

ST 05-2

Tax Type: Sales Tax

Issue: Reasonable Cause on Application of Penalties
Trade-In Transactions Under Illinois Use Tax Act

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

THE DEPARTMENT OF REVENUE	)	Docket No.	03-ST-0000
OF THE STATE OF ILLINOIS	)	IBT No.	0000-0000
v.	)	NTL No.	00 00000000000000
ABC MOTOR SPORTS, INC.,	)	John E. White,	
Taxpayer	)	Administrative Law Judge	

RECOMMENDATION FOR DISPOSITION

Appearances: James Dickett, Romanoff & Dickett, Ltd., appeared for ABC Motor Sports, Inc.; Shepard Smith, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis:

This matter arose when ABC Motor Sports, Inc. (“ABC” or “taxpayer”) protested a Notice of Tax Liability (“NTL”) the Illinois Department of Revenue (“Department”) issued to it to assess retailers’ occupation tax. Taxpayer sells and leases motor vehicles, and the tax at issue was assessed regarding sales taxpayer made during the period from January 1998 through and including November 2000. The issues are whether taxpayer is entitled to certain trade-in deductions, and whether a late-filing penalty should be abated due to reasonable cause.

The hearing was held at the Department’s offices in Chicago. ABC presented documentary evidence consisting of books and records, as well as the testimony of its president. I have reviewed that evidence, and I am including in this recommendation

findings of fact and conclusions of law. I recommend the issues be resolved in favor of the Department.

Findings of Fact:

1. *ABC* is engaged, in Illinois, in the business of leasing and selling motor vehicles. See Department Group Ex. 1, p. 2 (Department auditor's correction of returns); Hearing Transcript ("Tr.") p. 13 (testimony of *John Doe* ("*Doe*"), *ABC*'s president and owner).
2. The Department audited *ABC* regarding the period from January 1, 1998 through and including November 30, 2000. Department Ex. 1 (copies of auditor's correction of taxpayer's returns and the NTL issued to taxpayer), pp. 2-3; Tr. p. 40 (testimony of Roy Kretz ("*Kretz*"), the Department auditor who conducted the audit of *ABC*).
3. Kretz described the results of the audit in his auditor's comments, and he prepared audit workpapers to present his findings and determinations. Department Ex. 2 (copies of auditor's workpapers), pp. 7 (page 3 of auditor's comments), 8 (schedule titled, "Summary Analysis"), 10 (schedule titled, "Summary Recap of Audit Findings").
4. *ABC*, like all Illinois auto sellers, files tax returns to report its gross receipts from selling tangible personal property on a transaction-by-transaction basis. Department Ex. 2, p. 5 (page 1 of auditor's comments); 35 ILCS 120/3. That is, for each sale it makes, *ABC* files a separate return. 35 ILCS 120/3.
5. Due to the high number of transactions *ABC* made during the audit period, taxpayer was asked to provide Kretz with books and records pertaining to the

- vehicle sales it made during the year 2000. Department Ex. 2, p. 5. Those books and records were kept in the form of “dealer jackets,” one of which *ABC* created and maintained for each vehicle sale. *Id.*, pp. 5-6. The dealer jackets generally included: sales invoices; insurance cards; lease documents; bill of sale; odometer statement forms; certificates of title and other documents. *Id.*, p. 5. The auditor also reviewed other documents. *Id.*
6. Kretz then selected a sample of 35 transactions from the dealer jackets taxpayer maintained regarding its sales during the year 2000. Department Ex. 2, p. 6; Tr. pp. 43-44 (Kretz).
 7. After analyzing the audit sample, Kretz determined the amount of tax and penalties due regarding the 35 sample transactions, and then projected the tax due, for some determinations, to the entire audit period. Tr. pp. 46-47, 49 (Kretz); 56 (testimony of Angelo Lolis (“Lolis”), a Department auditor who assisted Kretz in the *ABC* audit).
 8. The great majority of tax assessed as a result of the audit was based on the Department’s determination that *ABC* was not entitled to a particular class of trade-in deductions that it claimed on certain transaction-by-transaction returns. Department Ex. 2, p. 7 (page 3 of auditor’s comments).
 9. Since *ABC* claimed \$712,062 as trade-in deductions for the 35 sample transactions, and \$384,241 of that total was disallowed (Taxpayer Ex. 1, p. 2; Department Ex. 2, p. 30), the auditors determined that 54% ($384,241 \div 712,062 \approx 0.539617$) of the total amount *ABC* claimed as trade-in deductions on all of the returns filed during the entire audit period should be similarly disallowed. Tr. pp.

46-47 (Kretz), 56 (Lolis).

10. Kretz made other determinations that resulted in tax liabilities being assessed against taxpayer (Department Ex. 2, pp. 6-8, 16, 21, 26-27, 31), but taxpayer concedes all tax assessed other than the tax that was projected for the entire audit period and based on the Department's disallowance of the seven disputed sample trade-in deductions. Tr. pp. 36-37 (*Doe*); Taxpayer's Brief, p. 3.
11. Six of the seven disputed sample trade-in transactions involved sales of vehicles for which a trade-in deduction was claimed for the value of a vehicle whose title, at the time of the sale, named a lessor as the vehicle's owner. *Compare* Taxpayer Ex. 1 (schedule entries marked as item nos. 3, 7-10) *with* Department Ex. 2 (*ABC's* paperwork regarding the sales and trade-ins for the disputed sample transactions); Tr. pp. 57-67 (Lolis). These six transactions are described more fully here:
 - The disputed sale the parties refer to as number 3 involved *ABC's* sale of a 1998 Mercedes Benz 2-door convertible to Firststar Bank, N.A., with a trade-in of a 1998 Mercedes Benz 4-door. Taxpayer Ex. 1; Department Ex. 2, pp. 39-41 (copies of books and records regarding this transaction, respectively: 6/9/00 bill of sale; 6/9/00 ST-556; check receipt); Tr. pp. 57-59 (Lolis). The Department disallowed the trade-in deduction for this transaction because the auditors determined that title to the trade-in vehicle was, on the date of the sale, held by a lessor, G.E. Credit Auto Lease, and not by the purchaser. Tr. p. 58 (Lolis).
 - The disputed sale the parties refer to as number 4 involved *ABC's* sale of a

2000 Mercedes Benz to Firststar Bank, N.A., as Lessor and to Access Electronics, as Lessee, with a trade-in of a different 2000 Mercedes Benz. Taxpayer Ex. 1; Department Ex. 2, pp. 42-44d (copies of, respectively: 6/22/00 bill of sale (marked “corrected”); 6/22/00 bill of sale; 3/12/01 letter on Sante Fe Motorcars letterhead, acknowledging Santa Fe’s purchase of trade-in vehicle from taxpayer; 7/11/00 ST-556; calculation worksheet; Wisconsin title certificate for the trade-in vehicle naming Mercedes Benz Credit Corp. as registered owner, and showing owner’s assignment of that vehicle to ABC on 8/30/00; Illinois Secretary of State registration application naming Firststar Bank, N.A., Lessor and Access Electronics, as registered owners of the 2000 Mercedes ABC sold to them on 6/22/00); Tr. pp. 46-50 (Kretz). The Department disallowed the trade-in deduction for this transaction because the auditors determined that title to the trade-in vehicle was, on the date of the sale, held by a lessor, Mercedes Benz Credit Corp., and not by the purchaser. Taxpayer Ex. 1; Department Ex. 2, p. 44c; Tr. pp. 46-50 (Kretz), 63-64 (Lolis). Department auditor Lolis also determined that Lake had collected tax in the amount of \$5,452 from the purchaser at the time of the retail sale, but had not turned over that amount to the Department. Tr. pp. 61-63 (Lolis).

- The disputed sale the parties refer to as number 7 involved ABC’s sale of a 2000 Lexus to Larry Freedman, with a trade-in of a 1999 Mercedes Benz. Taxpayer Ex. 1; Department Ex. 2, pp. 51-52b (copies of, respectively: 2/29/00 ST-556; 2/25/00 bill of sale; front of Illinois certificate of title to traded-in 1999 Mercedes Benz; back of same title showing title assignment by

Mercedes Benz Credit Corp. to ABC on 3/1/00); Tr. pp. 64-65 (Lolis). The Department disallowed the trade-in deduction for this transaction because the auditors determined that title to the trade-in vehicle was, on the date of the sale, held by a lessor, Mercedes Benz Credit Corp., and not by the purchaser. Tr. p. 65 (Lolis).

- The disputed sale the parties refer to as number 8 involved ABC's sale of a 1999 Audi to Firststar Bank – Lessor, with a trade-in of a 1995 Jaguar. Taxpayer Ex. 1; Department Ex. 2, pp. 53-54 (copies of, respectively: 6/29/00 bill of sale; 7/29/00 ST-556); Tr. p. 65 (Lolis). The Department disallowed the trade-in deduction for this transaction because the auditors determined that title to the trade-in vehicle was, on the date of the sale, held by a lessor, G.E. Capital Auto Lease, and not by the purchaser. Tr. p. 65 (Lolis).
- The disputed sale the parties refer to as number 9 involved ABC's sale of a 1998 Mercedes to XXXX and XXXX Smith, with a trade-in of two vehicles, one a 1991 Honda, and the other a 1989 Audi. Taxpayer Ex. 1; Department Ex. 2, pp. 55-56 (copies of, respectively: 6/19/00 bill of sale; 7/19/00 ST-556); Tr. pp. 65-66 (Lolis). The Department disallowed that portion of the trade-in amount that was traceable to the Audi because the auditors determined that title to that vehicle was, on the date of the sale, held by a lessor, U.B. Leasing, and not by the purchasers. Tr. p. 66 (Lolis). The remaining portion of the trade-in deduction claimed, and traceable to the Honda, was allowed because the auditors determined that the purchasers held title to that vehicle. *Id.*
- The disputed sale the parties refer to as number 10 involved ABC's sale of a

2000 Mercedes Benz to Firststar Bank, N.A. – Lessor, and to XXXX – Lessee, with a trade-in of a 2000 Lexus. Taxpayer Ex. 1; Department Ex. 2, pp. 57-59 (copies of, respectively: 11/4/00 bill of sale; 11/4/00 ST-556; 10/10/00 odometer disclosure statement by XXXX, as transferor, for the 2000 Lexus); Tr. pp. 66-67 (Lolis). The Department disallowed the trade-in deduction for this transaction because the auditors determined that title to the trade-in vehicle was held by a lessor, and not by the purchaser. Tr. p. 66 (Lolis).

12. The final disputed transaction, which the parties refer to as number 11, involved ABC's sale of a 2000 Jaguar to Firststar Bank, N.A., as Lessor and to XXXXXX, as Lessee, with a trade-in of a 1997 Mercedes Benz. Taxpayer Ex. 1; Department Ex. 2, pp. 60-61 (copies of, respectively: 9/6/00 bill of sale; 9/22/00 ST-556); Tr. pp. 67-68 (Lolis). The Department disallowed the trade-in deduction for this transaction because the auditor could not determine who owned the trade-in vehicle at the time of the sale. Tr. pp. 66-67 (Lolis).
13. The Department assessed a late filing penalty of \$4,387 for taxpayer's failure to timely file its ST-556 returns during the audit period. Department Ex. 1, p. 3.
14. The auditor calculated that penalty by projecting his findings from a review of the 35 sample transactions. Department Ex. 2, pp. 6, 19, 30. The auditor determined that 24 of the 35 sample transactions, or 69% of them, were filed an average of 25 days late. *Id.*, p. 30. He then projected that percentage against the total tax required to have been shown due on all returns filed during the audit period, and then multiplied that sum by the statutory penalty rate of 2%. *Id.*, pp. 6, 19; 35 ILCS 735/3-3(b). The auditor also eliminated the discount taxpayer took into

account on that percentage of the returns that he determined to have been filed late. *Id.*; see also 35 ILCS 120/3 (discount authorized to offset retailer's costs associated with proper preparation and filing of required tax returns).

Conclusions of Law:

Statutory Burden of Proof

Section 4 of the Retailers' Occupation Tax Act ("ROTA") provides that the Department's correction of a taxpayer's returns constitutes prima facie proof that tax is due in the amount determined by the Department. 35 ILCS 120/4. In this case, the Department established its prima facie case when it introduced Department Group Exhibit 1 under the certificate of the Director. Department Ex. 1; Tr. p. 10. That exhibit, without more, constitutes prima facie proof that ABC owes tax in the amount determined by the Department. 35 ILCS 120/4. The Department's prima facie case is overcome, and the burden shifts to the Department to prove its case, only after a taxpayer presents evidence that is consistent, probable and closely identified with its books and records, to show that the Department's determinations were not correct. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157-58, 242 N.E.2d 205, 207 (1968). Additionally, when a taxpayer seeks to take advantage of deductions or credits allowed by statute, the burden of proof is on the taxpayer. Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305, 347 N.E.2d 729 (1976); Balla v. Department of Revenue, 96 Ill. App. 3d 293, 296, 421 N.E.2d 236, 238 (1st Dist. 1981).

Summary of Issues and Arguments

The primary issue here is whether a vehicle tendered to an auto dealer as a trade-in by a third party, that is, by someone other than the person who is named as the owner

on the certificate of title for the vehicle, and where the named title holder is a lessor/retailer,¹ is amenable to the trade-in deduction.

Taxpayer first argues that, of the seven trade-ins at issue, all should have been allowed since they involved “a motor vehicle being traded-in for another motor vehicle.” Taxpayer’s Post-Hearing Brief (“Taxpayer’s Brief”), p. 4. Taxpayer’s argument is based on the statutory definition of the phrase “like kind and character,” as that phrase is used and defined in ROTA § 1. Taxpayer also asserts that the trade-ins satisfy Illinois retailers’ occupation tax regulation (“ROTR”) § 130.425(d), and that they appear to satisfy ROTR § 130.455(c)(1)(C). Taxpayer’s Brief, pp. 4-5.

The Department first responds that the trade-ins do not satisfy ROTR § 130.425(d) because, in the case of disputed transaction number 7, *ABC* sold the traded-in Mercedes Benz to another dealer, which was not a sale at retail. Department’s Brief, p. 5. It next asserts that all of the trade-ins were properly disallowed pursuant to ROTR § 130.455(c)(2)(A), “since the taxpayer, a dealer, always holds title to the trade-in vehicle.” *Id.* Finally, the Department argues that ROTR § 130.455(c)(1)(C) does not apply to this matter because none of the disputed transactions involves an allowable third party trade-in. Department’s Brief, p. 6.

The other issue² is whether the late filing penalty assessed should be abated for reasonable cause. Taxpayer’s Brief, p. 5. On this issue, *ABC* contends that the penalty

¹ I equate a motor vehicle lessor with a motor vehicle retailer because motor vehicle lessors who sell a used vehicle they are engaged in the business of leasing to a purchaser for use are deemed to be retailers of such used vehicles, to the extent of the gross receipts from such sales. 35 ILCS 120/1c.

² The Department addresses additional issues identified in the pre-hearing order issued for this contested case. *E.g.*, Department’s Brief, p. 4. Since taxpayer expressly conceded those other issues in its initial brief (Taxpayer’s Brief, p. 3), I do not address them here.

should be abated because taxpayer reasonably relied on an outside certified public accountant to handle its tax matters, and that it replaced that accountant, after the audit, because of its poor performance. Taxpayer's Brief, p. 5. The Department responds that, since the record does not reflect that the accountant had anything to do with taxpayer's preparation or filing of its transactions-by-transaction returns, taxpayer has failed to present facts showing reasonable cause. Department's Brief, p. 8.

Analysis

Issue 1: The Trade-In Deductions

Section 1 of the ROTA defines the phrase "trade-in," essentially, as that which is not included within the "selling price" of a particular item of tangible personal property.

35 ILCS 120/1. Specifically, § 1 provides, in pertinent part:

"Selling price" or the "amount of sale" means the consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property, other than as hereinafter provided, and services, **but not including the value of or credit given for traded-in tangible personal property where the item that is traded-in is of like kind and character as that which is being sold**, and shall be determined without any deduction on account of the cost of the property sold, ***

The phrase "like kind and character" shall be liberally construed (including but not limited to any form of motor vehicle for any form of motor vehicle, or any kind of farm or agricultural implement for any other kind of farm or agricultural implement), while not including a kind of item which, if sold at retail by that retailer, would be exempt from retailers' occupation tax and use tax as an isolated or occasional sale.

35 ILCS 120/1 (emphasis added).

On the transaction-by-transaction returns on which motor vehicle dealers are required to report their sales, the value of a motor vehicle received by a dealer in trade for

a particular sale is taken as a deduction from the selling price of the motor vehicle whose sale is being reported. 35 ILCS 120/3. Thus, by definition and in practice, the trade-in deduction is an exemption from the amount of a retailer's taxable gross receipts. *Id.*; McCoy Ford, Inc. v. Department of Revenue, 60 Ill. App. 3d 429, 432, 376 N.E.2d 1083, 1085 (4th Dist. 1978).

In their briefs, both parties cite or refer to the two regulations pertaining to the subject of trade-ins, and I address them both in this recommendation. First, ROTR § 130.425 provides, in pertinent part:

130.425 Traded-In Property

a) "Gross receipts" means the "selling price" or "amount of sale". "Selling price" or the "amount of sale" means the consideration for a sale valued in money whether received in money or otherwise, including cash, credits, property other than as hereinafter provided, and services, but not including the value of or credit given for traded-in tangible personal property where the item that is traded-in is of like kind and character as that which is being sold, and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever. ***

b) The phrase "like kind and character" includes, but is not limited to, the trading of any kind of motor vehicle on the purchase of any kind of motor vehicle, or the trading of any kind of farm implement on the purchase of any kind of farm implement, while not including a kind of item which, if sold at retail by that retailer, would be exempt from Retailers' Occupation Tax and Use Tax as an isolated or occasional sale.

c) A motor vehicle traded to a farm implement dealer for a farm implement would not qualify for the exemption unless such farm implement dealer is also a motor vehicle dealer because the farm implement dealer's sale of the motor vehicle would be exempt as an isolated or occasional sale. A farm implement traded to a motor vehicle dealer for a motor vehicle would not qualify for the exemption unless such dealer is also a farm implement dealer because the motor vehicle dealer's sale of the farm implement

would be an exempt isolated or occasional sale. A farm implement traded for a motor vehicle, or a motor vehicle traded for a farm implement, would qualify for the exemption if the seller is engaged in business both as a motor vehicle dealer and a farm implement dealer. Agricultural produce or animals traded for a motor vehicle or for a farm implement would not qualify for the exemption.

d) The real test is whether the retail sale of the traded-in tangible personal property by the person who accepts it in trade would be subject to Retailers' Occupation Tax, or whether such sale would be exempt as an isolated or occasional sale (see Section 130.110). In the former event, the tangible personal property qualifies for the trade-in exemption. In the latter event, it does not.

e) The value of tangible personal property taken by a seller in trade as all or a part of the consideration for a sale, where the item that is traded-in is of like kind and character as that which is being sold, shall not be considered to be "gross receipts" subject to the Retailers' Occupation Tax and need not be included in the seller's return, or may be deducted in the return from gross receipts if included in gross receipts as reported in the return. The value of traded-in real estate or intangible personal property is not deductible from gross receipts in computing Retailers' Occupation Tax liability.

f) The Retailers' Occupation Tax applies to the business of selling tangible personal property at retail in this State whether such property is new or used and regardless of how the seller may have acquired such property (i.e., by way of purchase, as a trade-in or in some other manner).

86 Ill. Admin. Code § 130.425.

Taxpayer is correct that all of the trade-ins clearly satisfy the plain terms of ROTR § 130.425. Taxpayer's Brief, p. 4. There is no doubt that, if *ABC* were to make a retail sale of one of the traded-in motor vehicles, it would be subject to tax on that sale, since *ABC* is a retailer of motor vehicles. 35 **ILCS** 120/1; 86 Ill. Admin. Code §

130.425(b)-(f). The Department's argument that ABC's sale of one particular trade-in to another retailer was not a sale at retail (Department's Brief, p. 5), in no way disproves the correctness of ABC's argument, or the general applicability of ROTR § 130.425 to the trade-ins here. Both the statute and ROTR § 130.425(d) expressly classify as being eligible for the credit property that is like, in kind and character, the property in which the dealer is engaged in selling at retail. 35 ILCS 120/1; 86 Ill. Admin. Code § 130.425(a)-(e). They do not limit the credit to items of property the dealer actually ends up selling at retail.

There is, however, another regulation pertaining to trade-ins, and that regulation is more specifically applicable to trade-ins in transactions involving leased motor vehicles.

That regulation, § 130.455, provides, in pertinent part:

130.455 Motor Vehicle Leasing and Advance Trade-Ins

a) Definitions

Advance Trade Credit means a trade-in credit earned as the result of the trade-in of a vehicle on the future purchase of a vehicle where the purchaser is contractually obligated to make a purchase within 9 months after the advance trade.

Lease means a true lease of a vehicle for a term of more than one year.

Lessee means any person that acquires possession of a vehicle pursuant to a lease.

Lessor means any person engaged in the business of leasing vehicles to other persons.

Purchaser means any person, whether an individual consumer or a lessor, that purchases a vehicle from a dealer.

c) Use of Trade-in Credits

- 1) A dealer may reduce his gross receipts by the *value of or credit given* for a traded-in motor vehicle where: (Section 1 of the Act)

- A) An individual trades a motor vehicle he owns on the purchase of a new or used motor vehicle;
 - B) A lessor trades a motor vehicle he owns on the purchase of a new or used motor vehicle for subsequent lease;
 - C) A lessor or other purchaser trades a motor vehicle owned by a prospective lessee or a third party where the prospective lessee or third party assigns the vehicle to the dealer and provides written authorization for the trade to the dealer, for the benefit of the lessor or other purchaser. The written authorization provided by the prospective lessee or third party should be specific to the immediate transaction, identifying the vehicle to be purchased by the lessor or other purchaser. A prospective lessee or third party trade-in authorization may not be used in conjunction with an advance trade transaction; or
 - D) A motor vehicle is traded-in as described in subsection (c)(1)(B) or (c)(1)(C) of this Section, and the dealer executes the lease but assigns the lease to a purchasing lessor, if the following requirements are part of the transaction:
 - i) the lease agreement states that the lease and vehicle will be assigned to the lessor making the trade of the motor vehicle, and
 - ii) title is issued directly to the lessor making the trade of the motor vehicle and not to the dealer so that the dealer remains outside the chain of title.
- 2) A dealer may not reduce his gross receipts by the *value of or credit given* for a traded-in motor vehicle where: (Section 1 of the Act)
- A) The dealer is the owner (meaning the dealer holds either title or certificate of origin) of the traded-in motor vehicle;

- C) The party holding title and offering the vehicle or vehicles for trade on behalf of another purchaser or lessor, as described in subsection (c)(1)(C) of this Section, would not be entitled to the isolated or occasional sale exemption if such vehicle or vehicles were sold by that party, rather than traded.

86 Ill. Admin. Code § 130.455(c).

The facts of record show that this matter does not involve advance trade-ins, as

such transactions are defined in ROTR § 130.455(a) (“a trade-in credit earned as the result of the trade-in of a vehicle on the future purchase of a vehicle where the purchaser is contractually obligated to make a purchase within 9 months after the advance trade”) and described in McCoy Ford, Inc. v. Department of Revenue, 60 Ill. App. 3d at 430-31, 376 N.E.2d at 1084-85. Rather, the record shows that, in six of the seven disputed transactions, the Department’s auditors determined that, at the time a vehicle was tendered to ABC as a trade-in regarding a particular purchase, a lessor — and not the purchaser — owned the vehicle offered in trade. Department Ex. 2, pp. 6-7; Department Ex. 3, pp. 40 (transaction number 3, trade-in owned by GE Credit Auto Lease), 44c (transaction number 4, trade-in owned by Mercedes Benz Credit Corp), 52 (transaction number 7, trade-in owned by Mercedes Benz Credit Corp.), 53 (transaction number 8, trade-in owned by GE Cap Auto Lease), 66 (transaction number 9, trade-in owned by UB Leasing, and transaction number 10, trade-in owned by Lexus Lease); Tr. pp. 57, 64-66 (Lolis).

I will first address the transaction in which the owner of the trade-in could not be determined. Taxpayer Ex. 1; Department Ex. 3, p. 61; Tr. pp. 67-68 (Lolis). A brief overview of the structure of the ROTA, and the class of transactions to which the trade-in deduction was intended to apply, will help. Retailers sell tangible personal property (hereinafter “goods”) at retail to persons for use or consumption, and they are taxed for the privilege of engaging in that occupation. In order to sell such goods, however, retailers must first acquire the goods themselves. See Taxpayer Ex. 6, p. 3 (copy of taxpayer’s 2001 federal corporate income tax return, line 2 (cost of goods sold)). Retailers acquire the goods they are engaged in the business of selling in different ways.

Some of the more common ways for a motor vehicle dealer to acquire his stock would be from manufacturers, from wholesalers, from other dealers, and from customers, who offer vehicles in trade. Retailers do not owe use tax measured by the cost of the goods they purchase for resale to others at retail. 35 **ILCS** 105/2; 35 **ILCS** 120/1. They just owe ROT as measured by the gross receipts of the goods they sell at retail.

This general description of the nature of the tax imposed on retailers, coupled by the substance of ROTR § 130.455(a), helps to reaffirm that the deduction was never intended to allow a retailer to reduce his tax base by designating as a trade-in its own cost of purchasing a particular item of property for resale, and claiming that amount as a credit against the receipts it realizes from selling another item of property. 35 **ILCS** 120/1 (“ ‘Selling price’ ... shall be determined without any deduction on account of the cost of the property sold”). Rather, the deduction was intended to allow the retailer to reduce his taxable gross receipts for those sales in which he actually receives an item of property (that is like the items of property he is engaged in selling) from another regarding a particular sale. This is no picayune concern. If a retailer could claim that it did not have to establish who owned an item of property it reported as being taken in trade, then the exemption might quickly swallow the tax. *See id.*

The foregoing introduction brings me to the transaction the parties refer to as number 11. In that transaction, *ABC* claimed a deduction of \$67,000 as the trade-in value of a Mercedes Benz that it deducted from its selling price of a Jaguar. Taxpayer Ex. 1; Department Ex. 3, p. 61; Tr. pp. 67-68 (Lolis). The Department’s auditors disallowed that deduction, but not because they determined that a lessor owned the vehicle whose value *ABC* claimed as a deduction on its return. Tr. pp. 67-68 (Lolis). Rather, it was

disallowed because they could not determine who owned the vehicle at all. *Id.*

Section 7 of the ROTA provides, in part:

To support deductions made on the tax return form, or authorized under this Act, on account of receipts from ... any other kind of transaction that is not taxable under this Act, entries in any books, records or other pertinent papers or documents of the taxpayer in relation thereto shall be in detail sufficient to show the name and address of the taxpayer's customer in each such transaction, the character of every such transaction, the date of every such transaction, the amount of receipts realized from every such transaction and such other information as may be necessary to establish the non-taxable character of such transaction under this Act.

It shall be presumed that all sales of tangible personal property are subject to tax under this Act until the contrary is established, and the burden of proving that a transaction is not taxable hereunder shall be upon the person who would be required to remit the tax to the Department if such transaction is taxable. ***

35 ILCS 120/7.

Since the auditors could not determine who owned the vehicle *ABC* claimed as a trade-in, it is possible that *ABC* may have owned it prior to the transaction on which it was reported as a deduction. See Taxpayer Ex. 1 (transaction number 6); Department Ex. 3, p. 50 (copy of bill of sale).³ At hearing, moreover, *ABC* failed to introduce any documentary evidence to show the specific circumstances surrounding *ABC*'s acquisition

³ In transaction number 6, for example, which taxpayer does not contest, the auditor determined that taxpayer had filed a return to report its sale of 1999 Chevrolet to Firststar Bank, N.A., on which return it also claimed a trade-in deduction of \$25,000 regarding a 1995 Mercedes Benz. Taxpayer Ex. 1; Department Ex. 3, p. 50 (copy of bill of sale). At hearing, however, taxpayer's president testified that *ABC* had taken the Mercedes on consignment, and had returned the trade-in to the customer, one day after the transaction on which it was reported as a trade-in, who sold it himself. Tr. pp. 31-32 (*Doe*). The record is altogether unclear whether the customer

of that particular vehicle. From this record, therefore, I cannot discern when or from whom *ABC* acquired that particular vehicle.

It is well to recall, moreover, that the mere entry of a vehicle description on the return itself does not constitute documentary evidence to establish that a particular item of property was actually taken in trade regarding a particular sale. 35 **ILCS** 120/7 (describing facts required to be shown by entries in retailer's books and records, to support deductions claimed on returns). The return filed regarding this transaction, for example, does not show the name and address of the person from whom *ABC* took title of the 1997 Mercedes Benz claimed as a trade-in, or the date on which *ABC* acquired it. In short, no books and records establish that the particular vehicle claimed as a trade-in on the return filed regarding the transaction the parties refer to as number 11 was, in fact, presented as a trade-in regarding that particular transaction. The Department's disallowance of the deduction for transaction number 11, therefore, was in all respects proper.

The Department disallowed the trade-in deductions claimed on the remaining six disputed sample transactions because the auditors determined that lessors owned the vehicles claimed as trade-ins on the returns filed regarding those sales. Department Ex. 2, pp. 6-7; Tr. pp. 47-48 (Kretz). That is, in these remaining situations, the Department does not contest that the vehicles were, in fact, tendered to them with regard to a particular sale of another vehicle. Instead, the Department's "fundamental basis" for upholding the audit determinations is ROTR § 130.455(c)(2)(A). Department's Brief, p. 5. Again, that particular subsection provides that "[a] dealer may not reduce his gross

who *Doe* said gave the Mercedes to *ABC* on consignment was the customer in the sale on which the Mercedes was reported as a deduction.

receipts by the *value of or credit given* for a traded-in motor vehicle where ... [t]he dealer is the owner (meaning the dealer holds either title or certificate of origin) of the traded-in motor vehicle[.]” The Department asserts that this particular section “clearly applies to this case since the taxpayer, a dealer, always holds title to the traded-in vehicle.” Department’s Brief, p. 5.

The Department disallowed the deductions claimed regarding these particular transactions after its auditor determined that, on the date they were acquired by *ABC*, a lessor was named as the owner on the title for each traded-in vehicle. Department Ex. 3, pp. 40 (transaction number 3, trade-in owned by GE Credit Auto Lease), 44c (transaction number 4, trade-in owned by Mercedes Benz Credit Corp), 52 (transaction number 7, trade-in owned by Mercedes Benz Credit Corp.), 53 (transaction number 8, trade-in owned by GE Cap Auto Lease), 66 (transaction number 9, disallowed trade-in owned by UB Leasing, and transaction number 10, trade-in owned by Lexus Lease). Thus, the Department’s own evidence has disproved its argument that *ABC* “always” owned the vehicles claimed as trade-ins regarding those transactions.

And even if counsel merely misspoke, and really meant to argue that *ABC* should be deemed the owners of the vehicles on the date of the transactions, since *ABC* took title directly from the third-party owners, I would still not agree that ROTR § 130.455(c)(2)(A) requires the denial of the deductions at issue. *ABC* did not own the traded-in vehicles until it acquired title to them as a result of taking such vehicles in trade. As taxpayer correctly notes in its response, moreover, a dealer will almost always be named as the owner on a certificate of title to a motor vehicle taken in trade, *after the trade takes place*, but that does not mean that it owned the vehicle when it was presented

for trade. Taxpayer's Response Brief, p. 3. The operative text of ROTR § 130.455(c)(2)(A) is written in the present tense. 86 Ill. Admin. Code § 130.455(c)(2)(A). It thus manifests an objective intent to deny the deduction if the dealer is the owner of the vehicle *at the time it is presented for trade*. The text does not manifest an intent to deny the deduction if the dealer *becomes* the owner of the vehicle traded-in *after* the sale. *Id.* If the Department were correct, and the words, "the dealer is the owner" really meant "the dealer will become the owner after the trade," the regulation would virtually eliminate the statutory exemption. I decline the opportunity to interpret ROTR § 130.455(c)(2)(A) in the way the Department suggests.

But concluding that taxpayer did not own the trade-in vehicles at the time they were presented for trade does not end the matter. The Department correctly argues that taxpayer has failed to show how the trade-in deductions are allowable under ROTR § 130.455(c)(1). Department's Brief, p. 6. The best taxpayer can do in its initial brief is to assert that the transactions "appear[] to fit within the parameters of Regulation 130.455(c)(1)(C)." Taxpayer's Brief, p. 5. That is, ROTR § 130.455(c)(1)(C) allows a deduction when "[a] lessor or other purchaser trades a motor vehicle owned by a prospective lessee or a third party where the prospective lessee or third party assigns the vehicle to the dealer and provides written authorization for the trade to the dealer, for the benefit of the lessor or other purchaser. ***" 86 Ill. Admin. Code § 130.455(c)(1)(C). Here, in each of the disputed transactions, an "other purchaser" is offering to *ABC* a motor vehicle that is owned by a "third party," and the "third party" assigns title to the vehicle to *ABC* for the benefit of the "other purchaser." Department Ex. 2, p. 7.

Regulation § 130.455(c)(2)(C), however, limits the circumstances under which a

dealer can claim a deduction pursuant to § 130.455(c)(1)(C). That subsection provides that, “[a] dealer may not reduce his gross receipts by the *value of or credit given* for a traded-in motor vehicle where ... [t]he party holding title and offering the vehicle or vehicles for trade on behalf of another purchaser or lessor, as described in subsection (c)(1)(C) of this Section, would not be entitled to the isolated or occasional sale exemption if such vehicle or vehicles were sold by that party, rather than traded.” The ROTA expressly provides that persons engaged in the business of leasing motor vehicles to others *are* subject to tax on their subsequent retail sales of such previously leased vehicles. 35 ILCS 120/1c. Thus, ROTR § 130.455(c), on its face, allows third party trade-ins to be claimed as a deduction by a dealer where the third party owner of the traded-in vehicle is not a retailer (86 Ill. Admin. Code § 130.455(c)(1)(C)), but not if the third party owner is a retailer. 86 Ill. Admin. Code § 130.455(c)(2)(C).

In its reply brief, *ABC* takes another approach to ROTR § 130.455(c), and implies that its transactions satisfy ROTR § 130.455(c)(1)(A) since: “(1) Taxpayer’s customer’s physically possess the leased trade-in vehicles; (2) Taxpayer’s customer’s have a right to buy-out such leases (see Tr. 37-38); (3) if Taxpayer’s customer’s buy-out the leases, titles to the trade-in vehicles would pass to the customers and then to Taxpayer upon the trade-in” Taxpayer’s Reply Brief, p. 2. While taxpayer characterizes its factual allegations as “obvious” (*id.*), there is absolutely no evidence in this record to discern what specific provisions were included within the actual leases used by the different leasing companies that owned the vehicles at issue. Thus, taxpayer’s arguments about the existence of contractual buy-out provisions (*id.*, allegation (2)), and the legal effect of such provisions, assuming they were, in fact, acted upon (*see id.*, allegation (3)), are based on facts that

are nowhere established within this record.

What is obvious is that *ABC* had the opportunity, at hearing, to introduce documentary evidence to establish whether facts supported its very tardy argument that the lessee, and not the lessor named on the title, owned a vehicle *ABC* claimed as a trade-in. Illinois courts, for example, have repeatedly held that “one can own an automobile though the certificate of title is in the name of another.” Country Mutual Ins. Co. v. Aetna Life & Casualty Ins. Co., 69 Ill. App. 3d 764, 768, 387 N.E.2d 1037, 1040 (2d Dist. 1979) (*quoting* State Farm Ins. Co. v. Lucas, 50 Ill. App. 3d 894, 898-99, 365 N.E.2d 1329, 1332 (4th Dist. 1977)). The presumption, however, is that the person named as the owner on a certificate of title for a vehicle is the owner of that vehicle. Nudi Auto RV & Boat Sales, Inc. v. John Deere Ins. Co., 328 Ill. App. 3d 523, 533, 765 N.E.2d 1163, 1171 (1st Dist. 2002) (“A certificate of title to an automobile is evidence of legal title.”). In other words, *ABC* had the opportunity to establish whether an individual who leased a vehicle, had, in fact, acquired ownership of the vehicle before tendering it to *ABC* as a trade — even if the parties to that transfer did not follow the requirements of the Illinois Vehicle Code. *See id.*; 625 **ILCS** 5/3-112, 3-113 (§ 112 of the Illinois Vehicle Code pertains to transfers of a vehicle’s ownership, and § 113 pertains to such transfers to or from dealers). For tax purposes, however, *ABC* had to rebut that presumption using documentary evidence closely identified with its books and records. 35 **ILCS** 120/7.

Further, if a particular contractual provision is an important element to a party’s theory of a case, it is incumbent upon that party to introduce the contract itself into evidence. *See* 35 **ILCS** 120/7 (description of documents required to support deductions); 735 **ILCS** 5/2-606. (“Exhibits. If a claim or defense is founded upon a written

instrument, a copy thereof, or of so much of the same as is relevant, must be attached to the pleading as an exhibit or recited therein, unless the pleader attaches to his or her pleading an affidavit stating facts showing that the instrument is not accessible to him or her. ***"); 86 Ill. Admin. Code § 200.155(a) ("The procedure at [Department] hearings shall be similar to that in court hearings. ***"). Here, the auditor's comments make plain that ABC kept copies of lease contracts in its dealer jackets. Department Ex. 2, pp. 5-6.

Thus, the situation is this: The Department disallowed certain deductions ABC claimed as trade-ins on its returns after an audit revealed that third-party lessors/retailers owned those traded-in vehicles. ABC protested that determination, and asked for a hearing. One of the arguments ABC presented after that hearing is that, at the time they were presented for trade, the traded-in vehicles were not really owned by the lessors whom the Department auditors were able to identify, but were instead owned by the lessees. Yet to support that assertion, ABC cites only to the testimony of its president. Taxpayer's Reply Brief, p. 2 (*citing* Tr. pp. 37-38).⁴ As a matter of law, such testimony is insufficient to rebut the Department's prima facie case. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34, 527 N.E.2d 1048, 1053 (1st Dist. 1988) ("A taxpayer cannot overcome the DOR's prima facie case merely by denying the accuracy of its assessments. Instead, evidence must be presented which is consistent, probable, and identified with its books and records.").

In summary, ROTR § 130.455(c)(2)(C) plainly provides that a dealer may not claim a trade-in deduction for a third party trade-in, otherwise described in ROTR

⁴ Worse still, the subject of *Doe*'s testimony on the transcript pages taxpayer cites does not even touch upon either the substance or effect of any provision that might have been included in one of the leases used by any of the lessors who owned the trade-in vehicles at issue. Tr. pp. 37-38 (*Doe*).

§ 130.455(c)(1)(C), where the vehicle offered in trade is owned by another retailer. Taxpayer has offered no credible and corroborated documentary evidence to show that the disputed transactions are allowable pursuant to some other subsection of ROTR § 130.455(c)(1). I reconcile ROTR §§ 130.455(c) and 130.425 by recognizing that the former is more specifically applicable to trade-in deductions claimed regarding transactions involving leased motor vehicles, and that, generally, in such circumstances, the more specific regulation is deemed to apply. See Williams v. Illinois State Scholarship Com’n, 139 Ill. 2d 24, 58, 563 N.E.2d 465, 480 (1990). I conclude, therefore, that ROTR § 130.455(c) requires me to recommend that the Director finalize the Department’s determination to disallow the trade-in deductions in dispute.

Issue 2: Reasonable Cause

The remaining issue is whether taxpayer had reasonable cause to abate the late filing penalty of \$4,387, which was imposed for taxpayer’s failure to timely file its ST-556 returns during the audit period. Department Ex. 1, p. 3. Pursuant to ROTA § 3, transaction-by-transaction returns are required to be filed not later than 20 days after the date the retailer delivers the motor vehicle sold at retail. 35 **ILCS** 120/3. Section 4 of the ROTA permits the Department to assess penalties, as part of a Notice of Tax Liability, in accordance with Illinois’ Uniform Penalty and Interest Act (“UPIA”). 35 **ILCS** 120/3. Section 3-3(b) of the UPIA authorizes the assessment of a 2% late filing penalty for failure to file a tax return on or before the prescribed due date. 35 **ILCS** 735/3-3(b). Section 3-8 of the UPIA provides that a penalty imposed by UPIA § 3-3, *inter alia*, “shall not apply if the taxpayer shows that his failure to file a return ... 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 § 700.400(b). The regulation further provides that, “[a] taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer’s experience, knowledge, and education. Accordingly, reliance on the advice of a professional does not necessarily establish that a taxpayer exercised ordinary business care and prudence, nor does reliance on incorrect facts such as an erroneous information return.” 86 Ill. Admin. Code § 700.400(c).

Taxpayer argues that it has established facts showing reasonable cause to abate that penalty since it used an accountant to handle its tax filing matters during the audit period, and reasonably relied upon that accountant. Taxpayer’s Brief, p. 5. It implies that its failure to timely file its ST-556 returns was occasioned by its accountant’s “poor service and bad advice” *Id.* The Department responds that the evidence *ABC* offered does not establish facts sufficient to constitute reasonable cause to abate the penalty, because there is no evidence that its accountant was in any way responsible for filing *ABC*’s transaction-by-transactions returns. Department’s Brief, p. 8. The Department is

correct.

Taxpayer offered a copy of its federal and state corporate income tax returns to show that it had one accountant in 1999 and 2000 (Taxpayer Ex. 6, pp. 1-2), and a different accountant in 2001 and 2002. *Id.*, pp. 3-4. It also offered the testimony of its president and owner, *Doe*, who testified that he was personally involved in the day-to-day operations of the business since it was created in 1998. Tr. pp. 12-13. *Doe* said that *ABC*'s accountants prepared its income tax returns, financial statements, payroll and also advised him regarding the audit that resulted in this contested case. Tr. pp. 13-14. *Doe* also testified he changed accountants in 2001, because he was not satisfied with their representation. Tr. p. 14.

There is no evidence, however, that *Doe* hired an accountant to file taxpayer's sales tax returns, or that the dismissed accountant *ABC* used during the audit period had anything to do with filing *ABC*'s transaction-by-transactions returns. Of those returns that are included in this record, none reflect that an accountant signed one as the taxpayer. Department Ex. 3, pp. 34, 36, 37, 40, 44a, 46, 51, 54, 56, 58, 61, 63, 65, 68. Further, here is no evidence that *Doe* or any of the managers at *ABC* ever asked an accountant when its returns were due. Similarly, there was no evidence to show that its returns were regularly filed late because an accountant advised taxpayer when its returns were due, and that the advice was wrong. The facts taxpayer cites as support to show why the penalty should be abated simply do not address the penalty assessed. 86 Ill. Admin. Code § 700.400(f)(2) (one of the relevant factors used by the Department to determine the existence of reasonable cause is whether taxpayer's reason addresses the penalty assessed).

The audit determinations, moreover, provide overwhelming evidence that the penalty was properly assessed. That 31% of the sample transactions were filed on time reflects that taxpayer knew when transaction-by-transaction returns were due, and that it was capable of filing them in a timely manner. *See* Department Ex. 2, p. 30. Just as surely, that 69% of the sample transaction returns were filed an average of 25 days late reflects that *ABC* did not make a good faith effort to file its returns in a timely manner. I recommend, therefore, that the Director not abate the late filing penalty assessed here.

Conclusion:

I recommend that the Director finalize the NTL as issued, with interest to apply pursuant to statute.

Date: 1/24/2005

John E. White
Administrative Law Judge