

UT 10-09
Tax Type: Use Tax
Issue: Tangible Personal Property

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

THE DEPARTMENT OF REVENUE	)	No.:	08-ST-0178
OF THE STATE OF ILLINOIS	)	Account ID:	0000-0000
	)	Reporting Periods:	07/2003-11/2003
v.	)		12/2003-11/2004
	)		12/2004-12/2005
ABC, LLC,)		
TAXPAYER.	)	Julie-April Montgomery	
	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: Kevin R. Krantz of Stahl, Cowen, Crowley, Addis, LLC, on behalf of ABC, LLC,; John D. Alshuler, Special Assistant Attorney General, on behalf of the Department of Revenue of the State of Illinois.

Synopsis:

The Illinois Department of Revenue (“Department”) issued three Notices of Tax Liability (“NTLs”) to ABC, LLC (“Taxpayer”) on August 28, 2008 covering the audit period July 1, 2003 through December 31, 2005. The NTL’s assessed Illinois Use Tax (“UT”) for purchases of dry ice deemed unwarranted resale transactions. Taxpayer protested all three NTLs and requested a hearing in the matter. The parties stated the issue to be decided was whether purchases of dry ice by Taxpayer were subject to UT or exempt as resale purchases. July 9, 2009 Order. The Department presented documentary evidence. Taxpayer presented testimonial evidence. Following a review of the testimony and evidence, it is recommended that the NTLs be finalized as issued. In support thereof, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the three NTLs reflecting Use Tax, late payment penalties, interest and applied payments, covering the audit period July 1, 2003 through December 31, 2005. Dept. Gr. Ex. No. 1; Tr. p. 9.
2. Taxpayer is an on-line grocer that delivered groceries to Illinois customers. Dept. Ex. No. 2 (Audit Narrative); Tr. p. 11.
3. Taxpayer filled grocery orders the night before (beginning at 10 p.m.) for next day delivery. Dept. Ex. No 2; Tr. pp. 12-13.
4. Taxpayer delivered grocery items from 6 a.m. until 8 p.m. Tr. p. 14.
5. Frozen and perishable items were packed in a Styrofoam tote together with dry ice that was wrapped in a plastic bag. This Styrofoam tote containing the frozen or perishable item and dry ice bag were then placed in a second liner board tote. Dept. Ex. No 2; Tr. pp. 12-13.
6. The purpose of the dry ice was to maintain frozen and perishable items in a cold state for at least 24 hours from the time that the order was filled (or approximately until 10 p.m. on the day of delivery). Tr. pp.12-14.
7. Taxpayer delivered grocery items to customers and kept the totes and whatever dry ice remained in the plastic bag. The plastic bag that contained the dry ice was usually "a gas, so there's really nothing there except an empty bag" (tr. p. 15) which was returned to Taxpayer's facility. Dept. Ex. No. 2; Tr. p. 15.
8. Taxpayer recycled the dry ice bag. Dept. ex. No. 2; Tr. pp. 15-16.
9. Taxpayer did not reuse the dry ice. Tr. pp. 14, 18.

Conclusions of Law:

In Illinois, the Use Tax Act (“UTA”) (35 ILCS 105/1 *et seq.*), imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 12 of the UTA incorporates by reference section 4 of the Retailers’ Occupation Tax Act (“ROTA”) (35 ILCS 120/1 *et seq.*), which provides that a certified copy of the NTL issued by the Department is *prima facie* correct and is *prima facie* evidence of the correctness of the amount of tax due. 35 ILCS 105/12; 120/4. Once the Department has established its *prima facie* case by submitting the certified copy of the NTL into evidence, the burden shifts to taxpayer to overcome the presumption of validity attached to the established *prima facie* case. Clark Oil & Refining v. Johnson, 154 Ill. App. 3d 773, 783 (1st Dist. 1987).

In order to overcome the presumption of validity attached to the NTL, taxpayer must produce competent evidence, identified with its books and records showing that the NTL is incorrect. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). Testimony alone is not enough. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203 (1st Dist. 1991). Documentary proof is required to prevail against an assessment of tax by the Department. Sprague v. Johnson, 195 Ill. App. 3d 798 (4th Dist. 1990).

In addition, “when a taxpayer claims that he is exempt from a particular tax...the burden of proof is on the taxpayer.” Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296 (1st Dist. 1981) (*citing* Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305 (1976); Bodine Electric Co. v. Allphin, 81 Ill. 2d 502 (1980)). To prove its case, a taxpayer must present more than just testimony that denies the Department’s determination. Balla at 296. Rather, taxpayer must present sufficient documentary evidence to support its claim. *Id.*

It is well established in Illinois that there is a presumption against exemption and therefore, “exemptions are to be strictly construed” with any doubts concerning the applicability of an

exemption “resolved in favor of taxation.” Van’s Material Co. Inc. v. Department of Revenue, 131 Ill. 2d 196 (1989). The taxpayer bears the burden of proving by “clear and convincing” evidence that the exemption applies. Evangelical Hospitals Corp. v. Department of Revenue, 223 Ill. App. 3d 225 (2nd Dist. 1991).

As previously stated, section 3 of the UTA imposes tax “upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 2 of the UTA defines a sale at retail to “include any such transfer made for resale unless made in compliance with Section 2c of the Retailers’ Occupation Tax Act, as incorporated by reference by Section 12 of the Use Tax Act.” 35 ILCS 105/2. “Thus, the Use Tax Act makes a statutory exception for property that is resold.” Armour Pharmaceutical Co. v. Department of Revenue, 321 Ill. App. 3d 662, 664 appeal denied 195 Ill. 2d 75 (1st Dist. 2001). In fact, “both the ROTA and UTA make statutory exceptions for property that is resold.” Container Corporation of America v. Wagner, 293 Ill App. 3d 1080, 1093 (1st Dist. 1997).

The Use Tax regulations provide:

The substance and provisions of all Retailers’ Occupation Tax Regulations...which are now in effect or which may hereafter be amended or promulgated, and which are not incompatible with the Use Tax Act...are incorporated herein by reference and made a part hereof. 86 Ill. Admin. Code, sec. 150.1201.

ROTA regulations provide:

a) Definition

[T]he term “containers” includes all...packaging materials... packaging, containing and wrapping materials in which tangible personal property may be contained. 86 Ill. Admin. Code, sec. 130.2070(a).

b) Sales for Resale

1) Sellers of containers to purchasers who sell tangible personal property contained in such containers to others are deemed to make sales of such containers to purchasers for purposes of resale, the receipts from which sales are not subject to Retailers’ Occupation

Tax, if the purchases of such containers transfer the ownership of the containers to their customers together with the ownership of the tangible personal property contained in such containers. 86 Ill. Admin. Code, sec. 130.2070(b)(1).

c) Sales For Use or Consumption

- 1) Sellers of containers to purchasers who do not transfer ownership thereof to others, but who intend such containers merely to provide a means of containing tangible personal property while in the process of being delivered to their customers, retaining and reusing or discarding the containers after such delivery is completed, and sellers of containers to purchasers who use such containers as a means of storing tangible personal property, are making sales for use or consumption, and their receipts from such sales are subject to the Retailers' Occupation Tax. 86 Ill. Admin Code, sec. 130.2070(c)(1).

At hearing, the Department introduced copies of three (3) NTLs under the certificate of the Director. Dept. Gr. Ex. 1; Tr. p. 9. This exhibit, without more, constituted *prima facie* proof of both the correctness of the amount of tax due and that Taxpayer was not entitled to an exemption. *See Quincy Trading Post v. Department of Revenue*, 12 Ill. App. 3d 725, 729-30 (4th Dist. 1973).

Taxpayer argued that the dry ice was packaging that was used to deliver products to Taxpayer's customers, and as such, the purchase of the dry ice by Taxpayer was not subject to tax. Tr. pp. 7, 27-28. The Department countered that the dry ice was "a part of the container...intend[ed]...merely to provide a means of containing tangible personal property while in the process of being delivered" (tr. pp. 25-26) and because the dry ice was not transferred to Taxpayer's customers, Taxpayer's purchase of the dry ice was not for resale, and as such, was subject to tax. *Id.* The Department is correct.

Taxpayer alleged that two Illinois private letter rulings which deemed dry ice to be "packaging" are "instructive." Tr. pp. 27-28. The first ruling stated that because the dry ice was "not [to] be resold by the purchaser...[it was] fundamentally different from ordinary packaging

materials” PLR 86-1058. The dry ice was deemed necessary to preservation of the meat that the dry ice was packed with inside of huge boxlike containers. This ruling found that such a use of dry ice was essential for the transport of the meat to customers and therefore concluded that the purchase of dry ice was to be taxed “like any other consumable supply.” *Id.*

The second ruling also involved the use of dry ice to transport meat. Here the Department stated “[i]f the dry ice...is boxed with the meat and shipped, then the purchase of the ice constitutes a non-taxable purchase for resale per Section 130.2070(b). When your client transfers ownership of the dry ice to its customers, as well as ownership of the meat packed therein, the ice is considered to be purchased for resale....Dry ice, however, which is used by your client for on-premises cooling purposes, is taxable.” PLR 92-0253.

The common thread in both of these Department private letter rulings was whether or not the dry ice was transferred to the customer along with the product. If the dry ice was transferred to the customer along with the product it was deemed a resale and not subject to tax. However, if the dry ice was not transferred along with the product it had been packed with there was no resale and tax was due. These letter rulings are consistent with Department regulation 130.2070 (“Regulation”) that specifically states containers include packing materials and packaging. 86 Ill. Admin Code, sec. 130.2070(b)(1). This Regulation also provides that sales for resale occur when there is a “transfer of ownership of the containers to...customers together with ownership of the tangible personal property contained in such containers.” *Id.* In addition, this Regulation provides that sales of containers which do not involve the transfer of ownership to others but are intended to provide “a means of containing tangible personal property while in the process of being delivered to their customers, retaining and...or discarding the containers after such delivery is

completed...are making sales for use or consumption” which are subject to tax. 86 Ill. Admin. Code Section 130.2070(c)(1).

Taxpayer admitted that seventy percent (70%) of its sales involved deliveries to customers who were in residence to receive their goods. When these same customers received foodstuffs that required a cold temperature to maintain them, Taxpayer’s employee delivered only the chilled food product and the dry ice that maintained the product remained with the delivery person who returned the dry ice bag with whatever dry ice remained to Taxpayer’s facility for destruction or recycling. Tr. pp. 15-18; Dept. Ex. No. 2 (“Audit Narrative: Consumable Supplies”). Pursuant to both the Department letter rulings and Regulation, these deliveries would be subject to tax because there was no transfer of the dry ice to Taxpayer’s customers.

Taxpayer presented testimony that the remaining thirty percent (30%) of its deliveries involved instances where the food along with the dry ice was left at the customer’s residence because no one was available for receipt. Tr. pp. 20-21. However, the Department in rebuttal presented its “Audit Narrative” which found “[i]t has been the company’s policy not to leave the products at the customer’s place without anyone to accept the delivery. In the event of unattended delivery, [T]axpayer takes the tote bag with the merchandise back to the warehouse.” Dept. Ex. No. 2 (“Audit Narrative: Consumable Supplies”).

The evidence necessary to overcome the presumption that the transaction is taxable because it is a sale for resale must be documentary in nature. 86 Ill. Admin. Code Sec. 130.810(c). Oral testimony is insufficient. Jefferson Ice Co. v. Johnson, 139 Ill. App. 3d 626 (1st Dist. 1985). Taxpayer proffered neither the testimony of a delivery man nor documentation, like delivery or driver logs, to substantiate its claim that deliveries were made in which the dry ice was transferred to customers. Moreover, Taxpayer presented no sur-rebuttal.

Taxpayer also represented that a minimal percentage of the deliveries made to customers in residence involved the transfer of the dry ice with the goods at the customer's request. Tr. p. 16. However, this claim also was not supported by any documentary evidence.

Taxpayer failed to substantiate, with documentation, that it transferred dry ice to its customers. Taxpayer consumed and therefore used the dry ice for its purpose of ensuring frozen/chilled products were still frozen/chilled when delivered to customers. Inasmuch as the dry ice was not delivered (or transferred) to customers along with the foodstuffs and because Taxpayer used the dry ice for its own purposes no resale of the dry ice was made by Taxpayer to its customers. Hence, Taxpayer's purchases of dry ice were subject to tax.

Taxpayer also avers that the late payment penalty it was assessed should be waived due to reasonable cause because Taxpayer did its own research to determine whether or not its purchases of dry ice were taxable. Tr. p. 30. Taxpayer presented testimony that its tax department researched whether dry ice purchases were subject to tax. This testimony alleged that based upon a letter ruling that deemed dry ice to be packaging the decision was made that dry ice was exempt from tax. Tr. pp. 17-18. Taxpayer did not produce any written documentation that substantiated this claim or the reasoning underlying such a determination. In addition, the letter ruling was not identified.

Section 9 of the UTA requires the filing of monthly returns and the accompanying payment of whatever tax is due not later than the twentieth day of the following calendar month for transactions that occurred in the proceeding calendar month. 35 ILCS 105/9. Section 12 of the UTA incorporates by reference the provisions of Section 5 of the ROTA. 35 ILCS 105/12. Section 5 of the ROTA permits the Department to assess penalties in accordance with Illinois' Uniformity Penalty and Interest Act, 35 ILCS 735/3-1 *et seq.* ("UPIA"). 35 ILCS 120/5. Section 3-3(a-10) of

the UPIA authorizes the assessment of a late payment penalty for failure to remit tax on or before the prescribed due date. 35 ILCS 735/3(b-10)(1), (b-15), (b-20)(1). Section 3-8 of the UPIA also provides that this penalty “shall not apply if the taxpayer shows that his failure to file a return or pay tax at the required time was due to reasonable cause.” 35 ILCS 735/3-8.

The Department has adopted a regulation regarding reasonable cause which provides that “[t]he 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 Sec. 700.400(b).

As previously stated, the Department’s private letter rulings both confirm that deliveries, like those made by Taxpayer, would deem dry ice purchases subject to tax because the dry ice was not transferred to Taxpayer’s customers. No other good faith efforts or legal precedent were proffered to establish reasonable cause for Taxpayer’s claim that it found its dry ice purchases were exempt. Hence, this penalty must be affirmed.

Conclusion:

WHEREFORE, for the reasons stated above, it is recommended that all three (3) NTLs be finalized as issued.

July 16, 2010

Julie-April Montgomery
Administrative Law Judge