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LIMITATION OF PERSONS SUBJECT TO THE RETAILERS' OCCUPATION TAX ACT

*Dearborn Wholesale Grocers,
Inc. v. Whitler*

82 Ill. 2d 471, 413 N.E.2d 370 (1980)

The Illinois Retailers' Occupation Tax Act¹ imposes a tax upon the privilege of engaging in the occupation of selling² tangible personal property at retail³ at the rate of two to four percent of the retailer's gross receipts from such retail sales.⁴ The tax was declared constitutional under the Revenue Article of the Illinois Constitution⁵ in 1933.⁶

1. Retailers' Occupation Tax Act, ILL. REV. STAT. ch. 120, §§ 440-453 (1979 & Supp. 1981) [hereinafter referred to as the Act]. See generally Ice, *The Retailers' Occupation Tax Act and Related Tax Laws*, 1961 U. ILL. L.F. 614 [hereinafter referred to as Ice].

2. The tax is not upon the sale as such, but on the taxpayer's occupation of making sales to users or consumers. *Central Television Service Inc. v. Isaacs*, 27 Ill. 2d 420, 426-27, 189 N.E.2d 333, 336 (1963).

3. A retail sale is defined as one to the ultimate consumer, *i.e.*, the person who will use or consume the item or otherwise remove the item from the retail market. See text accompanying notes 26-29 and 55-61, *infra*.

4. ILL. REV. STAT. ch. 120, § 441 (1979 & Supp. 1981) was amended to lower the State Retailers' Occupation Tax rate on retail sales of food and medicine from 4% to 3% as of January 1, 1980; the statute was further amended to lower the rate to 2% effective January 1, 1981. The Municipal Retailers' Occupation Tax, ILL. REV. STAT. ch. 24, § 8-11-1 (1981), and the County Retailers' Occupation Tax, ILL. REV. STAT. ch. 34, § 409.1 (1981), permit a municipality or county to impose a tax on a taxpayer of up to 1% of the taxpayer's gross receipts from retail sales. These taxes are mutually exclusive. In addition, the Regional Transportation Authority (R.T.A.) and Metro East Transportation Authority are empowered to impose a ¼% to 1% tax on the gross receipts of retailers within their boundaries. ILL. REV. STAT. ch. 111½, § 704.03e (1981). This translates generally into a total tax on non-food and non-medicine items of 6% in Cook County, 5¼% in the remainder of the R.T.A. District and in the Metro East District, and 5% throughout the rest of the state. On food and medicine, the rates are 4%, 3¼% and 3% respectively.

5. ILL. CONST. of 1870, art. IX, §§ 1-2 provided:

SECTION 1.

The General Assembly shall provide such revenue as may be needful, by levying a tax, by valuation, so that every person and corporation shall pay a tax in proportion to the value of his, her, or its property—such value to be ascertained by some person or persons, to be elected or appointed in such manner as the General Assembly shall direct, and not otherwise; but the General Assembly shall have power to tax peddlers, auctioneers, brokers, hawkers, merchants, commission merchants, showmen, jugglers, inn-keepers, grocery-keepers, liquor dealers, toll bridges, ferries, insurance, telegraph and express interests or businesses, vendors of patents, and persons or corporations owning or using franchises and privileges, in such manner as it shall, from time to time, direct by general law, uniform as to the class upon which it operates.

SECTION 2.

The specifications of the objects and subjects of taxation shall not deprive the General Assembly of the power to require other subjects to be taxed, in such manner as may be consistent with the principles of taxation fixed in this Constitution.

The new constitution provides:

However, due to its importance⁷ and the difficulties of its application, it has continued to be the subject of considerable litigation.⁸ Much of the litigation arising from the Act has concerned whether sales made by a taxpayer have been taxable as "sales at retail." The Act defines a "sale at retail" as any transfer for a valuable consideration of tangible personal property for the purchaser's "use or consumption" and not for the purpose of resale.⁹ The construction of the term "sale at retail," *i.e.*, the taxable event, therefore, is aligned very closely with the meaning of "use or consumption."

The latest in a series of Illinois Supreme Court cases attempting to interpret the term "use or consumption," as used in this definition, is *Dearborn Wholesale Grocers, Inc. v. Whittler*.¹⁰ In this case, the Illinois Appellate Court for the First District and the Illinois Supreme Court dealt with the effect of a pair of 1965 amendments to the Act.¹¹ The amendments require a seller to obtain a certificate of resale¹² from his purchaser in order to support a deduction from gross receipts on the basis that sales to that purchaser were not for use or consumption, but

SECTION 1. STATE REVENUE POWER

The General Assembly has the exclusive power to raise revenue by law except as limited or otherwise provided in this Constitution. The power of taxation shall not be surrendered, suspended, or contracted away.

SECTION 2. NON-PROPERTY TAXES—CLASSIFICATION, EXEMPTIONS, DEDUCTIONS, ALLOWANCES AND CREDITS

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. Exemptions, deductions, credits, refunds and other allowances shall be reasonable.

ILL. CONST. art. IX, §§ 1-2 (1970).

6. *Reif v. Barrett*, 355 Ill. 104, 188 N.E. 889 (1933), *overruled on other grounds sub nom. Thorpe v. Mahin*, 43 Ill. 2d 36, 250 N.E.2d 633 (1969).

7. In 1980, sales tax revenue accounted for over 33% of the total tax collections in Illinois. U.S. BUREAU OF THE CENSUS, QUARTERLY SUMMARY OF STATE AND LOCAL TAX REVENUE, OCT.-DEC. (1980).

8. This author has located over fifty cases which have been decided in the Illinois Supreme Court and appellate courts concerning the Retailers' Occupation Tax since 1957.

9. ILL. REV. STAT. ch. 120, § 440 (1979 & Supp. 1981).

10. 82 Ill. 2d 471, 413 N.E.2d 370 (1980).

11. ILL. REV. STAT. ch. 120, §§ 440, 441 (1979 & Supp. 1981).

12. The Illinois Department of Revenue has promulgated Retailers' Occupation Tax Articles and Rules as regulations pursuant to the power granted to it by ILL. REV. STAT. ch. 120, § 451 (1979 & Supp. 1981). Article 13 in pertinent part provides:

(2) A Certificate of Resale is a statement signed by the purchaser that the property purchased by him is purchased for purposes of resale.

(3) A Certificate of Resale must bear the seller's name and address, the name and address of the purchaser, the date when such certificate was signed by the purchaser, a sufficient identification of the property sold for resale to the purchaser, and the purchaser's registration number or resale number with the Department.

Id. at 58.

were for resale.¹³ In *Dearborn*, the appellate court held that the requirements of the statute¹⁴ were clear, and that without compliance with the statute the taxpayer could not benefit from the statutory exemption.¹⁵ The Illinois Supreme Court reversed, however, holding that the provisions concerning resale certificates apply only to retailers and that the taxpayer, a wholesaler, was not required to comply.¹⁶

This comment will first examine the Illinois Supreme Court's decision in *Dearborn* in the context of both the appellate court's interpretation of the case and previous Illinois Supreme Court decisions interpreting the sale at retail (and, therefore, use or consumption) provisions of the Retailers' Occupation Tax Act. This comment will then question the supreme court's determination that the 1965 amendments requiring resale certificates¹⁷ do not apply to 100 percent wholesalers¹⁸

13. The amendments, codified as ILL. REV. STAT. ch. 120, §§ 440, 441c (1979 & Supp. 1981), in pertinent part provide:

"Sale at retail" shall be construed to include any transfer of the ownership of or title to tangible personal property to a purchaser, for the use or consumption by any other person to whom such purchaser may transfer the tangible personal property without a valuable consideration, and to include any transfer, whether made for or without valuable consideration, for resale in any form as tangible-personal property, unless made in compliance with Section 2c of this Act.

ILL. REV. STAT. ch. 120, § 440 (1979 & Supp. 1981) (emphasis added to denote the amended portion).

If the purchaser is not registered with the Department as a taxpayer, but claims to be a reseller of the tangible personal property in such a way that such resales are not taxable under this Act or under some other tax law which the Department may administer, such purchaser . . . shall apply to the Department for a resale number. Such applicant shall state facts which will show the Department why such applicant is not liable for tax under this Act or under some other tax law which the Department may administer on any of his resales and shall furnish such additional information as the Department may reasonably require.

Upon approval of the application, the Department shall assign a resale number to the applicant and shall certify such number to him. The Department may cancel any such number which is obtained through misrepresentation, or which is used to make a purchase tax-free when the purchase in fact is not a purchase for resale, or which no longer applies because of the purchaser's having discontinued the making of tax exempt resales of the property.

The Department may restrict the use of the number to one year at a time or to some other definite period if the Department finds it impracticable or otherwise inadvisable to issue such numbers for indefinite periods.

Except as provided hereinabove in this Section, no sale shall be made tax-free on the ground of being a sale for resale unless the purchaser has an active registration number or resale number from the Department and furnishes that number to the seller in connection with certifying to the seller that any sale to such purchaser is nontaxable because of being a sale for resale.

ILL. REV. STAT. ch. 120, § 441c (1979 & Supp. 1981).

14. In order for a sale to be considered exempt, the statute requires a purchaser claiming to be a reseller to obtain a registration number or resale number and to supply such number to his vendor in conjunction with certifying that he will resell the property purchased. *Id.* at §§ 440, 441c.

15. 74 Ill. App. 3d 813, 815, 393 N.E.2d 1, 3-4 (1979).

16. 82 Ill. 2d at 477, 413 N.E.2d at 372-73.

17. ILL. REV. STAT. ch. 120, §§ 440, 441c (1979 & Supp. 1981).

in light of the original objectives of the Act. A taxable "sale at retail" originally was considered to be only a sale to the ultimate user.¹⁹ The 1965 amendments have expanded taxable sales to include all sales not documented as exempt.²⁰ Finally, this comment will conclude that since a change in the definition of a taxable sale necessarily alters the content of the category of *sellers* at retail who are subject to the tax, sellers who do not obey the statutory mandate are sellers at retail and should be taxed on their undocumented sales.

HISTORICAL BACKGROUND

Retailers' Occupation Tax Act

The Retailers' Occupation Tax Act was enacted in 1933 to replace property tax revenue which had been reduced as a result of the Depression.²¹ The tax is imposed upon the privilege of doing business in Illinois as a retailer of tangible personal property,²² and is measured by such sellers' gross receipts from sales at retail.²³ The term "retailer" is defined by statute,²⁴ not by common usage. Therefore, a person whose general occupation is that of a manufacturer or "wholesaler" may also be considered to be a retailer if he engages in the occupation of selling tangible personal property under the circumstances defined in the Retailers' Occupation Tax Act.²⁵ In *Franklin County Coal Co. v. Ames*,²⁶ the operators of a coal mine were held to be sellers at retail despite their assertion that they were producers, not retailers, of tangible personal property.²⁷ The Illinois Supreme Court noted that the taxpayer, Franklin, did sell a large part of its output of coal to consumers.²⁸ Since the taxable event under the Act was the sale of tangible personal property to a user or consumer, the court concluded that Franklin had

18. The statute and regulations deal with sellers in the categories of sellers at retail and sellers for resale. A 100% wholesaler in statutory terms would be a seller who always sold for resale. *Id.* at § 440.

19. ILL. REV. STAT. ch. 120, § 440 (1933). See also *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 194 N.E. 268 (1934).

20. In addition to the exemption for sales made for resale, the Act also exempts sales to charitable, religious or educational organizations, ILL. REV. STAT. ch. 120, § 441 (1979 & Supp. 1981), and sales of pollution control equipment. *Id.* at § 440a.

21. *Id.*, *supra* note 1, at 614.

22. The tax applies only to sales of tangible personal property. Sales of intangibles and of real property are exempt.

23. ILL. REV. STAT. ch. 120, § 441 (1979 & Supp. 1981).

24. *Id.* at § 440.

25. *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 186, 194 N.E. 268, 271 (1934).

26. 359 Ill. 178, 194 N.E. 268 (1934).

27. *Id.* at 182-83, 194 N.E. at 270.

28. *Id.* at 182, 194 N.E. at 270.

made taxable retail sales.²⁹

The earliest Illinois Supreme Court case seeking to interpret the term "sale at retail"³⁰ held that a retail sale was one made to the *user or consumer* of the tangible personal property.³¹ Furthermore, "[t]he user or consumer contemplated by the statute is the ultimate user or consumer who will use the articles as long as they last or until he desires to do away with them."³² However, until the 1965 amendments, there was no rule requiring that a taxpayer document that any given sale was not to the ultimate user or consumer in order to take a deduction from his gross receipts when computing his tax liability.³³

In 1943, the Illinois Supreme Court examined the validity of a Department of Finance policy of disallowing deductions taken without obtaining resale certificates³⁴ in *Fashion-Bilt Cloak Manufacturing Co. v. Department of Finance*.³⁵ The taxpayer in *Fashion-Bilt* was a business whose sales were approximately eighty-five percent for resale (wholesale) and fifteen percent retail, the retail sales being merely an accommodation to employees, friends and relatives of the owners. The wholesale sales were all credit transactions and the retail sales were cash sales. Because the company originally did not obtain resale certificates from any of its customers, the auditor for the Department of Finance treated the entire gross sales as retail sales, excepting only certain piece goods and those sales for which the taxpayer subsequently was able to produce resale certificates. The auditor made no effort to determine whether the sales were in fact retail in nature.³⁶

Based upon the auditor's findings, the Department of Finance issued a notice of tax liability for the amount of sales not exempted by resale certificates, to which the taxpayer registered a timely protest.³⁷

29. *Id.* at 185, 194 N.E. at 271.

30. The Act, in its original form, in pertinent part provided:

"'Sale at retail' means any transfer of the ownership of, or title to, tangible personal property to the purchaser, for use or consumption and not for resale in any form as tangible personal property, for a valuable consideration."

ILL. REV. STAT. ch. 120, § 440 (1937).

31. *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 194 N.E. 268 (1934). *See also Ice, supra* note 1, at 619-20.

32. *Revzan v. Nudelman*, 370 Ill. 180, 185, 18 N.E.2d 219, 222 (1938).

33. *Fashion-Bilt Cloak Mfg. Co. v. Department of Finance*, 383 Ill. 253, 258, 49 N.E.2d 41, 43 (1943).

34. There was no rule requiring resale certificates, only a Departmental policy of denying exemptions which were not supported by resale certificates. *See text accompanying note 39 infra*.

35. 383 Ill. 253, 49 N.E.2d 41 (1943).

36. *Id.* at 256, 49 N.E.2d at 42.

37. After examination of a taxpayer's return, if the tax computed is greater than the amount due under the return, the Department will issue a notice of tax liability for the amount claimed to be due under the auditor's corrected return. ILL. REV. STAT. ch. 120, § 443 (1979 & Supp. 1981).

At the hearing before the Department, the taxpayer did not produce any additional resale certificates; thus, his evidence was ruled insufficient to rebut the Department's prima facie case.³⁸ The Illinois Supreme Court, however, held that the evidence produced by Fashion-Bilt, *i.e.*, invoices for all "wholesale" sales, and testimony that all retail sales appeared in the taxpayer's records and that the tax had been paid on all such receipts, was ample to overcome the prima facie case made by the Department.³⁹ The court stated that despite the weight accorded to the Department's corrected returns, where the taxpayer's evidence is "not so inconsistent or improbable, in itself, as to be unworthy of belief," the Department's prima facie case is overcome and the burden of proof is shifted to the Department.⁴⁰

The court noted that the taxpayer, Fashion-Bilt, had kept and made available a fairly complete set of books and records and that, consequently, the only complaint made by the Department concerned the lack of resale certificates. However, the court stated that certificates were not required by any direct statutory provision or any rule promulgated by the Department.⁴¹ The court held that since the statute contained no sort of certificate requirement, the taxpayer need not obtain or retain certificates of resale.⁴² Therefore, as of 1943, a taxable retail sale occurred when a person either sold an item of tangible personal property to its ultimate consumer or sold an item to a reseller but could not document the exempt nature of the transfer.

Because at that time only sales to ultimate users or consumers were deemed taxable, sales to persons engaged in service occupations,⁴³ such as jewelry repairmen, shoemakers, optometrists and doctors, presented a special problem. Under the Act, sales to such servicemen were held exempt from tax since they were sales for resale,⁴⁴ while the service-

A taxpayer may, within 20 days of receipt of notice of tax liability, protest such liability and request a hearing before the Department. *Id.*

38. 383 Ill. at 257, 49 N.E.2d at 43.

39. *Id.* at 259, 49 N.E.2d at 44.

40. *Id.* at 257, 49 N.E.2d at 43, quoting *Feldstein v. Department of Finance*, 377 Ill. 396, 399, 36 N.E.2d 557, 558 (1941).

41. 383 Ill. at 258, 49 N.E.2d at 43. Illinois Retailers' Occupation Tax Article 8 required only that a taxpayer retain, in addition to his usual records, such information as was necessary to substantiate his return, specifically (1) a daily record of gross sales, (2) a daily record of the amount of merchandise purchased, and (3) a complete annual inventory of stock on hand. *Id.*

42. 383 Ill. at 258, 49 N.E.2d at 43.

43. ILL. REV. STAT. ch. 120, § 440 (1941).

44. *Revzan v. Nudelman*, 370 Ill. 180, 18 N.E.2d 219 (1938). *See also* *American Optical Co. v. Nudelman*, 370 Ill. 627, 19 N.E.2d 582 (1939); *Bradley Supply Co. v. Ames*, 359 Ill. 162, 194 N.E. 272 (1934).

men's transfers were exempt as incidental to the sale of a service.⁴⁵ In 1941, the Illinois legislature responded to this interpretation of the statute by amending the statutory definition of "use or consumption" to include sales to the ultimate consumer by persons engaged in service occupations.⁴⁶ Three years later in *Stolze Lumber Co. v. Stratton*,⁴⁷ the Illinois Supreme Court held this amendment to be an unconstitutional attempt to extend the tax to a class of persons not included in the original title. The amendment provided that "in addition to its usual and popular meaning,"⁴⁸ use or consumption would include situations wherein a person engaged in a service occupation transferred tangible personal property as an incident to the sale of his service.⁴⁹ The Illinois Supreme Court stated that the amendment contravened the Illinois Constitution by "creating a second subject matter within the act, not expressed in the title and inconsistent therewith."⁵⁰ The use or consumption referred to in the Act was said to be that of the *purchaser*, and not of someone in privity with the purchaser, so that the serviceman's purchase could not be taxed since *he* would not use or consume the tangible personal property.⁵¹ Further, the court stated that the amendment was directly contradictory to the Act because there was another provision in the statute which excluded from the definition of taxable sales at retail any sales made "for resale in any form as tangible personal property, for a valuable consideration."⁵² The court, noting this provision, held that "the transfer of property from the contractor to the owner contemplated in the amendment, is clearly a transfer in some form for a valuable consideration,"⁵³ which is therefore an exempt sale for resale.⁵⁴

At the same time that this amendment was legislated, the General

45. *Revsan v. Nudelman*, 370 Ill. at 185, 18 N.E.2d at 222-23 (1938).

46. ILL. REV. STAT. ch. 120, § 440 (1941).

47. 386 Ill. 334, 344, 54 N.E.2d 554, 558-59 (1944), *overruled*, *Modern Dairy Co. v. Department of Revenue*, 413 Ill. 55, 108 N.E.2d 8 (1952). In *Stolze* the taxpayer sold building materials and fixtures to construction contractors who would incorporate such items into buildings, thereby converting them into part of the real estate sold. The contractors were not themselves the users of the tangible personal property; the buyers of the real estate were the users.

48. ILL. REV. STAT. ch. 120, § 440 (1941).

49. *Id.*

50. 386 Ill. at 337-38, 54 N.E.2d at 556. The Illinois Constitution prohibits dual subject matter within a statute. ILL. CONST. art. IV, § 13.

51. 386 Ill. at 343, 54 N.E.2d at 558.

52. *Id.* at 339, 54 N.E.2d at 556 (citing ILL. REV. STAT. ch. 120, § 440 (1941)).

53. 386 Ill. at 340, 54 N.E.2d at 557.

54. It should be noted that there is some discrepancy between the phrase used in the statute (for resale in any form as *tangible personal property*) and the language of the court (a transfer in *some form*). The amendment was not as contradictory as the court in *Stolze* claimed. In fact, the items in this case were transferred in the form of real property.

Assembly amended the definition of "sale at retail" to embrace a sale to a person who will transfer the property to another without a valuable consideration.⁵⁵ This amendment was upheld in *Modern Dairy Co. v. Department of Revenue*,⁵⁶ where the Illinois Supreme Court held that the amendment was intended by the legislature to tax the use or consumption which takes the tangible personal property off the retail market where it can no longer be an object of the tax.⁵⁷

In *Modern Dairy*, the court stated that once legislative intent is ascertained, it should be given effect unless clearly unconstitutional.⁵⁸ The court reasoned that the General Assembly intended the amendment to correct the court's prior stilted interpretation of the term "user or consumer,"⁵⁹ which had indicated that the purchaser was the user or consumer when he clearly was not. Thus, the legislature amended the Act to tax the sale to a purchaser who would not himself use the item, but who would transfer the item to another without a valuable consideration and, therefore, without charging Retailers' Occupation Tax.⁶⁰ Writing for the majority in *Modern Dairy*, Justice Maxwell concluded that the *physical* consumption of the property was thereby made irrelevant. In his view, the legislature had intended that the term "use or consumption" encompass the employment of the tangible personal property which takes it off the retail market, freeing it from further taxation.⁶¹

In *G. S. Lyon & Sons Lumber & Manufacturing Co. v. Department of Revenue*,⁶² the Illinois Supreme Court applied the *Modern Dairy*

55. The amendment provided: "Sale at retail' shall be construed to include any transfer of the ownership of, or title to, tangible personal property to a purchaser, for use or consumption by any other person to whom such person may transfer the tangible personal property without a valuable consideration."

ILL. REV. STAT. ch. 120, § 440 (1941).

56. 413 Ill. 55, 108 N.E.2d 8 (1952). The taxpayer in *Modern Dairy* sold dairy food products at retail and for resale. Among its customers was the Chicago State Hospital which purchased milk to be consumed by its patients and employees. The patients and employees did not pay consideration for the milk. *Id.*

57. *Id.* See also *Fefferman v. Marohn*, 408 Ill. 542, 97 N.E.2d 785, (1951), wherein the court did not pass on the constitutionality of the amendment but held that "a sale is one for use and consumption and not for resale, even though the purchaser transfers the commodity purchased, provided he does not transfer it for a direct and specific consideration." *Id.* at 547, 97 N.E.2d at 788.

58. 413 Ill. at 66, 108 N.E.2d at 14.

59. *Id.* at 66-67, 108 N.E.2d at 14-15.

60. ILL. REV. STAT. ch. 120, § 440 (1979 & Supp. 1981) was amended to read: "Sale at retail' shall be construed to include any transfer of the ownership of or title to tangible personal property to a purchaser, for use or consumption by any other person to whom such purchaser may transfer the tangible personal property without a valuable consideration."

61. 413 Ill. at 66, 108 N.E.2d at 14-15.

62. 23 Ill. 2d 180, 177 N.E.2d 316 (1961).

analysis to tax sales to a construction contractor.⁶³ In *G.S. Lyon*, the court ruled that the contractor/purchaser's transformation of the *tangible personal property* he purchased into the *real estate* he sold⁶⁴ effectively removed the tangible personal property from the retail market. Thus, the taxpayer's act of destroying the identity of the material as tangible personal property in effect consumed the property within the meaning of the statute.⁶⁵ This case permitted the result sought by the legislature in its amendments, which were ruled unconstitutional in the *Stolze* case.⁶⁶ Thus, as of 1961, a taxable sale occurred when a person engaged in the occupation of retailing made a sale 1) to the actual ultimate consumer, 2) to a reseller, without any evidence that the sale was for resale, or 3) to any person whose use of the tangible personal property would take it off the retail market, *e.g.*, a person making a gift of the property or incorporating it into real estate.

In 1965, the legislature attempted to modify the second type of taxable sale—a sale for resale without documentation—by amending the Retailers' Occupation Tax Act. The amendment provided that a "sale at retail" was "any transfer, whether made for or without a valuable consideration, for resale in any form as tangible personal property unless made in compliance with Section 2c."⁶⁷ Section 2c, in turn, requires that "no sale shall be made tax free on the ground of being a sale for resale unless the purchaser has an active registration number from the Department [of Revenue] and furnishes that number to the seller in connection with certifying to the seller that any sale to such purchaser is nontaxable because of being a sale for resale."⁶⁸

Under the Act as amended, all sales of tangible personal property are subject to tax unless the contrary is proven by the taxpayer.⁶⁹ According to section 7 of the Retailers' Occupation Tax Act,⁷⁰ where a

63. *Id.* at 66-67, 108 N.E.2d at 15. The Department of Revenue took this holding as an invitation to tax all sales to servicemen who would retransfer property as an incident to the sale of a service. It changed its rules and regulations to tax such sales, effective December 13, 1952. The Illinois Supreme Court overruled this action in *Burrows Co. v. Hollingsworth*, 415 Ill. 202, 112 N.E.2d 706 (1953). See *Ice*, *supra* note 1, at 621.

64. The lumber company sold materials to real estate developers who converted the items into real estate by incorporating them into buildings.

65. 23 Ill. 2d at 184, 177 N.E.2d at 318-19.

66. See text accompanying notes 46-54 *supra*.

67. ILL. REV. STAT. ch. 120, § 440 (1979 & Supp. 1981).

68. *Id.* at § 441c. Prior to *Dearborn*, these amendments had not been interpreted by the Illinois Supreme Court. In an earlier attempt to raise these issues, the taxpayer had failed to exhaust his administrative remedies and, therefore, his appeal was dismissed. *Calderwood Corp. v. Mahin*, 57 Ill. 2d 216, 311 N.E.2d 691 (1974).

69. ILL. REV. STAT. ch. 120, § 446 (1979 & Supp. 1981).

70. *Id.*

taxpayer, on his return, deducts the receipts of nontaxable sales, he shall maintain books and records to support the reason for tax exemption.⁷¹ Such documents shall be made available for inspection by the Department of Revenue during regular business hours.⁷² Among the books and records which must be maintained by a taxpayer if he claims a tax exempt sale for resale is "a record of the purchaser's registration number or resale number with the Department."⁷³

The Illinois Supreme Court indicated which records are necessary to prove exemption from tax in *Copilevitz v. Department of Revenue*.⁷⁴ The court noted that section 7 is explicit in its requirement that documentary evidence be maintained.⁷⁵ Observing that the court had long held that statutory record-keeping requirements are mandatory, Justice Schaefer ruled that only the records specified in the Act would suffice as the minimum required to overcome the Department's prima facie case.⁷⁶

In *Copilevitz*, the taxpayer was a retail grocer who deducted from his gross receipts the proceeds from interstate sales and sales for resale made to relatives in Missouri. The Department assessed a tax deficiency based on the taxpayer's unreported sales for which there was no documentation of exemption.⁷⁷ The hearing officer allowed the taxpayer additional time to submit verification of the exempt nature of the sales; however, the taxpayer did not produce such documentation.⁷⁸

Oral testimony was presented in *Copilevitz* by the taxpayer and his brother to the effect that the unreported receipts were the result of interstate sales and sales for resale. This evidence was ruled insufficient

71. *Id.* The Act in pertinent part provides:

To support deductions made on the tax return form, or authorized under this Act, on account of receipts from . . . sales of tangible personal property for resale, . . . 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 amount of receipts realized from every such transaction and such other information as may be necessary to establish the nontaxable character of such transaction under this Act.

72. The Act states: "Books and records . . . shall be preserved until the expiration of such period [in which the Department is authorized to audit] unless the Department, in writing, shall authorize their destruction or disposal prior to such expiration." *Id.* A notice of tax liability may not be issued after January 1 or July 1 to cover more than three years prior to such January 1 or July 1. Therefore, the period in which an audit may be conducted and during which the taxpayer must retain his records, is approximately three years. *Id.* at § 443.

73. *Id.* at § 446.

74. 41 Ill. 2d 154, 242 N.E.2d 205 (1968). The court did not consider § 2c in this opinion.

75. *Id.* at 156, 242 N.E.2d at 206-07. See also *Du Page Liquor Store, Inc. v. McKibbin*, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943).

76. 41 Ill. 2d at 156-57, 242 N.E.2d at 207.

77. *Id.* at 155, 242 N.E.2d at 206.

78. *Id.*

because section 7 of the Act required retailers to keep documentary evidence such as books and records of all sales, copies of bills of sale, and other pertinent papers and documents. The court also noted that, specifically in relation to sales for resale and interstate sales, the statute provided that entries describing these sales "shall be in detail sufficient to show the name and address of each purchaser to whom a sale is made, the character of every such transaction (whether it is a sale for resale, (or) a sale in interstate commerce * * *), the date of every such transaction and the amount of receipts realized from every such transaction."⁷⁹ Finally, the court observed that the Department's regulations stated that sellers should "for their protection" take a resale certificate from their purchasers for resale,⁸⁰ and that interstate sales should be documented by a waybill, a Post Office receipt, or a trip sheet as well as other supporting data as required by section 7.⁸¹ Copilevitz argued that as a small businessman he should not be required to maintain a complicated set of records. However, he had produced adequate documentation to support his other exempt sales. Under these facts, the court held that the Department's case had not been overcome.⁸²

In summary, the major cases interpreting the Retailers' Occupation Tax Act's use or consumption provision,⁸³ which closely determines the occasion of a taxable retail sale, have established that a taxable sale occurs under the following circumstances: 1) when the taxpayer makes a sale to the ultimate user or consumer of the item; 2) when the taxpayer is unable to produce proof that the sale was for resale (or otherwise exempt) with the records required by section 7 of the Act; and 3) when the taxpayer sells to a purchaser who will transfer the property without receiving a valuable consideration (whose purchase takes the article off the retail market, so it can no longer be taxed). In 1965, the legislature added a fourth class of retail sale. According to the 1965 amendments,⁸⁴ when a taxpayer sells to a purchaser who does not supply him with a resale certificate, the sale is considered taxable. Furthermore, section 7 of the Act requires that records sup-

79. *Id.* at 157, 242 N.E.2d at 207, citing ILL. REV. STAT. ch. 120, § 446 (1979 & Supp. 1981).

80. *Id.*, citing Illinois Retailers' Occupation Tax Article 13, rules 2 & 3.

81. 41 Ill. 2d at 157, 242 N.E.2d at 207, citing Illinois Retailers' Occupation Tax Article 5. The *Copilevitz* court did not discuss the statutory requirement of resale certificates found in § 2c.

82. 41 Ill. 2d at 158, 242 N.E.2d at 207.

83. See *Copilevitz v. Department of Revenue*, 41 Ill. 2d 154, 242 N.E.2d 205 (1968); *Modern Dairy Co. v. Department of Revenue*, 413 Ill. 55, 108 N.E.2d 28 (1952); *Fashion-Bilt Cloak Mfg. Co. v. Department of Revenue*, 383 Ill. 253, 49 N.E.2d 41 (1943); *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 194 N.E. 268 (1934).

84. 1965 ILL. LAWS p. 116 amending ILL. REV. STAT. ch. 120, §§ 440, 441c (1979 & Supp. 1981).

porting a nontaxable sale must be retained by the taxpayer for the statutory period. It was in the context of these cases and statutes that the *Dearborn* case arose.

FACTUAL BACKGROUND

Dearborn Wholesale Grocers, Inc. v. Whittler

In 1975, the Department of Revenue conducted a field audit⁸⁵ of Dearborn Wholesale Grocers, Inc. Dearborn was an establishment which sold large quantities of grocery items to both restaurants and retail grocers on a wholesale basis.⁸⁶ The audit covered the period from July 1, 1972 through May 31, 1975. The auditor selected the third ten days of January 1972, the second ten days of May 1973 and the first ten days of August 1974 for review, as authorized by the taxpayer.⁸⁷

From examination of the taxpayer's invoices for these periods, the auditor determined Dearborn's gross receipts for a typical month. Extending this figure to cover the 36 month period of the audit, the auditor established Dearborn's gross receipts. Deductions for sales for resale⁸⁸ were allowed for approximately ninety-eight and one-half percent of this amount, the balance being treated as taxable sales. The Department assessed a tax liability⁸⁹ of \$128,977.37 on this basis.⁹⁰ Dearborn entered a timely protest and was granted a hearing to contest the assessment.⁹¹

At the taxpayer's hearing, the Department properly introduced its corrected returns and established its prima facie case. The taxpayer presented the testimony of its president, several salesmen and a truck driver that all sales and deliveries were to retail grocery stores.⁹² Dear-

85. ILL. REV. STAT. ch. 120, § 443 (1979 & Supp. 1981) declares that the Department of Revenue shall examine and, if necessary, correct the tax returns submitted by retailers. An auditor may go to the taxpayer's premises and examine the books and records required to be kept by the Act which support the taxpayer's returns (a field audit), or he may request the books and records of the taxpayer and conduct the audit at the Department (an office audit). *Id.* at §§ 446-47.

86. *Dearborn Wholesale Grocers, Inc. v. Whittler*, 74 Ill. App. 3d 813, 814, 393 N.E.2d 1, 2 (1979).

87. Matt White, Vice President of Dearborn, signed an agreement authorizing a test check audit on January 6, 1975. This agreement is reproduced as Appendix "A" in Brief for Appellee at 1a-2a, *Dearborn Wholesale Grocers, Inc. v. Whittler*, 82 Ill. 2d 471, 413 N.E.2d 370 (1980).

88. Dearborn had obtained self styled consumer information sheets for at least some of the undocumented sales. 74 Ill. App. 3d 813, 817, 393 N.E.2d 1, 4.

89. See note 37 *supra*.

90. 74 Ill. App. 3d at 814, 393 N.E.2d at 2.

91. See note 37 *supra*.

92. 82 Ill. 2d at 473-74, 413 N.E.2d at 371. Upon being questioned as to whether he had secured registration numbers from customers, the truck driver testified that having the numbers was "not a must." *Id.* at 471, 413 N.E.2d at 370.

born also submitted all of the invoices from the test check, photographs of the locations of the customers named on the invoices and their registration numbers.⁹³

The hearing officer found Dearborn to be a wholesaler.⁹⁴ Nonetheless, referring to Section 2c of the Act,⁹⁵ he recommended⁹⁶ that a final assessment be issued against the taxpayer, including penalties and interest compounded through May 31, 1977, because of the taxpayer's failure to present the necessary resale certificates.⁹⁷ Dearborn sought administrative review of the proceedings in the Circuit Court of Cook County.⁹⁸ Upon review, the court concurred with the hearing officer's finding that the taxpayer was a wholesaler, but reversed the assessment, holding that the requirements of section 2c were not applicable to Dearborn as a wholesaler.⁹⁹

The Appellate Court's Decision

The sole issue on appeal was whether Dearborn's failure to comply with section 2c, the requirement of obtaining resale certificates, controlled the nature of these sales in light of other evidence presented by the taxpayer, imposing Retailers' Occupation Tax liability. The appellate court held that it could.¹⁰⁰

Justice Medja, author of the appellate court's opinion, rejected Dearborn's contention that the tax did not apply to it as an exclusively wholesale business. In his view, a determination of the wholesale-retail¹⁰¹ question was irrelevant since the real issue was whether there was compliance with section 2c of the statute,¹⁰² which created a deduc-

93. *Id.*

94. The hearing officer found that the taxpayer was generally engaged as a seller to resellers. The Illinois Supreme Court had previously held that a taxpayer's general occupation was irrelevant when a taxpayer was also engaged in the business of selling tangible personal property to users or consumers. *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 194 N.E. 268 (1934). See text accompanying notes 25-29 *supra*. The finding as to the taxpayer's general occupation may have seemed irrelevant to the hearing officer, however, the Circuit Court of Cook County relied upon this finding in reversing the assessment. See text accompanying note 98 *infra*.

95. ILL. REV. STAT. ch. 120, § 441c (1979 & Supp. 1981).

96. A hearing officer does not decide the issues in a hearing. Only the Department can issue a final assessment, pursuant to a hearing. ILL. REV. STAT. ch. 120, § 443 (1979 & Supp. 1981).

97. 82 Ill. 2d at 474, 413 N.E.2d at 371.

98. The Act provides that a taxpayer may file suit under the Administrative Review Act, ILL. REV. STAT. ch. 110, § 264 (1979), to review any final assessment issued by the Department. ILL. REV. STAT. ch. 120, § 451 (1979 & Supp. 1981).

99. 74 Ill. App. 3d at 814, 393 N.E.2d at 2.

100. *Id.*

101. Along the lines of the *Franklin Coal* decision, the common designation for the taxpayer's calling is immaterial.

102. 74 Ill. App. 3d at 815, 393 N.E.2d at 2.

tion from gross receipts which was thereby exempted from tax. The court stated that the statutory requirements for obtaining the benefits of this exemption were clear, and that absent taxpayer compliance with these requirements, no exemption could be taken.¹⁰³

The court further rejected the taxpayer's argument that the statute merely created a presumption of taxability which, once overcome, shifted the burden to the Department.¹⁰⁴ Justice Medja noted that the legislature had amended the Act to require resale certificates to document "sale for resale" deductions from gross receipts after the Supreme Court in *Fashion-Bilt*¹⁰⁵ had held that, despite having no resale certificates, a taxpayer could overcome the presumption of taxability.¹⁰⁶ In light of Dearborn's noncompliance with the statute, the appellate court ordered the Department's final assessment reinstated.¹⁰⁷

In its supplemental opinion of denial of rehearing,¹⁰⁸ the court rejected the taxpayer's contention that the Act required a taxpayer only to obtain its vendees' registration numbers or resale numbers. The registration numbers submitted by the taxpayer provided no certification, as required by the Act, that the items purchased were for resale.¹⁰⁹

The Illinois Supreme Court's Decision

Justice Ward's opinion for the Illinois Supreme Court construed the requirements of the statute pertaining to the securing of resale certificates as applying only to persons engaged in the business of making sales at retail. The court held that Dearborn was not engaged in making sales at retail¹¹⁰ and that applying the statute to Dearborn would effectively tax a wholesaler despite uncontroverted evidence that the sales it had made were for resale.¹¹¹ Since taxing wholesalers is outside the scope of a tax on retailers, the court concluded that such an application would be unconstitutional as violative of the prohibition against dual subject matter.¹¹²

The *Dearborn* court found that the legislature had limited the tax

103. *Id.* at 815, 393 N.E.2d at 4.

104. *Id.* at 815-16, 393 N.E.2d at 3.

105. 383 Ill. 253, 49 N.E.2d 41 (1943). See text accompanying notes 33-42 *supra*.

106. 74 Ill. App. 3d at 816, 393 N.E.2d at 4.

107. *Id.*

108. *Id.* at 817, 393 N.E.2d at 4.

109. ILL. REV. STAT. ch. 120, § 441c (1979 & Supp. 1981) provides that a sale shall be exempt as a sale for resale only if the purchaser provides an active registration or resale number in conjunction with certifying that the item is nontaxable because it is being purchased for resale.

110. 82 Ill. 2d at 477, 413 N.E.2d at 373.

111. *Id.* at 477-78, 413 N.E.2d at 373.

112. *Id.* at 478, 413 N.E.2d at 373. See text accompanying notes 46-54 *supra*.

to the retail level in order to avoid multiple taxation of a single item,¹¹³ and noted that there was no evidence to suggest that Dearborn's vendees had not paid the tax.¹¹⁴ The court acknowledged that the requirement of a resale certificate provided a means to verify a retailer's claim that a particular sale is exempt because the purchaser will not himself use or consume the property. The court presented the example of a hospital as the purchaser of tangible personal property which will be used by its patients.¹¹⁵ In such a case the hospital would not hold a registration number since it is not engaged in the business of selling tangible personal property at retail. The court then concluded that the requirements of section 2c would furnish a means of verifying that the hospital's purchase was indeed for resale.¹¹⁶

Finally, the court held that similar provisions of the Act, such as section 7 which requires record-keeping¹¹⁷ and section 3 which requires the filing of returns¹¹⁸ also apply only to persons engaged in the business of selling tangible personal property at retail.¹¹⁹ Since Dearborn was held to be a wholesale operation, it was also held to be unencumbered by any of the sections calling for documentation of resale sales.¹²⁰

ANALYSIS

The Illinois Supreme Court reached its conclusion that section 2c was unconstitutional as applied to Dearborn only by ignoring the statutory definition of "sale at retail" and the established rules of statutory construction. When the legislature amends a statute after a court has interpreted the statute, it is evidencing dissatisfaction with the court's interpretation.¹²¹ The legislature is presumed to have known of the prior construction of the original act; therefore, when the act, as amended, is inconsistent with the prior judicial interpretation, the amendment controls.¹²²

113. 82 Ill. 2d at 479, 413 N.E.2d 373-74.

114. *Id.* at 479, 413 N.E.2d at 374.

115. *Id.* citing *inter alia* *Modern Dairy Co. v. Department of Revenue*, 413 Ill. 55, 108 N.E.2d 8 (1952).

116. *Id.* at 479-80, 413 N.E.2d at 374.

117. ILL. REV. STAT. ch. 120, § 446 (1979 & Supp. 1981).

118. *Id.* at § 442.

119. 82 Ill. 2d at 480, 413 N.E.2d at 374.

120. *Id.*

121. *See Modern Dairy Co. v. Department of Revenue*, 413 Ill. 55, 66, 108 N.E.2d 8, 14 (1952).

122. 1A SUTHERLAND'S STATUTORY CONSTRUCTION, § 22.35 (4th ed. 1972). *See also Modern Dairy Co. v. Department of Revenue*, 413 Ill. 55, 108 N.E.2d 8.

The Illinois Supreme Court earlier had noted in *Modern Dairy* that when the legislature has statutorily defined a term contrary to a prior judicial construction, "[it] would then seem incumbent upon the court to reconsider its construction of the act . . . to harmonize the court's construction with the legislative intent."¹²³ The court in *Fashion-Bilt*¹²⁴ held that a retailer need not produce resale certificates to support its deductions for sales for resale because at the time there was neither a statutory nor a regulatory requirement for the certificates.¹²⁵ Fashion-Bilt's sales, made without resale certificates, were held to be exempt as non-retail sales. However, the "positive rule of law" which was found lacking in *Fashion-Bilt*¹²⁶ is now a reality, having been supplied by the General Assembly in the form of the 1965 amendments declaring that a sale which is not documented as exempt is a sale at retail. In *Dearborn*, the Illinois Supreme Court was faced with an amendment to the Retailers' Occupation Tax Act which clearly contradicted the court's prior construction of a taxable sale at retail. By holding the amendments unconstitutional as applied to Dearborn, the court failed to take its own advice and harmonize its interpretation of the term sale at retail with the legislative mandate.

The *Dearborn* court held section 2c inapplicable to the taxpayer¹²⁷ because facts other than those required by the statute showed that Dearborn was not engaged in making retail sales.¹²⁸ It held that the statute only governs retailers and therefore did not govern wholesalers such as Dearborn. However, Dearborn's sales may be classified as retail sales under the three classifications previously established by the Illinois Supreme Court as well as under the 1965 amendments.

These classifications, as presented above, were 1) a sale to the user or consumer of the tangible personal property; 2) an allegedly exempt sale which is not documented as such; and 3) a sale to a purchaser who will not consume the item, but whose use will take the item off the retail market. The 1965 amendments provide that a sale is at retail even if made "at wholesale" if the seller does not obtain a resale certificate as prescribed in section 2c. For the purpose of discussion, the sales in classes one and three will be grouped together, since they relate to use or consumption. Also, the sales in class two and those covered by

123. 413 Ill. at 66, 108 N.E.2d at 14.

124. 383 Ill. 253, 49 N.E.2d 41 (1943). See text accompanying notes 30-40 *supra*.

125. 383 Ill. at 258, 49 N.E.2d at 43.

126. *Id.*

127. 82 Ill. 2d at 477, 413 N.E.2d at 373.

128. *Id.* at 473-74, 413 N.E.2d at 371.

section 2c will be grouped together, since they relate to the proper documentation of exempt sales.

In light of earlier Illinois Supreme Court cases construing the term "use or consumption," Dearborn *did* make taxable retail sales. Prior to the *Modern Dairy* case, the legislature had amended the Act so as to include in use or consumption the action which took the tangible personal property off the retail market and freed any later transfers of the item from the imposition of the tax.¹²⁹ Therefore, a sale to someone who would retransfer the tangible personal property without incurring tax would be a retail sale. When a seller does not obtain a resale certificate containing the purchaser's registration or resale number, he violates the provisions of section 2c. Violating section 2c takes the tangible personal property off the retail market and impairs the Department's ability to collect the tax. If the Department is unable to collect tax from Dearborn's customers, Dearborn's sales to those customers were at retail since they were the last sales at which tax could be collected.

While there is no evidence that Dearborn's customers did not remit the necessary tax, the Department of Revenue's enforcement mechanism is hindered when it cannot follow up on sales made for resale without resale certificates.¹³⁰ When the Department of Revenue conducts an audit, any "questionable"¹³¹ resale certificates presented by the taxpayer can trigger an audit of the purchaser.¹³² At the very least, an auditor will check Department records to ensure that the purchaser

129. 413 Ill. 55, 108 N.E.2d 8 (1952). See notes 55-61 *supra* and accompanying text.

130. Other jurisdictions have interpreted similar provisions requiring resale certificates. In *State v. Advertiser Co.*, 337 So. 2d 942, cert. denied 337 So. 2d 947 (Ala. 1976), the court held that the state sales tax did not apply to *wholesale* sales. However, it noted that the statutory definition of wholesale "covers a more restricted category of sales than the word denotes in common parlance." *Id.* at 945. The ordinary meaning of wholesale includes all sales to purchasers who will themselves resell the item, while the statutory meaning is limited to sales made to *licensed* retail merchants who are registered to collect and remit the tax on retail sales and who will resell the goods. The legislature so limited exempt sales to ensure collection of the tax. Where a wholesaler sells to a retailer who resells the item but does not collect and remit the tax, the wholesaler becomes liable for the tax. *Id.* Maryland and Arkansas also have interpreted similar requirements for exemption, *i.e.*, that sales be made to licensed retailers. The Maryland case, *F. & M. Schaefer Brewing Co. v. Comptroller of the Treasury*, 255 Md. 211, 218, 257 A.2d 416, 418 (1969), held that sales are exempt from tax only when made to licensed retailers. In Arkansas, a sale, to be exempt, must be made to a purchaser holding a sales tax permit. The Arkansas court in *Hervey v. Southern Wooden Box*, 253 Ark. 290, 486 S.W.2d 65 (1972), held that, while the statute was designed to prevent double taxation of the same item, "there is a correlative legislative intent that all property be subjected to the tax at some point in the course of its manufacture and sale to the ultimate consumer." *Id.* at 295, 486 S.W.2d at 69.

131. Audit and Collection Bureau Operating Bulletin, Ill. Dep't of Revenue, A-17 Revision, July 31, 1979. This bulletin provides that a questionable resale certificate is one lacking in reasonableness and apparent good faith.

132. *Id.*

indeed has an active registration number.¹³³ However, this can only happen if a resale certificate is available for inspection so that the Department can identify the purchaser for resale. While Dearborn kept its own records¹³⁴ which were available for Department inspection, this is not always the practice of other wholesalers. For example, a wholesaler could sell on a cash basis, keeping only a cash register tape containing no data about his purchasers. The Department would then have no means to police the ultimate disposition of the property and thereby ensure that the proper tax is collected.

The legislature obviously intended that the tax be imposed *once*¹³⁵ in the sales history of any item of tangible personal property.¹³⁶ Dearborn's sales of tangible personal property without collecting tax, or obtaining resale certificates, impairs the Department's ability to monitor the transfers of the items so that their ultimate taxable sale in Illinois is properly reported.¹³⁷ Its sales are, therefore, the final sales envisioned by the court in *Modern Dairy*,¹³⁸ and are taxable as retail sales. Since it has made retail sales, Dearborn is a retailer under the statute and is subject to the provisions of the Act, despite its common designation as a wholesaler.

The second set of classifications of retail sales concerns the proper documentation of exempt sales. The Act provides that all sales of tangible personal property are subject to tax unless the contrary is proven by the taxpayer,¹³⁹ and it dictates the records necessary to prove exemption.¹⁴⁰ The Illinois Supreme Court has held that the record requirements of the Act are mandatory, and that when records are required, only the records specified in the Act will suffice.¹⁴¹ Section 2c requires documentation, and the form of the documentation is specified.¹⁴² Dearborn's failure to obtain the required resale certificates for

133. *Id.*

134. These records included invoices and consumer information sheets. *See* note 87 *supra*.

135. *See* note 127 *supra*.

136. *Modern Dairy Co. v. Department of Revenue*, 413 Ill. at 67-68, 108 N.E.2d at 15 (1952).

137. Out of state purchasers are exempt from the requirement of supplying resale certificates. ILL. REV. STAT. ch. 120, § 441c (1979 & Supp. 1981). Not all sales of tangible personal property to users or consumers are taxable. *See* note 20 *supra*.

138. 413 Ill. 55, 108 N.E.2d 28 (1952).

139. ILL. REV. STAT. ch. 120, § 446 (1979 & Supp. 1981).

140. *Id.*

141. *Copilevitz v. Department of Revenue*, 41 Ill. 2d 154, 242 N.E.2d 205 (1968).

142. ILL. REV. STAT. ch. 120, § 441c (1979 & Supp. 1981). The Act also specifies that sales shall not be exempt as sales for resale unless the purchaser supplies his resale or registration number in connection with certifying that he is purchasing the tangible personal property for resale.

one and one-half percent of its alleged sales for resale¹⁴³ should have rendered those sales taxable. However, the Illinois Supreme Court turned its back on its own prior decisions,¹⁴⁴ and held that sales of tangible personal property were exempt despite the lack of statutorily mandated documentation which the court had earlier held to be the only means of proving exemption.¹⁴⁵

The *Dearborn* court was concerned that denying exemption to Dearborn, a putative wholesaler, would permit multiple taxation.¹⁴⁶ It is true that multiple taxation may occur, but multiple taxation is not forbidden. In addition, the court's statement was "that by limiting the tax to sales at the retail level the legislature avoided the multiple taxation which would result if sales at every level of the distributive process were taxed."¹⁴⁷ While the legislature did not tax sales at every level, it did provide in the Act that every retail sale made by a person engaged in the business of selling at retail is subject to the tax.¹⁴⁸ Occasionally, a single item of tangible personal property is sold at retail more than once, and the Act requires that a tax must be charged *each* time such sale meets the statutory definition of a sale at retail.¹⁴⁹

For example, when a lessor of tangible personal property purchases an item to lease, his supplier incurs tax on the sale because the act of leasing is considered to be a taxable use.¹⁵⁰ If the lessor should later sell the tangible personal property for use or consumption, he would incur tax on *his* sale as well. The fact that the item was used is irrelevant; it is still tangible personal property whose sale for use or consumption is taxable.¹⁵¹ The same item has been subjected to the same form of taxation twice, yet this is not forbidden multiple taxation. It is a matter of an item being sold twice under the conditions which the legislature has set forth to determine when a taxable retail sale has

143. Dearborn's sales for resale were only disallowed as to the 1.5% for which it did not obtain resale certificates. For the vast majority of its sales, Dearborn had obtained resale certificates and was permitted the deduction from its gross receipts. 82 Ill. 2d at 473, 413 N.E.2d at 371.

144. See *Copilevitz v. Department of Revenue*, 41 Ill. 2d 154, 242 N.E.2d 205 (1968); *Modern Dairy v. Department of Revenue*, 413 Ill. 55, 108 N.E.2d 28 (1952); *Fashion-Bilt Cloak Mfg. Co. v. Department of Revenue*, 383 Ill. 253, 49 N.E.2d 41 (1943); *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 194 N.E. 268 (1934).

145. *Dearborn Wholesale Grocers, Inc. v. Whitler*, 82 Ill. 2d 471, 413 N.E.2d 370 (1980).

146. *Id.* at 479, 413 N.E.2d at 373-74.

147. *Id.*

148. ILL. REV. STAT. ch. 120, § 440 (1979 & Supp. 1981).

149. *Id.* See *Franklin County Coal Co. v. Ames*, 359 Ill. 178, 194 N.E. 268 (1934) and text accompanying notes 25-29 *supra*.

150. Illinois Retailers' Occupation Tax Article 14.

151. ILL. REV. STAT. ch. 120, § 440 (1979 & Supp. 1981). See *Howard Worthington Inc. v. Department of Revenue*, 96 Ill. App. 3d 1132, 421 N.E.2d 1030 (1981).

taken place. Therefore, when Dearborn sells to its customers without obtaining resale certificates, it has made taxable sales at retail. If the purchasers later sell the items to users or consumers, their sales will be taxable retail sales as well. If Dearborn were concerned that tax may be collected twice, it could have collected resale certificates, as required, on *all* of its sales, rather than on ninety-eight and one-half percent of them.

The Illinois Supreme Court stated that the purpose of section 2c is to verify the claim of a retailer that a particular sale is exempt because the purchaser is not himself the ultimate user or consumer of the property.¹⁵² This is an accurate interpretation of the statute. However, as an example of this type of situation, the court discussed *Modern Dairy*, where a hospital purchased property for the use of its patients.¹⁵³ In such a case, the court suggested that the hospital would not hold a registration number since it is not engaged in the business of selling property at retail. The court then concluded that the section 2c requirement provided a means of verifying that this sale to the hospital was indeed a sale for resale.¹⁵⁴ However, there are several problems with this analysis. The initial problem is that the court did not posit whether the hospital would be charging a valuable consideration for the goods transferred to the patients for their use. If the hospital would not charge a valuable consideration, then the sale *to* the hospital would be a taxable sale at retail under its own *Modern Dairy* decision, the very case it cites. In addition, the court would be holding a "non-retailer" to the requirements of the Act if it held section 2c requirements applicable to a hospital which was "using" tangible personal property via its patients. If the hospital would charge a valuable consideration, the hospital would be making retail sales¹⁵⁵ and would have a registration number, contrary to the belief of the court. Since the court stated that resale certificates should provide a means of verifying that the hospital's purchase was for resale, presumably the hospital would have a resale or registration number with the Department. Thus, the court apparently has misinterpreted the requirements and purpose of section 2c.

The final reason presented by the court for refusing to apply the requirement of a resale certificate to Dearborn was its holding that all of the sections of the Act apply only to sellers at retail. Since it denied

152. 82 Ill. 2d at 479, 413 N.E.2d at 374.

153. 413 Ill. 55, 108 N.E.2d 8.

154. 82 Ill. 2d at 479-80, 413 N.E.2d at 374.

155. 413 Ill. 55, 108 N.E.2d 8.

that Dearborn was a retailer, it held that none of the recording or reporting provisions of the Act applied.¹⁵⁶ The proposition that the Retailers' Occupation Tax Act applies only to retailers is perfectly acceptable. What the court overlooked is that Dearborn *did* make retail sales as defined by the Act, and was therefore a retailer to whom all of the requirements of the Act apply.

The *Dearborn* court suggested that even if it did accept the construction of the term "sale at retail" to include sales made without resale certificates, the amendments to section 2c would be unconstitutional as violating the constitutional prohibition against dual subject matter.¹⁵⁷ However, the court has permitted similar legislative expansion of the term "sale at retail" in earlier cases. For instance, in *Modern Dairy*, the court condoned the definition which included sales to any person who will retransfer tangible personal property to another person without receiving a valuable consideration. This expansion was permitted although the statute was entitled "[a]n Act in relation to a tax upon persons engaged in the business of selling tangible personal property to purchasers for use or consumption."¹⁵⁸ In *Modern Dairy*, the purchaser did not use or consume the tangible personal property; however, in cases such as *Dearborn*, the purchaser may ultimately decide to use or consume the property, with the Department left unable to collect tax since it has no record of the purchaser's identity.

Another flaw in the *Dearborn* court's reasoning is that it presumed that the taxpayer was a wholesaler without providing any test for determining who fits the class of wholesaler. Dearborn and other sellers are only required to obtain and produce resale certificates if they are selling at retail. However, the only way for the Department to determine on a day-to-day basis that any seller is a retailer is to examine the seller's sales records which a non-retailer is not required to keep. By removing the requirement that a seller keep such records and obtain such certificates, the court is forcing the Department of Revenue to determine whether a seller is making retail sales based only on the seller's self-serving declarations that all of his sales are for resale, and any records which the seller may keep.

To lessen the impact of the *Dearborn* decision, the Department of Revenue has taken the position that *Dearborn* is to be strictly construed as applying only in situations where the seller made no "sales at re-

156. 82 Ill. at 480, 413 N.E.2d at 374.

157. *Id.* at 477-78, 413 N.E.2d at 373. See text accompanying notes 46-54 *supra*.

158. ILL. REV. STAT. ch. 120, § 440 (1950) (emphasis added).

tail.”¹⁵⁹ When auditing a “wholesaler,” an auditor now will search for retail sales which will make the taxpayer subject to the section 2c resale certificate requirement.¹⁶⁰ The *Dearborn* decision serves as an incentive for a seller to keep as few records as possible, so as to avoid providing the information necessary to be proven a retailer and, therefore, subject to the tax. Since resale exemptions are a major source of deductions from gross receipts,¹⁶¹ the ambiguity as to who is governed by section 2c will seriously complicate the enforcement of what remains of the tax imposed on retail sales. Unfortunately, the Department of Revenue does not keep records of total amounts in any category of deductions from gross receipts,¹⁶² but *whenever* a purported wholesaler is audited, all of his sales must now be examined in order to determine whether he must obtain resale certificates under section 2c.

To reduce this ambiguity, the legislature should amend the Act by adding to section 2c the reasons why a resale certificate is required. That is, the statute should set forth the fact that the imposition of tax on the ultimate sale is endangered when a seller is not required to obtain resale certificates to document his exempt sales. For example, there is little motivation for a seller to deal only with properly registered retailers who in good faith are purchasing for resale, if the seller is not obligated to obtain resale certificates or pay tax on the sale. Further, interpretation of the Act by the courts should take into account its legislative purpose. Under such an approach a court would have a more difficult time narrowly limiting the scope of the statutory definition, and perhaps all sales declared by the legislature to be sales at retail could again be taxed.

In sum, while the Illinois Supreme Court correctly held that the Retailers' Occupation Tax applies only to persons engaged in the busi-

159. Interview with Thomas J. Grudichak, Supervisor Regulations Section, Sales and Excise Tax Legal Division, Chicago Office, October 5, 1981.

The Fourth District Appellate Court examined a situation similar to *Dearborn* in *Illinois Cereal Mills v. Department of Revenue*, 106 Ill. App. 3d 53, 435 N.E.2d 774 (1982). In that case, the court held that the taxpayer's admitted retail sales, 66% of its gross sales, rendered the taxpayer subject to all of the provisions of the Retailers' Occupation Tax Act, including the section 2c requirement that resale certificates be obtained to justify resale deductions. *Id.* The dissent expressed concern lest a single retail sale be permitted to subject a taxpayer to all Retailers' Occupation Tax requirements. *Id.*

Agreeing with the *Illinois Cereal Mills* decision, the First District Appellate Court has held that the making of *some* retail sales brings a seller within the coverage of the Retailers' Occupation Tax Act. *Tri-America Oil Company v. Department of Revenue*, No. 81-950 (First Dist. July 30, 1982).

160. Interview with Frank Levin, Auditor District 10, Illinois Dep't of Revenue, November 16, 1981.

161. *Id.*

162. Interview with Thomas McGee, Manager, Revenue Accounting, October 16, 1981.

ness of selling at retail, it failed to implement legislative intent in its interpretation of "sale at retail." The General Assembly intended to tax the sale which takes an item of tangible personal property off the retail market. Dearborn's act of selling tax-free without resale certificates took tangible personal property off the traceable retail market, endangering enforcement of tax collection on the ultimate sale. This removal from the market constituted a taxable retail sale and should have been deemed so by the court.

The court's fear of permitting multiple taxation is unfounded. Dearborn could have avoided multiple taxation by obtaining and producing resale certificates, which it had done ninety-eight and one-half percent of the time, for the remaining one and one-half percent of its sales. It was Dearborn's failure to produce resale certificates for the remaining one and one-half percent which rendered those taxable as sales at retail. Dearborn was, therefore, a retailer subject to the Act, and should not benefit from the statutory exemption when its actions impair the enforcement of the tax.

CONCLUSION

From its first decisions interpreting the Retailers' Occupation Tax Act, the Illinois Supreme Court has held that sales meeting the statutory definition are taxable as sales at retail.¹⁶³ In *Fashion-Bilt*, the court held that a taxpayer need not supply a resale certificate only because the Act did not require one.¹⁶⁴ Prior to *Dearborn*, this requirement was supplied by the General Assembly by way of an amendment to the Act.¹⁶⁵ The *Modern Dairy* decision established a "removal from the market" test which provided that the last traceable sale of tangible personal property is subject to tax.¹⁶⁶ Dearborn's sales met this test by cutting off all record of the sales. And, in *Copilevitz*, the Illinois Supreme Court held that the statutory record-keeping requirements of the Act are mandatory.¹⁶⁷

The legislature has clearly established its intent in the 1965 amendments to the Act: the sale of tangible personal property without obtaining a resale certificate is a taxable retail sale; the person making such a sale is a retailer and, therefore, subject to the Retailers' Occupation Tax Act. By failing to obtain its purchaser's registration or resale

163. See text accompanying notes 24-29 *supra*.

164. See text accompanying notes 33-42 *supra*.

165. ILL. REV. STAT. ch. 120, §§ 440, 441 (1979 & Supp. 1981).

166. See text accompanying notes 55-62 *supra*.

167. See text accompanying notes 73-81 *supra*.

numbers in conjunction with statutorily required resale certificates, *Dearborn* removed the primary means of assuring that the tax will ultimately be paid, thereby effectively removing the tangible personal property from the retail market. Since its actions met the supreme court's own definition of "use of consumption," *Dearborn* should have been held liable for the tax on "sales for resale" for which it could not produce resale certificates as required by section 2c.

The court suggested that a construction of the term "sale at retail" to include sales undocumented by resale certificates would be unconstitutional as violative of the prohibition against dual subject matter. However, having ruled that physical consumption of the tangible personal property is irrelevant if the tangible personal property is removed from the market, the court could have held *Dearborn's* sales were taxable because such sales removed tangible personal property from the traceable retail market. That would have avoided leaving the taxable status of future sellers dependent upon the sellers' unsubstantial claims that their sales are for resale. Until resale certificates and records are required to substantiate the exempt nature of sales for resale, a substantial disincentive is provided to sellers to ensure that their tax-free sales are made only to registered purchasers who will collect tax on the ultimate sale.

LESLIE SKILBECK