ILLINOIS INDEPENDENT TAX TRIBUNAL

MIDWEST MEDICAL EQUIPMENT SOLUTIONS, INC.,	)	
Petitioner	)	
	)	Case Nos. 17-TT-120; 19-TT-93; and
v.	)	21-TT-77
ILLINOIS DEPARTMENT OF REVENUE,	)	Chief Judge James M. Conway
Respondent.	)	

THE ILLINOIS DEPARTMENT OF REVENUE'S MEMORANDUM IN SUPPORT OF ITS CROSS-MOTION FOR SUMMARY JUDGMENT AND RESPONSE TO THE PETITIONER'S MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

The Illinois Department of Revenue (the "Department") respectfully requests an order of summary judgment against the Petitioner, Midwest Medical Equipment Solutions, Inc. ("Midwest Medical"), for all three matters before this Tribunal.[1]

The parties have stipulated that the primary issue before the Illinois Independent Tax Tribunal (the "Tribunal") is whether Midwest Medical's sales of durable medical equipment ("DME") to individuals enrolled in Medicaid is subject to Illinois Retailers' Occupation Tax ("ROT"), regardless of whether reimbursements for that DME were made by managed care

[1] Throughout this memorandum, Petitioner's supporting brief and the Exhibits attached thereto shall be referred to as "MM SJ Memo" and "MM SJ Memo Ex."

organizations ("MCOs") or by the State of Illinois through the Illinois Department of Healthcare and Family Services ("IDHFS").[2] (Stip. ¶90).[3]

For the reasons discussed in detail below, reimbursements from MCOs to Midwest Medical for sales made to Medicaid enrollees are not subject to a governmental body exemption. MCO reimbursements are properly taxable under applicable Illinois law and regulations. Therefore, the Department respectfully requests that the Tribunal enter judgment in favor of the Department that the three Notices of Tax Liability ("NTLs") at issue should be affirmed as issued.

STANDARD FOR SUMMARY JUDGMENT

Under Section 2-1005 of the Illinois Code of Civil Procedure, summary judgment is proper when "the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Performance Mktg. Assoc. v. Hamer*, 2013 IL 114496, ¶ 12 (2013)(quoting 735 ILCS 5/2-1005(c)). In particular, there is a long line of Illinois case law which holds that questions involving the interpretation or effect of a statute are appropriately resolved under the summary judgment procedure.[4] In such a situation, summary judgment serves as an efficient manner in which to resolve such purely legal disputes. *Bryant v. Glen Oaks Medical Ctr.*, 272 Ill.App.3d 640, 649 (1st Dist. 1995). When both parties file motions for summary judgment, they

[2] The primary issue which has been stipulated is not "whether Midwest Medical's sales of DME to individuals enrolled in Medicaid is subject to ROT regardless of whether the reimbursement payments come from IDHFS or from IDHFS via the MCO." This language, as stated in Petitioner's brief, incorporates the Taxpayer's primary arguments. (*See* MM SJ Memo pp. 6-7). Additionally, Stipulation ¶90 states "providing" of DME, but Midwest Medical states in its brief that these matters involve "sales" of DME. The Department agrees that these matters involve sales of DME and related services.

[3] The parties have entered into a Stipulation of Facts and Other Matters (the "Stipulation"). The Stipulation and Stipulation Exhibits are hereby incorporated in full within this Department memorandum. References within this memorandum will be cited as "Stip." and "Stip. Ex."

[4] *See, e.g., Banes v. Western States Ins. Co.*, 247 Ill.App.3d 480, 481-82 (2d Dist. 1993)(Insurance Code); *Sage Information Servs. v. Suhr*, 2014 IL App (2d) 130708, ¶ 7, 10 N.E.3d 241 (Property Tax Code); *American Home Assurance Co. v. Taylor*, 402 Ill.App.3d 549, 551, 931 N.E.2d 313 (1st Dist. 2010) (Insurance Code); *G.I.S. Venture v. Novak*, 388 Ill.App.3d 184, 187, 902 N.E.2d 744 (2d Dist. 2009) (School Code); *Allegis Realty Investors v. Novak*, 223 Ill.2d 318, 330, 860 N.E.2d 246 (2006) (Illinois Highway Code).

agree that no material facts are in dispute and invite a decision as a matter of law. *Irwin Indus. Tool Co. v. Dep't of Revenue*, 238 Ill. 2d 332, 339-40 (2010).

This dispute involves the applicability of the Retailers' Occupation Tax Act's (the "ROTA") governmental body exemption under Section 2-5(11), and the application of the related regulations, including Regulation 130.2080(a). (*See* Stips. ¶¶91-98). Notably, Midwest Medical's petitions for these three matters do not have counts, but list alleged errors for 1) the assessments, 2) assessing penalties (asking for reasonable cause abatement), and 3) the amount of tax shown on the protestable Notices. *See* Midwest Medical petitions in 17-TT-120, 19-TT-93, and 21-TT-77.[5] Midwest Medical has also filed a Motion for Summary Judgment.[6] Thus, these matters are ripe for summary judgment.

THREE NOTICES OF TAX LIABILITY

The Department audited Midwest Medical for three separate audit periods in relation to ROT. (Stip. ¶71). The three audit periods are June 1, 2012 through December 31, 2015 (the "First Tax Period"), January 1, 2016 through December 31, 2017 (the "Second Tax Period"), and January 1, 2018 through April 30, 2020 (the "Third Tax Period") (collectively, the "Periods at Issue"). (Stips. ¶¶74, 79, 86). Notably, the applicable tax rate for the Periods at Issue was 1% ("low rate") plus the applicable local rate for the sale of nebulizers. The applicable tax rate was the normal 6.25% ROT rate ("high rate") plus the applicable local rate for the sale of breast pump equipment. (Stip. ¶73; Stip. Ex. A at IDOR000027-28, IDOR000366; Stip. Ex. S).

[5] Midwest Medical's petition in matter 17-TT-120 also includes a Taxpayer Statement for periods in 2008 through May 2012. This Taxpayer Statement is not a protestable Notice and these earlier periods are not at issue.
[6] Additionally, the Department notes that the deposition transcripts of Midwest Medical's President Robert Buikema, Jr., General Manager Zachary Buikema, CPA Robert Lloyd, and IDHFS Deputy Administrator Robert Mendonsa are included within the Stipulation Exhibits (Stip. Exs. D, E, F, and G), and at a prior Tribunal status these deposition transcripts were admitted into evidence for the purpose of the Tribunal making its determinations.

For the First Tax Period, the Department issued a Notice of Tax Liability, CNXXX11XX669XX89, on July 18, 2017 (the "First NTL"). The First NTL assessed $71,173.00 in unpaid tax. The First NTL also includes interest in the amount of $5,858.19 and late payment penalties of $14,940.00. Interest has continued to accrue since the First NTL was issued. (Stip. ¶77; Stip. Ex. T). For the Second Tax Period, the Department issued a Notice of Tax Liability, CNXXXX7372332XX6, on January 22, 2019 (the "Second NTL"). The Second NTL assessed $163,819.00 in unpaid tax. The Second NTL also includes interest in the amount of $13,744.72 and late payment penalties of $32,965.00. Interest has continued to accrue since the Second NTL was issued. (Stip. ¶82; Stip. Ex. U). For the Third Tax Period, the Department issued a Notice of Tax Liability, CNXXX18667917925, on June 3, 2021 (the "Third NTL"). The Third NTL assessed $79,923.00 in unpaid tax. The Third NTL also includes interest in the amount of $5,961.34 and late payment penalties of $22,824.00. Interest has continued to accrue since the Third NTL was issued. (Stip. ¶88; Stip. Ex. V).

SUMMARY OF MATERIAL FACTS

Midwest Medical

Midwest Medical provides DME, specifically nebulizers and maternity products. (Stip. ¶2). The DME is generally provided to patients either via consignment to physician offices or shipping to patients' homes. Midwest Medical's sales are made up of nebulizers and breast pumps, and approximately 70% of its sales are to individuals enrolled in Medicaid. (Stip. ¶3; Stip. Ex. C).

Midwest Medical has compiled payments by reimbursement providers ("Transaction Reports"), which include both: 1) Medicaid reimbursement payments from an agency of the State of Illinois and 2) Medicaid reimbursement payments from various MCOs, for January 2013 through April 2020. (Stip. ¶11; Stip. Ex. C). For the purpose of this litigation, payments listed in

the Transaction Reports as by the Illinois Department of Public Aid are synonymous with payments from IDHFS. (Stip. ¶12; Stip. Ex. C).[7] The Transaction Reports include both payments from the State of Illinois, through IDHFS (referred to herein as "direct" payments), and payments from MCOs (referred to herein as "indirect" payments). Midwest Medical treated both direct and indirect payments as exempt in its Transaction Reports. (Stip. ¶13; Stip. Ex. C). Correspondingly, during the Periods at Issue, Midwest Medical treated its MCO reimbursement sales as exempt. (Stip. ¶59).

Midwest Medical's President and Chief Executive Officer is Robert C. Buikema, Jr. ("Robert Buikema"). (Stip. ¶6). Midwest Medical's general manager/billing manager and Chief Operations Officer is Zachary Buikema ("Zachary Buikema"). (Stip. ¶7). Robert Lloyd ("Mr. Lloyd") has served as a CPA and outside financial advisor for Midwest Medical. He was also the Department's direct contact with Midwest Medical for the three audits at issue. (Stip. ¶9).

IDHFS and Managed Care

IDHFS is the State of Illinois agency responsible for facilitating Medicaid. (Stip. ¶21). Robert Mendonsa ("Mr. Mendonsa") has been a Deputy Administrator at IDHFS since about February 2013. Mr. Mendonsa's team currently manages contracts with MCOs, and manages compliance and quality performance improvements for MCOs. (Stip. ¶22). Mr. Mendonsa

[7] Although the applicable Periods at Issue include June 2012 through December 2012, there were no Transaction Reports for this seven-month period and no agreed-upon stipulation for this period. (*See* Stip. ¶13; Stip. Ex. C). Midwest Medical has attempted to add this information in its brief and accompanying affidavit. "For the period of June 1, 2012 through December 31, 2012, Midwest Medical issued $723,673.00 in nebulizers, breast pumps, and services related thereto to individuals in Illinois enrolled in Medicaid. This represented 79.3% of Midwest Medical's sales for that period of time…" (MM SJ Memo Ex. 1 - Z. Buikema Affidavit ¶5; *see also* MM SJ Memo p.5; MM SJ Memo Ex. A). However, the document referenced on which Mr. Buikema bases his calculation is a Department audit file document, already contained within the stipulated exhibits, which shows that the $723,673.00 referenced is for exempt sales reimbursed through IDPA only (the State of Illinois through the Illinois Department of Public Aid). (*See* Stip. Ex. S). Thus, this figure does not appear to include other sales for which patients were enrolled in Medicaid but were not directly reimbursed by the State of Illinois, such as with reimbursement payments from MCOs. This is noted merely for clarification. Generally speaking, the applicable percentage of Midwest Medical's sales made to individuals enrolled in Medicaid was between 62% and 75% for the Periods at Issue. (Stip. ¶14; Stip. Ex. C).

provided deposition testimony for these matters which details IDHFS's role in relation to Medicaid, and his knowledge of managed care and related programs. (Stip. Ex. G).

Over approximately the last decade, IDHFS has increased its contracting with MCOs in order to handle claims and care coordination for Medicaid enrollees. (Stips. ¶¶23, 52; Stip. Ex. G at 24:1-25:20). Over this same time period, IDHFS has implemented mandatory managed care programs in relation to Medicaid. Notably, voluntary managed care programs have existed in relation to Medicaid in Illinois for approximately 20-25 years. (Stips. ¶¶24, 47, 48; Stip. Ex. G at 24:1-27:4, 53:7-14).[8] Currently, over eighty percent (80%) of Illinois Medicaid enrollees utilize a MCO. (Stip. ¶50). In 2018, Illinois expanded its managed care program into what is known as HealthChoice Illinois. Since the implementation of HealthChoice Illinois, many Medicaid patients are required to be enrolled in the HealthChoice Illinois program. (Stips. ¶¶57-58).

Under the current managed care framework, eligible patients have 30 days to choose a MCO. The deadline is listed within the enrollment letter sent to patients. If patients do not choose a MCO by the deadline, a MCO is assigned to them. (Stip. ¶53; Stip. Exs. N and O). New enrollees can change their health plan one time in the first 90 days, and then again annually during the "open enrollment" period. (Stip. ¶54). IDHFS also has MCO plan report cards and other documentation available on its website in order to monitor and publicly report the different benefits and performances of MCOs. (Stip. ¶55; Stip. Exs. M, N, P, Q, and R).

Indirect Medicaid Reimbursement Payments

At its core, these matters involve two types of reimbursement payments for DME sold to Medicaid enrollees: 1) "direct" Medicaid reimbursement payments to Midwest Medical from the

[8] Robert Buikema, Zachary Buikema, and Mr. Lloyd have generally testified (not verbatim) that until approximately 2013, the majority of reimbursements for Midwest Medical products sold to Medicaid enrollees were coming directly from the State of Illinois (through a State Agency) to Midwest Medical. (Stip. ¶20).

State of Illinois through IDHFS and 2) "indirect" Medicaid reimbursement payments to Midwest Medical from MCOs. (*See* Stip. ¶25). The three NTL assessments at issue do not include direct Medicaid reimbursement payments. Those direct payments were already deemed exempt in the underlying audits. (Stip. Ex. A at IDOR000029, 34-35, 367, 358, 425; Stip. Ex. S). The current dispute solely relates to indirect payments for the Periods at Issue.

The indirect payments at issue involve two separate sets of contracts, two different sets of parties/entities, and two distinct types of payment arrangements. (Stips. ¶¶26, 27, 32, 35, 37). The two applicable sets of contracts are 1) between Midwest Medical, as a Healthcare Provider of DME, and each MCO ("Midwest Medical-MCO Contracts") and 2) between IDHFS and each MCO ("IDHFS-MCO Contracts"). (Stip. ¶27). Pursuant to Midwest Medical-MCO Contracts, Midwest Medical receives reimbursement payments from MCOs on a Fee for Service basis for Medicaid enrollees. (Stip. ¶35). Pursuant to the IDHFS-MCO Contracts, the MCOs receive reimbursement payments which are based on a capitated rate, from the State of Illinois through IDHFS. (Stip. ¶37; Stip. Exs. I, J, and K).

Midwest Medical-MCO Contracts

In regard to the Midwest Medical-MCO Contracts, Midwest Medical has contracted with various MCOs, and Robert Buikema executed such contracts on behalf of Midwest Medical. (Stips. ¶¶ 28, 30; Stip. Group Ex. H). The Midwest Medical-MCO Contracts contain similar standard provisions. (Stip. ¶31; Stip. Group Ex. H). The amount of reimbursements MCOs provide Midwest Medical for DME provided to patients utilizing Medicaid is related to a fee schedule posted by IDHFS. (Stip. ¶32; Stip. Group Ex. H at MIDWEST_000036-37, 97, 101, 133, 156, 193, and 207). The reimbursements contemplated within the Midwest Medical-MCO Contracts are also known as "Fee for Service" since a specific fee would be remitted from a MCO to Midwest

Medical for specific DME provided to a patient based on the applicable fee schedule. (Stip. ¶35). Midwest Medical's negotiations of Midwest Medical-MCO Contracts did not involve any discussions regarding who would be responsible for any related sales tax liabilities. (Stip. ¶36).

Robert and Zachary Buikema generally testified regarding Midwest Medical's process of confirming a patient's Medicaid eligibility and submitting for reimbursement. (*See* Stips. ¶¶62-68). In order to be reimbursed for indirect Medicaid sales for patients utilizing a MCO, pursuant to Midwest Medical-MCO Contracts, Midwest Medical would prepare an invoice for the product(s) transferred to the patient as part of its service, and would submit the invoice to the MCO for payment. (Stip. ¶65; Stip. Group Ex. H). The MCO would remit such payments to Midwest Medical. (Stip. ¶66).[9]

IDHFS-MCO Contracts

In regard to IDHFS-MCO Contracts, MCOs are reimbursed from IDHFS via capitated payments for patients utilizing Medicaid. The capitated payments are based on a variety of rate cells, which can contain age, sex, location, and other information. The capitated payments to a MCO are a result of multiplying the amount in each rate cell by the total number of patients for a particular month. In other words, a fixed fee per patient multiplied by the number of patients is provided to the MCOs. (Stip. ¶37; Stip. Ex. I Section 7.1 at IDORDHFS000938, Attachment IV at IDORDHFS001001-1002; Stip. Ex. J Section 7.1 at contract p. 83, Attachment IV at contract pp. 127-28; *See also* Stip. Ex. K Section 7.1 at IDORDHFS001294, Attachment IV at IDORDHFS001352; Stip. Ex. G at 36:19-37:12.). MCOs receive this per member per month amount to manage their entire patient population. (Stip. ¶38; Stip. Ex. G at 22:9-23:10). Notably,

[9] During the Periods at Issue, Midwest Medical was not provided with any exemption certificates from the MCOs and could not present any exemption certificates from the MCOs to the Department's auditors. (Stip. ¶70; Stip. Ex. A at IDOR000029, 33-35, 367, and 358; Stip. Ex. F at 53:4-21).

the IDHFS-MCO Contracts also provide generally that the MCOs' acceptance of capitated payments pursuant to the contract is considered payment in full. (Stip. ¶44; Stip. Ex. I Section 7.14 at IDORDHFS000951; Stip. Ex. J Section 7.14 at contract p. 90; Stip. Ex. K Section 7.14 at IDORDHFS001301).

The IDHFS-MCO Contracts are substantially similar, and a model contract is available to be used and adjusted as appropriate between IDHFS and the MCOs. (Stip. ¶39; Stip. Ex. I). The IDHFS-MCO Contracts contain duties that a MCO, as the "Contractor," is obligated to fulfill. (Stip. ¶40; Stip. Ex. I Article 5 at IDORDHFS000863-936; Stip. Ex. J Article 5 at contract pp. 34-81; Stip. Ex. K Article 5 at IDORDHFS001253-1292.). The duties of a MCO include providing covered services for enrollees, establishing, maintaining, and providing a provider network for enrollees, providing care coordination services, care management services, health assessments, and care planning, informing enrollees of provided services, meeting quality assurance guidelines, meeting health and safety guidelines and monitoring safety and welfare, remitting payments to providers, and entering agreements with providers. (Stip. ¶41).[10] The IDHFS-MCO Contracts also contain limited duties of IDHFS. These duties include tasks related to enrollment, paying the MCO, reviewing marketing materials, and providing MCOs with historical claims data. (Stip. ¶42;

[10] The Federal Medicaid website currently describes Managed Care as follows, in part: "Managed Care is a health care delivery system organized to manage cost, utilization, and quality. Medicaid managed care provides for the delivery of Medicaid health benefits and additional services through contracted arrangements between state Medicaid agencies and managed care organizations (MCOs) that accept a set per member per month (capitation) payment for these services." *Managed Care,* Medicaid.gov, https://www.medicaid.gov/medicaid/managed-care/index.html. (Stip. ¶100). Midwest Medical argues in its brief that the Medicaid website describes the MCO as a "conduit," although that term is not cited in the referenced website language and could not be found by the Department. Conversely, Midwest Medical also acknowledges that MCOs provide "for the delivery of Medicaid health benefits and additional services." (MM SJ Memo p. 9). As an example, these additional services include better care coordination for higher risk patients by MCOs. (Stip. ¶102). In sum, the improvement in quality and utilization by Medicaid patients are the function of the independent insurance companies acting as MCOs and not merely as conduits for the more limited services the State of Illinois could provide.

Stip. Ex. I Article 6 at IDORDHFS000937; Stip. Ex. J Article 6 at contract p. 82; Stip. Ex. K Article 6 at IDORDHFS001293).

Notably, the IDHFS-MCO Contracts also include provisions which specifically limit a MCO's relationship with IDHFS. The IDHFS-MCO Contracts contain a provision that specifically states that the MCO is acting "as an independent Contractor and not an agent or employee of, or joint venture with, the State." (Stip. ¶45; Stip. Ex. I at Section 9.1.10 at IDORDHFS000965; *see also* Stip. Ex. J at Section 9.1.10 at contract p. 101, and Stip. Ex. K at Section 9.1.10 at IDORDHFS001313). Also, there are provisions which state that MCOs shall indemnify and hold IDHFS harmless for certain claims, complaints, and causes of action related to a MCO's failure to pay providers. (Stip. ¶43; Stip. Ex. I Section 7.13 at IDORDHFS000950; Stip. Ex. J Section 7.13 at contract p. 89; Stip. Ex. K Section 7.13 at IDORDHFS001301). There are certain indemnification provisions which hold IDHFS and its officers, agents, and employees harmless from disputes between MCOs and any third parties. (Stip. ¶46; Stip. Ex. I Section 9.1.28 at IDORDHFS000969; Stip. Ex. J Section 9.1.28 at contract p. 104; Stip. Ex. K Section 9.1.28 at IDORDHFS001316). Additionally, there are indemnification provisions which hold the State and its officers, agents, and employees harmless in relation to breaches or violations by the MCOs of its certifications, representations, warranties, covenants, and agreements, death or injury to an individual or damage to property claimed to be caused by a MCO's negligent performance, and any act or omission by a MCO or any of its employees, representatives, subcontractors, or agents. (Stip. Ex. I Section 9.1.8 at IDORDHFS000965; Stip. Ex. J Section 9.1.8 at contract p. 94; Stip. Ex. K Section 9.1.8 at IDORDHFS001313).

LEGAL ANALYSIS

I. Retailers' Occupation Tax Act Section 2-5(11) and Regulation 130.2080(a)

At issue here is whether Midwest Medical's sales of DME to individuals enrolled in Medicaid is subject to Illinois ROT regardless of whether those reimbursements were made by MCOs or by the State of Illinois through IDHFS. (*See* Stip. ¶90). The ROTA provides: "A tax is imposed upon persons engaged in the business of selling at retail tangible personal property…" 35 ILCS 120/2(a); *see also* 86 Ill.Admin.Code 130.101. "The Tax is measured by the seller's gross receipts from such sales made in the course of such business." 86 Ill.Admin.Code 130.101 (Stip. ¶92). In this context, "gross receipts" includes "all the consideration actually received by the seller…" 86 Ill.Admin.Code 130.401 (Stip. ¶93).

The applicable law includes Section 2-5(11) of the ROTA, hereafter referred to as the "governmental body" exemption. Under "Exemptions," Section 2-5 states: "Gross receipts from proceeds from the sale of the following tangible personal property are exempt from the tax imposed by this Act:… (11) Personal property sold to a governmental body…" 35 ILCS 120/2-5(11). (Stip. ¶91). Applicable regulations include Regulation 86 Ill.Admin.Code 130.2080(a) ("Regulation 130.2080(a)"), which deals with "Sales to Governmental Bodies, Foreign Diplomats and Consular Personnel." From April 17, 1991 through January 12, 2015, Regulation 130.2080(a) provided, in pertinent part:

> Sales made to a governmental body (Federal, State, local or foreign) are exempt from the Retailers' Occupation Tax. Such sales are not exempt from the Retailers' Occupation Tax unless a governmental body has an active exemption identification number issued by the Department. However, retailers may accept U.S. Government Bank Cards in sales to the U.S. Government and its agencies without requiring an Illinois exemption number…

From January 12, 2015 through current, Regulation 130.2080(a) has provided, in pertinent part:

> Exemption Identification Number. On and after January 1, 2015, except as provided in subsections (b) and (c), sales of tangible personal property made to a governmental body

(federal, State, local or foreign) are exempt from the Retailers' Occupation Tax only if the governmental body has an active exemption identification number ("E-number") issued by the Department and it provides this active E-number to the retailer, who records that number instead of collecting the tax. In addition, only sales of tangible personal property invoiced directly to and paid by governmental bodies that possess active E-numbers are exempt. If an individual government employee provides a credit card to the retailer containing the name of the employee along with the name of the governmental body, tax will be due even if the employee provides an active E-number. However, until December 31, 2014, retailers may accept U.S. Government Bank Cards in sales to the U.S. Government and its agencies without requiring an Illinois active exemption identification number… (Stips. ¶¶96-98; Stip. Ex. W).[11]

II. The Three Notices Of Tax Liability Are *Prima Facie* Correct And Have Not Been Sufficiently Rebutted

The Department established the *prima* facie correctness of its assessments when it introduced its three NTLs into evidence under the Department Director's certification. (Stip. Exs. T, U, and V). Other pertinent Department workpapers have also been provided under the Department Director's certificates of records. (*See* Stip. Exs. A and S). ROTA Section 120/4 provides:

> As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgment and information… any return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown therein… Proof of such correction by the Department may be made at any hearing before the Department or the Illinois Independent Tax Tribunal or in any legal proceeding by a reproduced copy or computer print-out of the Department's record relating thereto in the name of the Department under the certificate of the Director of Revenue… Such certified reproduced copy or certified computer print-out shall without further proof, be admitted into evidence before the Department or in any legal proceeding and shall be prima facie proof of the correctness of the amount of tax due, as shown therein… 35 ILCS 120/4.

[11] Regulation 130.120 is referenced in Midwest Medical's brief, and provides, in pertinent part: "The tax does not apply to receipts from sales…(i) that are made to any governmental body (*see* Section 130.2080 of this Part)…" 86 Ill.Admin.Code 130.120 (Stip. ¶95). Regulation 130.120 generally restates what the ROTA's governmental body exemption states and refers to Regulation 130.2080. So, while applicable, Regulation 130.120 does not add any detail for the applicability of the governmental body exemption not otherwise found in Section 2-5(11) of the ROTA or Regulation 130.2080.

The Department's *prima facie* case can only be rebutted if a taxpayer presents competent evidence, closely identified with its books and records, of the incorrectness of the Department's three NTLs. *Chak Fai Hau v. Dep't of Revenue*, 2019 IL App (1st) 172588, ¶¶ 52-56; *Copilevitz v. Dep't of Revenue*, 41 Ill.2d 154, 156-57 (1968); *A.R. Barnes & Co.*, 173 Ill.App.3d 826, 831-32 (1st Dist. 1988); *Vitale v. Dep't of Revenue*, 118 Ill.App.3d 210, 213 (3d Dist. 1983).

Midwest Medical has argued that the indirect reimbursements it received from MCOs are subject to the ROTA's governmental body exemption. This is a legal argument. However, Midwest Medical's primary documentary support includes 1) financial data that shows how indirect and direct Medicaid reimbursements were incorrectly categorized together by Midwest Medical as exempt (Stip. ¶¶11-13; Stip. Ex. C) and 2) Midwest Medical-MCO Contracts which indicate that Midwest Medical knowingly contracted with MCOs for indirect Medicaid Fee for Service reimbursement payments (Stip. ¶¶28-36; Stip. Group Ex. H). Much of the remaining evidence provided by Midwest Medical is based on testimony regarding what Midwest Medical's principals believed concerning the applicability of the governmental body exemption, and how they used a similar internal process for the processing of both direct and indirect Medicaid reimbursements. (*See* Stip. ¶¶59-60, 62-68; MM SJ Memo Ex. 1). Although Midwest Medical is arguing that the governmental body exemption applies, Midwest Medical has confirmed that indirect reimbursement invoices were submitted to MCOs for payment and such payments were remitted from the MCOs. (Stip. ¶¶65-66). The financial data and Midwest Medical-MCO Contracts further support this. (Stip. ¶¶ 11-13; Stip. Ex. C; Stip. Group Ex. H; *see also infra*, Section VI).

Midwest Medical cited Mr. Mendonsa's testimony which generally states that when a healthcare provider is ultimately paid pursuant to their MCO contract, they are paid from the MCO,

and the MCO, in one way or another, is funded by the State. *See* MM SJ Memo p. 9. (Stip. ¶61). However, Mr. Mendonsa also clarified as follows:

> Q. I want to focus then a little bit more on how service providers, I guess, are ultimately reimbursed or paid through the Medicaid process. You said that even for service provider contracts with an MCO, the State is the party that ultimately pays; is that correct?
> A. So if we're paying the MCO, then the MCO is responsible for paying those claims. So fee-for-service is different, right? We pay the providers directly. **Once it's in a manage care organization, the providers have to either contract with the manage care organization or they quickly bill out in every service; but they have to bill the MCO. We're out of that business. That's the responsibility of the manage care organization to pay**.
> (Stip. Ex. G at 33:18-34:9) (emphasis added).

This testimony explains how providers, such as Midwest Medical, need to bill MCOs for indirect Fee For Service reimbursements, and how IDHFS is not involved in indirect reimbursement payments remitted from MCOs to providers. Unlike MCO Fee for Service payments, IDHFS direct reimbursements are capitated payments which do not relate to specific services or sales of DME. (Stip. ¶37).[12]

As shown above and as detailed further within, Midwest Medical has not provided any documentary evidence, or related testimonial evidence, to sufficiently rebut the Department's *prima facie* case. Additionally, as set forth below, Midwest Medical has not met its additional burden to meet the clear and convincing standard that it is entitled to the governmental body exemption.

[12] These IDHFS capitated payments to the MCOs are not based on any sales of specific tangible personal property ("TPP"), unlike the MCO Fee for Service reimbursements which are based on specific services provided and sales of specific items of TPP. This distinction is noteworthy since the ROTA applies to proceeds from the sale of TPP. 35 ILCS 120/2(a). This difference is also an indication that the indirect Fee for Service reimbursements from insurance companies acting as MCOs are taxable.

III. Illinois Law Favors Taxation Over Exemption And Midwest Medical Has Not Proven Its Entitlement To The Governmental Body Exemption

It is black-letter Illinois law that exemptions from taxation are to be construed against exemption and in favor of taxation. 35 ILCS 120/7 ("It shall be presumed that all sales of tangible personal property are subject to tax under this [ROT] 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…"); *See also Provena Covenant Medical Center v. Dep't of Revenue*, 236 Ill. 2d 368, 388 (2010) (property tax); *McCoy Ford, Inc. v. Dep't of Revenue,* 60 Ill.App.3d 429, 432 (4th Dist. 1978) (retailers' occupation tax); *LeaderTreks, Inc. v. Dep't of Revenue*, 385 Ill.App.3d 442, 446 (2nd Dist. 2008) (property tax); *Metro Developers, LLC v. City of Chicago Dep't of Revenue*, 377 Ill.App.3d 395, 397 (1st Dist. 2007) (Chicago real property transfer tax); *LeTourneau R. Services, Inc. v. Dep't of Revenue,* 134 Ill.App.3d 638, 642 (4th Dist. 1985) (retailers' occupation tax); *Thomas M. Madden and Co. v. Dep't of Revenue*, 272 Ill.App.3d 212, 215-16 (2nd Dist. 1995) (use tax); *Schawk, Inc. v. Zehnder*, 326 Ill.App.3d 752, 755 (1st Dist. 2001) (income tax). "A person claiming an exemption from taxation has the burden of proving clearly that he comes within the statutory exemption. Such exemptions are to be strictly construed, and doubts concerning the applicability of the exemptions will be resolved in favor of taxation." *Zenith Electronics Corp. v. Dep't of Revenue*, 293 Ill. App. 3d 651, 655 (1st Dist. 1997) (citing *Van's Material v. Dep't of Revenue*, 131 Ill.2d 196, 216 (1989)); "The taxpayer seeking exemption carries the burden of proving entitlement by clear and convincing evidence." *JB4 Air LLC v. Dep't of Revenue*, 388 Ill.App.3d 970, 974 (2nd Dist. 2009). "This derives from the fact that deductions and exemptions are privileges created by statute as a matter of legislative grace." *Balla v. Dep't of Revenue*, 96 Ill.App.3d 293, 295 (1st Dist. 1981).

The recent Appellate Court of Illinois decision in *Safety-Kleen Systems, Inc. v. Department of Revenue* is particularly instructive. *Safety-Kleen* involved the applicability of the Illinois Use Tax Act's (the "UTA") temporary storage exemption on solvent which the Department argued was stored in Illinois multiple times, thereby making the exemption inapplicable regardless of any changes to the solvent's characteristics. The Tax Tribunal had originally held that the temporary storage exemption did not apply. *Safety-Kleen Systems, Inc. v. Dep't of Revenue*, 16-TT-167 (Summary Judgment Order, Sept. 6, 2018). This decision was affirmed by the Appellate Court. In making its determination, the Court held:

> Ultimately, as we have stated, this court has no authority to create exemption to taxation through judicial construction. *City of Chicago*, 147 Ill. 2d at 491. With that in mind, *Safety-Kleen* cites no legal authority supporting a finding that the temporary storage exemption can apply where a property is significantly altered by its use but ultimately refined and reused for the same activity after undergoing a recycling procedure. Any doubt that rises from this inquiry must be resolved in favor of taxation. *Horsehead Corp.*, 2019 IL 124155, ¶ 42.
>
> *Safety-Kleen Systems, Inc. v. Dep't of Revenue*, 2020 IL App (1st) 191078, ¶35; *aff'd* in *Safety-Kleen Systems, Inc. v. Dep't of Revenue,* 154 N.E.3d 754 (Ill. 2020) (petition for leave to appeal denied); *See also Horsehead Corp. v. Dep't of Revenue,* 14-TT-227 (Final Judgment Order, Oct. 13, 2017)(held that the sales tax manufacturing exemption was inapplicable in that case), *affirmed by Horsehead Corp. v. Dep't of Revenue*, 2018 IL App (1st) 172802 (1st Dist. 2018), *affirmed in relevant part by Horsehead Corp. v. Dep't of Revenue*, 2019 IL 124155 (2019).

Midwest Medical has cited no legal authority or applicable facts which support a finding that the governmental body exemption from ROT can apply to reimbursements from private insurance companies like the MCOs. Midwest Medical cites to Department General Information Letters ("GILs"), and caselaw which describes the "substance over form" doctrine and how the MCOs are acting as agents of the State even though the express contractual language states the opposite. (MM SJ Memo pp. 9-14). As discussed below, much of what is cited, and the related authority actually supports the Department's position.

Further, in its brief Midwest Medical does not acknowledge the applicable standard of proof and voluminous caselaw describing the high standard for proving that it is entitled to the governmental body exemption. Instead, Midwest Medical argues that the MCOs are merely a "conduit" for the State, and therefore Midwest Medical should be eligible for the governmental body exemption on that basis. This is in spite of, among other facts, 1) the MCOs being private insurance companies that provide detailed additional services to Medicaid enrollees that the State could not provide at the cost, volume, and quality provided by the MCOs, 2) IDHFS and MCOs having separate contracts from that of Midwest Medical and the MCOs, 3) Midwest Medical executing the Midwest Medical-MCO Contracts with the MCOs, 4) IDHFS remitting capitated payments to MCOs pursuant to the IDHFS-MCO Contracts, 5) MCOs remitting Fee for Service payments to providers such as Midwest Medical, 6) express contractual language which states that MCOs are not acting as agents or employees of the State, and 7) express contractual language by which the MCOs indemnify IDHFS and the State. Facts such as these clearly show that the MCOs are not simply conduits of the State, and the governmental body exemption does not apply. However, even if such facts were not dispositive, Midwest Medical has not met the applicable standard for proving the entitlement to the governmental body exemption by clear and convincing evidence, particularly where the law defaults to taxation over exemption.

Additionally, Midwest Medical argues that the Department's interpretation would be harmful to Midwest Medical's business, particularly since the cost of the additional ROT could not be passed to Medicaid enrollees. (MM SJ Memo pp. 14-15).[13] Any such impacts, however, do not bear on the question of whether indirect reimbursements are exempt from tax. The Department cannot deviate from what the ROTA and applicable regulations require.

[13] Notably, Mr. Mendonsa generally testified (not verbatim) that there is no rule or regulation in place that would prevent a provider from raising their charges for MCOs. (Stip. ¶69; Stip. Ex. G at 42:19-43:23).

Likewise, the Tribunal is not in a position to allow taxpayers, such as Midwest Medical, to be deemed exempt from ROT for indirect reimbursements from private insurance companies. Such a determination could have unforeseen effects on what would otherwise be appropriately subject to tax. Exemptions are the function of legislative grace. Accordingly, any potential expansion of the governmental body exemption to specifically include such indirect Medicaid reimbursement payments could only be enacted through the Illinois legislature.[14]

IV. The Governmental Body Exemption Does Not Apply To Reimbursement Payments Made By Non-Governmental Bodies

The governmental body exemption is set forth in Section 2-5(11) of the ROTA, which provides: "Gross receipts from proceeds from the sale of the following tangible personal property are exempt from the tax imposed by this Act:… (11) Personal property sold to a governmental body…" 35 ILCS 120/2-5(11). (Stip. ¶91).[15] To determine the meaning and scope of the exemption, one must look to its plain language. "The fundamental principle of statutory construction is to determine and give effect to the intent of the legislature. The statutory language is the best indication of legislative intent." *Quality Saw & Seal, Inc. v. Ill. Commerce Comm'n*, 374 Ill.App.3d 776, 781, (2nd Dist. 2007); *See also Horsehead Corp.*, 2019 IL 124155, ¶37 ("The plain language of the statute remains the best indication of this intent… Where the language of a statute is clear, we may not read into it exceptions that the legislature did not express, and we will

[14] *See Subway Rests. of Bloomington-Normal, Inc. v. Topinka*, 322 Ill.App.3d 376, 386-87 (4th Dist. 2001), which is detailed when discussing Agency in Section VII, *infra.*

[15] The full ROTA Section 2-5(11) stated during the Periods at Issue, and currently states, that the following are exempt:

> (11) Personal property sold to a governmental body, to a corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious, or educational purposes, or to a not-for-profit corporation, society, association, foundation, institution, or organization that has no compensated officers or employees and that is organized and operated primarily for the recreation of persons 55 years of age or older. A limited liability company may qualify for the exemption under this paragraph only if the limited liability company is organized and operated exclusively for educational purposes. On and after July 1, 1987, however, no entity otherwise eligible for this exemption shall make tax-free purchases unless it has an active identification number issued by the Department. 35 ILCS 120/2-5(11).

give it effect as written."); *Andrews v. Kowa Printing Corp.*, 217 Ill. 2d 101, 106 (2005). ("Where the language is clear and unambiguous, we must apply the statute without resort to further aids of statutory construction."). In this case, under the plain meaning of the statutory exemption, DME must be sold to a governmental body in order to be exempt from ROT.

In *Lombard Public Facilities Corporation v. Department of Revenue*, the Appellate Court discussed the plain meaning of the governmental body exemption. *Lombard Pub. Facilities Corp. v. Dep't of Revenue*, 378 Ill.App.3d 921, 923 (2nd Dist. 2008). *Lombard* involved the Village of Lombard's ("Village's") incorporation of the Lombard Public Facilities Corporation ("LPFC") to assist the Village in securing financing for the construction of a convention hall and hotel facility. LPFC was granted various authorities from the Village, including the ability to issue, sell, and deliver its bonds, encumber any real property or equipment acquired for the purpose of financing the project, and enter into contracts related to the sale of bonds and construction and acquisition of the property. *Id.* at 923-24. The Village's address was listed as LPFC's address, and the purpose of LPFC under its articles of incorporation was "to assist the Village of Lombard in its essential governmental purposes." *Id..* at 924. Various related Village approvals, appointments of LPFC's directors, and Village consents were also required. *Id.* at 924-26. Additionally, the Village had assumed risk under its arrangements because if there was a shortfall in revenue from the project, the Village would be responsible for providing a backstop guaranty. *Id.* at 926.

LPFC's application for the governmental body exemption from ROT was denied. *Id.* at 924-25. The Department argued, in part, that the term "governmental body" in the ROTA was not intended to cover nonprofit corporations that were acting as agencies or instrumentalities of the government. *Id.* at 927. The Court applied traditional rules of statutory construction since the ROTA does not define the term "governmental body." *Id.* at 929. The Court held:

> The best indication of legislative intent is the language of the statute, given its plain and ordinary meaning, and considering the statute in its entirety… Where the meaning of a statute is unclear, courts may look beyond the language of the statute and consider the purpose of the law, the evil it was intended to remedy, and the legislative history of the statute… **Following these rules, we look at the term "governmental body," using its plain and ordinary meaning, and find the term to be unambiguous. The statute clearly applies to governmental bodies and not agents or instrumentalities thereof…** *Id.* at 929-30 (emphasis added; citations omitted).

Under *Lombard*, the term "governmental body" is unambiguous. The governmental body exemption only applies to governmental bodies, in this case the State of Illinois through the Illinois Department of Healthcare and Family Services. The MCOs are not agents or instrumentalities of the State. However, even if they were, the governmental body exemption does not apply to reimbursements from agents or instrumentalities of the State.

The plain and ordinary language of the governmental body exemption is determinative. Moreover, even under a prior more expansive version of the exemption, the meaning of "governmental body" did not extend to private entities. In 1966, the Illinois Supreme Court reviewed a prior form of the governmental body exemption, which stated in pertinent part that gross receipts from the retail sales of TPP would exclude from ROT "the proceeds of such sales to any governmental body or any agency or instrumentality thereof…" *Berwyn Lumber Co. v.*

Korshak, 34 Ill.2d 320, 322 (1966).[16] This language was included for actual agencies or Departments of the government (i.e. IDHFS).[17]

In *Berwyn Lumber*, the Court addressed the applicability of the governmental body exemption to materials sold by a lumber company which were used by contractors doing construction work for the Chicago Housing Authority. *Id.* at 321. Even under that more expansive language, the Court affirmed the denial of the governmental body exemption. *Id.* at 323. The Court noted:

> It is beyond dispute that the sales in question here are not sales to exempt organizations but sales to independent contractors. If the intention of the General Assembly was to make the exclusion depend upon more remote economic effects it has not said so, and courts are not at liberty to enlarge the scope of plain provisions in order to more effectively accomplish the general purpose. The legislative intent must be sought primarily from the language used in the statute and where intent can be ascertained therefrom it should prevail without resort to other aids for construction. *Id.*[18]

It is also worth noting that the governmental body exemption, as stated in Section 2-5(11) of the ROTA, makes no reference to Medicaid or any similar programs. The exemption applies only to sales made to governmental bodies, and Section 2-5(11) references only a "governmental

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[16] An exemption for State and units of local governments, or any instrumentality or institution thereof, and organizations operated exclusively for charitable, religious, or educational purposes was added to the ROTA by Laws 1953, p. 1310, §1, effective July 13, 1953. The exemption for the State and units of local governments was removed by Laws 1961, p. 2312-14, §2, effective July 31, 1961. An exemption for proceeds of sales to any governmental body or any agency or instrumentality thereof was added by Laws 1963, p. 735-36, §1, effective March 21, 1963. The exemption's language was narrowed to any governmental body by Laws 1965, p. 136-37, §1, effective March 16, 1965. The excerpts of prior versions of the governmental body exemption are attached as IDOR SJ Ex. A. The current version of the governmental exemption found in ROTA Section 2-5(11), was promulgated in 1990 ILL. P.A. 1475, effective January 10, 1991. The governmental body exemption language has not been adjusted since the promulgation of Section 2-5.

[17] The 1963 "agency or instrumentality" language was added to the governmental body exemption to include governmental agencies and departments. Otherwise, it would be impossible for State or other governmental agencies to conduct their business. However, to remove any confusion as to what was meant by the language "agency and instrumentality," this language was removed in 1965, and only the term "governmental body" has remained. *See* IDOR SJ Ex. A at Laws 1965, p. 137, §2, effective March 16, 1965.

[18] The language of the governmental body exemption is unambiguous. However, even if the language was not clear, statutory words and phrases should be construed in light of the entire statute. *See JB4 Air*, 388 Ill.App.3d at 974. Section 2-5(11) of the ROTA clearly outlines a number of entities for which an exemption from ROT applies based on their type of organization, whether that be governmental, charitable, religious, educational, or non-profit. This list in no way indicates that sales to or reimbursements from independent for-profit entities, such as the MCOs, should be exempt.

body." There is no statutory language or additional ROTA exemption provision specific to sales to Medicaid. This omission further supports the limitation on the exemption to only governmental bodies, particularly in these matters. After all, Section 2-5(11) of the ROTA is the "governmental body" exemption, not a "Medicaid" exemption. The express language of the governmental body exemption contained within Section 2-5(11) of the ROTA is sufficient to determine that Midwest Medical's reimbursements from MCOs for Medicaid-related sales are taxable and not exempt.

V. Regulation 130.2080(a) Precludes Exemption For MCO Reimbursements

As described, ROTA Section 2-5(11) is unambiguous. Under the ROTA, "The Department is authorized to make, promulgate and enforce such reasonable rules and regulations relating to the administration and enforcement of the provisions of this Act as may be deemed expedient." 35 ILCS 120/12. Regulation 130.2080(a), which concerns sales to governmental bodies, provides more detail regarding substantiation for the governmental body exemption, and is the key regulation at issue. (*See* Stip. ¶96; Stip. Ex. W).

From April 17, 1991 through January 12, 2015, Regulation 130.2080(a) provided in pertinent part:

> Sales made to a governmental body (Federal, State, local or foreign) are exempt from the Retailers' Occupation Tax. Such sales are not exempt from the Retailers' Occupation Tax unless a governmental body has an active exemption identification number issued by the Department. However, retailers may accept U.S. Government Bank Cards in sales to the U.S. Government and its agencies without requiring an Illinois exemption number… 86 Ill.Admin.Code 130.2080(a). (Stip. ¶97; Stip. Ex. W).

Regulation 130.2080(a) was amended on January 12, 2015 to provide, in pertinent part:

> Exemption Identification Number. On and after January 1, 2015, except as provided in subsections (b) and (c), sales of tangible personal property made to a governmental body (federal, State, local or foreign) are exempt from the Retailers' Occupation Tax only if the governmental body has an active exemption identification number ("E-number") issued by the Department and it provides this active E-number to the retailer, who records that number instead of collecting the tax. In addition, only sales of tangible personal property invoiced directly to and paid by governmental bodies that possess active E-numbers are

> exempt. If an individual government employee provides a credit card to the retailer containing the name of the employee along with the name of the governmental body, tax will be due even if the employee provides an active E-number. However, until December 31, 2014, retailers may accept U.S. Government Bank Cards in sales to the U.S. Government and its agencies without requiring an Illinois active exemption identification number… (Stip. ¶98; Stip. Ex. W).

Department regulations are treated and interpreted in the same manner as statutes. *Medcat Leasing Co. v. Whitley*, 253 Ill.App.3d 801, 803 (4th Dist. 1993) ("Administrative regulations have the force and effect of law and must be construed under the standards governing the construction of statutes… Like statutes, administrative regulations enjoy a presumption of validity."); *See also Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, ¶ 38 (administrative regulations have the force and effect of law and are interpreted with the same canons as statutes); *Church v. State*, 164 Ill.2d 153, 161-62 (1995) ("Where the legislature expressly or implicitly delegates to an agency the authority to clarify and define a specific statutory provision, administrative interpretations of such statutory provisions should be given substantial weight unless they are arbitrary, capricious, or manifestly contrary to the statute… A court will not substitute its own construction of a statutory provision for a reasonable interpretation adopted by the agency charged with the statute's administration.").

The language of Regulation 130.2080(a) is unambiguous and should be understood by its plain and ordinary meaning as if it was a statute. Under both versions of Regulation 130.2080(a) which applied during the Periods at Issue, only sales of TPP made to a governmental body are exempt. There are two main distinctions between the two versions of Regulation 130.2080(a).

First, the former regulation stated that such sales were not exempt from ROT unless "a governmental body has an active exemption identification number issued by the Department." (Stip. ¶97). The current regulation states that in order for a retailer to claim the governmental body exemption on and after January 1, 2015, the governmental body must have an active E-number,

the E-number needs to be recorded by a retailer, and "only sales of tangible personal property invoiced directly to and paid by governmental bodies that possess active E-numbers are exempt." (Stip. ¶98). The current regulation merely provides more clarity as to what documentary substantiation is required for a retailer to prove entitlement to the government exemption. In order for a retailer to claim the benefit of the governmental body exemption, some form of documentation has always been required. Nothing in the prior form of the regulation indicates that non-governmental bodies were entitled to an exemption. Only sales to governmental bodies are eligible for the exemption. Thus, sales directly invoiced to and payments made from such governmental bodies have always been necessary. This standard is further supported by the second distinction between the original and current form of Regulation 130.2080(a).

The second difference is that the former version of Regulation 130.2080(a) provides an exception for substantiating the governmental body exemption in which "retailers may accept U.S. Government Bank Cards in sales to the U.S. Government and its agencies without requiring an Illinois exemption number." (Stip. ¶97). The fact that the original regulation provides a specific exception for U.S. Government Bank Cards provides further certainty that if the regulation contemplated that payments from non-government entities could qualify for the governmental body exemption, the regulation would include language to so specify.

The current form of Regulation 130.2080(a) is also more stringent in relation to government employees using government issued credit cards, and the use of U.S. bank cards. The current regulation provides: "If an individual government employee provides a credit card to the retailer containing the name of the employee along with the name of the governmental body, tax will be due even if the employee provides an active E-number. However, until December 31, 2014, retailers may accept U.S. Government Bank Cards in sales to the U.S. Government and its

agencies without requiring an Illinois active exemption identification number." (Stip. ¶98). In sum, individual government employees using credit cards could not claim the governmental body exemption even with an E-number provided, and effective January 1, 2015 retailers could no longer accept U.S. Government Bank Cards in sales to the U.S. government or its agencies without an active E-number. These clarifications and changes add further support for the narrow application of the governmental body exemption. Again, the current form of Regulation 130.2080(a) shows that if the regulation contemplated any sort of applicability of the governmental body exemption beyond governmental bodies with active E-numbers, it would state as such.[19]

Under both applicable versions of Regulation 130.2080(a), the indirect MCO reimbursements remitted to Midwest Medical are not subject to the governmental body exemption. IDHFS is a governmental body, not the MCOs. IDHFS was not directly invoiced and there were no payments from IDHFS for those indirect reimbursements because those reimbursements were submitted to and paid by the MCOs. As noted within in detail, the MCOs have a separate and distinct capitated reimbursement arrangement with IDHFS. Even though the MCOs' contract with IDHFS and provide additional Medicaid services for Medicaid enrollees, the MCOs are simply not governmental bodies nor agents of the State.[20] Of note, there is also no language in either version of Regulation 130.2080(a) which is specific to Medicaid or similar programs. Given all of

[19] Midwest Medical has argued in its brief that it would be impractical for all MCOs to provide exemption certificates for every transaction. (MM SJ Memo p. 13). To clarify, Regulation 130.2080(a) contemplates a taxpayer documenting an exemption identification number (E-number), not gathering exemption certificates. Notably, the auditors for these matters stated that no exemption certificates were provided, but nevertheless removed the direct State of Illinois (marked as Illinois Department of Public Aid) reimbursements from taxable reimbursements. (*See* Stip. Ex. A at IDOR000029, 34-35, 367, 358, and 425; Stip. Ex. S at IDOR000061, 391, and 439).
However, Midwest Medical's argument misses the point of the regulatory language. The regulation contemplates payments from a governmental body as being exempt. Regardless of the difference between the Department requiring support through an exemption certificate or a documented E-number, the MCOs are not exempt governmental bodies. Therefore, under either form of documentary support, the indirect reimbursements from the MCOs are taxable.

[20] As discussed in Section IV, *supra*, even if the MCOs were agents of the State, such indirect reimbursements would not qualify for the governmental body exemption.

the above, the indirect Medicaid reimbursements provided by the MCOs for DME sold by Midwest Medical are taxable under Regulation 130.2080(a).

VI. The "Substance Over Form" Doctrine Does Not Apply

Midwest Medical spends much of its brief arguing about the "Substance Over Form" doctrine, which is often intertwined with the "Economic Substance" doctrine. (*See* MM SJ Memo pp. 10-14). The "Substance Over Form" doctrine does not allow indirect MCO reimbursements to qualify for the governmental body exemption.

The *JB4 Air LLC v. Department of Revenue* case is instructive. In *JB4 Air*, the Department argued that under Section 3-70 of the UTA, the non-resident individual exemption did not apply to JB4 Air because it was an LLC, not an individual. An "individual" is what is described in the exemption. JB4 argued that the exemption should apply because it was substantively an individual since a person, John Bell, was the LLC's only member and the only person who used the airplane. *JB4 Air LLC v. Dep't of Revenue*, 388 Ill.App.3d at 971. The Department's ALJ had previously determined that tax exemptions are to be strictly construed in favor of taxation, and the term "individual" had a plain and well-understood meaning that did not include entities, such as a limited liability company. *Id.* at 972. The Court upheld the prior determination that the term was unambiguous. *Id.* at 975.

In reaching its holding, the *JB4* Court also rejected JB4's "substance over form" argument. *Id.* at 975-76. In support of this argument, JB4 cited the case of *JI Aviation, Inc. v. Department of Revenue*, 335 Ill.App.3d 905 (1st Dist. 2002). The *JB4 Air* Court discussed that *JI Aviation* addressed whether a use tax exemption for an occasional sale applied where JI Aviation purchased an aircraft from Richland, a company that was not in the business of selling aircraft, and where Richland directed the sale through Nationsbanc, which was an aircraft retailer. The "substance

over form" doctrine determined the economic realities of the transaction. "The economic realities, stated another way, meant the true seller and true purchaser." *JB4 Air*, 388 Ill.App.3d at 976-77.

Midwest Medical relies on *JI Aviation*. (MM SJ Memo pp. 10-13). However, the *JB4* Court rejected the application of *JI Aviation* to efforts to reclassify a purchasing or selling entity, stating:

> In those cases, the courts faced situations where an intermediary was used in the sales transaction and where the sales documents limited the role of the intermediary and identified the role of the intermediary as an agent of the true seller or purchaser… The courts in those cases also reviewed whether the entities involved had any liability for transferring good title, whether the entities were required to immediately convey title, whether the entities were able to keep any amount of the purchase price, and whether the entities paid any of the closing costs…The *JI Aviation* and *Weber-Stephen* courts used the "substance over form" doctrine to identify the purchasers or sellers in the transactions to determine whether an exemption applied, but neither case used the "substance over form" doctrine to reclassify an entity that purchased or sold the property as JB4 asks us to do now… *Id*. at 977 (citations omitted).

JI Aviation is likewise inapplicable here.[21] It is incorrect to reclassify the MCOs as either the State of Illinois or IDHFS. Nothing contained within the IDHFS-MCO Contracts changes the result. These contracts actually reinforce the separate nature of the MCOs from the State. The IDHFS-MCO Contracts specifically state that the MCOs do not act as agents, employees, or a joint venture with the State. (Stip. ¶45; Stip. Ex. I at Section 9.1.10; Stip. Ex. J at Section 9.1.10; Stip. Ex. K at Section 9.1.10). The IDHFS-MCO Contracts also contain provisions indemnifying the State and IDHFS from potential MCO liabilities. (Stips. ¶¶43, 46; Stip. Ex. I at Sections 7.13, 9.1.8, and

[21] *See also Shakman v. Dep't of Revenue*, 2019 IL App (1st) 182197, ¶54 (noting that there is no indication that a substance-over-form inquiry, like was discussed in *JI Aviation*, was meant to apply in all tax situations).
The other "substance over form" cases cited by Midwest Medical are also inapplicable. *In re Stoecker*, 179 F.3d 546, 550 (7th Cir. 1999) (finding the doctrine inapplicable for a use tax exemption in a situation in which title was transferred to a retailer, which is treated as a sale under Illinois law even if the purpose is to grant a security interest); *Estate of Weinert v. C.I.R.*, 294 F.2d 750 (5th Cir. 1961) (holding that the transaction at issue, involving the technical area of taxation of oil and gas, was not a loan transaction but a "carried interest" transaction); *Comdisco, Inc. v. United States*, 756 F.2d 569, 578 (7th Cir. 1985) (applying substance over form in the context of a sought investment tax credit, specifically stating that its holding is acceptable because the government will never have a conflicting claim).

9.1.28; Stip. Ex. J at Sections 7.13, 9.1.8, and 9.1.28; Stip. Ex. K at Sections 7.13, 9.1.8, and 9.1.28).[22]

Notably, Midwest Medical executed Midwest Medical-MCO Contracts without reviewing the referenced IDHFS-MCO Contracts. Robert Buikema testified that he never reviewed the IDHFS-MCO Contracts, and that no one at Midwest Medical would have an understanding as to what is contained within those contracts. (Stip. Ex. D at 44:21-45:8; *see also* Stip. Ex. E at 84:19-85:3; Stip. Ex. F at 51:14-17). Robert Buikema also did not review any IDHFS-MCO Contracts prior to executing Midwest Medical-MCO Contracts.[23] (Stip. Ex. D at 58:14-59:10). IDHFS's role and the existence and importance of the IDHFS-MCO Contracts themselves are often referenced within the Midwest Medical-MCO Contracts. (*See, e.g.,* Stip. Group Ex. H at MIDWEST_000099 (acknowledgement that MCO is a contractor for IDHFS), 126 (similar acknowledgment), 127 (references "State Contract," which is the IDHFS-MCO Contract), 153 (same), 196 (references IHFS Contract), 197 (acknowledgement that provider is also subject to terms of DHFS Contract to the extent applicable), 210 (similar acknowledgment)). A review of the MCO-IDHFS Contracts would have expressly informed Midwest Medical that the MCOs were not agents of the State.[24]

[22] Another difference from *JI Aviation* is that the MCOs have an ongoing economic interest since they are being reimbursed on a capitated basis by IDHFS. As Mr. Mendonsa testified, the capitated payments to the MCOs are all the MCOs receive from the State to cover the Medicaid benefit expenses, administrative expenses, and profit. (Stip. Ex. G at 35:22-37:12). The MCOs also exercise a high level of independent control over how the MCOs provide DME and related services to Medicaid enrolled patients. (*See, e.g.,* Section III, *supra*). Therefore, the MCOs are not pure conduits, as was the case in *JI Aviation*.

[23] Of Note, Midwest Medical's negotiations of Midwest Medical-MCO Contracts also did not involve any discussions regarding who would be responsible for any sales related tax liabilities. (Stip. ¶36).

[24] "It is a rule universally recognized that a written contract is the highest evidence of the terms of an agreement between the parties to it, and it is the duty of every contracting party to learn and know its contents before he signs it." *Vargas v. Esquire, Inc*., 166 F.2d 651, 654 (7th Cir. 1948); *see also Schweihs v. Chase Home Fin., LLC*, 2016 IL 120041, ¶57 (2016).

The express language in the Midwest Medical-MCO Contracts is also informative. Stipulation Group Exhibit H, includes a sampling of Midwest Medical-MCO Contracts. (Stip. Group Ex. H). Most of these sample contracts are executed by Robert Buikema, as President of Midwest Medical, and counter-executed by a representative of the specific MCO. The MCOs consistently represented themselves as private insurance companies who remitted reimbursement payments to Midwest Medical for DME sold to Medicaid enrollees.[25]

For example, the HealthSpring of Illinois ("HealthSpring") Contract has a provision which states that, "Provider Agrees to Seek Payment Only from HealthSpring." (Stip. Group Ex. H. at MIDWEST_000027). Any notices contemplated under that HealthSpring Contract are to be sent to HealthSpring's president, with a copy to HealthSpring's legal department. (Stip. Group Ex. H. at MIDWEST_000032-33). Claims for Medicaid covered services are to be filed with and paid by HealthSpring. (Stip. Group Ex. H. at MIDWEST_000038). The Harmony Health Plan of Illinois, Inc. ("Harmony") Contract specifically states that Midwest Medical would provide healthcare items and services in exchange for payments from Harmony. (Stip. Group Ex. H. at MIDWEST_000052). The address for notices is to the attention of Harmony's Vice President of Network Management. (Stip. Group Ex. H. at MIDWEST_000071). Claims for Medicaid covered services are to be filed with and processed by Harmony. (Stip. Group Ex. H. at MIDWEST_000097). The Family Health Network, Inc. ("Family Health") Contract states that Midwest Medical, as a provider of DME, is arranging for health care services or items in exchange for payments from Family Health. (Stip. Group Ex. H. at MIDWEST_000103). Claims are to be

[25] Both IDHFS and the MCOs are their own separate entities that had business purposes for their arrangements with each other. MCOs would provide additional services which would increase quality and utilization for Medicaid patients. The MCOs would receive capitated payments from IDHFS. Thus, IDHFS has a substantive business purpose to contract with the MCOs and the MCOs have a substantive business purpose to contract with IDHFS and separately contract with providers such as Midwest Medical. This negates Midwest Medical's substance over form and economic substance arguments.

prepared by Midwest Medical and submitted to Family Health to be processed. (Stip. Group Ex. H. at MIDWEST_000113). The address for notices is to the attention of Family Health's President at Family Health's address. (Stip. Group Ex. H. at MIDWEST_000120-121). The NextLevel Health Partners, Inc. ("NLHP") Contract states, "Provider will provide DME Services to Members (as defined below) in exchange for payments from NLHP…" (Stip. Group Ex. H. at MIDWEST_000164). NLHP pays or denies claims. (Stip. Group Ex. H. at MIDWEST_000175-176). Notices are to be sent to the Vice President of Network Management at NLHP. (Stip. Group Ex. H. at MIDWEST_000185). NLHP clarifies that it would reimburse Midwest Medical for eligible Medicaid services in accordance with the compensation terms specified, which was at the rate of 100% of the State of Illinois Medicaid fee schedule. (Stip. Group Ex. H. at MIDWEST_000193). Finally, the Blue Cross and Blue Shield of Illinois ("BCBSIL") Contract states that, "BCBSIL shall pay Provider for Covered Services rendered to BCBSIL Medicaid Subscribers pursuant to this Agreement…" Additionally, the BCBSIL Contract specifically states that claims to the State or IDHFS are prohibited:

> **Claims to State Government Prohibited. Provider shall not request payment for Covered Services provided under this Agreement in any form from IHFS [IDHFS] or any other agency of the state of Illinois or their designees for items and services furnished in accordance with this Agreement**, except as may be approved in advance by BCBSIL and IHFS." (Stip. Group Ex. H. at MIDWEST_000198, emphasis added).

BCBSIL also provides details for the submission of claims to BCBSIL. (Stip. Group Ex. H. at MIDWEST_000208).

It is not in dispute that under the Midwest Medical-MCO Contracts, Midwest Medical would prepare an invoice for the product(s) transferred to the patients and would submit the invoices to the MCOs for payment. (Stip. ¶65; Stip. Group Ex. H). Neither is it in dispute that the MCOs would remit such payments to Midwest Medical. (Stip. ¶66). However, the aforementioned

provisions cited from the Midwest Medical-MCO Contracts detail how the MCOs expressed in their contracts, which were signed by Midwest Medical's President, that the payments related to DME provided to Medicaid enrollees were filed, processed, and paid by the MCOs acting as third party private insurance companies.[26] The "substance over form" doctrine does not apply. To deem the MCOs governmental bodies for the purpose of this exemption would impermissibly expand this doctrine.

VII. The MCOs Are Not Agents Of The State

Midwest Medical has also made the related argument that the MCOs are substantively acting as agents of the State. (MM SJ Memo pp. 13-14). Under Section 2-5(11) of the ROTA, even if the MCOs were deemed to be agents of the State, indirect reimbursements from the MCOs would not be eligible for the governmental body exemption since the MCOs are not governmental bodies. However, the statutory language notwithstanding, the MCOs are not agents of the State or IDHFS.

The applicable legal standards for an agency relationship are as follows. "An agency is essentially 'a fiduciary relationship in which the principal has the right to control the agent's conduct and the agent has the power to act on the principal's behalf'… In determining whether an agency relationship exists, 'the right to control the manner of doing the work is a predominant factor.'" *Union Planters Bank, N.A. v. FT Mortg. Cos.*, 341 Ill.App.3d 921, 928 (5th Dist. 2003)(citations omitted).[27] "A principal-agent relationship exists when the principal has the right to control the manner in which the agent performs his work **and** the agent has the ability to subject

[26] Midwest Medical's general manager/billing manager, Zachary Buikema also testified that he reviewed the Midwest Medical-MCO Contacts when they were entered and periodically thereafter. Other principals at Midwest Medical also reviewed the Midwest Medical-MCO Contracts. Such contracts followed a general form. (Stip. Ex. E at 89:18-91:20).
[27] *Union Planters Bank* is cited by Midwest Medical, but notably the case held that no agency existed because in that matter there was no express or implied authority for the mortgage company to exercise control over the manner in which the title researcher reported its title search. *Union Planters Bank*, 341 Ill.App.3d at 928.

the principal to liability." *Saletech, LLC v. E. Balt, Inc.*, 2014 IL App (1st) 132639, ¶15 (1st Dist. 2014) (emphasis added). Under basic agency-law principles, the principal is the only source of an agent's authority. *Lombard*, 378 Ill.App.3d at 932. An agent's authority may be actual or apparent, and actual authority may be either express or implied. Actual express authority exists where a principal explicitly grants the agent authority to perform a particular act. Apparent authority, by contrast, arises when the principal holds an agent out as possessing the authority to act on its behalf, and a reasonably prudent person, exercising diligence and discretion, would assume the agent to have this authority in light of the principal's conduct. Under an apparent agency theory, the aggrieved party must prove 1) the principal's consent to or knowing acquiescence in the agent's exercise of authority, 2) the third party's knowledge of the facts and good-faith belief that the agent possessed such authority, and 3) the third party's detrimental reliance on the agent's apparent authority. *Saletech*, 2014 IL App (1st) 132639, ¶14.[28]

Under the IDHFS-MCO Contracts, the MCOs have agreed to indemnify the State and IDHFS, and the MCOs' receipts of capitated payments are deemed payments in full. (Stips. ¶¶43, 44, and 46; Stip. Ex. I at Sections 7.13, 7.14, 9.1.8, and 9.1.28; Stip. Ex. J at Sections 7.13, 7.14, 9.1.8, and 9.1.28; Stip. Ex. K at Sections 7.13, 7.14, 9.1.8, and 9.1.28). Since the MCOs' conduct cannot subject IDHFS to liability, there is no agency relationship at all, regardless of the type of agency.

There is no express actual authority because the IDHFS-MCO Contracts explicitly state that the MCOs are not the State's agents. (Stip. ¶45). There is also no implied actual authority. Midwest Medical has not provided any documentary support to show that IDHFS or the State of

[28] Notably, *Saletech* and many of the cases dealing with the concept of agency involve areas of tort law and attempts to hold a principal liable, which is not at issue in the current matters. *See, e.g., Saletech, LLC v. E. Balt, Inc.*, 2014 IL App (1st) 132639 (breach of contract); *Lang v. Silva*, 306 Il.App.3d 960 (1st Dist. 1999) (negligence); *Knapp v. Hill*, 276 Ill.App.3d 376 (1st Dist. 1995) (willful and wanton misconduct).

Illinois ever expressed, even implicitly, that the MCOs were acting as their agents.[29] Conversely, the IDHFS-MCO Contracts show that the MCOs are involved in providing additional services to Medicaid enrollees beyond what IDHFS could provide. Pursuant to the IDHFS-MCO contracts, as contractors, the MCOs perform many duties, which include providing covered services for enrollees, establishing, maintaining, and providing a provider network for enrollees, providing care coordination services, care management services, health assessments, and care planning, informing enrollees of provided services, meeting quality assurance guidelines, meeting health and safety guidelines and monitoring safety and welfare, remitting payments to providers, and entering agreements with providers. (Stip. ¶¶40, 41).[30] These additional services that the MCOs are able to provide Medicaid enrollees further support the separate nature of the MCOs from IDHFS. As Mr. Mendonsa testified:

> Q. If you could please describe for me, what's the benefit to the ultimate Medicare (sp) beneficiary of working with an MCO as opposed to using the Medicaid system beforehand without the MCO? How is it better for the ultimate consumer?
> A. The real investment was for care coordination, which really doesn't exist in fee-for-service. So if you get an individual in for fee-for-service, you're left up to your own devices. And, you know, we felt strongly that, especially in Medicaid where you have, you know, a preponderance of health issues, these people have sometimes very poor support systems. It was very important that we provided them a support structure that was done through care coordination. So each of the plans have a team of care managers that are responsible for -- you know, they stratify higher risk people that they can focus on, constantly looking at data. The other thing that the plan is much better at is the analytics are able to identify who the population needs the most kind of support. So -- and the goal was to actually – to

[29] Midwest Medical alleges in its 3 petitions: "Further, Medicaid HMO's sign a contract with the State to act as an agent for the State." (Petition 17-TT-120 ¶10; Petition 19-TT-93 ¶11; Petition 21-TT-77 ¶9). However, there has been no contract or document provided which states that the MCOs act as an agent for the State. In this regard, Robert Buikema testified that he did not know if there were contracts between the MCOs and the State of Illinois which state that the MCOs would act as agents or employees of the State. Mr. Buikema later stated that he believed there was a document stating that MCOs were acting as agents of the State, but did not know what document would state this. (Stip. Ex. D 47:20-49:9). Zachary Buikema did not know if MCOs are considered agents or employees of the State pursuant to the MCOs' contracts with the State. (Stip. Ex. E 94:13-16). Likewise, Mr. Lloyd testified that he did not know the legal standing of the MCOs in relation to the State. (Stip. Ex. F 52:7-11).

[30] Meanwhile, the duties IDHFS has to MCOs are limited to a page in the IDHFS-MCO Contracts. These duties are related to enrollment, paying the MCO, reviewing marketing materials, and providing MCOs with historical claims data. (Stip. ¶42; Stip. Ex. I Article 6 at IDORDHFS000937; Stip. Ex. J Article 6 at contract p. 82; Stip. Ex. K Article 6 at IDORDHFS001293).

> achieve is to control expenses, at the same time you have the quality of care. (Stip. Ex. G at 24:21-25:19).[31]

Mr. Mendonsa also testified that IDHFS has no responsibility to review contracts between MCOs and providers. (Stip. Ex. G. at 42:19-43:12, 46:11-24).

The detailed duties of a MCO, as stated in the IDHFS-MCO Contracts, is not unusual given the highly regulated areas of Medicaid and managed care under federal and state law.[32] Likewise, the Midwest Medical-MCO Contracts also contain many pages of duties and obligations that Midwest Medical must fulfill. These provider duties include, but are not limited to, providing covered services, maintaining proper credentials, maintaining appropriate liability insurance, complying with policies and procedures identified in the provider manuals, evaluating and ensuring quality of care and utilization management, ensuring proper claim submissions, and meeting specific federal and state regulatory guidelines. (*See, e.g.,* Stip. Group Ex. H at MIDWEST_000022-26, 38-50, MIDWEST_000055-63, 81-94, MIDWEST_000108-117, 126-132, 135-140, MIDWEST_000144-149, 157-162, 168-175, MIDWEST_000196-201, 210-211).[33] Given their separate and distinct roles and obligations under the agreements, Midwest Medical is not an agent of the MCOs and the MCOs are not agents of IDHFS.

Finally, apparent authority does not exist either. Midwest Medical has not shown that IDHFS had knowledge of the MCOs' exercise of authority, that Midwest Medical was aware of

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[31] Mr. Mendonsa also stated that prior voluntary forms of managed care existed about 20 years ago, and mandatory managed care programs began in 2011. (Stip. Ex. G at 24:1-15, 53:7-14).

[32] *See, e.g.,* Stip. Ex. I, Section 5.1, which states in pertinent part: "Contractor shall comply with the terms of 42 CFR §438.206 (b) and (c) and provide, or arrange to have provided, to all Enrollees the services described in 89 Ill. Adm. Code, Part 140, 59 Ill. Adm. Code, Part 132, the State Plan and related waivers, as amended from time to time and not specifically excluded therein in accordance with the terms of this Contract. Covered Services shall be provided in the amount, duration, and scope as set forth in 89 Ill. Adm. Code, Part 140, in 59 Ill. Adm. Code, Part 132, in the State Plan and related waivers, and in this Contract, and shall be sufficient to achieve the purposes for which such Covered Services are furnished." *See also* 42 CFR 438, which details numerous managed care requirements.

[33] The Midwest Medical-MCO Contracts also often contain provisions stating that Midwest Medical and the MCOs are not agents, employees, or representatives of each other. The relationships are that of independent contractors. There are often also "hold harmless" indemnification provisions. (*See* Stip. Group Ex. H at MIDWEST_000030-31, 67, 121, 150, 181, 204).

the facts and had a good-faith belief that the MCOs were agents, and there was detrimental reliance by Midwest Medical. As detailed above, the IDHFS-MCO Contracts expressly state that no agency relationship exists, and the Midwest Medical-MCO Contracts do not state or imply that an agency relationship exists. Additionally, IDHFS has brochures and other documentation available on its website which makes clear to Medicaid enrollees that they will be obtaining the services of MCOs (often referred to as "health plans"). This documentation discusses enrollment options and differences between Medicaid MCOs. IDHFS also provides MCO plan report cards and other documentation in order to monitor and publicly report the different benefits and performances of MCOs. (Stip. ¶55; Stip. Exs. M, N, P, Q, and R). This information also informs Medicaid enrollees of how they can contact their MCO and advises them to contact their health plan if they are changing providers, or if their providers leave the health plan's network, for example. (Stip. Exs. M, N, O). This documentation also details the services which are specific to different MCOs. (Stip. Exs. P, Q, and R). In sum, there are no documents in the record which show that the MCOs acted as apparent agents of IDHFS, and that Midwest Medical had a good-faith belief on that basis.[34]

In *Subway v. Topinka*, the Appellate Court of Illinois held that the Subway restaurant was not an agent of Illinois State University for the purpose of the applicable educational institution exemption under 86 Ill.Admin.Code 130.2005. *Subway*, 322 Ill.App.3d at 383. Subway had leased space from the university which provided the students, faculty, and staff members with a dining option aside from the university-run cafeterias. The leases provided that the relationship between the university and Subway was of lessor and lessee. The university did not assist Subway in operating or managing the four Subway restaurants on campus. The university reserved the right to review Subway's prices and menu format. The leases also expressly stated that Subway was

[34] *See also* Section VIII*, infra.*

prohibited from acting as an agent of the university, Subway functioned as a lessee and independent contractor for the university, no employee of Subway was deemed an employee of the university, Subway was required to conform to all rules and regulations of the university, the university could inspect Subway's restaurants at any time, and all disputes were required to be submitted to the university's residence hall food service director. *Id*. at 379-80.

The Court held that the educational exemption from ROT did not apply for university-issued debit card purchases at Subway because it was not acting as the university's agent. *Id.* at 383. Although the university retained certain rights to review Subway's operation, nothing in the record showed that Subway acted as the university's agent when it sold food and beverages to debit-card holders at the on-campus restaurants. In making its determination, the *Subway* Court noted: "When construing exemption provisions, we must be mindful that (1) 'taxation is the rule. Tax exemption is the exception'…, and (2) all debatable questions must be resolved in favor of taxation." *Id.* From a policy perspective, the Court also stated:

> In so concluding, we note that Subway makes several policy-related arguments in support of its contention that for-profit businesses which have contracted with a university to operate on-campus restaurants and conduct debit-card sales should be exempt from ROT for food and beverage sales to holders of university-issued debit cards… Whatever merit these assertions may possess, the appellate court is not the forum to which they should be addressed. Instead, Subway should address its proposed change in the law to the institution in this state charged with making public policy – the General Assembly. As an alternative, Subway could address its proposal to the Department.
> *Id*. at 386-87.[35]

Additionally, the U.S. Supreme Court decision in *United States v. New Mexico* 455 U.S. 720 (1982), involving contractors who had contracts with the federal government to manage certain government-owned laboratories in New Mexico, undercuts Midwest Medical's claim to the governmental body exemption. The Supreme Court determined that those contractors should

[35] *See also Continental Illinois Leasing v. Dep't of Revenue*, 108 Ill. App 3d 583 (1st Dist. 1982)(a charitable exemption from use tax did not apply because the purchasing entity was a leasing company, and not a hospital).

not be considered part of the federal government, and therefore the property the contractors purchased was not immune from state use tax, even if the contractors had procured the materials and paid for goods with federal government funds. *Id.* at 733-37. The Court discussed that the contractors were privately owned corporations, the government did not run their day-to-day operations, and the government had no ownership interests in those corporations, so the contractors could not be deemed to be "constituent parts" of the federal government. *Id.* at 740. In discussing prior precedent and in reaching its decision, the Court held:

> What the Court's cases leave room for, then, is the conclusion that tax immunity is appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned… Thus a finding of constitutional tax immunity requires something more than the invocation of traditional agency notions: to resist the State's taxing power, a private taxpayer must actually 'stand in the Government's shoes.' (citation omitted) *Id.* at 735-36.[36]

Like sovereign federal immunity, the Illinois governmental body exemption has a limited scope. In order to be determined to be an agency or instrumentality of the State of Illinois, an entity should be so closely connected to the State of Illinois that it should be deemed to be a constituent part of the State of Illinois or IDHFS, at least for the taxable activity.[37] This is simply not the case here. The MCOs are third party private insurance companies who run their own day-to-day activities and are not owned or run by the government. Therefore, the governmental body exemption does not apply to the indirect reimbursements at issue.

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[36] Additionally, in *U.S. v. New Mexico*, the contractors were not deemed subject to governmental immunity even though the funds used were federal funds. In the current matters, the state funds are even less connected to the ultimate taxpayer and the goods sold because the funds used for Medicaid reimbursements are remitted to MCOs from IDHFS via separate capitated payments. (Stip. ¶37).

[37] *See* ST 97-25, pp. 17-20, which is attached as IDOR SJ Exhibit H. ST 97-25 is a redacted version of a Department Final Administrative Decision, which contains a similar legal analysis of the *U.S. v. New Mexico* case in relation to the governmental body exemption found in the UTA.

VIII. Late Payment Penalties Should Be Assessed And Prior Department Guidance Is Consistent With The Department's Position

Late payment penalties have been assessed under the Illinois Uniform Penalty and Interest Act (the "UPIA"). 35 ILCS 735/3-1, *et seq.* No discussion of applicable penalties is contained within Midwest Medical's brief, even though all three petitions include alleged errors based on the Department's assessment of penalties, and appear to request penalty abatement based on reasonable cause.

Section 3-8 of the UPIA provides for reasonable cause abatement of penalties: "The penalties imposed… shall not apply if the taxpayer shows that their failure to file a return or pay tax at the required time was due to reasonable cause. Reasonable cause shall be determined in each situation in accordance with the rules and regulations promulgated by the Department." 35 ILCS 735/3-8. Regulation 700.400 also states: "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 the proper tax liability and to file returns and pay the proper liability in a timely fashion." 86 Ill.Admin.Code 700.400(b). "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." 86 Ill.Admin.Code 700.400(c).

Midwest Medical executed contracts with the various MCOs, not IDHFS. (Stips. ¶¶28, 30). As detailed above, Midwest Medical's principals also did not review the applicable IDHFS-MCO Contracts, which make clear that MCOs are not agents of the State. *See* Section VI, *supra*. Notably, Midwest Medical cites portions of several Department GILs in its brief. (MM SJ Memo p. 10). Midwest Medical's long-standing constructive or actual knowledge of the Department's

interpretation of the taxability of indirect Medicaid reimbursements is particularly important to the question of reasonable cause.[38]

Midwest Medical had a prior protested matter with the Department, which dealt with the proper tax rate for nebulizers, and if the nebulizers sold were "medical appliances" under the ROTA. The recommendation for disposition ("decision") is dated November 18, 2013.[39] (*See* attached IDOR SJ Ex. B, which is the redacted decision for that matter, as found on the Department's website). The holding in that matter is not at issue. Contained within the decision is the following finding of fact: "The taxpayer is compensated for 60% of its sales through reimbursements from the State of Illinois Medicaid program… The taxpayer also receives payments from Medicare and from private insurance companies… Reimbursement payments received from Medicare and Medicaid do not include Retailers' Occupation Tax." (IDOR SJ Ex. B at ¶10). Referenced after this finding of fact is a footnote which states:

> While the record contains no evidence whether Medicare and Medicaid reimbursements were included in the tax base used to arrive at the Department's assessment, it is assumed that these amounts were not taxed. **The Department has previously opined that no tax is due on payments made directly to vendors by Medicare, Medicaid or the Illinois Department of Healthcare and Family Services. See General Information Letter No. ST 11-0074 (September 13, 2011).**" (emphasis added)

ST-11-074- GIL, which is also cited by Midwest Medical in its brief, states in pertinent part:

> Under the traditional Medicare and Medicaid plan, sales made directly to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification number. See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services. This means, for example, when Medicare directly pays 80% of the

[38] Excerpts of the language from these GILs are cited in Midwest Medical's brief, without providing full context. The full language in the GILs support the Department's historical position that Medicaid payments not directly made by governmental bodies are not exempt. These GILs are attached as IDOR SJ Exhibits C, D, and E.

[39] The subsequent appeal in Circuit Court was dismissed with prejudice based on a settlement on September 28, 2015. *Midwest Med. Equip. Sols., Inc. v. Dep't of Revenue*, 2015 Ill.Cir. LEXIS 4456.

> medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. 86 Ill. Adm. Code 130.2005 and 130.2007.
>
> **It is important to note that payments will only be exempt from tax when they are paid directly to the provider/vendor by the government agency that has been issued an active exemption identification number by the Department. It is not enough that a payment to the provider/vendor is made by a patient or insurance company and then the patient or insurance company is reimbursed by the government agency.**
> IDOR SJ Ex. C (emphasis added).

ST-11-074-GIL was issued on September 13, 2011, prior to the Periods at Issue. Midwest Medical cites other GILs in its brief, including ST-11-0110-GIL and ST-12-0015-GIL, all of which are from the same general time period and have similar language. (IDOR SJ Exs. D and E). There are other earlier GILs issued by the Department, which contain some or all of this language. (*See*, *e.g.,* attached ST-09-0141-GIL and ST-06-0143 GIL at IDOR SJ Exs. F and G).[40] Therefore, Midwest Medical should have had knowledge of the Department's position prior to the Periods at Issue. At minimum, Midwest Medical should have known of the Department's position that indirect Medicaid payments were taxable when it received the Department ALJ's decision, since that decision otherwise had a substantial tax impact on its business.

Additionally, the audit history worksheets show that the first audit at issue was initiated around August 29, 2014. (Stip. Ex. A at IDOR000032). Midwest Medical discussed this governmental body exemption issue with the auditor at least as early as around May 26, 2016. (Stip. Ex. A at IDOR000033). However, the relevant audit periods for the Periods at Issue extend until April 30, 2020. (Stip. ¶86). The ROTA has a mechanism for taxpayers to file claims for taxes

[40] Midwest Medical argues in its brief that the GILs indicate that ROT on the sale price of DME is "covered" by Medicaid and exempt from ROT, even if the payments are indirect payments made by a MCO. (MM SJ Memo p. 10). Even though GILs are not binding on the Department under 2 Ill.Admin.Code 1200.120, Midwest Medical's brief mischaracterizes what the GILs state. A retailer is liable for ROT for any portions of bills not directly paid by Medicare, Medicaid, or IDHFS.

that were remitted but not owed. 35 ILCS 120/6. Instead of filing such claims, Midwest Medical chose to under-remit taxes, and thereafter protest the resulting liabilities.

In contrast to Midwest Medical's conscious decision to disregard applicable guidance, the Illinois Supreme Court found reasonable cause to abate penalties in its *Horsehead* decision based on the absence of applicable guidance. In *Horsehead*, a technical standard of what constituted a "direct and immediate change" in the UTA chemical exemption had no specific statutory definition. *Horsehead*, 2019 IL 124155, at ¶51. There was also no caselaw that Horsehead could evaluate for guidance. *Id.*

Conversely, here the Department specifically provided Midwest Medical guidance and there was Department guidance available prior to the Periods at Issue. There was also caselaw discussing the inapplicability of the governmental body exemption to indirect payments. Still, Midwest Medical did not remit the ROT due.

Midwest Medical has not demonstrated a good faith effort to determine its proper tax liabilities and pay the tax assessment in a timely manner nor did it exercise ordinary business care and prudence considering the clarity of the law. *See* 86 Ill.Admin.Code 700.400(c). Therefore, late payment penalties should be upheld as issued.

IX. Denial Of The Governmental Body Exemption Is Appropriate

The Department is not unsympathetic to Midwest Medical's business concerns. However, the application of the law is clear. Indirect Medicaid reimbursements from the MCOs are not subject to the governmental body exemption under Section 2-5(11) of the ROTA, as interpreted by Regulation 130.2080(a).

The exemption applies to payments for TPP made by governmental bodies, as specifically stated in the statute. Notably, the exemption is not specific to Medicaid, it is specific to sales made

to governmental bodies. The Illinois legislature would have explicitly stated if it intended payments for TPP from other entities to be deemed subject to the governmental body exemption. The Legislature also could have included language or another statutory provision which is more specific to Medicaid for the tax exemption sought. It did not do so.

CONCLUSION

The Department respectfully requests that summary judgment be granted in favor of the Department, that Midwest Medical be assessed for the tax, interest (which continues to accrue at its normal rate), and penalties, as stated in the three NTLs at issue, and for any other relief that is just.

Dated: March 17, 2022

Respectfully submitted,
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/s/Konstantina J. Tsatsoulis
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CERTIFICATE OF SERVICE

We, Seth J. Schriftman and Konstantina J. Tsatsoulis, attorneys for the Illinois Department of Revenue, state that we served a copy of the attached **ILLINOIS DEPARTMENT OF REVENUE'S CROSS-MOTION FOR SUMMARY JUDGMENT AND RESPONSE TO PETITIONER'S MOTION FOR SUMMARY JUDGMENT and SUPPORTING MEMORANDUM** upon:

Kathleen M. Lach
Thomas A. Laser
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By email to Kathleen.Lach@saul.com and Tom.Laser@saul.com on March 17, 2022

/s/ Seth J. Schriftman
/s/ Konstantina J. Tsatsoulis

REVENUE.

RETAILERS OCCUPATION TAX—EXEMPTIONS.

(SENATE BILL NO. 503. APPROVED JULY 13, 1953.)

AN ACT *to amend Section 2 of the Retailers' Occupation Tax Act, approved June 28, 1933, as amended.*

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

SECTION 1. Section 2 of the Retailers' Occupation Tax Act, approved June 28, 1933, as amended, is amended to read as follows:

§ 2. A tax is imposed upon persons engaged in the business of selling tangible personal property at retail in this State at the rate of three per cent (3%) of the gross receipts from such sales of tangible personal property made in the course of such business prior to July 1, 1941, and two per cent (2%) of ninety eight per cent (98%) of the gross receipts from such sales after June 30, 1941 (.) , excluding, however, from said gross receipts, commencing August 1, 1953, the proceeds of such sales to the State of Illinois, any county, political subdivision or municipality thereof, or to any instrumentality or institution of any of the governmental units aforesaid, and excluding the proceeds of such sales to any corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes. However, such tax is not imposed upon the privilege of engaging in any business in interstate commerce or otherwise, which business may not, under the constitution and statutes of the United States, be made the subject of taxation by this State.

APPROVED July 13, 1953. (Ill. Rev. Stat., Vol. 2, p. 755.)

REVENUE.

REVENUE ARTICLE REVISION COMMISSION.

(HOUSE BILL NO. 149. APPROVED JULY 13, 1953.)

AN ACT *to create a Revenue Article Revision Commission and to define its powers and duties.*

WHEREAS, at the last general election there was submitted to the voters of Illinois a proposed revision of the Revenue Article of the Illinois constitution, wh
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APPROVED July 13,

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AN ACT *to amend S*

Be it enacted by t
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civil cases appealed to said Supreme Court. The remedy herein provided for appeal shall be exclusive.

Service upon the Director of Revenue or the Assistant Director of Revenue of the Department of Revenue of summons issued in an action to review a final administrative decision of the Department shall be service upon the Department. The Department shall certify the record of its proceedings if the taxpayer shall pay to it the sum of 5c per 100 words of such record. If payment for such record is not made by the taxpayer within 30 days after notice from the Department or the Attorney General of the cost thereof, the Court in which the proceeding is pending, on motion of the Department, shall dismiss the complaint and (where the administrative decision as to which the suit for judicial review was filed is a final assessment) shall enter judgment against the taxpayer and in favor of the Department for the amount of tax and penalty shown by the Department's final assessment to be due, and for costs.

Whenever any proceeding provided by this Act shall have been begun before the Department, either by the Department or by a person subject to this Act, and such person shall thereafter die or shall become incompetent before said proceeding shall have been concluded, the legal representative of said deceased or incompetent person shall notify the Department of such death or incompetency. Said legal representative, as such, shall then be substituted by the Department in place of and for the said person. If the legal representative fails to notify the Department of his appointment as such legal representative, the Department may, upon its own motion, substitute such legal representative in the proceeding pending before the Department for the person who died or became incompetent.

Passed in General Assembly June 30, 1961.
APPROVED July 31, 1961. (Ill. Rev. Stat. Vol. 2, p. 1398.)

REVENUE.

RETAILERS' OCCUPATION TAX ACT—STATE TO PAY SALES TAX.

(HOUSE BILL No. 1609. APPROVED JULY 31, 1961.)

AN ACT *to amend Section 2 of the Retailers' Occupation Tax Act, approved June 28, 1933, as amended, for the purpose of exempting from the measure of the retailers' occupation tax the proceeds of sales to charitable, religious or educational institutions if, but only if, such sales can be exempted from the measure of that tax without*

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E TO PAY SALES TAX.

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rs' Occupation Tax Act, the purpose of exempting tion tax the proceeds of l institutions if, but only easure of that tax without

the creation of an exemption from the measure of that tax for the proceeds from sales to the United States Government, its agencies, instrumentalities or contractors.

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

SECTION 1. The General Assembly recognizes and declares that corporations, societies, associations, foundations and institutions organized and operated exclusively for charitable, religious or educational purposes relieve the State of many burdens it would otherwise be obliged to bear, and that it is in the public interest to take into account the economic effect of the fact that the actual burden of the tax imposed by this Act is passed on to, and therefore falls upon such institutions. But the General Assembly recognizes that there is judicial opinion and it is the present view and assertion of the Department of Justice of the United States that if a State exempts the proceeds of sales to charitable, religious or educational institutions from a tax that would otherwise be measured by the gross receipts from such sales, such an exemption discriminates against the United States Government and therefore operates automatically to exclude from the measure of any such tax the proceeds of sales to the United States Government, its agencies, instrumentalities or contractors with the United States Government.

The General Assembly recognizes that the United States presently assumes and bears the economic burden of taxes measured by the gross receipts from sales to or for the use of that Government except in states which tax those sales while exempting sales to other governmental bodies, charitable, religious or educational institutions, which exemptions the Department of Justice asserts and some judicial opinions hold unconstitutionally discriminate against the Government of the United States.

The General Assembly declares it to be in the public interest and the public policy of the State of Illinois to exempt from the measure of the Retailers' Occupation Tax Act the proceeds of sales to any corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes, unless the creation of such an exemption will automatically, and contrary to the intent of this Act, exempt from the measure of the Retailers' Occupation Tax Act the proceeds of sales to the United States Government, its agencies and instrumentalities and contractors with that Government.

§ 2. Section 2 of the Retailers' Occupation Tax Act, approved June 28, 1933, as amended, is amended to read as follows:

§ 2. A tax is imposed upon persons engaged in the business of selling tangible personal property at retail at the rate of 2½% of the gross receipts from such sales of tangible personal property made

in the course of such business prior to July 1, 1959, or after June 30, 1961, and at the rate of 3% of the gross receipts from such sales after June 30, 1959, and prior to July 1, 1961, excluding, however, from said gross receipts, the proceeds of such sales to any corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes. However, such tax is not imposed upon the privilege of engaging in any business in interstate commerce or otherwise, which business may not, under the constitution and statutes of the United States, be made the subject of taxation by this State.

Passed General Assembly June 30, 1961.
APPROVED July 31, 1961. (Ill. Rev. Stat. Vol. 2, p. 1389.)

REVENUE.

USE TAX ACT—STATE TO PAY TAX.

§ 1. Amends Section 3 of Act of 1955.
§ 3. Tangible Personal Property Purchased at Retail—Use Tax — Rate — Collection and Remittance—Exceptions.

(HOUSE BILL No. 1610. APPROVED JULY 31, 1961.)

AN ACT *to amend Section 3 of the Use Tax Act, approved July 14, 1955, as amended, for the purpose of exempting from the measure of the use tax the proceeds of sales to charitable, religious or educational institutions if, but only if, such sales can be exempted from the measure of that tax without the creation of an exemption from the measure of that tax for the proceeds from sales to the United States Government, its agencies, instrumentalities or contractors.*

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

SECTION 1. Section 3 of the Use Tax Act, approved July 14, 1955, as amended, is amended to read as follows:

§ 3. A tax is imposed upon the privilege of using in this State tangible personal property purchased at retail on and after August 1, 1955, from a retailer. Such tax is at the rate of 2½% of the selling price of such property if purchased before July 1, 1959, or after June 30, 1961, and at the rate of 3% of the selling price of such property if purchased after June 30, 1959, and prior to July 1, 1961: Provided that if the property that is purchased at retail from a retailer is acquired outside Illinois and used outside Illinois before being brought to Illinois for use here and is nevertheless taxable hereunder, the "selling price" on which the tax is computed shall be reduced by an amount which represents a reasonable allowance for depreciation for the period of such prior out-of-State use.

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APPROPRIATIONS.

PAROLE BOARD—COMPENSATION—ADDITIONAL APPROPRIATION.

§ 1. Appropriates $21,000. § 2. Emergency.

(SENATE BILL NO. 441. APPROVED MARCH 21, 1963.)

AN ACT *making an additional appropriation for the pay of certain officers of the State Government.*

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

SECTION 1. In addition to any sums heretofore appropriated for such purposes, the following amounts, or so much thereof as may be necessary, are appropriated to pay certain officers of the State government, in accordance with the provisions of Senate Bill 119, enacted by the 73rd General Assembly:

For the Chairman of the Parole and Pardon Board, for increased compensation, as provided by law..... $1,500

For two additional members of the Parole and Pardon Board, at the rate of $9,000 per annum, until July 1, 1963..... 6,000

§ 2. Whereas, Senate Bill 119, enacted by the 73rd General Assembly, provided for additional compensation for the member of the Pardon and Parole Board who serves as Chairman, and provided also for additional members of the Board; and, whereas, no funds are appropriated for these purposes, as enumerated in Section 1 of this Act;

Therefore, an emergency exists and this Act shall take effect immediately upon its becoming law.

Passed in General Assembly March 19, 1963.

APPROVED March 21, 1963.

REVENUE.

RETAILERS' OCCUPATION TAX—GOVERNMENTAL AGENCY EXEMPT.

§ 1. Amends Section 2 of Act of 1933.
§ 2. Imposition of tax—Exceptions.
§ 2. Emergency.

(SENATE BILL NO. 444. APPROVED MARCH 21, 1963.)

AN ACT *to amend Section 2 of the "Retailers' Occupation Tax Act", approved June 28, 1933, as amended.*

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

SECTION 1. Section 2 of the "Retailers' Occupation Tax Act", approved June 28, 1933, as amended, is amended to read as follows:

§ 2. A tax is imposed upon persons engaged in the business of selling tangible personal property at retail at the rate of 2½% of the gross receipts from such sales of tangible personal property made in the course of such business prior to July 1, 1959, or after June 30, 1963, and at the rate of 3½% of the gross receipts from such sales after June 30, 1959, and prior to July 1, 1963, excluding, however, from said gross receipts, the proceeds of such sales to any governmental body or any agency or instrumentality thereof, or to any corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes. However, such tax is not imposed upon the privilege of engaging in any business in interstate commerce or otherwise, which business may not, under the constitution and statutes of the United States, be made the subject of taxation by this State.

§ 2. Whereas, the imposing of the retailers' occupation tax on the proceeds from sales to the Federal Government is driving business out of Illinois by encouraging purchasing Federal Government agencies to make their purchases of tangible personal property outside Illinois, and since much of such selling from outside Illinois cannot be taxed under the Retailer's Occupation Tax Act because of interstate commerce, and since the use tax, which is a tax on the purchaser, cannot be imposed on such purchases without violating the doctrine of the immunity of the Federal Government from State taxation, and

WHEREAS, it is urgent that this situation be corrected as soon as possible, and

WHEREAS, there would be no reason for increasing the purchasing costs of the State of Illinois and of local governments in Illinois by taxing the proceeds from sales of the State of Illinois and to local governments in Illinois if the proceeds from sales to the Federal Government are not going to be taxed, thus making it desirable for the proceeds from sales to all kinds of governmental bodies to be exempted from tax if the proceeds from sales to the Federal Government are to be exempted from tax,

NOW, THEREFORE, an emergency exists, and this Act shall take effect upon its becoming a law.

Passed in General Assembly March 19, 1963.

APPROVED March 21, 1963. (Ill. Rev. Stat. Vol. 2, p. 1631.)

REVENUE.

SERVICE OCCUPATION TAX ACT—GOVERNMENTAL AGENCY EXEMPT.

§ 1. Amends Section 2 of Act of 1961. § 2. Emergency.
§ 2. Definitions.

(SENATE BILL NO. 445. APPROVED MARCH 21, 1963.)

AN ACT *to amend Section 2 approv*

Be it enacted by the Peop the General Assembly:

SECTION 1. Section 2 o approved July 10, 1961, is ame

§ 2. "Transfer" means of the ownership of property as security for the payment o

"Cost Price" means the a purchase valued in money, including cash, credits and se any deduction on account of or on account of any other e plier; but shall not include suppliers on account of the p the Service Use Tax Act or Tax Act or under the Cour account of the supplier's duty

"Department" means the

"Person" means any nat tion, joint stock company, joi and any receiver, executor, tr appointed by order of any cou

"Sale of Service" shall n of tangible personal property Tax Act, approved June 28, Act, approved July 14, 1955, personal property for the pur of tangible personal property for or by any governmental thereof, or for or by any co or institution organized and o or educational purposes.

The purchase, employm property as newsprint and i news (with or without other a purchase, use or sale of se shall be deemed to be intang

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"Sale at Retail" shall m tailers' Occupation Tax Act.

to governmental bodies or other exempted types of purchasers, on account of receipts from sales of tangible personal property in interstate commerce, and 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 nontaxable 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. In the course of any audit or investigation or hearing by the Department with reference to a given taxpayer, if the Department finds that the taxpayer lacks documentary evidence needed to support the taxpayer's claim to exemption from tax hereunder, the Department shall notify the taxpayer in writing to produce such evidence, and the taxpayer shall have 60 days subject to the right in the Department to extend this period either on request for good cause shown or on its own motion from the date when such notice is sent to the taxpayer by certified or registered mail (or delivered to the taxpayer if the notice is served personally) in which to obtain and produce such evidence for the Department's inspection, failing which the matter shall be closed, and the transaction shall be conclusively presumed to be taxable hereunder.

Books and records and other papers reflecting gross receipts received during any period with respect to which the Department is authorized to issue proposed assessments as provided by Sections 4 and 5 of this Act shall be preserved until the expiration of such period unless the Department, in writing, shall authorize their destruction or disposal prior to such expiration.

Passed in General Assembly March 10, 1965.
Approved March 16, 1965. (Ill. Rev. Stat., Vol. 2, p. 1961.)

REVENUE.

RETAILERS' OCCUPATION TAX — REMOVES "INSTRUMENTALITY".

(Senate Bill No. 166. Approved March 16, 1965.)

An Act *to amend Sectio*
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Be it enacted by the
the General Assembly:

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§ 2. Whereas, it is
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Passed in General A
Approved March 16

RETAILERS' OC

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An Act *to amend Secti*
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sales of tangible personal property
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taxable. In the course of any audit
Department with reference to a
finds that the taxpayer lacks docu-
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nd the taxpayer shall have 60 days
nent to extend this period either on
on its own motion from the date
payer by certified or registered mail
he notice is served personally) in
evidence for the Department's in-
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shall authorize their destruction or

larch 10, 1965.
(Ill. Rev. Stat., Vol. 2, p. 1961.)

ENUE.

– REMOVES "INSTRUMENTALITY".

§ 2. Emergency.

APPROVED MARCH 16, 1965.)

AN ACT *to amend Section 2 of the "Retailers' Occupation Tax Act", approved June 28, 1933, as amended.*

Be it enacted by the People of the State of Illinois, represented in the General Assembly:

SECTION 1. Section 2 of the "Retailers' Occupation Tax Act", approved June 28, 1933, as amended, is amended to read as follows:

§ 2. A tax is imposed upon persons engaged in the business of selling tangible personal property at retail at the rate of 2½% of the gross receipts from such sales of tangible personal property made in the course of such business after June 30, 1965, and at the rate of 3½% of the gross receipts from such sales after June 30, 1961, and prior to July 1, 1965, excluding, however, from said gross receipts, the proceeds of such sales to any governmental body, or to any corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious or educational purposes. However, such tax is not imposed upon the privilege of engaging in any business in interstate commerce or otherwise, which business may not, under the constitution and statues of the United States, be made the subject of taxation by this State.

§ 2. Whereas, it is necessary to eliminate "instrumentality" from the exemption for sales to governmental bodies in order to improve the State's chances of being sustained in the Courts in imposing the retailers' occupation tax and related taxes on sales to banks, savings and loan associations and other privately-owned financial institutions of this character,

And Whereas, the State's failure to do this would cause this State to lose substantial amounts of revenue which it needs and otherwise should and could have,

Now, Therefore, an emergency exists, and this Act shall take effect upon its becoming a law.

Passed in General Assembly March 9, 1965.

APPROVED March 16, 1965. (Ill. Rev. Stat., Vol. 2, p. 1941.)

REVENUE.

RETAILERS' OCCUPATION TAX—SECTIONS COMBINED.

§ 1. Amends Sections 1 and 3 of Act of 1933.
§ 1. Definitions. § 3. Returns.

(SENATE BILL NO. 150. APPROVED MARCH 16, 1965.)

AN ACT *to amend Sections 1 and 3 of the "Retailers' Occupation Tax Act", approved June 28, 1933, as amended.*

[redacted]

ST 14-05
Tax Type: Sales Tax
Tax Issue: Medicines & Medical Appliance Exemption (Low Rate)

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	**No. XXXX**
	Account ID XXXX
v.	**Letter ID XXXX**
	XXXX
	XXXX
	XXXX
	XXXX
	XXXX
	XXXX
	XXXX
	XXXX
	Period 1/07-5/12
ABC BUSINESS,	**Ted Sherrod**
Taxpayer	**Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Kathleen Lach, Esq. of Arnstein & Lehr LLP for ABC BUSINESS; John Alshuler, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter arose by way of requests for an initial review pursuant to 86 Ill. Admin. Code, Ch. I, section 200.175 of the Department's Notices of Tax Liability for Form EDA-105-R, ROT Audit Report issued June 8, 2011 and December 17, 2012. At issue is whether a specialized compressor device known as a nebulizer used to deliver medications to patients suffering from asthma and other lung disorders qualifies as a "medical appliance" under the provisions of 35 **ILCS** 120/2-10 of the Retailers' Occupation Tax Act, 35 **ILCS** 120/2-10.

A secondary question is whether the taxpayer should be taxed as a pharmacist under the Service Occupation Tax Act, 35 **ILCS** 115/1 *et seq.* rather than as a retailer subject to the Retailers' Occupation Tax Act, 35 **ILCS** 120/1 *et seq.* On the basis of the evidence presented at hearing in this matter, it is my recommendation that this matter be decided in favor of the Department. In support of this recommendation, the following "findings of fact" and "conclusions of law" are made.

Findings of Fact:

1. The Department's *prima facie* case, including all jurisdictional elements, was established by the admission into evidence, without objection of the Department's Notices of Tax Liability for Form EDA-105-R, ROT Audit Report covering the tax period January 1, 2007 through May 31, 2012. Transcript ("Tr.") p. 10; Department Exhibit ("Ex.") 1. Following such admission, the Department rested.[1]
2. A nebulizer is a small compressor machine used to deliver medications to patients suffering from asthma, COPD, cystic fibrosis and other lung disorders. Tr. pp. 15-18, 20. Its principal function is to break down and dilute medications into an aerosol mist that contains particles small enough to pass through constricted air passages of persons suffering from lung health disorders. *Id.* The medications delivered using a nebulizer widen airways to allow greater flow of oxygen into the lungs and reduce lung inflammation. Tr. pp. 19, 20.
3. Patients having cystic fibrosis and pediatric asthma patients would suffer fatal lung malfunctions without the multiple daily use of a nebulizer to deliver drugs and other

[1] Under applicable statutory and case law, the Department is not required to do anything more to establish its *prima facie* case. See 35 ILCS 120/4, 5; A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988).

pharmaceuticals. Tr. pp. 19, 22, 35. Use by such patients varies from two to twelve times a day. Tr. pp. 27, 28. Because 98% of the patients to whom the taxpayer dispenses nebulizers are children, patients in this category constitute at least 98% of the taxpayer's clientele. Tr. p. 49.

4. Nebulizers are frequently used to administer medications in crisis situations when a patient cannot breathe and is losing oxygen levels rapidly. Tr. p. 17.
5. The taxpayer, a corporation registered with the Department to do business in Illinois, is engaged in the business of selling and otherwise providing nebulizers to patients of medical doctors having offices and clinics in the Anywhere metropolitan area. Tr. pp. 35, 51, 54, 59. The taxpayer also provides services related to its nebulizer sales including training in the use of such equipment, equipment repair and customer inquiry assistance. Tr. pp. 25, 30, 39, 40; Taxpayer's Ex. 1, 2, 5, 6.
6. John Doe is the President and principal owner of the taxpayer. Tr. p. 30. The shares of the corporation that he does not own are owned by other members of his family. *Id.*
7. The taxpayer is licensed to engage in the distribution and sale of medical devices by the Taxpayer Commission on Accreditation of Health Organizations. Tr. pp. 45-50.
8. The taxpayer's primary source of income is from the sale of nebulizers. Tr. p. 59.
9. The nebulizers the taxpayer offers are provided to its patients by the taxpayer only when their use is prescribed by a physician. Tr. p. 40.
10. The taxpayer is compensated for 60% of its sales through reimbursements from the State of Illinois Medicaid program. Tr. pp. 48-50. The taxpayer also receives payments from Medicare and from private insurance companies. Tr. pp. 42, 59, 60. Reimbursement

payments received from Medicare and Medicaid do not include Retailers' Occupation Tax. Tr. pp. 42, 67, 68.[2]

11. No Retailers' Occupation Tax was paid on nebulizer sales made by the taxpayer during the tax period in controversy. Department Ex. 1. The Department's Notices of Tax Liability are based upon its determination that the nebulizers sold by the taxpayer during the tax period in controversy were not "medical appliances" and were therefore taxable at the generally applicable state and local tax rate of 9.75%. Tr. p. 9.
12. Other than the general description of their specific purpose during the hearing, there was no testimony given or documentation offered which would tend to show that the nebulizers sold by the taxpayer substituted for a malfunctioning part of the body.

Conclusions of Law:

This case involves the application of section 2-10 of the Illinois Retailers' Occupation Tax Act, 35 **ILCS** 120/2-10 ("section 120/2-10") to nebulizers the taxpayer sold and provided to patients presenting prescriptions for such devices from physicians having practices or clinics in Illinois during the period January 2007 through May 2012. Section 120/2-10 provides in pertinent part:

> Unless otherwise provided in this Section, the tax imposed by this Act is at the rate of 6.25% of either the selling price or the fair market value, if any, of tangible personal property …
> With respect to … prescription and nonprescription medicines, drugs, medical appliances … and insulin, urine testing materials, syringes, and needles used by diabetics, for human use, the tax is imposed at the rate of 1%. (Emphasis supplied)
> 35 **ILCS** 120/2-10

[2] While the record contains no evidence whether Medicare and Medicaid reimbursements were included in the tax base used to arrive at the Department's assessment, it is assumed that these amounts were not taxed. The Department has previously opined that no tax is due on payments made directly to vendors by Medicare, Medicaid or the Illinois Department of Healthcare and Family Services. See General Information Letter No. ST 11-0074 (September 13, 2011).

The taxpayer filed its returns without reporting or paying any tax on its nebulizer sales presumably based upon its assumption that section 120/2-10 provides a complete exemption for medical appliances. Department Ex. 1. However, medical appliances are not completely exempt under Illinois law, but are taxable at a reduced tax rate. *Id.* Accordingly even if the provision noted above pertaining to medical appliances is applicable in this case, as the taxpayer contends, the taxpayer would remain liable for a portion of the tax due on the nebulizers it sold during the tax period in controversy.

The Department established its presumptively correct *prima facie* case when it introduced the Notices of Tax Liability at issue into the record.[3] The burden of going forward and rebutting the Department's presumptively correct determination then shifted to the taxpayer. A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988); Central Furniture Mart v. Johnson, 157 Ill. App. 3d 907 (1st Dist. 1987); Vitale v. Illinois Department of Revenue, 118 Ill. App. 3d 210 (3d Dist. 1983). A taxpayer can overcome the Department's *prima facie* case only by producing competent evidence closely identified with the taxpayer's books and records. *Id.*

Section 120/2-10 noted above, which taxes medical appliances at the rate of 1%, does not define the term "medical appliances." It only provides that they must be for human use. However, the Department has adopted a regulation that defines this term. The applicable regulation interpreting this statutory section is 86 Ill. Admin. Code, ch. I, section 130.310(c) which, as in effect for the period at issue, provides in relevant part as follows:

(c) Medicines and Medical Appliances

[3] Pursuant to 35 **ILCS** 120/4, the Department's Notice of Tax Liability is entitled to a presumption of correctness. See Balla v. Department of Revenue, 96 Ill. App. 3d 293 (1981), wherein the Illinois Appellate Court states the following: "The Illinois legislature, in order to aid the Department in meeting its burden of proof …, has provided that the findings of the Department concerning the correct amount of tax due are prima facie correct." Balla, *supra* at 295.

> (2) A medical appliance is an item that is intended by its manufacturer for use in directly substituting for a malfunctioning part of the human body. These items may be prescribed by licensed health care professionals for use by a patient, purchased by health care professionals for the use of patients, or purchased directly by individuals. Purchases of medical appliances by lessors that will be leased to others for human use also qualify for exemption. Included in the exemption as medical appliances are such items as artificial limbs, dental prostheses and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines (including the dialyzer). Corrective medical appliances such as hearing aids, eyeglasses and contact lenses qualify for exemption. Diagnostic equipment shall not be deemed a medical appliance, except as provided in Section 130.310(d). Other medical tools, devices and equipment such as x-ray machines, laboratory equipment, and surgical instruments that may be used in the treatment of patients but that do not directly substitute for a malfunctioning part of the human body do not qualify as exempt medical appliances. Sometimes a kit of items is sold so the purchaser can use the kit items to perform treatment upon himself or herself. The kit will contain paraphernalia and sometimes medicines. An example is a kit sold for the removal of ear wax. Because the paraphernalia hardware is for treatment, it generally does not qualify as a medical appliance. However, the Department will consider the selling price of the entire kit to be taxable at the reduced rate when the value of the medicines in the kit is more than half of the total selling price of the kit.
> 86 Ill Admin. Code, Ch. I, section 130.310.[4]

In the case at hand, the taxpayer sold and provided the nebulizers at issue in this case to patients pursuant to prescriptions from physicians authorizing the use of these devices in the treatment of asthma and other lung disorders. Tr. pp. 35, 40, 51, 54, 59. As noted above, medical devices used for the treatment of patients do not fall within the definition of the term "medical appliance" contained in this regulation because the regulation expressly states that "[o]ther medical tools…that may be used in the treatment of patients but do not directly substitute for a malfunctioning part of the human body do not qualify as exempt medical appliances." Moreover,

[4] Effective in 2010, the Department revised section 130.310 from one that addressed food, drugs and medical appliances to one that addressed only the types of property that would (or would not) be considered food subject to tax at the low rate. 34 Ill. Reg. 12935, 12946-71 (issue 36) (September 3, 2010)(effective August 19, 2010). It removed the medicine and medical appliance subsections that were previously included within section 130.310, and substantially rewrote those subsections within a newly numbered regulation section 130.311, bearing the heading, "Drugs, Medicines, Medical Appliances and Grooming and Hygiene Products." 86 Ill. Admin. Code, ch. I, section 130.311(2010); 34 Ill. Reg. 12963-71.

a perusal of regulation 130.310(c) noted above indicates that neither the nebulizer at issue nor any similar device is expressly mentioned in this regulation as falling within the Department's definition of a "medical appliance." The failure to specifically enumerate either the nebulizer or any other device used for a similar purpose in the list of items that qualify for the reduced tax rate as "medical appliances" is additional and persuasive evidence that this device is not the type of item contemplated by section 120/2-10 or the regulation defining the term "medical appliances" noted above for taxation at the low rate.

Furthermore, notwithstanding the foregoing, the taxpayer introduced no evidence nor offered any expert opinion that the nebulizers at issue substitute for any malfunctioning human systems or body organs which is a prerequisite to coming within the definition of "medical appliances" under the aforementioned regulation. Although testimony was offered to explain what a nebulizer device is and how it is used, there was no statement, medical conclusion or other indicative evidence that would establish a direct or inferential qualification of nebulizers under this criteria of the regulation. As a consequence, the taxpayer has not overcome the presumption of correctness with respect to the Department's classification of the nebulizers at issue as taxable at the high rate. Accordingly the taxpayer's attempt to qualify the taxpayer's nebulizers as a medical appliance must be denied.

Taxpayer's right to be taxed under the Service Occupation Tax

The taxpayer also contends that it should be taxed as a pharmacist under the Service Occupation Tax Act because, like a pharmacist, it is licensed to dispense medical devices to patients pursuant to prescriptions it receives from physicians. Tr. pp. 53-74; Taxpayer's Brief pp. 6, 7. The Service Occupation Tax ("SOT") Act, 35 **ILCS** 115/1 *et seq.*, is a tax on persons making sales of a service. The SOT is intended to place service providers on a tax parity with

retailers to the extent they transfer tangible personal property to the ultimate consumer as an incident to the sale of service. A.R. Barnes & Co., *supra* at 829. The SOT is a tax on the cost to service providers (servicemen) of tangible personal property transferred as an incident to such sale. Hagerty v. General Motors Corp., 59 Ill. 2d 52, 55 (1974).

Regulation 130.2035 (86 Ill. Admin. Code section 130.2035), which makes the SOT applicable to certain prescription sales is only applicable to registered pharmacists and druggists that are licensed to practice pharmacy. The taxpayer, by its own admission, is not owned or operated by a registered pharmacist or druggist licensed to practice this profession. Tr. p. 51. Accordingly, the application of the tax methodology used by pharmacists to the taxpayer is not authorized by the Department's regulations.

Moreover, as a general rule, the Retailers' Occupation Tax ("ROT") applies to all sales at retail unless the taxpayer produces evidence in the form of books and records to show that the sales are not subject to ROT. H.D., Ltd. v. Department of Revenue, 297 Ill. App. 3rd 26, 34 (2d Dist. 1998). Section 4 of the Retailers' Occupation Tax Act provides that the certified copy of the notice of tax liability issued by the Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 **ILCS** 120/4. Once the Department has established its *prima facie* case by submitting the notice of tax liability into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. A.R. Barnes & Co., *supra* at 832. To prove its case, a taxpayer must present more than its testimony denying the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217 (1st Dist. 1991). The taxpayer must present sufficient documentary evidence to support its claim. *Id.*

In the instant case, the only evidence in the record to support the taxpayer's claim that it is entitled to be taxed under the SOT is testimony by its accountant, Robert Lloyd, a certified public accountant, giving reasons why he believes the taxpayer should be taxed under the SOT. Tr. pp. 53-74. Since this testimony is not corroborated by any documentary evidence, it is insufficient to rebut the Department's *prima facie* correct determination that the taxpayer was properly taxed under the Retailers' Occupation Tax Act.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's Notices of Tax Liability at issue in this case be upheld.

T**ed Sherrod**
Administrative Law Judge

Date: November 18, 2013

ST 11-0074-GIL 09/13/2011 EXEMPT ORGANIZATIONS

Please be advised retail sales made directly to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented. See 86 Ill. Adm. Code 130.2080(a). (This is a GIL.)

September 13, 2011

Dear Xxxxx:

This letter is in response to your letter dated August 24, 2011, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

> The purpose of this letter is to request information regarding the application of Illinois sales tax to sales of medical supplies made to Medicare patients. Specifically, we are requesting a **General Information Letter** regarding the application of Illinois sales tax on sales of medical supplies to patients covered under Medicare Part A and Medicare Part B.
>
> Based on previous GILs issued by the Department specifically addressing Medicaid and Medicare patients (ST 10-0098-GIL, ST 09-0141 GIL, and ST 99-0147-GIL), we understand that sales made to the federal government are exempt from tax as sales made to a government body. Such exempt sales must be documented through the use of an active exemption identification number.
>
> Under the traditional Medicare and Medicaid plan, sales made to Medicare and Medicaid are exempt from tax as sales to a government body. No tax is due on payments made directly to vendors by Medicare or Medicaid. However, tax is due upon any portion of the bills paid by individuals not covered by Medicare or Medicaid. (See ST 09-0141 GIL) While the statement extracted from the GIL may be read in one of two ways, it appears that the Department means to associate 'not covered by Medicare or Medicaid' to the 'portion of the bills paid' and not to the 'individuals'.

Under Medicare Part A, all payments are made by the federal government directly to the provider/vendor. However, under Medicare Part B, payments are made by the federal government either to the patient or directly to the provider/vendor. Medicare Part B patients are covered by Medicare, irrespective of whether payments under Medicare Part B are paid to the provider/vendor or the patient.

For example, Patient X is covered under Medicare Part B where Medicare pays the vendor directly. Patient Y is covered under Medicare Part B where Medicare pays the patient. Both patients 'purchase' $100 of medical supplies. Medicare will pay 80% of the charge or $80 – either directly to the vendor for Patient X or to the patient for Patient Y.

We look forward to your clarification of the treatment of sales made to Medicare patients. If you require any additional information, please call me.

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. Please note that medicines and medical appliances are not taxed at the normal rate of 6.25%. These items are taxed at a lower rate of 1%. See the Department's regulation at 86 Ill. Adm. Code 130.310 which can be found on the Department's website.

Under the traditional Medicare and Medicaid plan, sales made directly to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification number. See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services. This means, for example, when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. 86 Ill. Adm. Code 130.2005 and 130.2007.

It is important to note that payments will only be exempt from tax when they are paid directly to the provider/vendor by the government agency that has been issued an active exemption identification number by the Department. It is not enough that a payment to the provider/vendor is made by a patient or insurance company and then the patient or insurance company is reimbursed by the government agency.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Debra M. Boggess
Associate Counsel

DMB:msk

ST 11-0110-GIL 12/29/2011 DELIVERY CHARGES

Charges designated as delivery or transportation charges are not taxable if it can be shown that they are both agreed to separately from the selling price of the tangible personal property which is sold and that such charges are actually reflective of the costs of shipping. See 86 Ill. Adm. Code 130.415. (This is a GIL.)

December 29, 2011

Dear Xxxxx:

This letter is in response to your letter dated July 12, 2011, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

> We have questions concerning sales tax law that we are asking for further clarification. An agent with the Illinois Department of Revenue said that we could request an answer from your department since they were unable to give us an answer and support the decision with information from the Department's website. Our question relates to an ophthalmology office.
>
> When applying ST10-0118-GIL 12/20/2010 Medical Appliances, we understand the following:
>
> > When health care professionals such as optometrists render service, they are not subject to Retailers' Occupation Tax liability. They are, however, subject to liability under the Service Occupation Tax Act to the extent they transfer tangible personal property incident to their rendering service.
>
> When applying ST08-00036-GIL 03/21/2008 Medical Appliances, we understand the following:
>
> > Sales made to Medicaid and Medicare are exempt from tax as sales to a government body so long as the exemption is properly documented

through provision of an active exemption identification number. While no tax may be due on payments made directly to vendors by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services. This means, for example, when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. It is important to note that payments will only be exempt from tax when they are paid directly by the government agency. It is not enough that a payment to the vendor is made by a patient or insurance and reimbursed by the government agency.

Our questions are as follows:

1. Are qualifying taxable sales, which are provided to patients covered by COMPANY State of Illinois, treated for sales tax; the same way sales to Medicaid and Medicare patients are?

2. In addition, are the excess shipping and handling charges the over actual cost taxable for Medicaid and Medicare patients?

3. If the excess shipping and handling is taxable, which sales tax rate is applied when the sales are related to qualifying medical appliances that are taxed at the lower qualifying rate?

4. When the patient's taxable co-pay is a set exact fee, are the amounts received assumed to have sales tax already included in that set amount or is the full amount received subjected to sales tax? For example: If the patient's co-pay $20.00, is it assumed that the $20 represents sales and sales tax? Or is the sale accounted for at $20 and the seller responsible to remit sales tax in addition to the $20? Please keep in mind that the seller, by contact [sic], cannot receive additional receipts and will not be paid the sales tax that should then be assessed.

Enclosed are copies of the referenced Department responses.

Thank you for your clarification and assistance

DEPARTMENT'S RESPONSE:

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information, please see the Department's Regulation at 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax which can be found on the Department's website. Sales of services by optometrists are subject to Service Occupation Tax, unless an exemption exists.

Sales to a governmental body are subject to tax unless the governmental body has an active exemption identification "E" number. If an organization or governmental body does not have an "E" number, then its purchases are subject to tax. Only sales to the organization or governmental body holding the "E" number are exempt, not sales to individual members of the organization.

Accordingly, sales made to Medicare and Medicaid are exempt from tax as sales to a governmental body so long as the exemption is properly documented through the use of an active exemption identification number (“E” number). See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare or Medicaid, tax is due upon any portion of the sale that is paid by individuals or private insurance companies not covered by Medicare and Medicaid. For example, when Medicare directly pays 80% of the total sale and the remaining 20% of the sale is paid by the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a sale to a governmental body while the 20% is taxable.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. In any event, persons making purchases from servicemen incur a corresponding Service Use Tax.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Persons making purchases from this class of registered de minimis servicemen incur the corresponding Service Use Tax on their purchases absent exemptions. The servicemen remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the tangible personal property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and

remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers, nor are they liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

Most optometrists are registered de minimis servicemen because they are generally registered under the Retailers' Occupation Tax Act because they sell other kinds of tangible personal property. (See the third method payment above.) These servicemen pay Service Occupation Tax to the Department based upon the cost price of tangible personal property transferred incident to their sales of service. If a portion of a sale of service by a registered de minimis serviceman is to an exempt organization, such as a governmental entity with an E-number, that portion of the transaction is not taxable. As a technical matter, that portion of the transaction that is not taxable represents the portion of the cost price of the tangible personal property transferred incident to the sale of service that is not subject to the Service Occupation Tax. Likewise, the remaining portion of the transaction that is taxable represents the portion of the cost price of the tangible personal property transferred incident to the sale of service that is subject to the Service Occupation Tax. However, unlike the Retailers' Occupation Tax, servicemen are not required to separately state the tax and many do not. For this reason, it may appear that they are not collecting the tax when, in fact, they may be indirectly collecting it from the individual or third party.

The Department's regulation "Cost of Doing Business Not Deductible" 86 Ill. Adm. Code 130.410, provides, in part, that in computing Retailers' Occupation Tax liability, no deductions shall be made by a taxpayer from gross receipts or selling prices on account of the cost of property sold, the cost of incoming freight or transportation costs, or any other expenses whatsoever. Costs of doing business are an element of the retailer's gross receipts subject to tax even if separately stated on the bill to the customer.

Note, if a seller delivers the tangible personal property to the buyer, and the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his or her tax liability. See the Department's regulation at 86 Ill. Adm. Code 130.415(d).

As noted in subsection (d) of Section 130.415, if the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability.

A separate listing on an invoice of such charges is not sufficient to demonstrate a separate agreement. The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice. As stated in Section 130.415 of the Department's regulations, if the charges for transportation or delivery exceed the cost of delivery or transportation, the excess amount is subject to tax.

Please be aware, however, in light of a Supreme Court of Illinois case of *Kean v. Wal-Mart Stores*, *Inc*., 235 Ill.2d 351, 919 N.E.2d 926 (2009) concerning the taxation of delivery charges, the Department is considering amending Section 130.415.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Debra M. Boggess
Associate Counsel

DMB:msk

ST 12-0015-GIL 03/16/2012 GROSS RECEIPTS

This letter discusses sales of prescription drugs by servicemen. See 86 Ill. Adm. Code Part 140. (This is a GIL.)

March 16, 2012

Dear Xxxxx:

This letter is in response to your inquiry of recent date, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

> I am the president and the majority owner of PHARMACY and in June of 2011 I received a call in regards to an audit of our business for the tax period July 1, 2008 to December 31, 2010. On the first day I was under the understanding that Medicaid and Medicare were exempt from sales tax which is 90% of my business. I was not aware that Medicare Part D is not considered Medicare since it is enforced by private insurances [sic] companies (PDP's). Only way I was able to change by [sic] belief was attempt [sic] to collect from a Part D plan. I had to call the software company (who questioned why I was doing this) and had them create a segment in the adjudication part of the claim and put in a 1% sales tax and then sent the claim electronically and in disbelief the insurance actually paid the sales tax. At that time I had to believe that indeed the Medicare part D plans pay sales tax at 1%. As I investigated further I pulled some old EOB's (explanation of benefits) from some commercial insurances. I found that they had already been paying a tax. So now at this time I know that not only the commercial insurances had been paying taxes but now I can bill the tax to the Medicare Part D plans and get reimbursed the tax. But, here is where the irritation starts. I had never sent a claim to a commercial insurance with a sales tax in the adjudication. I had to get the software company to put that in the claim segment. So the question is why were the commercial insurances paying a sales tax automatically and the Medicare Part D plans were not. I understand when the Medicare Part D plans negotiate their agreements with each state (that have a sales tax on prescriptions) they include the tax in the pricing. By the way, Illinois is 1 of 2 states out of 50 that even charge a sales tax

on prescriptions. Here is where the problem lies. That is my money that the plans kept prior to us fixing our system so we could charge taxes. I paid the taxes due and penalties and interest out of our bottom line since I had never collected from Part D plans. I want my money! The PDP's are keeping something that does not belong to them.

If a commercial insurance already paid taxes without us even charging it on the prescription then they obviously knew there is [sic] a tax in Illinois. Why are the Medicare Part D plans getting away with it! I even called a pharmacy in Missouri to make sure they do not get taxes on prescriptions. They looked at a commercial insurance EOB to make sure it was not some other fee and that they did not get tax paid. They indeed did not get a tax reimbursement because there is not a tax in Missouri. I can guarantee that #1 a majority of the pharmacies in Illinois are not aware of a sales tax and #2 they are not collecting it from the insurances and #3 they are not paying the proper taxes. I called 5 fellow pharmacists that own their own pharmacies and 3 pharmacies are not even paying a 1% sales tax the proper way. There were 3 different methods to the madness on how they calculated it. Two pharmacies which had been audited in the past knew about the tax, and all 5 of them had no idea that they could collect the tax from the Medicare Part D plans by having their software vendor put it in the adjudication.

The tax is collectable but my problem is that I need a letter from the Illinois Department of Revenue that states it is a sales tax so I can continue my journey on this to the Medicare Part D plans who owe the money to my business. They are knowingly getting money in the negotiated price to cover the State of Illinois tax and keeping it because a majority of pharmacies do not know that they can collect it. The reality in pharmacy is the margins of profit are ridiculously low. Everyone has an insurance plan there are very little cash paying customers it is a struggle to keep a business open that is independently owned and operated. I am trying my best to keep 23 employees employed but it will not continue to happen with the shrinking margins. I am trying to support the State of Illinois but we are being taxed to death. I am taxed on the income of this business 3 times. The business pays a 1.5% tax on the income, the business pays 1% on prescriptions and I pay personal income tax on my % of the company. I get very little monetary benefit from owning my own business just satisfaction that I run a good business and have very little turn over on staff and clients. That is something I am proud of. What I am not proud of is the fact that I never knew there was a tax on prescriptions but in my defense not too many other pharmacists know [sic] that either until they were audited. I blame my self [sic] and my accountant.

Several things need to happen.

#1 there needs to be a formula derived that everyone follows to pay the taxes properly or consistently so it is fair to all. The software does not make it easy to just run a report for sales tax collected. That would be the simple way and I am still working on that with the vendor.

#2 The Department needs to inform their staff about the taxes on prescriptions they have no clue about it or even how it should be calculated. I purposely have called on several different occasions and asked what the sales tax on prescriptions is and I have been told "there is not a tax on prescriptions". So not only does the department not know there is a tax on prescriptions do you really think they can tell me how to calculate it!

#3 the service occupation tax (SOT) needs to be null and void. This de minimus and not de minimus stuff for pharmacists is stupid and outdated. That worked well in the 80's but come on seriously let's update a little! According to the Department on how to calculate tax based on SOT. [sic] This is the third way that is recommended to pay a service tax:

> The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may Qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts Production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.10

Really can this be anymore [sic] ridiculous to understand! I can guarantee you that no one or very few know how to pay unless they were audited. BECAUSE WE DIDN'T KNOW! My accountants and other accountants don't even know!

#4 the ST-1 tax form which is for sales tax is going to have to be different for a pharmacy. If you are going to have a tax on prescriptions then have a form that pertains to pharmacy only. The one now is more complicated than it has to be. Every tax in the State of Illinois is more complicated then [sic] it has to be!

Finally, if you expect for small businesses to still do business in this fine State that we live in then you are going to have to quit taxing so much. Our margins are shrinking daily there is no more or very little cash paying customers, everyone has an insurance of some sort probably 99% of the population has something. This state loves to give out Medicaid like throwing candy off a float but cannot pay their vendors in a timely manner.

We do not determine the price that we are reimbursed by the insurances, PDP'S, Medicare or Medicaid. They do. Let us bring up the lovely State of Illinois prescription benefit for State employees (MEDCO) plan. We lose money on 90% of the prescriptions that we fill for a 90 days [sic] supply! Where is the justice in that? I am not in business to become filthy rich that would be the oil companies. Believe it or not independent pharmacies do not have much of a profit and it continues to shrink. I am in business to employee [sic] as many employees that I possibly can and help lower our State's unemployment. I am in business so I can give my staff a raise if they deserve it and free health insurance. How many businesses do that! I am in business to support the State of Illinois, but where is the support from my State when I am trying to recoup lost tax money. The Medicare part D plans should have been automatically paying the taxes like the commercial insurances have been doing.

I need a letter and assistance from the STATE to bring the Medicare Part D plans PDP's to justice. I need for the State to determine this tax as a "sales tax" because that is what it is! I am entitled to the taxes that the PDP's have been keeping since Medicare Part D started in January 1, 2006.

I am asking for the State to assist me in this task. I have been told that I need a letter from the State of Illinois stating this is a sales tax in order to continue my pursuit in retrieving lost taxes for my business.

Please let me know if this can be accomplished and what I need to do next in my mission towards justice.

Thank you in advance for you assistance.

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The tax is measured by the seller's gross receipts from retail sales made in the course of such business. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. *See* 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the retailer does not collect the Use Tax from the purchaser for remittance to the Department, the purchaser is responsible for remitting the Use Tax directly to the Department. *See* 86 Ill. Adm. Code 150.130.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

The Department's regulation at 86 Ill. Adm. Code Section 130.311 governs Drugs, Medicines, Medical Appliances and Grooming and Hygiene Products and can be found on the Department's website. Those products that qualify as drugs, medicines and medical appliances are taxed at a lower State rate of 1% plus any applicable local taxes. Those items that do not qualify for the low rate of tax are taxed at the general merchandise rate of 6.25% plus applicable local taxes.

Pharmacists who sell prescription drugs to customers are considered to be servicemen under the Service Occupation Tax Act.

Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on the cost price if they are registered de minimis servicemen; or, (4) Use Tax on the cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling

price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen do not have the option of determining whether they are de minimis using a transaction-by-transaction basis. See 86 Ill. Adm. Code 140.109.

It is my understanding that most pharmacists in this State use the third method to calculate their liability. As noted above, the third method is based upon the serviceman's cost price for the tangible personal property transferred. For example, if the serviceman paid $20 for the drugs, he will owe Service Occupation Tax based upon his $20 cost price even when he sells the drugs with a markup. It is important to stress that the third method is applicable only to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business.

Customers purchasing prescriptions from these servicemen incur a corresponding Service Use Tax liability. The provisions of the Service Use Tax Act require the pharmacists to collect this tax from their customers. See 35 ILCS 110/3-40. Servicemen can collect this tax in one of two ways: (1) they can separately state the tax from the price of the service (and must do so if requested by the customer); or (2) they can include the tax in the total price of the service. How taxes are collected by such servicemen is generally a business decision of the servicemen and is not within the jurisdiction of the Department. Traditionally, many pharmacists in this State have included tax in the total price of the service.

In general, sales made to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active

exemption identification number "(E" number). See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare or Medicaid, tax is due upon any portion of the bill paid by individuals or private insurance companies not covered by Medicare and Medicaid. This means when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. In the case of an unregistered de minimis serviceman, (see the final method above), he or she may take a pass through of the exemption when selling to Medicare or Medicaid. Such servicemen will still owe Use Tax on the portion of the cost billed to the patient. See 86 Ill. Adm. Code 140.108(a)(2)(A) and 86 Ill. Adm. Code 140.108(a)(2)(B).

The Medicare Part D Prescription Plan is organized differently. The government provides funds on a per capita basis to the Prescription Drug Providers ("PDPs"). The PDPs operate as private insurance companies under contract with the government. They, not the government, are responsible for purchasing drugs for their beneficiaries. The beneficiaries usually pay a co-pay. Since sales are made to the PDPs and not directly to the government, the drug sales do not qualify for the government tax exemption. Therefore sales of drugs are not exempt from tax under the Medicare D Plan. Please note that according to the U.S. Department of Health and Human Services, sales tax cannot be added to a beneficiary's co-payment under the Plan. As a result, sales tax is due on drugs sold under the Medicare Part D Plan, but it may not be charged to the beneficiary. The same applies to the State of Illinois Rx Program.

If tangible personal property is not sold for use or consumption, but rather, for resale, the seller may accept a Certificate of Resale from the purchaser. No tax is imposed on a sale of property purchased for resale. Illinois law requires a Certificate of Resale to contain the information set out in 86 Ill. Adm. Code 130.1405(b). An example of a sale for resale might be if you sell prescription drugs to a long term care facility, and the long term care facility sells them to their residents as part of the residents' monthly fee. Again, unregistered de minimis servicemen may not give a certificate of resale. They must pay the Use Tax to their suppliers.

Please note that there is also an exemption for prescription and non-prescription medicines and drugs sold for use by a person receiving medical assistance under Article 5 of the Illinois Public Aid Code who reside in a licensed long-term care facility, as defined in the Nursing Home Care Act. See 35 ILCS 115/3-5(13).

The Department acknowledges the complexity of determining tax owed under the Service Occupation Tax Act. The Act has evolved over time to address different circumstances faced by servicemen in different occupations. For example, pharmacists have a different threshold for determining whether they de minimis servicemen. The rules are based on Service Occupation Tax Act and cannot be changed by the Department without the General Assembly first making changes to the Act.

We apologize if the persons you contacted at the Department provided you with inaccurate information regarding the taxability of prescription drugs. However, prescription drugs have been taxed at the rate of 1% for some time. The Department's website provides resources to determine the taxability of different types of tangible personal property. The website contains links to the Department's regulations, past letter rulings, forms and instructions, bulletins and taxpayer publications. Any accountant knowledgeable about State sales taxes should have known that prescription drugs are taxed at the rate of 1%.

The Form ST-1 and instructions are continually revised to address the latest tax changes. The form makes explicit provision for the taxation of food, drugs and medical appliance at the 1% rate.

The form is designed to address all retailers and servicemen. The Department cannot possibly design separate forms for every class or type of retailer or servicemen.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Associate Counsel

RSW:msk

ST 09-0141-GIL 10/26/2009 EXEMPT ORGANIZATIONS

Please be advised retail sales made directly to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented. See 86 Ill. Adm. Code 130.2080(a). (This is a GIL).

October 26, 2009

Dear Xxxxx:

This letter is in response to your letter dated August 31, 2009, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am the Controller for COMPANY.

My Company is a nationwide company, based out of STATE, providing billing services to physicians who dispense medications(s) to their Workers' Compensation patients. The patient obtains the medication(s) at the physician's practice with no out of pocket cost to the patient. My Company then bills the Workers' Compensation carrier who, in turn, pays for the medication.

It is our understanding that federal programs such as Medicaid/Medicare and Workers' Compensation are exempt from paying the 1% sales tax on prescription drugs in the state of Illinois. Would you kindly provide me, or direct me to, a copy of the exemption?

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. Please note that medicines and medical appliances are not taxed at the normal rate of 6.25%. These items are taxed at a lower rate of 1%. See the Department's regulation at 86 Ill. Adm. Code 130.310 which can be found on the Department's website.

Items subject to this lower tax rate include prescription and nonprescription medicines, drugs, medical appliances, and insulin, urine testing materials, syringes, and needles used by diabetics, for human use. Note, beginning September 1, 2009, nonprescription medicines and drugs subject to the

lower tax rate do not include grooming and hygiene products (e.g., shampoo, toothpaste, mouthwash, antiperspirants, soaps and cleaning solutions) even if those products make medicinal claims. A medical appliance is defined as an item which is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body. See part (c) of Section 130.310. Medical devices that are used for diagnostic or treatment purposes do not qualify for the lower tax rate.

Under the traditional Medicare and Medicaid plan, sales made to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification number. See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services. This means, for example, when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. 86 Ill. Adm. Code 130.2005 and 130.2007.

It is important to note that payments will only be exempt from tax when they are paid ***directly*** by the government agency that has been issued an active exemption identification number by the Department. It is not enough that a payment to the vendor is made by a patient or insurance company and reimbursed by the government agency.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Debra M. Boggess
Associate Counsel

DMB:msk

ST 06-0143-GIL 07/13/2006 DRUGS

Sales of prescription drugs are not exempt from sales tax under the Medicare Part D Plan because these are not sales to the government. However, the Prescription Drug Provider ("PDP") rather than the insured is responsible for the tax. (This is a GIL.)

July 13, 2006

Dear Xxxxx:

This letter is in response to your letter dated March 24, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

> We are requesting a Private Letter Ruling concerning the recently enacted Medicare Part D Prescription Plan and its effect upon ABC, which conducts business in ninety-nine retail supermarkets located in Illinois. Ninety-one of these locations have a pharmacy that dispenses prescription drugs. We are inquiring about the Service Occupation Tax (SOT) that is remitted to the State of Illinois Department of Revenue each month.
>
> This is our current understanding of the SOT calculation:
>
> The sale of prescription drugs by a pharmacist when the cost of the drugs is less than 75% of its sales price is subject to the state and local SOT. The pharmacist is considered a de minimis serviceman. The tax is based on the cost of the drugs sold and applying the low tax rate in effect at the location of the sale. It is paid by a registered de minimus, such as ABC.
>
> When a prescription drug sale is made and paid for by the federal or state government, such as Medicare or Medicaid, no SOT is due on that portion paid by the federal or state government.

We have not seen any publication from the Illinois Department of Revenue that provides information regarding the Medicare Part D Prescription Plan and the Service Occupation Tax.

- **Are prescriptions sold under this plan to be treated differently from those sold under the traditional Medicare plan, specifically in regard to tax issues?**

- **Does Illinois impose a different tax liability on these prescriptions?**

ABC operates under IBT #. XYZ is the parent company of ABC.

The tax period at issue is January 2006 forward. There is a no tax audit being conducted by the Illinois Department of Revenue at this time.

There are no contracts, agreements, instruments or other documents relevant to this request.

To the best of our knowledge the department has not ruled upon on these issues and we have not submitted these issues before.

There are no trade secrets to delete from the publicly disseminated version of this letter.

DEPARTMENT'S RESPONSE

Under the traditional Medicare and Medicaid plan, sales made to Medicare and Medicaid are exempt from Retailers' Occupation Tax as sales to a government body. No tax is due on the portion of the payment made by Medicare or Medicaid. However, Retailers' Occupation Tax is due on any portion of the bill paid by the beneficiaries or a private insurance company. In other words, when Medicare pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, the 20% will be subject to sales tax. The 80% payment is a governmental payment and is not subject to the tax.

The Medicare Part D Prescription Plan is organized differently. The government provides funds on a per capita basis to the Prescription Drug Providers ("PDPs"). The PDPs operate as private insurance companies under contract with the government. They, not the government, are responsible for purchasing drugs for their beneficiaries. The beneficiaries usually pay a co-pay. Since sales are made to the PDPs and not directly to the government, the drug sales do not qualify for the government tax exemption. Therefore sales of drugs are not exempt from tax under the Medicare D Plan. Please note that according to the U.S. Department of Health and Human Services, sales tax cannot be added to a beneficiary's co-payment under the Plan. As a result, sales tax is due on drugs sold under the Medicare Part D Plan, but it may not be charged to the beneficiary. As between the beneficiary and the PDP, any sales tax due is the responsibility of the PDP. For example, a qualifying senior covered under the Medicare Part D Plan with a $10 co-pay may not be charged tax on that co-pay. Please see the Department's memo, enclosed.

Please note that servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.109. However, servicemen

no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk

ST 97-25
Tax Type: SALES TAX
Issue: Audit Methodologies and/or Other Computational Issues

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

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS,	)	
v.	)	No.
TAXPAYER,	)	IBT: NTL:
Taxpayer	)	

FINAL ADMINISTRATIVE DECISION

Appearances: Mr. Michael R. Collins of Collins & Collins, for TAXPAYER; Mr. Mark Dyckman, Special Assistant Attorney General, for the Illinois Department of Revenue.

Synopsis:

This matter comes on for hearing pursuant to the Department of Revenue's denial of TAXPAYER's Claim and Request for Review of Audit for Retailers' Occupation and Related Taxes. Taxpayer was assessed Use Tax for the audit period of September 1988 through December 1993. At issue are the questions 1) whether the taxpayers have "used" the tangible personal property purchased from suppliers so as to subject the transaction to the provisions of the Use Tax Act, 2) whether some of the materials taxed are exempt as temporary storage under the multistate exemption, 3) whether the sampling techniques done during

the audit are representative and 4) whether the taxpayer is entitled to the governmental exemption.

On September 14, 1990 taxpayer contracted with the United States Department of Energy ("USDOE") to provide research and development services and reports on the production of a multicarbonate fuel cell. This contract provided that the title to all goods purchased by the taxpayer in fulfillment of the governmental contract passed to the USDOE upon delivery to the taxpayer. Among other contentions, the taxpayer maintains these activities do not constitute a "use" under the Illinois statute because although the taxpayer uses the property in fulfillment of its contractual obligations, title rests with the USDOE.

I have thoroughly reviewed the record and with particularity all evidence admitted of record as well as the ALJ's Findings of Facts and Conclusions of Law. As a result of that review, I determine that the ALJ's recommendation that the transactions involved are not subject to the Use Tax Act is contrary to Illinois law and I cannot adopt it as the final determination of this matter.

In furtherance of my decision to reject part of the ALJ's recommendation, I adopt his findings of facts and make additional findings based upon the evidence of record. The additional findings concern other matters at issue herein. These findings are made as I have determined that the ALJ's findings are incomplete. As I do not concur with his analysis of the law, the following conclusions of law form the basis of my decision to finalize the Department's denial of taxpayer's claim for credit. I have also included in my conclusions, further discussion regarding other matters at issue.

Findings of Fact:

1. The Department's *prima facie* case, inclusive of all jurisdictional elements, was established by the admission into evidence of the Tentative Determination of the Claim for $92,665.00 for taxes paid. Dept. Ex. Nos. 1, 2.

2. The Department of Revenue ("Department") conducted an audit of TAXPAYER Corporation ("Taxpayer" or "TAXPAYER") for the audit period September, 1988 through December, 1993. Dept. Ex. No. 2.

3. In connection with the audit the auditor prepared a Global Taxable Exceptions table. The Global Taxable Exceptions represent the detail of the personal property for certain test periods. The Department annualized these test periods and assessed Use Tax against the taxpayer based thereon (hereinafter referred to as the "Assessment"). Stip ¶ 2

4. At the completion of the audit the taxpayer paid the full amount of tax contained in the assessment, that being $139,749.00. Stip. ¶ 3. Thereafter, taxpayer filed a Claim and Request for Review of Audit for Retailers' Occupation and Related Taxes. Stip. ¶ 5.

5. On September 14, 1990 the taxpayer entered into a contract with the U.S. Department of Energy Morgantown Energy Technology Center ("DOE Contract"). Stip. ¶ 8. At all relevant times the USDOE was a governmental body statutorily exempt from sales tax for tangible personal property pursuant to tax exemption identification number. Stip. ¶ 6.

6. Taxpayer's principal performance obligation under the DOE Contract was to conduct research and prepare reports for a Simulated

Coal Gas Molten Carbonate Fuel Cell Power Plant System Verification. Stip. ¶ 10.

7. The DOE Contract provides that the USDOE and taxpayer will each perform based upon a Cost-Participation arrangement. Stip. ¶ 11.

8. The DOE contract contains the following clause with regards to passage of title:

> Clause 63. Dear 952.245-5 on page 26 of the Contract Clauses (DOE SET 304) Cost Reimbursement Service Contracts of the Contract ("Clause 63") provides in relevant part:
>
> (c) Title.
>
> (1) The Government shall retain title to all Government furnished property.
>
> (2) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a
>
> direct item of cost under this contract shall pass to and vest in the Government upon the vendor's delivery of such property.
>
> (3) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon
>
> (i) Issuance of the property for use in contract performance;
>
> (ii) Commencement of processing of the property or use in contract performance; or
>
> (iii) Reimbursement of the cost of the property by the Government, whichever occurs first;
>
> (4) All Government-furnished property and all property acquired by the Contractor, title to which vests in the Government under this paragraph (collectively referred to as "Government property"), are subject to the provisions of this clause. Title to Government property shall not be affected by its incorporation into or attachment to any property not owned by the Government, nor

shall Government property become a fixture or lose its identity as personal property by being attached to any real property.

(d) Use of Government property

The Government property shall be used only for performing this contract, unless otherwise provided in this contract or approved by the Contracting Officer.

Stip. ¶ 13.

9. TAXPAYER is engaged in the business of developing for commercial application a device known as a multicarbonate fuel cell. Tr. p. 16. TAXPAYER's principal performance obligations under the contract with the USDOE were to conduct research and prepare reports for a Simulated Coal Gas Molten Carbonate Fuel Cell Power Plant System and Verification and to provide incidental materials in connection therewith. Stip. ¶ 17. Upon completion of its performance under the contract TAXPAYER provides USDOE with a written report. Stip. ¶ 18.

10. This research is sponsored by the U.S. Department of Energy (USDOE). The contract between the taxpayer and the USDOE is a cost type contract, that is, the contractor incurs costs and then is reimbursed by the USDOE. Tr. pp. 17, 18.

11. TAXPAYER is a privately owned corporation. Tr. pp. 29, 30.

12. TAXPAYER's day to day operations are not controlled by the USDOE. Tr. p. 30.

13. Taxpayer hires its own employees to conduct operations. Tr. p. 30.

14. TAXPAYER directly enters into sales contracts with its vendors. Tr. pp. 71, 72.

15. The vendors ship the materials and supplies, purchased to fulfill the obligations under the USDOE contract, to the TAXPAYER

facilities in Illinois. Tr. p. 72. Many of the materials are incorporated into fuel cell stacks. Tr. p. 42. These fuel cell stacks are used for research and testing and are never transferred to the USDOE. Tr. p. 72.

16. Vendors are directly paid by taxpayer. TAXPAYER receives invoices from the vendors and issues payment checks from its own bank account to the suppliers. Tr. p. 30.

17. Upon the vendor's delivery of the property, the taxpayer immediately tags the property with U.S. Government tags and segregates the property on its premises. Taxpayer prepares and delivers to the USDOE a monthly Property Report showing all USDOE owned property. Stip. ¶¶ 15, 16.

18. None of the materials and supplies in question were ever shipped to the USDOE facilities in West Virginia, either directly from the vendor or from TAXPAYER. Tr. p. 72.

19. The auditor reviewed invoices from the test period of September 1992 through August 1993. Tr. p. 76. Exceptions were listed on the Global Taxable Exceptions list. From this list the auditor calculated what tax should have been assessed for that test period. A percentage of error was developed and the exceptions were projected to the remaining years during the audit period. Tr. pp. 75-77.

20. TAXPAYER did not provide any resale certificates to their vendors. Tr. p. 78.

21. TAXPAYER was not registered as a reseller during the audit period. Tr. p. 78.

Conclusions of Law:

The first issue to be addressed is whether the taxpayer has "used" the tangible personal property purchased from suppliers so as to subject the transaction to the provisions of the Use Tax Act. Section 2 of the Use Tax Act ("UTA") provides the definition of use and states in pertinent part:

> "Use" means the exercise by a person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased, and does not include the use of such property by its owner for demonstration purposes: Provided that the property purchased is deemed to be purchased for the purpose of resale, despite first being used, to the extent to which it is resold as an ingredient of an intentionally produced product or by-product of manufacturing. "Use" does not mean the demonstration use or interim use of tangible personal property by a retailer before he sells that tangible personal property. ... "Use" does not mean the physical incorporation of tangible personal property, to the extent not first subjected to a use for which it was purchased, as an ingredient or constituent, into other tangible personal property (a) which is sold in the regular course of business or (b) which the person incorporating such ingredient or constituent therein has undertaken at the time of such purchase to cause to be transported in interstate commerce...

35 **ILCS** 105/2. (*formerly*, Ill. Rev. Stat. 1991, ch. 120, ¶ 439.2).

Taxpayer asserts that its conduct with regards to the property at issue does not constitute a "use" under the statute. Taxpayer focuses

on the language "incident to the ownership of that property" in Section 2 of the UTA and contends that the government, the eventual legal title holder, is the "user" of the property within the meaning of the Use Tax Act. Taxpayer maintains it cannot be the "user" of the property since TAXPAYER is not the owner and does not possess any control incident to ownership over that property. Taxpayer Brief p. 8.

The taxpayer's contention that the government, as the title holder, is necessarily the "user" of the tangible personal property is predicated on Telco Leasing, Inc. v. Allphin, 63 Ill. 2d 305 (1976) and Philco Corp. v. Dept. of Revenue, 40 Ill. 2d 312 (1968). In both Telco Leasing and Philco the Court affirmed the imposition of the use tax on the lessor, as the owner of the property and the party exercising dominion and control, rather than upon the lessee who was merely using the property and had no powers incident to ownership.

In Telco, the lessor sought to avoid the assessment of use tax on property leased to not-for-profit institutions. Telco (the lessor), purchased the equipment only after the not-for-profit institution placed an order. The lessor never actually took physical possession of the equipment, as it was delivered directly to the not-for-profit lessee. The lease also provided that the lessee bore the burden of all use taxes. In spite of these factors, the court found that based upon a statutory analysis of the definition of "use" the owner and lessor of the property was the "user" within the meaning of the Use Tax Act. Telco, at 309. The Telco court observed: "[T]he right or power exercised by the plaintiff incident to its ownership of the

property in question is the right or power to lease the property in an attempt to make a profit." *Id.* at 310.

In Philco, *supra*, another case where the Court affirmed the imposition of the use tax on the lessor, the Court looked to the Supreme Court of California's holding in Union Oil Co. v. State Board of Equalization, 386 P. 2d 496, (1964), appeal dismissed, 377 U.S. 404, a case which presented the same issue and where the California court said: "[O]wnership is not a single concrete entity but a bundle of rights and privileges as well as of obligations. It finds expressions through multiple methods. One such method is the lease. ... *Id.* at 500.

The case at hand is not analogous to the facts present in either Telco Leasing, or Philco. Both of these cases deal with lessor/lessee relationships. Taxpayer tries to align itself with the lessee in this situation and thus, escape liability. However, several important facts distinguish the cases cited from the case at hand. In fact, when examined closely, they show that TAXPAYER's dominion and control more closely reflect that of the lessor, the party the courts in both Telco and Philco found to have properly borne the use tax burden.

TAXPAYER contracts directly with the suppliers to purchase goods, as do the lessors. The items are directly invoiced to TAXPAYER and TAXPAYER buys the goods with its own funds. The same is true as to the lessors in Telco and Philco. TAXPAYER exercises its dominion and control by choosing to contract directly with the USDOE and agreeing to transfer legal title to the Government. Aside from taxpayer's physical use of the property, its power to transfer legal title is

akin to the lessor's power to lease and constitutes a use incident to ownership under the statute.

Taxpayer asserts that title passes directly to the government and it is, therefore, never the owner of the property in question. The record reflects, however, that it is even the taxpayer's secretary and general counsel's own understanding that under the property clause of the contract the contractor purchased the property and subsequently resold it to the U.S. Government. Tr. pp. 24, 25. The mere fact that the taxpayer chose to enter into a contract with the government to subsequently transfer title does not change the substance of the initial transaction. Looking to the realities of the transaction, the consideration for the purchase of goods by the taxpayer ran from the taxpayer to the vendors, not the government to the vendors. TAXPAYER, issued the purchase orders, paid the vendors with its own funds and consequently had the unlimited right to take title to the goods purchased. Taxpayer purchased these supplies from the vendors directly to fulfill its own contractual obligations.

The taxpayer notes that the government ultimately bears the burden of the use tax. However, this is of little significance because there is no indication that the legislative intent was to exempt a corporation from payment of the use tax merely because the taxpayer might pass this financial obligation on to the USDOE. *See*, Telco Leasing, *supra* at 311. (Court did not find evidence that the legislative intent was to exempt corporations from the imposition of use tax even when the burden of the use tax was passed on to a charitable institution.) When tangible personal property is sold and directly invoiced to the government it is put to an exclusively exempt

purpose. Here, that is not the case. Taxpayer 1) directly purchased goods it needed to satisfy its contractual obligations; 2) these goods were directly invoiced to the taxpayer, not the government and TAXPAYER, an independent, private corporation, used the property pursuant to its own considerations of how to fulfill its contract to conduct testing and providing these results to the government.

The fact that the taxpayer chose to limit its right by transferring title to the USDOE and thereafter subjecting itself to inventory control and regulation by the USDOE is also of little importance. TAXPAYER contracted directly with its suppliers and received the privilege of using the tangible personal property in Illinois without limit. The fact that it chose to subsequently transfer title is not relevant to the taxability of the initial transaction. Furthermore, when contracting with its vendors, taxpayer exercised its power to use the property of its own choice for its benefit. Taxpayer's benefit was his ability to enter into contracts with regards to the materials and supplies in question to ultimately carry on its business operations.

Taxpayer's second argument that a sale for resale has occurred is also without merit. Section 120/1 of the Retailers' Occupation Tax Act defines a sale at retail as any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration: ... ." 35 **ILCS** 120/1.

It is well established in Illinois that a contractor uses or consumes the materials purchased to satisfy a contractual obligation and does not make a sale at retail. Modern Dairy Co. v. Department of Revenue, 413 Ill. 55 (1952). In Modern Dairy, the court stated:

> Considering the purpose of the Retailer's Occupation Tax Act, it is reasonable to assume the legislature intended the term "use" to include any employment of a thing which took it off the retail market so that it was no longer the object of a tax on the privilege of selling it at retail.

Id. at 67.

The Illinois Supreme Court has also established that a construction contractor is the user of tangible personal property when it takes materials off the market as tangible personal property and converts them into real estate. G.S. Lyon & Son Lumber and Manufacturing Company v. Department of Revenue, 23 Ill. 2d 177 (1961). This principle was recently affirmed by the Fourth Appellate District in Craftmasters v. Department of Revenue, 269 Ill. App. 3d 934 (4th Dist. 1995). Although the taxpayer herein does not actually incorporate materials into real estate, the basic principle that a use of the materials takes the item off the retail market and precludes a sale at retail still holds true.

Further, the object of the contract between the USDOE and the taxpayer was not to build property for resale to the government. The USDOE has no interest in securing possession of the actual materials and supplies in question. At the time of purchase, the taxpayer's intent is to purchase materials to enable it to fulfill its contractual obligations to the USDOE. It conducts research and

development pursuant to the contract, compiles the results into a report and hands this report over to the USDOE. It is these testing reports which are of value to the government, not the actual materials and supplies. The record reflects that the taxpayer never gives up possession of the tangible personal property to the USDOE. Nor does the contract even address in detail what should be done with the property after the testing is completed, in fact, many of the items are consumed during the testing process itself. Thus, it is quite clear that the USDOE's objective is not to acquire the materials or supplies.

Taxpayer's argument that a sale for resale has occurred is further undermined by two important points: 1) taxpayer is registered as a business/professional service corporation, not a retailer, and 2) no resale certificates were provided by the taxpayer to its suppliers as required pursuant to statute. *See*, 35 **ILCS** 120/2c.

Another issue to be addressed is whether some of the materials taxed qualify under the temporary storage exemption. The temporary storage exemption provides:

> The temporary storage, in this State, of tangible personal property that is acquired outside this state and that, after being brought into this State and stored here temporarily, is used solely outside this State or is physically attached to or incorporated into other tangible personal property that is used solely outside this state, or is altered by converting, fabricating, manufacturing, printing, processing, or shaping, and, as altered, is used solely outside this State.

35 **ILCS** 105/3-55(e).

Taxpayer argues that this exemption applies because the purchased materials were eventually shipped to California and incorporated into multicarbonate fuel cell stacks for research and testing and, therefore, were only temporarily stored in Illinois.

Taxpayer has failed to rebut the *prima facie* correctness of the tentative determination of the claim with respect to proving such items fall under the temporary storage exemption. Pursuant to Illinois statute and case law, the Claim Denial is *prima facie* correct and constitutes *prima facie* evidence of the correctness of tax due as shown therein. 35 **ILCS** 120/6b; A.R. Barnes and Co. v. Department of Revenue, 173 Ill. App. 3d 826 (1st Dist. 1988). The record reflects that the stacks were constructed in Illinois. Tr. p. 26. Taxpayer has failed to present documentary evidence showing that these goods were shipped to California and, thereafter, were never returned to Illinois for further testing. Merely asserting that these items were shipped to California without further proof is insufficient to rebut the *prima facie* correctness of the Department's determinations. A.R. Barnes and Co., *supra*.

Taxpayer also raised the issue of whether the sampling techniques used during the audit were representative. As discussed above, the Correction of Returns and the Claim Denial are *prima facie* correct. *See*, 35 **ILCS** 120/4; 35 **ILCS** 120/6b; A.R. Barnes, *supra*. The taxpayer's mere assertion that these sampling techniques are not representative of the population is insufficient to rebut the *prima facie* correctness of the Department's proposed adjustments. Simply questioning the correctness of the Department's determination or denying its accuracy does not shift the burden back to the Department.

Quincy Trading Post, Inc v. Department of Revenue, 12 Ill. App. 3d 725 (1973). The Department's determinations are rebutted only after a taxpayer introduces evidence which is consistent, probable and identified with taxpayer's books and records, showing that the Department's determination is incorrect. Copilevitz v. Department of Revenue, 41 Ill. 2d 154 (1968). A taxpayer's oral testimony, without sufficient corroborative evidence, will not rebut the Department's *prima facie* case. A. R. Barnes, *supra*.

Taxpayer did not present sufficient evidence to prove that the audit methodology was incorrect and/or unreasonable. Although the taxpayer questioned the auditor regarding sampling methods, the record does not reflect any evidence which proves that the sampling method was unreasonable or that the sample was not sufficiently representative of the population.

The transaction in the case at hand does not fall within the purview of the Service Occupation Tax Act ("SOTA"). The Department's regulations provide that:

> A serviceman making a sale of service in which the cost price of tangible personal property transferred as an incident to the sale of service is less than 35% (75% in the case of servicemen transferring prescription drugs, or servicemen engaged in graphic arts production as the term graphic arts production is defined in Section 2-30 of the Retailers' Occupation Tax Act) of the total gross receipts from the transaction is not subject to Service Occupation Tax. However, the purchase of such tangible personal property by the serviceman shall be subject to tax under the Retailers' Occupation Tax and Use Tax and should be paid by the serviceman to his supplier or self-assessed and paid to the Department. ...

86 Admin. Code ch. I, Sec. 140.101; *See also*, 35 **ILCS** 115/2(g).

A serviceman who transfers tangible personal property with a cost price of less than 35% of the total gross receipts from the transaction is not subject to the service occupation tax. As clearly stated in the Department regulations, that serviceman is subject to the Retailers' Occupation Tax and Use Tax Act and should be paying tax to its supplier or self-assessing use tax and remitting it to the Department directly. If the tangible personal property's cost price was greater than 35% of the gross receipts from the transaction, the taxpayer must file returns reflecting its total receipts and indicate any receipts from exempt transactions and remit SOT to the Department. It was determined in audit that the taxpayer fell under the 35% threshold and that use tax was properly due. Taxpayer has not presented any documentary evidence which proves that its annual cost of tangible personal property is over 35% of its annual aggregate receipts from the sale of service, nor does it file returns reflecting total receipts from its sales of service and remit Service Occupation Tax ("SOT"). Thus, taxpayer has not successfully rebutted the *prima facie* correctness of the Department's determination that use tax was properly due. A.R. Barnes, *supra*.

Taxpayer, in his opening statement, also argued that the Service Use Tax ("SUT") under 35 **ILCS** 110 would preclude assessment of tax on a service provided incident to a contract with the government. In the case at hand, taxpayer is an Illinois business purchasing supplies from out of state vendors. Service Use Tax is inapplicable, in that it is a complementary tax to the SOT, and is imposed upon the privilege of using in this State property acquired as an incident to the purchase of service from a serviceman. *See,* 35 **ILCS** 115/1;

115/2. It is unclear from the record why the taxpayer argues the service use tax would be applicable under these circumstances. As discussed above, the taxpayer is not subject to SOT, rather the taxpayer should be paying tax to its supplier or self-assessing and remitting use tax to the Department. The record does not provide evidence to prove that the taxpayer should be subject to SOT or that it should be collecting SUT from its customers, thus, taxpayer has failed to meet its burden and rebut the Department's *prima facie* case.

Taxpayer also proposes that because title passes to the USDOE upon delivery of the tangible personal property to the taxpayer, the exemption pertaining to government entities applies. Section 105 of the UTA provides: "Exemptions. Use of the following tangible personal property is exempt from the tax imposed by this Act: ... (4) Personal property purchased by a government body ... ." 35 **ILCS** 105/3-5

The United States Supreme Court, faced with similar facts and circumstances, has upheld the taxing authority of the State in United States v. New Mexico, 455 U.S. 724 (1982), wherein a government contractor and the United States Department of Energy entered into a series of management contracts to manage certain Government-owned atomic laboratories.

In New Mexico, the contracts provided that title to all tangible personal property purchased by the contractors passed directly from the vendor to the Government. The Government bore the risk of loss for property procured by the contractors. Taxpayer submitted an annual voucher of expenditures for Government approval, and the agreements gave the Government control over the disposition of all

property purchased under the contracts, as well as over each contractor's property management procedures. In addition, all work done by the contractors was performed at Government facilities and the Government reimbursed the taxpayer for all state taxes paid by the contractor. Further, one of the contractor's purchase orders stated that it made purchases "for and on behalf of the Government." The contractors placed the orders with suppliers in their own names and identified themselves as the buyers. The taxpayers controlled day-to-day operations and the hiring and direct supervision of employees.

The contract in the present case is in all relevant respects identical to the ones discussed in U.S. v. New Mexico, *supra*. In one respect, however, the contracts differ. In New Mexico, the parties used an "advanced funding" procedure to pay the vendors. Creditors were paid with federal funds which had been deposited in a special account, upon which the contractors could issue a draft. Thus, only federal funds were expended when the contractors purchased supplies. In the instant case, the taxpayer writes its own checks and uses its own funds to purchase the goods. Therefore, the case at hand presents an even stronger scenario in favor of upholding the State's ability to levy the use tax.

The Supreme Court in holding that federal contractors are not immune from use tax liability stated: "[W]hereas the Government is absolutely immune from direct taxes, it is not immune from taxes merely because they have an "effect" on it, or "even because the Federal Government shoulders the entire economic burden of the levy." *Id.* at 734. In fact, it is "constitutionally irrelevant that the United States reimburses all the contractor's expenditures, including

those going to meet the tax." *Id.* (citing Alabama v. King v. Boozer, 314 U.S. 1, 62 S. Ct. 43 (1941)). Tax immunity is "appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities." U.S. v. New Mexico, *supra* at 1383.

The Use tax statute in New Mexico and Illinois are similar in purpose and intent.[1] The New Mexico statute levies a use tax equivalent in amount to New Mexico's gross receipts tax, "[f]or the privilege of using property in New Mexico." N.M. Stat. Ann. § 72-16A-7. New Mexico's tax is not imposed on the "receipts of the United States or any agency or instrumentality thereof," or on the "use of property by the United States or any agency or instrumentality thereof." N.M. Stat. Ann. §§ 72-16A-12.1, 72-16A-12.2.

TAXPAYER at no time became an "instrumentality" of the United States. Courts have considered the requisite factors in determining whether a company should be considered a federal instrumentality and have described the relationship as "virtually ... an arm of the Government." Department of Employment v. United States, 385 U.S. 359, 360 (1942), 87 S.Ct. 467. "To resist the State's taxing power, a private taxpayer must actually "stand in the Government's shoes."

[1]. New Mexico levies a use tax "[f]or the privilege of using property in New Mexico." §72-16A-7. Property acquired out-of-state in a "transaction that would have been subject to the gross receipts tax had it occurred within [New Mexico]". §72-16A-7(A)(2). Thus, like the use tax in Illinois it serves as an enforcement mechanism for the correlating gross receipts or the Illinois Retailers' Occupation Tax Act. In addition, like the Illinois use tax, New Mexico's Use Tax statute is not imposed on the "... use of property by the United States or any agency or instrumentality thereof." §§ 72-16A-12.1, 72-16A-12.2.

City of Detroit v. Murray Corp., 355 U.S. 466, 503 (1958), 78 S. Ct. 474, 467.

The record reflects that TAXPAYER is in a position almost identical to that of the contractor in U.S. v. New Mexico, *supra*, wherein the United States Supreme Court declined to find the contractor a federal agent or instrumentality of the U.S. Government. The taxpayer, an independent, privately owned company conducted its business operations in its private facilities, purchased its supplies directly from vendors with its own funds all to fulfill its contractual obligation to the USDOE. The similarity in facts between the case at hand and U.S. v. New Mexico, is unmistakable and provides clear and thoughtful insight into why the government exemption is not applicable to TAXPAYER.

A summary breakdown of the protested items on Exhibit A of the Stipulation of Facts is as follows:

Protested - (I) Incorporated into material	$507,094.00
Protested - (U) Used up during R & D	$ 607.00
Protested - (O) for "Other" reasons	$ 70,877.00

Obviously, any item which is used up in the research and development cannot be properly classified as a sale for resale. These items are consumable supplies which the taxpayer admittedly "consumes" in the testing and, therefore, can never be returned to their original condition or used again for its intended purpose. Thus, taxpayer is necessarily the "end user" of these items. Therefore, I find all items designated with a "U" on the Global Exceptions List (taxpayer's abbreviation for "used up") taxable. *See*, Stipulation of Facts, Exhibit A.

Some materials and supplies which the taxpayer has classified as being incorporated into the testing stacks are actually used up or consumed during the taxpayer's performance of his contractual obligations. The items are more properly classified as supplies or are tools or equipment which are used and never actually incorporated into the testing stacks. Although, both the items marked "I" for incorporated into and "U" for used up are deemed taxable, the following are technically used up or consumed in the process and are listed separately below for clarity:

ITEMS WHICH WERE MARKED AS INCORPORATED BUT WERE ACTUALLY USED UP OR CONSUMED DURING THE TESTING PROCESS:

DATE	NO.	VENDOR	ITEM	AMOUNT
3/5/93	30595	ABBEON CAL, INC.	PAINT PEN	7.00
8/7/92	325781	ALDRICH CHEMICAL	SODIUM PELLETS	80.00
3/2/93	007521	AUBURN MANUF	AMI-GLAS TAPE	59.00
5/5/93	52702	COOL-AMP	PLATING POWDER	288.00
3/1/93	100015456	COMPRESSOR ENG. CO.	ELEMENT, FILTER	31.00
2/9/93	100014708	COMPRESSOR ENG. CO.	FILTER, OIL	29.00
7/10/92	1193	DELTA RESOURCES	BLACK EPOXY POWDER	96.00
1/8/93	0009002	EXMET	PRODUCT: 5AL7-1/OF	1000.00
7/19/93	57286	SCOTT SPEC. GASES	CARB. MONO/NITROGEN	430.00
5/3/93	20673	JOHN DUSENBERY	RAZOR BLADE	50.00
4/20/93	20241	JOHN DUSENBERY	RAZOR BLADE	260.00
TOOLS AND/OR EQUIPMENT				
3/1/93	856340	TRAVERS TOOL CO.	DIE, HAND TAP	120.00
5/21/93	909760	TRAVERS TOOL CO.	BALL/PLUNGER	90.00
7/14/93	20101	MARTIN THIELE CO.	SOCKET CAP	18.00
5/12/93	18529	MARTIN THIELE	SOCKET CAP	57.00
10/22/92	10357	MARTIN THIELE	SOCKET CAPSCREW	525.00
12/8/92	15834	ULTRAFAB, INC.	STATIC ELIM BRUSH	210.00
12/22/93	03120	CONTAQ	LD1000-V10	1514.00

Stipulation of Facts, Exhibit A; Tr. pp. 64-71.

Other materials which were incorporated into the fuel cell stacks are taxable for the reasons discussed above. Thus, all the remaining items designated with a "I" on the Global Exceptions List (taxpayer's abbreviation for "incorporated") are taxable. *See*, Stipulation of Facts, Exhibit A.

Of the "O" property the following item was protested because tax was paid:

3/22/93 OUCO41 Premier Refrac. Flat Plate $13,408.00

A review of the invoice indicates tax was paid and thus this item should be deleted from the taxable exceptions list. *See*, Stipulation of Facts, Exhibit G.

"O" Items protested because taxpayer claims they are service invoices and do not involve tangible personal property:

4/8/93	522206	Aurora Area Express	$ 30.00
3/4/93	122166	Ideal Tool & Mfg.	$35,094.00
6/8/93	4583	McKey Perf. Nickel	$ 1,927.00
6/8/93	4584	McKey Perf. Nickel	$ 1,323.00
6/8/93	4585	McKey Perf. Nickel	$ 1,477.00

A review of the invoices indicates that the first item is freight and is therefore not taxable. *See*, Stipulation of Facts, Exhibit G. The remaining items are labor charges and are also not taxable. *Id.* Thus, all of the above items should be deleted from the taxable exceptions list.

Some remaining items marked "O" were as follows:

11/30/92	92324012801	ASTM	$ 117.00
11/04/92	923042009801	ASTM	$ 12.00
11/06/92	2242	AQA CI	$ 88.00
11/02/92	PO 004309	Amer. Nat'l Stnds	$ 50.00
11/18/92	991925	ASQC	$ 45.00

A review of these invoices and the explanation given in the transcript does not provide adequate documentation to allow these exceptions. It is unclear whether the items in question are books or periodicals. Thus, because taxpayer has not sufficiently rebutted the *prima facie* correctness of the Department's determinations, all of the remaining five invoices listed above should remain on the taxable exceptions list. *See*, Stipulation of Facts, Exhibit G.

The remaining items marked "O" on the Global Taxable Exceptions List are as follows:

12/15/92	505672	Corralloy Inc.	Alloy Sheet	7298.00
7/15/93	313-66229	Pckg Co. of Amer	Cardboard	621.00
2/8/93	12124-001	Seton Name Plate	Labels	241.00
1/5/93	10982	U.S. Corrulite	Corrulite	22187.00
12/4/92	663979	Consol. Plastics	Steel Grad	367.00

The first three items listed above are taxable for the reasons discussed in this decision. The last two items are measuring equipment which are also taxable for the reasons discussed above. The taxpayer has not offered any basis under which this equipment would qualify for an exemption nor have I found any basis in the record. Stipulation of Fact, Exhibit G.

Wherefore, for the reasons stated herein, the Department's denial of the Claim for Credit should be finalized as revised by this decision.

Date

Kenneth E. Zehner, Director
Illinois Department of Revenue