

NOTICE

This order was filed under Supreme Court Rule 23 and may not be cited as precedent by any party except in the limited circumstances allowed under Rule 23(e)(1).

2013 IL App (4th) 121116-U

Order filed 10/23/13

NO. 4-12-1116

IN THE APPELLATE COURT

OF ILLINOIS

FOURTH DISTRICT

MATTOON KAWASKI YAMAHA, INC., an)	Appeal from
Illinois Corporation,)	Circuit Court of
Plaintiff-Appellant,)	Coles County
v.)	No. 12TX6
THE DEPARTMENT OF REVENUE; and DAN)	
RUTHERFORD, as State Treasurer of the)	Honorable
State of Illinois,)	Mitchell K. Shick,
Defendants-Appellees.)	Judge Presiding.

JUSTICE APPLETON delivered the judgment of the court.
Justices Pope and Holder White concurred in the judgment.

ORDER

- ¶ 1 *Held:* The trial court erred in granting summary judgment in favor of defendants when the record demonstrates that plaintiff's receipt of "dealer reserve payments" from the manufacturer do not constitute gross receipts from the sale of its vehicles to customers, but rather are nontaxable reimbursements from amounts previously paid as part of plaintiff's purchase of the vehicle from the manufacturer.
- ¶ 2 In November 2012, the trial court entered summary judgment in favor of defendants, the Illinois Department of Revenue (IDOR) and Dan Rutherford, State Treasurer of the State of Illinois (Treasurer) (collectively referred to as the State). Plaintiff, Mattoon Kawasaki Yamaha, Inc., appeals from the judgment, claiming the court erred in determining that, as a matter of law, the amounts returned to plaintiff by the manufacturers, Kawasaki and Yamaha, as "dealer reserve payments" constitute gross receipts subject to sales taxation by

IDOR. We reverse and remand with directions to enter summary judgment in favor of plaintiff.

¶ 3

I. BACKGROUND

¶ 4 Plaintiff sells new and used Kawasaki and Yamaha motorcycles and all-terrain vehicles. In its regular course of business, plaintiff purchases its inventory directly from each manufacturer. Plaintiff's cost for each vehicle includes a "dealer reserve payment," which is 5% of the manufacturer's suggested retail price (MSRP). Once plaintiff sells a vehicle to a customer and satisfies the dealer's specific requirements and conditions, the manufacturer will return the "dealer reserve payment" to plaintiff.

¶ 5 In January 2011, IDOR audited plaintiff and reported that plaintiff had received \$60,414.69 in "dealer reserve payments" between January 2008 and September 2010. IDOR determined such amount to be taxable under the Retailers' Occupation Tax Act (ROTA) (35 ILCS 120/1 to 14 (West 2010)), and calculated the sales tax due on that amount as \$3,775.99 plus penalties (\$1,139.51) and interest (\$391.88), for a total due of \$5,307.38. Plaintiff paid \$5,307.38 to IDOR under protest.

¶ 6 In February 2012, plaintiff filed a complaint against the State for injunctive and declaratory relief, ultimately seeking a reimbursement of the amount paid under protest. In March 2012, the trial court entered a preliminary injunction, enjoining the State from transferring the money paid by plaintiff under protest until the lawsuit is resolved. Thereafter, each party filed a motion for summary judgment.

¶ 7 Attached to the State's motion for summary judgment was the discovery deposition of Terry Glaze, owner of the dealership, together with his father. Glaze explained when he purchased a vehicle from the manufacturer, whether it be Kawasaki or Yamaha, he paid

the "dealer invoice amount." The "dealer invoice amount" included three separate amounts: (1) the wholesale cost of the vehicle, (2) shipping, and (3) the "dealer reserve payment" or "retail bonus." Glaze issued one check for the total of all three amounts and, in turn, he would receive the vehicle and the certificate of origin. Glaze explained the process and the requirements after a buyer purchased the vehicle at retail. He said: "Payoff, registration, of course everything has to be correct, and everything as to be current and no discrepancies, and if everything goes right, you should get your money back." The manufacturer would send a check back to Glaze for the amount paid as the "dealer reserve payment" included in the original dealer invoice.

¶ 8 Attached to plaintiff's motion for summary judgment was the affidavit of its accountant, Charles Winders. Winders explained the effect of the "dealer reserve payment" on plaintiff's bookkeeping records as follows:

"When [plaintiff] pays the Dealer Reserve Payment to a manufacturer, such cost, along with the net dealer cost of the vehicle and transportation charge, is included in its balance sheet as an asset under the caption "Inventory." When [plaintiff] receives a reimbursement of the Dealer Reserve Payment from the manufacturer, it includes the reimbursement as revenue on its income statement. This revenue is offset by the amount of the Dealer Reserve Payment which was previously capitalized as an asset under the caption "Inventory." For purposes of [plaintiff]'s balance sheet, the amount of the reimbursement increases its "Cash" account and decreases its "Inventory" account by the same

amount. Thus, the payment and reimbursement of a Dealer Reserve Payment has no economic effect on [plaintiff]'s balance sheet. [Plaintiff] could have separately stated its payment of the Dealer Reserve Payment on its balance sheet as a current asset and reversed the accounting entry upon reimbursement of the same. In either case, no income or loss would have been associated with its payment and reimbursement of the Dealer Reserve Payment."

¶ 9 In October 2012, the trial court conducted a hearing on the cross-motions for summary judgment. After considering the arguments of counsel, the court took the matter under advisement.

¶ 10 In November 2012, the trial court removed the matter from advisement and entered a written judgment, finding section 130.2125(e)(1) of Title 86 of the Illinois Administrative Code (the Administrative Code) (86 Ill. Adm. Code 130.2125(e)(1) (2008)) applied, causing the "dealer reserve payments" received by plaintiff from the manufacturers to qualify as "automobile dealer incentives," and thus part of plaintiff's taxable gross receipts and subject to sales tax. The court entered judgment in favor of the State and dissolved the pending preliminary injunction. This appeal followed.

¶ 11 II. ANALYSIS

¶ 12 Plaintiff argues this court should reverse the trial court's order of summary judgment in favor of the State and remand with directions for the court to enter summary judgment in favor of plaintiff because, as a matter of law, the "dealer reserve payments" should not be subject to sales tax under ROTA. We agree.

¶ 13 Our review of a grant of summary judgment is *de novo*, as it is based entirely on a question of law. *Stark Materials Co. v. Department of Revenue*, 349 Ill. App. 3d 316, 321 (2004). " '[T]axing statutes are to be strictly construed. Their language is not to be extended or enlarged by implication, beyond its clear import. In case of doubt they are construed most strongly against the government and in favor of the taxpayer.' " *Van's Material Co. v. Department of Revenue*, 131 Ill. 2d 196, 202 (1989) (quoting *Mahon v. Nudelman*, 377 Ill. 331, 335 (1941)) . The State asserts the meaning of the statute or regulation at issue is not necessarily in dispute. Rather, the State contends, it is the application of the facts of this case to the meaning of the statute or regulation which is in dispute, and therefore, the usual standard of construing the taxing statutes against the government does not apply. We disagree and find the meaning of the provision in the Administrative Code relied upon by the trial court and the State is in dispute. Each party assigns different meaning to the language set forth in the statute and regulation.

"A plaintiff taxpayer must establish by competent evidence that a return corrected by the Department is not correct, and until it provides such proof, corrected returns are presumptively correct. [Citations.] A taxpayer may overcome the presumption by presenting his books and records. [Citations.] 'As a general rule, all sales of tangible personal property are taxable unless the taxpayer produces evidence identified with its books and records to establish its claim of nonliability.' " *Stark Materials*, 349 Ill. App. 3d at 322 (quoting *Soho Club, Inc. v. Department of Revenue*, 269 Ill. App. 3d 220, 229 (1995)).

¶ 14 A decision in this case is dependent upon an understanding of (1) the nature of plaintiff's business, (2) the procedure related to plaintiff's purchase of inventory, and (3) the effect of a retail sale on plaintiff's bookkeeping. Only after we understand and analyze these things can we determine the tax consequences at issue. We believe the Fifth Circuit Court of Appeals said it best: "Tax incidence should reflect the realities of a business transaction. Here, therefore, as in many tax cases, sometimes to the benefit of the government and sometimes to the benefit of the taxpayer, it is necessary to peel off the outer layers of a business transaction and get down to its core." *Texas Trailercoach, Inc. v. Commissioner*, 251 F.2d 395, 396 (5th Cir. 1958). It is important not to be "fascinated by the form of the transaction and overlook[] the substance." *Texas Trailercoach*, 251 F.2d at 396.

¶ 15 Glaze and Winders explained the business transaction as follows. Plaintiff pays to either manufacturer, Kawasaki or Yamaha, the dealer invoiced amount. Though paid in one sum, that amount is delineated into three separate amounts: (1) the wholesale cost of the vehicle to be purchased by plaintiff, (2) the cost of shipping the vehicle to plaintiff, and (3) the "dealer reserve payment" (the amount at the center of this controversy), which equates to 5% of the MSRP. The "dealer reserve payment" is held by the manufacturer until certain conditions of a retail sale to a consumer are met by plaintiff. Then, that amount is returned to plaintiff, though not in the same form, but in the same amount.

¶ 16 Neither party presented evidence to support this theory, but we believe the nature of this transaction has two central purposes: (1) the manufacturer's general intention to control the retail sale, and (2) the manufacturer's specific intention to maintain discretionary authority over 5% of the MSRP, giving plaintiff a restricted contingent interest, until plaintiff satisfies

certain conditions in the manufacturer's favor with the goal of protecting its brand. Pursuant to their guidelines, the respective manufacturers require, *inter alia*, (1) a *bona fide* retail sale, as defined by its own specifications, (2) a sale of eligible models, (3) a certain time frame for payment and delivery of vehicle, and (4) the existence of a valid manufacturer's dealer agreement. Once the specified conditions are satisfactorily met, the manufacturer remits the "dealer reserve payment" to plaintiff. Conversely, if the conditions are not satisfactorily met, the manufacturer retains the "dealer reserve payment" and plaintiff forfeits the same. It is in the manufacturer's sole discretion to decide whether to remit or retain the "dealer reserve payment."

¶ 17 Under section 1 of ROTA, "gross receipts" are the "total selling price or the amount of such sales." 35 ILCS 120/1 (West 2010); see also 86 Ill. Adm. Code 130.401 (2000) (defining "gross receipts" as "all the consideration actually received by the seller"). The issue then becomes whether the "dealer reserve payments" are included within the "selling price." 86 Ill. Adm. Code 130.2125(e)(1) (2008). If the "dealer reserve payments" are included within the "selling price," the payment is an element of cost to the seller and the seller may not deduct such expense in computing its ROTA liability. 86 Ill. Adm. Code 130.2125(e)(1) (2008). The "selling price" is defined in pertinent part as:

"the consideration for a sale *** which *** shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever, but does not include charges that are added to prices by sellers on account of the seller's tax liability under this Act ***." 35 ILCS 120/1 (West 2010).

Here, no evidence suggests plaintiff added to the selling price the amount of the "dealer reserve payment."

¶ 18 In deciding the issue on the motions for summary judgment, the trial court relied on section 130.2125(e)(1) of Title 86 of the Administrative Code in determining that the "dealer reserve payments" are actually "incentives for the retail sale of a vehicle paid to [plaintiff] upon the basis of that sale, and qualify as part of [plaintiff]'s taxable gross receipts." We disagree.

The Administrative Code section provides as follows:

"This subsection (e) is effective for sales made on and after July 1, 2008. The taxation of automobile dealer incentives will depend upon whether the dealer receives a payment from a source other than the purchaser that is conditioned upon the retail sale of an automobile. *If an automobile dealer receives a payment as an incentive for the retail sale of an automobile, the amount of that reimbursement or payment is part of the taxable gross receipts received by the dealer for the sale of that automobile.* If a dealer receives payment in exchange for the purchase of an automobile from a supplier or manufacturer, and that payment is not conditioned upon the sale of that automobile to a retail consumer, the amount of that payment is not part of the taxable gross receipts received by the dealer for the retail sale of that automobile. The determination of taxability under the provisions of this subsection (e)(1) is not dependent on whether the retailer is required to lower

the selling price of the vehicle as a condition for receiving the incentive payment. Notwithstanding the provisions of this subsection (e)(1), the payment is not part of the taxable gross receipts from a retail sale if, at the time of the retail sale, the payment is contingent on the dealer making or having made any additional retail sales. In addition, a dealer incentive or bonus contingent on the dealer meeting certain manufacturer required marketing standards, facility standards, or sales and service department satisfaction goals is not part of the taxable gross receipts from a retail sale of vehicles sold by that dealer, even if the incentive or bonus is calculated using the gross receipts, Manufacturer's Suggested Retail Price (MSRP), or a flat amount per vehicle." (Emphasis added.) 86 Ill. Adm. Code 30.2125(e)(1) (2008).

The State relies on the emphasized sentence above. This regulation also provides six examples of taxable versus nontaxable dealer incentives payments. Generally, based on these examples, the payments are taxable as gross receipts if the payments are contingent upon a retail sale of a vehicle and increase the amount received by a dealer upon a sale. Such contingency ensures that all amounts received from all sources, whether from the retail customer or the manufacturer, by the dealer upon a sale of a vehicle, be included as receipts generated from the sale. In this vein, IDOR seeks to tax the *total* selling price. See 35 ILCS 120/1 (West 2010) (definition of gross receipts "from the sales of tangible personal property at retail means the total selling price or the

amount of such sales.") In our opinion, the "dealer reserve payments" in this case do not qualify because those payments do not *add to* the total selling price of a particular vehicle to plaintiff's benefit.

¶ 19 Example 5 set forth as part of section 130.2125(e) of Title 86 of the Administrative Code is most like the facts of this case. It provides as follows:

"An automobile manufacturer establishes a performance bonus program for automobile dealers who obtain a certain customer service index (CSI) score that demonstrates a substantial degree of satisfaction from their sales and service customers. Upon meeting the requirement, the automobile dealer will receive an incentive payment from the manufacturer calculated as 2% of the MSRP of the vehicles sold by that dealer during the incentive period. Because the bonus is contingent on the dealer meeting certain customer satisfaction goals as indicated by the CSI score, the manufacturer's performance bonus would not be part of the gross receipts received by that dealer for the sales of those vehicles." 86 Ill. Adm. Code 130.2125(e)(2) (2008).

According to Winders, plaintiff's accountant, plaintiff receives no gain or loss related to the payment and receipt of a "dealer reserve payment." He stated that "a 'dealer reserve payment' has no economic effect on [plaintiff]'s balance sheet."

¶ 20 In this case, the State has asked plaintiff to pay sales tax on money it received as reimbursement of the exact nature and the exact sum it had previously paid to the manufacturer.

The "dealer reserve payment" was not affected by the actual retail sale price but rather, it was a set percentage of the MSRP, wholly independent from the gain or loss actually realized by plaintiff in its sale of the vehicle to the customer. It is not returned to plaintiff as a gross receipt upon the sale, but as a rewarded reimbursement after the sale. In other words, the return of the "dealer reserve payment" to plaintiff was contingent only upon the *occurrence* of a retail sale, not upon the *amount* of the retail sale, it was not included in the selling price, and the same should not be included in plaintiff's gross receipts.

¶ 21 We determine the meaning of section 130.2125(e) provides that IDOR is required to tax the total amount of plaintiff's sale of a vehicle, including those payments received from sources other than the retail purchaser. Indeed, the following language in the section supports our interpretation. It sets forth: "The taxation of automobile dealer incentives will depend upon whether the dealer receives a payment from a source other than the purchaser [toward the total sale price of the vehicle] that is conditioned upon the retail sale of an automobile." 86 Ill. Adm. Code 130.2125(e)(1) (2008). We added the bracketed language to make the provision clear that these "incentives" should be taxed *only if* they supplement the purchase price of the vehicle.

¶ 22 In this case, based upon the record before us, the "dealer reserve payments" do not supplement the purchase price of the vehicle to plaintiff's benefit. Rather, at best, they reduce plaintiff's cost of the vehicle, and that is only if plaintiff satisfies the specific conditions set forth by the manufacturer. The "dealer reserve payments" do not act as additional consideration in plaintiff's agreement to sell a vehicle to a purchaser. Therefore, as a matter of law, the "dealer reserve payments" are not included in the gross receipts and should not be subject to taxation under ROTA. We find plaintiff sustained its burden in demonstrating the "dealer reserve

payments" were separate and apart from the "selling price" of a vehicle. *Cf. Stark Materials*, 349 Ill. App. 3d at 324-25.

¶ 23 Contrary to the State's argument, we find *Ogden* is not controlling. There, the court was asked to decide whether Ogden's receipt of payments from Chrysler's employee-purchase program should be included in gross receipts and subject to ROTA. *Ogden Chrysler Plymouth, Inc. v. Bower*, 348 Ill. App. 3d 944, 946 (2004). The Second District found such payments should be included in gross receipts. *Ogden*, 348 Ill. App. 3d at 956. Ogden participated in a program whereby active or retired Chrysler employees could purchase or lease Chrysler vehicles at a reduced price. The dealer received from Chrysler 6% of the employee purchase price, plus \$75 upon selling a vehicle to a participant. *Ogden*, 348 Ill. App. 3d at 947. Thus, the dealer received the total purchase price from a combination of payments from the employee and Chrysler. In other words, Chrysler's payment supplemented the payment Ogden received from the employee toward the purchase price.

¶ 24 Such is not the case here. The total purchase price of a retail sale paid to plaintiff comes solely from the customer. The "dealer reserve payment" is paid as a reimbursement of that same amount previously paid by plaintiff to the manufacturer only if plaintiff satisfactorily complies with certain conditions and requirements. The return of the reimbursement (the "dealer reserve payment") has no affect on the amount of the purchase price paid by the retail customer. The purchase price is not discounted or reduced to the customer in the amount of the reimbursement. The two amounts are wholly independent. *Cf. Ogden*, 348 Ill. App. 3d at 955 (purchaser effectively tenders a coupon to a dealer participating in the program and purchases the vehicle at a reduced price, and the dealer receives "reimbursement" as a result of providing a

reduced price). We conclude the "dealer reserve payments" should not be included as gross receipts subject to taxation under ROTA.

¶ 25

III. CONCLUSION

¶ 26 For the foregoing reasons, we reverse the trial court's order of summary judgment and remand with directions to enter summary judgment in plaintiff's favor, finding the "dealer reserve payments" plaintiff receives from the manufacturers should not be included in plaintiff's gross receipts for purposes of taxation under ROTA.

¶ 27

Reversed and remanded with directions.