The best indication of legislative intent is the statutory language, given its plain and ordinary meaning." *Andrews v. Kowa Printing Corp.*, 217 Ill. 2d 101,106 (2005). "Where the language is clear and unambiguous, we must apply the statute without resort to further aids of statutory construction." *Id*. Moreover, in giving a statute or regulation reasonable construction, one should avoid "interpretations that render any part of the statute meaningless or void, and presuming that the legislature did not intend absurdity, inconvenience, or injustice." *Central Illinois Light Co. v. Ill. Dep't of Revenue*, 335 Ill. App. 3d 412, 415 (3rd Dist. 2002). Another tenet of statutory construction is that "statutory provisions should be read in concert and harmonized." *Hartney Fuel Oil Co. v Hamer*, 2013 IL 115130, ¶ 25 (citing *People v. Rinehart*, 2012 IL 111719, ¶ 26).

The plain language of 35 ILCS 120/6d(a) must be read in its entirety to give effect to all words and phrases in that statute subsection. That statute subsection consists of a singular paragraph with three sentences. Sentences within a statutory paragraph should be construed harmoniously. *See Freeman United Coal Min. Co. v. Industrial Com'n*, 308 Ill. App. 3d 578, 583 (5th Dist. 1999).

The first sentence of subsection 6d(a) lists three requirements that must be met to be relieved of a liability premised on a bad debt for a tax that becomes due

and payable in the future: "[1] if the tax is represented by amounts that are found to be worthless or uncollectible, [2] have been charged off as bad debt on the retailer's books and records in accordance with generally accepted accounting principles, and [3] have been claimed as a deduction pursuant to Section 166 of the Internal Revenue Code on the income tax return filed by the retailer." Those three requirements must all be met as they must be read in the conjunctive due to the word "and" which is used to join all three requirements.

The second sentence of subsection 6d(a) is to provide a similar refunding mechanism for taxes previously paid. The second sentence refers back to the first sentence by the use of the phrase "such a tax" which tax is described in the first sentence as "represented by amounts that are found to be worthless or uncollectible, have been charged off as bad debt on the retailer's books and records in accordance with generally accepted accounting principles, and have been claimed as a deduction pursuant to Section 166 of the Internal Revenue Code on the income tax return filed by the retailer." Therefore, in those instances where the tax has been previously paid as opposed to having to be paid in the future, the same three requirements must be met. The facial purpose of new subsection 6d(a) is to provide exacting guidance on what documentation must be shown before a refund for ROT or relief from paying ROT in the future can be obtained.[3] To allow for the strained reading and parsing of the second sentence as Kishwaukee suggests would provide for inconsistent standards of documentary proof based solely on the timing of the payment of the tax at issue.

Additionally, Kishwaukee failed to address the third sentence of subsection 6d(a) which reads: "If these accounts are thereafter, in whole or in part, collected by the retailer, the amount collected shall be included in the first return filed after the collection, and the tax shall be paid with the return." That sentence describes the situation where the uncollectible tax amount has been written off or the liability to pay has been extinguished, but the retailer is able to collect some of the written-off debt afterwards. The retailer is required to submit the previously written-off tax amount to the Department. The third sentence contains the phrase "these accounts" which further bolsters the inclusive language of subsection 6d(a) in describing the tax defined in that section to refer to tax amounts that become worthless or uncollectible, can be charged off on a taxpayer's books and records and

[3] 35 ILCS 120/6d(b), dealing with private label credit card transactions and discussed below, states, in part: "A retailer claiming a deduction or refund for bad debts from purchases made using a private label credit card shall meet the same standards of documentation as a retailer that claims a deduction or refund for bad debts that are from purchases made not using a private label credit card." 35 ILCS 120/6d(b)(5).

can be claimed as a bad debt deduction on a federal income tax return regardless of whether the tax amount was previously paid or is payable in the future.

Moreover, Kishwaukee frames its argument by highlighting the term "charged off" found in both the first two sentences of subsection 6d(a) and claims it charged off its bad debt on its internal books and records for "financial accounting purposes." Stip. at ¶14. However, the term "charged off" is further defined in the first sentence to situations where tax amounts "have been charged off as bad debt on the retailer's books and records in accordance with generally accepted accounting principles…" The only accounting method accepted by GAAP, or generally accepted accounting principles, is the accrual basis accounting method. Because Kishwaukee voluntarily chooses to use the cash basis method of accounting, its internal recording keeping cannot be considered to be a charge off in accordance with generally accepted accounting principles.

A fair reading of subsection 6d(a), taken in context, does not prescribe two separate situations confined within its one paragraph, one which requires a federal bad debt deduction and one that does not. The first two sentences of that section when read together simply means that a taxpayer does not have to pay tax in the future it would otherwise be obligated to do if the tax amount is deemed worthless or uncollectible as evidenced by a bad debt both in the taxpayer's books and records and on its federal income tax return, and, if it did pay any of that tax prior to the tax becoming worthless or uncollectible, it can claim a deduction for that amount already paid in. In those instances, the requirements that the debt be charged off on the taxpayer's books and records according to GAAP and taken as a bad debt deduction on the taxpayer's federal income tax return must be met.

Had the Illinois legislature intended for refunds for worthless and uncollectible taxes previously paid to be documented differently than worthless and uncollectible taxes not yet paid to the Department, it could have easily broken the singular paragraph of subsection 6d(a) into separate statutory paragraphs or sections. The absence of separately enumerated paragraphs or additional sections suggest that the legislature intended for section 6d(a) to be read as a whole. *See Keating v. 68th and Paxton, L.L.C.*, 401 Ill. App. 3d 456, 464 (1st. Dist. 2010).

Conversely, by accepting Kishwaukee's argument, reading out the documentation requirements of subsection 6d(a) for tax amounts previously paid would lead to the inconsistent result that the documentation required to prove a tax was worthless and uncollectible would be different solely based on whether the tax was previously paid or not. "In construing a statute, we presume that the

legislature did not intend absurdity, inconvenience, or injustice." *Alvarez v. Pappas*, 229 Ill. 2d 217, 228 (2008) (citing *Burger v. Lutheran General Hospital*, 198 Ill. 2d 21, 40 (2001)).

The clear purpose of subsection 6d(a) gleaned from a plain reading of that statute section is to require taxpayers who wish to seek a refund for a portion of ROT to document the worthless or uncollectible portion of ROT by 1) charging off that uncollectible debt and recording the charge off in its books and records and 2) by claiming a bad debt deduction on its federal income tax return. That allows the Department to administer such refund claims by being able to review a taxpayer's books and records for contemporaneous documentation to show the bad debt being written off when it becomes worthless or uncollectible and it allows for the corroboration of the bad debt through a review of the related, but independent, federal income tax return to validate the worthless and uncollectible portion of the tax by the treatment of that debt on the federal return. Such documentation supports a finding of a substantial inability to collect the debt.

Section 6d, as it applies to bad debts, creates a statutory benefit only as a matter of legislative grace, *see e.g. Weil-McClain Co. v. Collins*, 395 Ill. 503, 507 (1947) which requires section 6d and the related Department regulation to be read narrowly.[4] "[D]eductions and exemptions are privileges created by statute as a matter of legislative grace. Statutes granting such privileges are to be strictly construed in favor of taxation." *Balla v. Dep't of Revenue*, 96 Ill. App. 3d 293, 294 (1st Dist. 1981) (citing *Bodine Electric Co. v. Allphin*, 81 Ill. 2d 502 (1980); *Telco Leasing, Inc. v. Allphin*, 63 Ill. 2d 305 (1976)).

Accordingly, section 6d provides a refund mechanism for ROT due and payable or previously paid, but only for taxpayers who can properly document an internal charge off on its books and records pursuant to GAAP and a corresponding bad debt deduction on its federal income tax return which reflect the debt that became worthless or uncollectible.

The Department expressly acknowledged the documentation requirements of 35 ILCS 120/6d(a) when it amended its regulation, 86 Ill Adm. Code 130.1960-Finance Companies and Other Lending Agencies—Installment Contracts—Bad

[4] Kishwaukee claims it "bore the burden" of paying the tax at issue. Pet'r Summ, J. Mot. at 3. The Department does not dispute that claim. That language is found in 35 ILCS 120/6, but after July 15, 2105, refund claims premised on bad debts must meet the specific requirements spelled out in 35 ILCS 120/6d. Section 6 of the ROTA is a "special remedial statute. Its general purpose is limited to those who have paid a tax pursuant to the act, which, by reason of some mistake of law or fact, they should not have paid." *Peoples Store of Roseland v. McKibbin*, 379 Ill. 148, 152 (1942).

Debts, to include subsection (d)(5)-Bad Debt Procedural Requirements –Record Keeping—Limitations Period on and after July 31, 2015. In addition to restating the documentary requirements set out in subsection 6d(a), that regulation subsection specifically states "Retailers or lenders that file federal returns on a cash basis and cannot claim a deduction pursuant to section 166 of the Internal Revenue Code are not eligible for the bad debt deduction." 86 Ill. Adm. Code 130.1960(d)(5)(B).[5]

Premised on its argument that a bad debt deduction is not required under 35 ILCS 120/6d, Kishwaukee contends that the Department's new regulation on bad debts, 86 Ill. Adm. Code 130.1960, impermissibly expands the language of 35 ILCS 120/6d(a) by requiring that a bad debt deduction be taken in order to claim a refund of ROT already paid in. Pet'r Supp. Br. in Supp. of Mot. for Summ. J. at 8. Because the taking of a bad debt deduction is just one prerequisite necessary to obtain a refund under subsection 6d(a) as explained above, the Department's regulation merely restates that requirement and does not enlarge or expand the scope of that statute. "Administrative agencies have deference in enacting regulations, and regulations are presumed valid." *Hartney Fuel Oil Co.,* 2013 IL 115130 at ¶ 58 (citing cases). However, a regulation cannot narrow or broaden the scope of intended taxation under a taxing statute. *Kean v. Wal-Mart Stores, Inc.*, 235 Ill. 2d 351,372 (2009).

Finally, Kishwaukee also claims that the new regulation does not apply at all to its used car sales tax transactions as subsection 6d(b)(4)(A) states "The deduction or refund allowed under this Section: (A) does not apply to credit sale transaction amounts resulting from purchases of titled property." Pet'r Mot. for Summ. J. at 4.

In enacting 35 ILCS 120/6d, the Illinois legislature addressed two areas regarding bad debt deductions. Subsection 6d(a), as discussed above, sets out certain required documentary procedures that must be met in order to obtain a refund of ROT based on a bad debt. Under subsection 6d(b), somewhat similar procedures are listed in order for retailers to take a bad debt deduction for taxes paid on certain transactions that are made through private label credit cards for

[5] Kishwaukee claims the new regulation's effective date is after the tax periods at issue. *Pet'r Resp. to Dep't Mot. for Summ. J.* at 1. The parties stipulated that all the refund claims at issue were filed after July 31, 2015. Stip. at ¶11. The Department's amended regulation, 86 Ill. Adm. Code 130.1960, has an effective date of January 16, 2018. Nevertheless, the amended regulation is based on and incorporates the specific language of 35 ILCS 120/6d, which had an effective date of July 31, 2015. With or without the new regulation, all claims were filed after the effective date of 35 ILCS 120/6d, which contains the requirements necessary to claim a bad debt deduction, as explained above.

amounts charged off on the lender's books and records and taken as a bad debt deduction on the lender's federal income tax return.[6] Subsection 6d(b), states:

> (b) With respect to the payment of taxes on purchases made through a private-label credit card:
>
> (1) If consumer accounts or receivables are found to be worthless or uncollectible, the retailer may claim a deduction on a return in an amount equal to, or may obtain a refund of, the tax remitted by the retailer on the unpaid balance due if:
>
> (A) the accounts or receivables have been charged off as bad debt on the lender's books and records on or after January 1, 2016;
>
> (B) the accounts or receivables have been claimed as a deduction pursuant to Section 166 of the Internal Revenue Code on the federal income tax return filed by the lender; and
>
> (C) a deduction was not previously claimed and a refund was not previously allowed on that portion of the account or receivable.
>
> (2) If the retailer or the lender subsequently collects, in whole or in part, the accounts or receivables for which a deduction or refund has been granted under paragraph (1), the retailer must include the taxable percentage of the amount collected in the first return filed after the collection and pay the tax on the portion of that amount for which a deduction or refund was granted.
>
> (3) For purposes of the deduction or refund allowable under this Section, the limitations period for claiming the deduction or refund shall be the same as the limitations period set forth in Section 6 of this Act for filing a claim for credit, and shall commence on the date that the account or receivable has been claimed as a bad debt deduction pursuant to Section 166 of the Internal Revenue Code on the federal income tax return filed by the lender, regardless of the date on which the sale of the tangible personal property actually occurred.
>
> (4) The deduction or refund allowed under this Section:

[6] "Finance companies and other lending agencies are, generally, liable for payment of tax in cases in which they engage in the business of selling to users or consumers tangible personal property to which they hold or acquire title. 86 Ill. Adm. Code 130.1960(a) (2000)." *Citibank*, 2017 IL 121634 at fn. 1.

(A) does not apply to credit sale transaction amounts resulting from purchases of titled property;

(B) includes only those credit sale transaction amounts that represent purchases from the retailer whose name or logo appears on the private-label credit card used to make those purchases;

(C) may only be taken by the taxpayer, or its successors, that filed the return and remitted tax on the original sale on which the deduction or refund claim is based; and

(D) includes all credit sale transaction amounts eligible under paragraph (B) that are outstanding with respect to the specific private-label credit card account or receivable at the time the account or receivable is charged off, regardless of the date the credit sale transaction actually occurred.

(5) The retailer and lender shall maintain adequate books, records, or other documentation supporting the charge off of the accounts or receivables for which a deduction was taken or a refund was claimed under this Section. A retailer claiming a deduction or refund for bad debts from purchases made using a private label credit card shall meet the same standard of documentation as a retailer that claims a deduction or refund for bad debts that are from purchases made not using a private label credit card. For purposes of computing the deduction or refund, payments on the accounts or receivables shall be prorated against the amounts outstanding on the account.

35 ILCS 120/6d(b)

While the entirety of 35 ILCS 120/6d(b) relates to the payment of taxes on purchases made through certain private-label credit cards, Kishwaukee points to subsection 6d(b)(4) which begins with the language "The deduction or refund allowed under this Section: (A) does not apply to credit sales transaction amounts resulting from the purchase of titled property…" as well as the first sentence of subsection 6d(b)(5) which states: "The retailer and lender shall maintain adequate books, records, or other documents supporting the charge off of the accounts receivable for which a deduction was taken or a refund was claimed under this Section." 35 ILCS 120/6d(b)(5). Kishwaukee argues that the use of the word "Section" applies not just to subsection 6(d)(b), but also subsection 6(d)(a) and, therefore, the entirety of 35 ILCS 120/6d is inapplicable for Kishwaukee's titled used car transactions. As a result, Kishwaukee contends its ability to obtain

refunds for the ROT it paid up front when it sold a car, should be allowed under the general refund statute, 35 ILCS 120/6.[7]

It is clear that the placement of the word "section" entirely within the confines of subsection 35 ILCS 120/6d(b) is nothing more than a scrivener's error and that the word "subsection" should have been employed instead. First, the first sentence of paragraph 6d(b) begins with the limiting language "With respect to the payment of taxes on purchases made through a private-label credit card." Second, the location of the term "section" three times within that subsection viewed in the overall structure of the statute logically dictates that those references at paragraphs 6d(b)(3), (4)(A) and (5) apply only to transactions under 35 ILCS 120/6d(b). "It is a cardinal rule of statutory construction that the intent and meaning of a statute are to be determined from the entire statute. A statute is passed in whole and not in part. Each section and provision should be construed in connection with every other part or section." *Huckaba v. Cox*, 14 Ill. 2d 126, 131 (1958).

Third, there are multiple references to solely private label credit card transactions in subsection 6d(b) paragraphs (3), (4)(B) and (D) and (5) which indicate the entirety of subsection 6d(b) relates only to private label credit card transactions. Paragraph 6d(b)(3) mandates a statute of limitations commencement date based solely on a federal return of a lender, a calculation that can only be made when a lender is involved and not when the debt in question is still held by a retailer as envisioned in sub-section 6d(a). Paragraph 6d(b)(4)(A) must be read in conjunction with paragraphs 6d(b)(4)(B)-(D), all of which are joined with the word "and." Paragraph 6d(b)(4)(B) is applicable solely to certain private-label credits cards and paragraph 6d(b)(4)(D) similarly references and is limited to private-label credit card accounts and receivables. Paragraph 6d(b)(5) describes the record keeping requirements for both retailers and lenders involved in bad debt/ private label credit card transactions and pointedly states that the documentary requirements for a retailer claiming a bad debt deduction or refund for bad debts from transactions that do involve private label credit cards shall be the same as those for retailers claiming a bad debt deduction or refund for bad debts from

[7] For the reasons stated above, the enactment of section 6d and the corresponding revisions to the Department's regulation to withdraw ROT paid on an account receivable that becomes a bad debt to be considered a tax paid in error absent the requirements found in section 6d being met, runs counter to Kishwaukee's argument that its refunds would be allowed under section 6 if section 6d was determined to be inapplicable to its situation.

transactions that do not involve private label credit cards claiming a bad debt deduction or refund.

Third, the Illinois legislature expressly provided for certain terms to be applied throughout the entire body of section 6d as it included sub-section 6d(c) which is titled "For purposes of this Section:" and which provides certain definitions to be applied throughout all of section 6d. Additionally, the legislature included sub-section 6d(d) which begins "This Section" and provides that the entire statute section is exempt from provisions of other statutes. Had the legislature wanted to make sub-section 6d(a) not apply to titled transactions as it did with sub-section 6d(b), it could have placed that specific prohibition in either of those provisions where it expressly set forth terms that apply to the statute in its entirety or within subsection 6d(a), itself.

Kishwaukee points to a Westlaw slip copy for a Northern District of Illinois Bankruptcy Court case, *In re Total Finance Investment Inc.*, 2019 WL 2432089, in which the court ruled*, inter alia,* on a pending motion as to whether a debtor and a related, non-debtor entity, which sold used cars, were entitled to tax credits for sales tax paid upfront on used car transactions that ultimately defaulted and which were similar to the Kishwaukee transactions at issue in this matter. The bankruptcy judge reviewed the use of the word "Section" in 35 ILCS 120/6d(b)(4) and observed "Although this sentence appears in paragraph (b) of section 6d which applies only to private label credit card transactions…the phrase 'this Section' appears to refer to the entire section 6d, not just the paragraph covering private label cards. The phrase 'this Section' also appears in paragraphs 6(d)(c) and (d), both of which apply to the entire section 6d and not just the private label credit card provisions in paragraph 6d(b)." In concluding that section 6d did not apply to that bankruptcy matter, the court also stated "The placement of the exclusion for titled assets in the section devoted only to private label cards instead of one of the two later paragraphs that apply to the entire provision is odd, but it nonetheless appears to apply to all of Section 6d." *Id.*

An unreviewed ruling on a pending motion in a bankruptcy matter is neither precedential nor binding. Moreover, the basis for the bankruptcy judge finding the usage and placement of the word "section to be "odd," that is, the placement of the term "section" solely within a subsection, is also the basis for a determination that the term "section" was mistakenly used instead of the word "subsection." Accordingly, I find the prohibition to extend the application of section 6d refunds or claims to transactions involving titled transactions applies only to those

transactions that can be described as section 6d(b) private label credit card transactions.[8]

B. The Illinois Constitution's Uniformity Clause

Kishwaukee argues that the Department's regulation, 86 Ill. Adm. Code 130.1960, violates the Illinois Constitution which states, in part: "In any law classifying the subjects or objects of non-property taxes or fees, the classes shall be reasonable and the subjects and objects within each class shall be taxed uniformly." Ill. Const. art. IX, § 2.

Kishwaukee contends that that if a section 166 bad debt deduction must be taken as a prerequisite to claiming a refund for ROT previously paid on a defaulted installment contract thereby precluding cash basis taxpayers from claiming a refund, while accrual basis taxpayers are able to do so, creates an arbitrary classification that is unreasonable. Pet'r Supp. Br. in Support of its Mot. for S.J. at 8.

In support of its argument, Kishwaukee cites to *Searle Pharmaceuticals, Inc. v. Dep't of Revenue*, 117 Ill. 2d 454 (1987). In *Searle*, the Illinois Supreme Court held that a 1977 amendment to section 203(e)(2)(E) for the Illinois Income Tax Act which allowed a corporation as a member of an affiliated corporate group which filed a separate federal income tax return to carry back net operating losses while denying a corporation as a member of an affiliated corporate group that filed a consolidated return the ability to carry back net operating losses violated the uniformity clause of the Illinois Constitution. *Id*. at 477.

The Supreme Court set forth the test to determine whether or not a non-property tax classification meets the uniformity requirement of the Illinois Constitution in *Searle*. "[T]his Court has stated that the appropriate test to be that the classification must be based on *a real and substantial difference between the people taxed and those not taxed, and that the classification must bear some reasonable relationship to the object of the legislation or to public policy*." *Id*. at 468. (citing cases).

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[8] In enacting its new bad debt regulation, 86 Ill. Adm. Code 130.1960(d)(4), the Department also concluded that the prohibition to apply 35 ILCS 120/6d to titled transactions is limited to private-label credit card transactions. 86 Ill. Adm. Code 130.1960(d)(4)(b) states: "The deduction or refund allowed under subsection (d)(4)(A): i) does not apply to credit sale transaction amounts resulting from purchases of titled property…"

A taxpayer raising a uniformity challenge is not required to prove that every conceivable explanation for a tax is unreasonable. Rather, the taxing body must "produce a justification for its classifications. The plaintiff then has the burden to persuade the court that the defendant's explanation is insufficient as a matter of law, or unsupported by the facts." *Arangold Corp. v. Zehnder*, 204 Ill. 2d 142, 156 2003) (citing *Geja's Cafe v. Metropolitan Pier and Exposition Authority*, 153 Ill. 2d 239, 248-249 ((1992). "The ultimate burden remains with the plaintiff, however, to demonstrate that the taxing body's asserted justification is unsupported by the facts or insufficient as a matter of law. To hold otherwise would undermine the well-settled principle that a statute bears a strong presumption of constitutionality and that the party challenging the statute has the burden of demonstrating the statute's unconstitutionality." *Arangold*, 2014 Ill. 2d at 157. Additionally, "The legislature, therefore, has authority to grant a deduction to one class of taxpayers and not to another. The constitution recognizes that there will be differences in the deductions granted to various classes of taxpayers and merely imposes a requirement of reasonableness on these deductions." *National Realty and Inv. Co. v. Illinois Dep't of Revenue*, 144 Ill. App. 3d 541,552 (2nd Dist. 1986).

Cash basis accounting is very different than accrual basis accounting in the timing and recognition of income and expenses. In explaining a rational basis for treating those two classes of taxpayers differently when it comes to allowing refunds and claims for ROT amounts of uncollectible debt under Section 6d and the Department's related regulation, the Department posits that "there are clearly real and substantial differences between cash basis and accrual basis taxpayers." Dep't Supp. Reply Br. at 3-4.

The classification of allowing only accrual basis taxpayers to claim a refund of ROT under 35 ILCS 120/6d and 86 Ill. Adm. Code 130.1960(d)(3) is related to at least one object of the legislation, that is, to mandate accounting and reporting procedures that compel taxpayers to maintain adequate books, records or other documentation supporting the charge off of the accounts or receivables for which a deduction was taken or a refund was claimed and to reflect and to provide an independent federal tax return to corroborate and reflect such a deduction.

Kishwaukee has voluntarily placed itself in the classification of being a cash-basis taxpayer for which it now claims is given disparate tax treatment. However, all cash-basis taxpayers are treated uniformly as all are treated the same and are denied a refund of ROT under 35 ILCS 120/6d and 86 Ill. Adm. Code 130.1960(d)(3).

Finally, even if this court were to accept Kishwaukee's argument, it would be without authority to declare any statute or regulation unconstitutional under the Illinois Independent Tax Tribunal Act of 2012 (35 ILCS 1010/1-1 *et seq*.). Section 45(f) of the Tax Tribunal Act allows the Tax Tribunal to decide questions of constitutionality for statutes and rules adopted by the Department as applied to an individual taxpayer, but the Tax Tribunal cannot declare a statute or rule unconstitutional.

3. Conclusion

The ROTA's subsection, 35 ILCS 120/6d(a), and Department's related regulation, 86 Ill. Adm. Code 130.1960(d)(3), provide a procedural route for retailers, like Kishwaukee, to obtain refunds of ROT taxes written off as bad debt. The Illinois legislature determined that such refunds should be granted only to accrual basis taxpayers who can document that a refund amount based upon a bad debt is proven to be uncollectible or worthless by being charged off on a taxpayer's books and records and by being claimed as a bad debt deduction on a federal income tax return.

Because Kishwaukee has voluntarily chosen to use the cash basis method of accounting, it cannot obtain refunds as described above.

For the reasons stated above, the Petitioner's Motion for Summary Judgment is DENIED, and the Department's Motion for Summary Judgment is GRANTED.

This is a final order subject to appeal under section 3-113 of the Administrative Review Law, and service by email is service under section 3-113(a). See 35 ILCS 1010/1-90; 86 Ill. Adm. Code 5000.330. The Tribunal is a necessary party to any appeal.

_/s/ *James Conway*_____
JAMES M. CONWAY
Chief Administrative
Law Judge

Date: January 7, 2020