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*Illinois local sales tax liability
imposed at the location where
purchase orders are accepted*



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In brief

In a 2-1 decision, an Illinois Appellate Court judicial panel found that, consistent with the plain language of state statutory law and regulatory guidance, local sales tax situs was fixed at the locality where a taxpayer maintained its sales office and accepted purchase orders. The court acknowledged that the taxpayer intentionally structured its sales location and procedures to minimize its tax liability. However, there was nothing in Illinois statutes or regulations that supported a contrary outcome.

[[Hartney Fuel Oil Co. v. Hamer](#), Appeal Nos. 3-11-0144 and 3-11-0151, Ill. App. Ct (9/17/12)]

In detail

Hartney Fuel Oil Co. (Hartney) purchased fuel oil from large fuel suppliers and sold it to customers such as railroads, trucking companies, gas stations, and other fuel distributors. The Illinois Department of Revenue (IDOR) audited Hartney for the period January 1, 2005, to June 30, 2007, to determine the Illinois locality where Hartney had a collection responsibility for local sales taxes. At issue were three locally imposed taxes: (1) city retailers' occupation tax; (2) county retailers' occupation tax; and (3) the regional transportation authority's retailer's occupation tax. For purposes of this publication, we refer to these taxes collectively as local sales

taxes. During the audit period, Hartney maintained its corporate headquarters in Forest View, Illinois and operated a sales office in Mark, Illinois.

A third party sales agent provided Hartney with a sales representative and office space in Mark, Illinois for a fee of \$1,000 per month. There were two types of sales transactions processed at the Mark sales office: (1) daily purchase orders; and (2) long-term purchase orders. Daily purchase orders were made to established customers. The sales representative generally accepted a customer's order on the spot and arranged delivery. For activity reviewed during the audit period, the representative did not need order approval from Hartney's Forest View headquarters.

Long-term purchase orders were made to customers via long-term requirements contracts. The contracts were negotiated with customers by the president of Hartney. The president generally signed contracts and sent them to customers. Customers would send signed agreements to the Mark sales office. If the president had not signed the contract, he would travel to Mark to sign the agreement.

Audit and trial court determinations

During the audit period, Hartney reported that substantially all of its fuel sales occurred in Mark, Illinois (which did not impose local sales taxes). The IDOR issued a notice of tax liability for the audit period concluding that Hartney's intrastate sales were attributable to Forest View, not Mark. Accordingly, local sales taxes applied at an aggregate rate of 2.5% for intrastate sales attributable to Forest View, resulting in tax, interest, and penalties of over \$23 million.

The trial court reversed the IDOR's assessment, finding that: (1) daily purchase orders were completed and accepted at its dedicated sales office in Mark; and (2) long-term purchase orders became binding upon execution and return to the Mark sales office, whether first or later signed in Mark by Hartney's president. For more details on the trial court's decision, please read our [May 2011 summary](#).

Local sales tax liability is determined according to where acceptance of purchase orders takes place

The IDOR argued that there was not "enough" selling activity in Mark, Illinois to justify the trial court's finding that Mark was the relevant local jurisdiction and that the appellate court should consider the location of other activity such as where credit decisions were made and where the timing of deliveries was determined. However, the court found that the IDOR failed to cite any persuasive authority to support the application of a "totality of the circumstances" test. Accordingly, the court did not consider other selling activity advocated by the IDOR.

The court recognized that Illinois regulations create a "bright-line" test for the imposition of local sales taxes determined by "where acceptance occurs." The court afforded the regulations their plain and ordinary meaning and concluded that "[i]f Hartney accepted the daily and long-term purchase orders in Mark, then the applicable [local sales tax] liability is fixed in Mark."

Acceptance of purchase orders occurred at the sales office in Mark

The trial court found that daily purchase orders were accepted at the Mark sales office for reasons including: (1) customers were directed to place their orders with the sales office; (2) any calls to Hartney's Forest View office were redirected to Mark; and

(3) each sale was completed upon acceptance of the purchase order by the Mark sales office and no further approval, credit check, or confirmation was required or obtained from Hartney's Forest View office during the period at issue.

The trial court found that long-term purchase contracts became binding upon their execution and return to the Mark sales office, whether signed first or later signed in Mark by Hartney's president. Hartney's Forest View personnel had no customer contact other than to invoice for sales and delivery.

The appellate court could not say that the trial court's factual findings were against the manifest weight of the evidence. Because all daily and long-term purchase orders were accepted in Mark, the appellate court concluded that local sales tax liability was fixed in Mark and ruled in favor of Hartney.

In so holding, the court acknowledged that "it seems clear to us that Hartney has intentionally structured its sales locations and procedures in a deliberate attempt to minimize its tax liability. We find no indication in the statutory authority before us or in the Administrative Code of legislative intent to prohibit such business decisions."

Past taxpayer-favorable audits not reviewed by IDOR, records destroyed

Prior to the 2005-2007 audit, Hartney was audited five times where it engaged in similar operations with a sales office separate from its Forest View headquarters. While different local taxes may have been at issue in prior audits, the IDOR concluded each time that Hartney was accepting orders at its sales office and not at its Forest View headquarters. In conducting the audit at issue, the auditor did not review any of Hartney's prior audit files. Furthermore, as the audit was nearing completion, the IDOR destroyed the prior audit files relating to its investigations of Hartney.

The trial court stated that the IDOR "violated its common law duty to preserve the prior audit records." However, the appellate court recognized that the prior audits were not part of its record and therefore "the previous audits have not factored in any way into the panel's decision." However, the appellate court did appear to give some weight to the fact that past decisions by the IDOR did not attempt "to punish Hartney for its previous efforts to minimize its costs of doing business by implementation of the same sales practices employed in Mark."

Actions to think about

In this case, all acceptance activities occurred at the taxpayer's sales office. Taxpayers with similar procedures should be aware that order acceptance decisions made in locations outside the sales office could impact the location of where orders are "accepted" for local sales tax purposes. For example, the court suggested that if final approval, credit verification, or sales confirmation occurred in a locality other than the sales office, there may have been a different outcome.

Taxpayers should also recognize how tax motivated transactions are treated differently depending on whether a sales tax or an income tax is at issue. *Hartney* follows the tradition that courts are more prone to apply a form over substance analysis in sales tax cases than they are for income tax decisions. Even when a taxpayer's motivations are transparent and overtly recognized by the court - as they

were here - courts remain compelled to follow the plain language of statutes and regulations in the sales tax arena.

Finally, it appears that the rationale in the decision is not impacted by deficient audit process resulting from the IDOR's destruction of records. The court did not appear to put significant weight on the IDOR's "flawed" audit practice, but rather relied on generally applicable analytical principles that should remain equally relevant to future taxpayers.

Let's talk

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