

**ILLINOIS INDEPENDENT
TAX TRIBUNAL**

ZIMMER US, INC.,)	
)	
Petitioner,)	
)	
v.)	18 TT 13
)	Chief Judge James M. Conway
ILLINOIS DEPARTMENT)	
OF REVENUE,)	
)	
Respondent.)	

ORDER ON SUMMARY JUDGMENT MOTIONS

Zimmer US, Inc. is challenging an Illinois Department of Revenue Notice of Tentative Audit Denial of Claim for the monthly tax periods between July 2012 and April 2015 that totals approximately \$673,240. According to the notice, the Department denied the claim because it determined that Zimmer was liable for use tax on specialized instruments provided by Zimmer to Illinois nonprofit healthcare institutions, including hospitals, that are required during the installation process of certain prosthetic devices sold by Zimmer to those institutions. Consequently, the Department rejected Zimmer’s refund claim for the tax periods and amount above for use tax previously paid by Zimmer on those specialized instruments.

In its summary judgment motion, Zimmer argues that 1) Zimmer, itself, did not use the instruments in Illinois within the meaning of the Illinois Use Tax statute section 35 ILCS 105/2; 2) Zimmer donated the use of the instruments to the hospitals as a gift of its property and, while a gift is generally considered a taxable use, use tax does not apply in instances where the sale of the same property would be exempt from Illinois Retailer’s Occupation Tax (“ROT”); and 3) alternatively, Zimmer leased the instruments to the hospitals and there is no use tax on leased equipment to hospitals under the Department’s regulation found at 86 Ill. Adm. Code 150.331(b)(Persons Who Lease Tangible Personal Property to Exempt Hospitals).

In its summary judgment motion, the Department argues that 1) Zimmer’s act of providing the specialized instruments, including if one argues that act is a gift, constitutes a taxable use under the Use Tax statute; 2) Zimmer retained ownership of the specialized instruments and, absent a sale of those instruments, the reciprocal use tax exemption for sales of items that are exempt under ROTA is not implicated; and 3) if the act of providing the instruments is considered to be a lease, Zimmer failed to enter into a leasing arrangement with the hospitals that met the requirements for a use tax exemption under 86 Ill. Adm. Code 150.331(b).

As explained below, Zimmer’s summary judgment motion is denied, and the Department’s summary judgment motion is granted.

1. Background

The Illinois Retailers’ Occupation Tax Act, (35 ILCS 120/1 *et seq.* (West 2016)), imposes a tax 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 Illinois Use Tax Act, (35 ILCS 105/1 *et seq.* (West 2016)), 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. The purpose of the use tax is “primarily to prevent avoidance of [the sales] tax by people making out-of-State purchases, and to protect Illinois merchants against such diversion of business to retailers outside Illinois.” *Performance Marketing Ass’n v. Hamer*, 2013 IL 114496, ¶ 3 (quoting *Klein Town Builders, Inc. v. Dep’t of Revenue*, 36 Ill. 2d 301, 303 (1966)).

35 ILCS 105/2 provides that “Use’ means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property...”

35 ILCS 105/3-65 provides:

Sec. 3-65. R.O.T. nontaxability. If the seller of tangible personal property for use would not be taxable under the Retailers’ Occupation Tax Act despite all elements of the sale occurring in Illinois, then the tax imposed by this Act does not apply to the use of the tangible personal property in this State.

86 Ill. Adm. Code 150.331(b) (Persons Who Lease Tangible Personal Property to Exempt Hospitals) provides:

b) Effective January 1, 1996 through December 31, 2000, and on and after August 2, 2001, equipment, other than that specified in subsection (a), used in the diagnosis, analysis, or treatment of hospital patients that is purchased by persons who lease that equipment to exempt hospitals is not subject to Use Tax. As noted in this subsection, the exemption is not available during the period January 1, 2001 through August 1, 2001 because it expired under the provisions of Section 3-90 of the Use Tax Act [35 ILCS 105/3-90] and was not reinstated until August 2, 2001. The exemption is otherwise available, provided that:

- 1) the equipment described above must all be purchased for lease to a tax exempt hospital under a lease that has been executed or is in effect at the time of purchase;
- 2) the lease must be for a period of one year or longer; and
- 3) the lease must be to a hospital that has an active tax exemption identification number issued by the Department under Section 1g of the Retailers' Occupation Tax Act (see 86 Ill. Adm. Code 130.2007).

Zimmer, US Inc.

Zimmer sells prosthetic devices, such as artificial hip, elbow and shoulder joints to healthcare institutions throughout the United States, including to state-licensed hospitals and other nonprofit healthcare institutions (collectively "nonprofit institutions") located in Illinois. Agreed Stipulation of Facts ("Stip.") at ¶¶ 2 and 6. When Zimmer sells prosthetic devices to its customers, Zimmer provides the customers with the use of specialized instruments required for the safe and accurate installation of the prosthetic devices into patients' bodies. *Id.* at ¶ 3. Zimmer delivers the specialized instruments to common carriers outside Illinois who ultimately deliver the specialized instruments to the nonprofit institutions in Illinois. Jenk's Affidavit at ¶ 5.

At the times Zimmer provides the specialized instruments with the prosthetic devices to its customers, it does not separately charge for the instruments. Zimmer's instrument costs are factored in the pre-markup selling price of the prosthetic devices. Stip. at ¶¶ 4 and 7. Zimmer retains ownership of the specialized instruments at all times. *Id.* at ¶4. In the underlying contract terms for the sale of a prosthetic device, the customer expressly agrees to indemnify Zimmer for loss, damage, or destruction of any of the provided specialized instruments. If one of

those risks materializes, Zimmer invoices the customer for the cost of replacing the instrument. *Id.* at ¶ 5.

During the monthly tax periods between July 2012 and April 2015, Zimmer remitted use tax to the Department on the specialized instruments provided to Illinois customers. In December of 2015, Zimmer timely filed claims for refunds of that use tax in the amount of \$637,243. *Id.* at ¶ 10. In November of 2017, the Department denied the claims in their entirety which led to the present litigation before the Tax Tribunal. *Id.* at ¶¶ 11 and 12.

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, Zimmer filed a Motion for Summary Judgment, the Department filed its own Summary Judgment Motion, and Zimmer filed a Reply in Support of its Motion for Summary Judgment. 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).

In Illinois, “taxation is the rule,” and “[t]ax exemption is the exception.” *Oswald v. Hamer*, 2018 IL 122203, ¶ 12. “Statutes granting tax exemptions must be strictly construed in favor of taxation...” *Provena Covenant Medical Center v. Dep’t of Revenue*, 236 Ill. 2d 368, 388 (2010). A party claiming an exemption from taxation has the burden of proving clearly and conclusively that he is entitled to the exemption. *Id.*; *United Air Lines, Inc. v. Johnson*, 84 Ill. 2d 446, 455-456 (1981).

A. “Use” of the Specialized Instruments in Illinois

Zimmer points to stipulated facts concerning the transfer of the specialized instruments to the Illinois nonprofit institutions to argue that Zimmer, itself, did not “use” the specialized instruments in Illinois. As described above, Zimmer

contracts with third parties to deliver the specialized instruments from outside Illinois to inside Illinois and once a nonprofit institution receives them, it decides how to utilize the specialized instruments vis-à-vis any orthopedic implant surgery. Zimmer suggests that it is the nonprofit institutions, as opposed to itself, that “uses” the specialized instruments in Illinois for purposes of the Use Tax Act.

The Use Tax Act defines “use” as the exercise by any person of any right or power over tangible personal property incident to the ownership of that property. 35 ILCS 105/2. Because Zimmer chooses to retain ownership of the specialized instruments, Stip. at ¶ 4, it continues to be the owner of the specialized instruments while the nonprofit institutions physically possess the tools and employ them during orthopedic procedures.

Zimmer’s argument that it does not use the specialized instruments has been foreclosed by the Illinois Supreme Court which analyzed section 2 of the Use Tax Act in *Telco Leasing, Inc. v. Allphin*, 63 Ill. 2d 305 (1976).

Telco was a corporation engaged in leasing medical and scientific equipment to health care service and research institutions. When the Illinois Department of Revenue assessed use tax on Telco for the use of the leased equipment, Telco paid the tax under protest and filed suit against the Department. When the Circuit Court ruled against Telco following the submission of summary judgment motions, the Illinois Supreme Court allowed for a direct appeal and decided the case for the Department.

The Illinois Supreme Court held that the owner and lessor of property is the user of property for purposes of the Use Tax Act. “As previously stated, section 2 of the Use Tax Act defines ‘use’ as the exercise of some right or power over property ‘incident to the ownership of that property.’ It follows that only the owner of property can be a user within the meaning of the Act.” *Telco*, 63 Ill. 2d at 310. By retaining ownership of the specialized instruments, Zimmer is the only one who uses that property for purposes of the Use Tax Act, not the Illinois nonprofit institutions.

To support its argument that the Illinois nonprofit institutions “used” the specialized instruments as opposed to itself, Zimmer points to the fact that the contracts between Zimmer and the nonprofit institutions were executed in Indiana, as opposed to Illinois. Jenk’s Supp. Affidavit at ¶ 4. Zimmer also emphasizes that once common carriers deliver the specialized instruments into Illinois, Zimmer did not store or repair any instruments and the individual surgeons and nonprofit

institutions determined how to apply those devices in their surgical practices. Pet'r Reply Br. at 1-4.

Zimmer also cites to a non-binding and non-precedential Michigan state case that found that the act by a lessor in ceding control of property “[c]an, itself, be an exercise of a right incident to ownership.” *NACG Leasing v. Dep’t of Treasury*, 495 Mich. 26 (2014). That case does not need be addressed as the Illinois Supreme Court determined that “use” for a lessor is a continuing “use” in *Telco* and that rights exercised incident to ownership are not limited to the sole act of executing of a lease. “After a lease of personal property is consummated, however, the property is still owned by the lessor and is still being ‘used’ by the lessor in his endeavors to make a profit.” *Telco*, 63 Ill. 2d at 312-313.

Because *Telco* was silent as to whether *Telco*, as lessor, was domiciled in Illinois or outside, this court allowed supplemental briefing by the parties following oral argument on the summary judgment motions based on the petitioner’s argument that there is a distinction between in-state lessors and out-of-state lessors. Zimmer argues, in the alternative if found to be a lessor, that it is domiciled out of state, leases out-of-state property, directs shipment of that property into Illinois, and has nothing to do with the property once it is in the hands of the Illinois lessees. Pet'r Supp. Br. at 2.

In its supplemental brief, Zimmer cites to *Philco Corporation v. Dep’t of Revenue*, 40 Ill. 2d 312 (1968), and distinguishes the facts in that case from the present one, including that *Philco*, itself, installed the equipment at issue in Illinois. Accordingly, Zimmer argues that *Philco* has no applicability to the present case as *Philco*, a lessor, was actively involved with its equipment after delivery into Illinois for the duration of a lease, while Zimmer had nothing to do with its specialized instruments once delivered to common carriers outside Illinois. Pet'r Supp. Br. at 2.

However, Zimmer additionally refers to language in *Philco* that a lessor uses its property when the lease is for profit-making or income-producing purposes. *Id.* at 3. Zimmer refers to the fact that it did not explicitly break out a charge for the specialized instruments in its sales documents for prosthetic devices as if somehow that means those transactions did not benefit Zimmer. *Id.* at 2-4. While Zimmer concedes that *Philco* did not hold that “a charge for leased property as the sine qua non of a ‘use’ under the Use Tax Act,” Zimmer argues the use of leased property must still be “for the benefit of the property owner.” *Id.* at 3. But that is exactly what *Telco* said, as well, *Telco*, 63 Ill. 2d at 312-313, and that is exactly what applies to Zimmer in this case. Zimmer provided the specialized instruments as

part of its for-profit enterprise of selling the related prosthetic devices and passed along its costs of the specialized instruments in its overall pricing structure for the related prosthetic devices. As discussed below, Zimmer did not have an altruistic purpose in providing the specialized tools to the nonprofit institutions in Illinois, and that wouldn't matter in any event even if it did.

B. Zimmer did not Provide a Tax-free Gift to the Nonprofit Institutions.

Zimmer argues, in the alternative, that it donated the “use” of the specialized instruments to the nonprofit institutions which constitutes a tax-free gift. Pet'r Mot. for Summ. J. at 4-5. Zimmer acknowledges that, in general, the donation or gift of an item is normally a taxable use pursuant to 86 Ill. Adm. Code 150.305(c). In furthering its argument, Zimmer points to 35 ILCS 105/3-65 for the proposition that had Zimmer sold the specialized instruments to the nonprofit institutions, those sales would be exempt from retailer's occupation tax and not subject to use tax.

Zimmer conflates the idea of a making a gift with the complementary ROT/Use Tax provisions governing the sale of tangible personal property to arrive at its conclusion that it made a tax-free gift of the specialized instruments.

A gift is free goods or services: “something voluntarily transferred by one person to another without compensation.” *Provena Covenant Medical Center v. Dep't of Revenue*, 384 Ill. App. 3d 734, 751(4th Dist. 2008) (citing Merriam-Webster's Collegiate Dictionary 491 (10th ed. 2000)). First, Zimmer did not make a gift of the specialized instruments as it retained ownership of the tools. Second, it did not make a gift of the use of the tools as Zimmer, as the owner of the specialized instruments, can be the only one who used the specialize tools under the rationale of *Telco* for purposes of the Illinois Use Tax Act. Third, Zimmer's own stipulation belies the notion that it made a gift as Zimmer admits that its specialized instrument costs were factored into the pre-markup selling price of its prosthetic devices. Stip. at ¶7.

As stated previously, Illinois' sales tax structure on the sale of tangible personal property is comprised of both Retailers' Occupation Tax and Use Tax. If a retailer pays the ROTA tax, it does not have to pay the UTA tax on a sale. “As a result, when a single purchase and sale occur, two taxes are assessed, but ‘only one of the two payments need to be remitted to the state, and the single payment

satisfies both taxes.” *Brown v. Zehnder*, 295 Ill. App. 3d 1031, 1034 (1st Dist. 1998) (citing *Dep’t of Revenue v. Steinkopf*, 160 Ill. App. 3d 1008, 1014 (1st Dist. 1987)). Similarly, if personal property is not taxable under ROTA, it is not taxable under UTA. *Id.* 35 ILCS 105/3-65 is simply the codification of that proposition.

35 ILCS 105/3-65 has no applicability to Zimmer’s specialized instruments transactions. That statute section states “If a seller of tangible personal property for use would not be taxed under [ROTA], despite all the elements of the sale occurring in Illinois, then the tax imposed by [UTA] does not apply to the use of the tangible personal property in this state.” For that section to apply, a sale of property must occur. Because Zimmer chooses to retain ownership of the specialized instruments, no sale of specialized instruments occurs when it provides them to the nonprofit institutions. With no sale as a condition precedent, section 3-65 does not offer a safe harbor for Zimmer.

Illinois state taxation on the sale of the prosthetic devices, in and of themselves, is not at issue in this matter as those sales were tax-exempt to the extent those sales were made to Illinois nonprofit institutions. Stip. at ¶ 9. Furthermore, had Zimmer sold the specialized instruments to the nonprofit institutions outright instead of retaining ownership of the instruments, the sale of those instruments would be tax-exempt as well as the sale to the nonprofit institutions would not be taxable under the Retailers’ Occupation Tax Act (35 ILCS 120/2-5(11)). As a consequence of any actual sale not being taxable under ROTA, there would be no use tax imposed on the sales of the specialized instruments pursuant to 35 ILCS 105/3-65.

C. Zimmer’s Transactions do not Qualify as Exempt Leasing Transactions

Because Zimmer’s specialized instruments transactions with Illinois nonprofit institutions are neither sales nor gifts, they can be best described as ill-defined leases as Zimmer retains title of the specialized instruments, accounts for its cost of the specialized instruments in the sales price of the related orthopedic products, and demands express indemnification terms from its customers in product purchase agreements for the orthopedic devices.

Zimmer argues, in the alternative, that to the extent it leases the specialized instruments to the Illinois nonprofit institutions, those transactions would be

exempt from use tax pursuant to 86 Ill. Adm. Code 150.331. Pet'r Mot. for Summ. J. at 5-6.

86 Ill. Adm. Code 150.331 (Persons Who Lease Tangible Personal Property to Exempt Hospitals) allows, in general, that equipment leased to exempt hospitals is exempt from use tax. Zimmer's specialized instruments transactions are available to take advantage of that regulation, at least to the extent the customer is an exempt hospital, presumably a smaller subset of all Illinois nonprofit institutions that are Zimmer's customers which are provided the specialized instruments.

The Department readily acknowledges that Department regulation section 150.331 "provides a path" for Zimmer to claim exemption from use tax. Dep't Mot. for Summ. J. at 10-11. However, Zimmer's transactions, as presently cast, fail to meet the requirements under the regulation.

86 Ill. Adm. Code 150.331 provides, in part, that the exemption is available when the following occurs:

- 1) the description of the equipment...must all be purchased for lease to a tax exempt hospital under a lease that has been executed or is in effect at the time of the lease;
- 2) the lease must be a for a period of one year or longer; and
- 3) the lease must be to a hospital that has an active exemption identification number issued by the Department under Section 1g of the Retailers' Occupation Tax Act (see 86 Ill. Amin. Code 130.2007.

86 Ill. Adm. Code 150.331(b).

Additionally, a qualifying hospital customer must provide the seller with a certificate stating that the equipment is being purchased for lease to a tax-exempt hospital under a lease for a period of one year and that the equipment is for use in the diagnosis, analysis, or treatment of hospital patients. 86 Ill. Adm. Code 150.331(c).

Zimmer fails to meet the requirements of 86 Ill. Adm. Code 150.331(b) and (c) to qualify any of its specialized instruments transactions with Illinois customers as exempt from use tax and it has not produced any documentation evidencing any compliance with the regulation. By simply casting its transactions to comport with the regulation, the leasing of the specialized instruments would exempt Zimmer from paying use tax.

3. Conclusion

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

The Department's Notice of Tentative Audit Denial of Claim is affirmed.

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: September 10, 2019