

Illinois Supreme Court Invalidates “Jurisdictional Questions” Regulations—Used to Determine Tax Situs under ROT Acts—as Inconsistent with Statutes, Case Law

November 26, 2013

Overview

In *Hartney Fuel Oil Co. v. Hamer*,¹ the Illinois Supreme Court invalidated the Illinois Department of Revenue’s “Jurisdictional Questions” regulations, which provided guidance regarding proper situs for tax liability under retail occupation tax schemes (hereinafter “ROT”).² The court held that the regulations “impermissibly narrow[ed] the local ROT Acts” after the court construed the regulations as erroneously and conclusively establishing tax situs based upon the location of purchase order acceptance.³ The court stated that it instead favored a case-by-case determination of tax situs based upon a “totality-of-the-circumstances” analysis, concluding that the bright-line test in the regulations was “too inconsistent with the statutes and case law to stand.”⁴ The gap left by the regulations’ invalidation creates uncertainty that may potentially leave the court’s totality-of-the-circumstances view⁵ as the only guidance on the sourcing of such purchase order sales.⁶ In this Tax Alert we summarize this court decision.

Background

This case arose from a Department of Revenue (“Department”) audit that attempted to shift the situs of Hartney Fuel Oil Company’s (hereinafter “Hartney”) sales from its “sales office” to its home office, thereby creating a large ROT tax liability, which Hartney challenged. Hartney is a retailer of fuel oil with its home office in Forest View, Illinois. From this office, Hartney conducted most of its business activity, including setting fuel prices, communicating with customers, billing, and accounting. Additionally, Hartney’s transportation company—jointly owned but separately incorporated—was also located at the Forest View office, serving as a common carrier and filling many of Hartney’s fuel orders.

The ROT Acts “allow home rule county and municipal governments and the Regional Transportation Authority to impose a retail occupation tax ‘upon all persons engaged in the business of selling tangible personal property at retail within the county, municipality, or metropolitan region.’”⁷ In an effort to reduce its ROT liability, Hartney utilized a “sales office” located in Mark, Illinois to approve sales to customers. Hartney contracted with a painting business in Mark to lease 200 square feet of space and the services of a clerk. For daily orders, customers would call the Mark sales office clerk directly to place orders. Each daily order was accepted or rejected by the clerk in Mark based upon whether the applicable customer appeared on Hartney’s list of “customers with approval to order on credit.”⁸ For long-term orders, contracts were negotiated by Hartney’s president, who would instruct the customer to sign the contract and return it by mail to the Mark office. If Hartney’s president had not yet signed the contract, he would travel to the Mark Office to sign it. The executed contracts were stored at the Mark office.

The Department audited Hartney’s selling activity from Jan. 1, 2005, to June 30, 2007, concluding the proper situs of selling activity to be Hartney’s Forest View office, as opposed to its Mark sales office, and assessing

¹ *Hartney Fuel Oil Co. v. Hamer*, Dkt. Nos. 115130, 115131 cons. (Nov. 21, 2013).

² *Id.* at 22. The ROT statutes at issue here included the Home Rule County Retailers’ Occupation Tax Law (55 ILCS 5/5-1006 (West 2012)), the Home Rule Municipal Retailers’ Occupation Tax Act (65 ILCS 5/8-11-1 (West 2012)), and the Regional Transportation Authority Act (70 ILCS 3615/4.03 (West 2012)). The regulations corresponding to these ROT statutes are largely identical and only vary in layout. See 86 Ill. Adm. Code 220.115 (2000); 86 Ill. Adm. Code 270.115 (2000); 86 Ill. Adm. Code 320.115 (2000).

³ *Hartney* at 21.

⁴ *Id.* at 22; see also, *id.* at 13, 21.

⁵ *Ex-Cell-O Corp. v. McKibbin*, 384 Ill. 316 (1943).

⁶ See *Hartney* at 22 (“Should the legislature decide that tax certainty warrants a single-factor determination of retail occupation tax situs, it can draft such a test. However, by consistently employing the ‘business of selling’ language [in state statutes,] that we have interpreted to require a fact-intensive inquiry to find the proper situs of a composite of many activities, the legislature has effectively invoked this court’s precedent on the Retailers’ Occupation Tax Law.”).

⁷ *Id.* at 5, citing 55 ILCS 5/5-1006, 65 ILCS 5/8-11-1, and 70 ILCS 3615/4.03.

⁸ *Id.* at 3.

additional liability of \$23,111,939.11, including interest and penalties, for the unpaid ROT taxes of Cook County, Forest View, and the Regional Transportation Authority. Hartney paid the assessment and sued for a refund. The Putnam County Circuit Court ruled in Hartney's favor, "establish[ing] a bright-line test for situs of sale: where purchase orders are accepted, tax liability is incurred."⁹ The appellate court affirmed.¹⁰ The Department appealed the matter to the Illinois Supreme Court.

Illinois Supreme Court's Decision

On November 21, 2013, the Illinois Supreme Court affirmed in part and reversed in part, holding that Hartney's sales were—at that time—properly sourced to its Mark sales office, but invalidating prospectively the "Jurisdictional Questions" regulations upon which Hartney had relied.¹¹ The court utilized the traditional canons of statutory construction to analyze both the ROT statutes and regulations at issue, ultimately finding that the regulations improperly implemented the statutes, were inconsistent with case law, and were therefore invalid.¹² Although it held the regulations invalid, the court determined that under the Taxpayers' Bill of Rights the Department was required to apply the regulations to Hartney's facts.¹³ As reasoned by the court, the Taxpayers' Bill of Rights allows taxpayers to rely on written information or advice given by the Department, even if that information or advice is erroneous.¹⁴ On this basis, the court: (1) affirmed the trial and appellate court findings that, by application of the regulations, Hartney's sales occurred in Mark and, accordingly, (2) required the Department to abate taxes, penalties and interest assessed against Hartney for the unpaid ROT taxes of Cook County, Forest View, and the Regional Transportation Authority.¹⁵

Considerations

It is conceivable that the issues discussed in this decision may at some point be addressed directly by the General Assembly or through newly promulgated Department regulations. Meanwhile taxpayers may wish to consider how the analysis and conclusions in this decision may impact how their transactions are situated for ROT purposes.

Contacts

If you have questions regarding this Illinois Supreme Court decision or pertaining to other Illinois sales or use tax matters, please contact any of the following Deloitte Tax professionals.

Dominic Greco
Director
Deloitte Tax LLP, Chicago
dgreco@deloitte.com
(312) 486-9271

Brian Walsh
Director
Deloitte Tax LLP, Chicago
bwalsh@deloitte.com
(312) 486-3728

Anna Marie Alberti Hearn
Senior Manager
Deloitte Tax LLP, Chicago
aalbertihear@deloitte.com
(312) 486-2754

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2013 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited

⁹ *Id.* at 4.

¹⁰ *Hartney Fuel Oil Co. v. Hamer*, 976 N.E.2d 682 (Ill. App. Ct. 2012).

¹¹ *Hartney* at 22–23. Despite the court's opinion that Hartney acted inconsistently with ROT statutes, the court acknowledged that Hartney did act consistently with the Department's regulation published at the time. Therefore, under the Taxpayers' Bill of Rights Act, the Department had a duty to "abate [the] taxes and penalties assessed based upon erroneous written information or advice given by the Department." 20 ILCS 2520/4(c) (West 2008).

¹² *Hartney* at 5–22. A regulation cannot "broaden or narrow a statute's intended scope of taxation," and the court will invalidate any regulation that is "inconsistent with the statute under which [it is] adopted." *Id.* at 11.

¹³ *Id.* at 22–23.

¹⁴ *Id.*

¹⁵ *Id.* at 23.