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Illinois Appellate Court Holds Sale of Appliances Installed by Retailer Subject to Illinois Retailer Occupation Tax

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On June 30, 2020, the Illinois appellate court issued an order in *Best Buy Stores, L.P. v. The Illinois Department of Revenue; David Harris, as Director of Revenue, and Michael Frerichs, as Treasurer of the State of Illinois*, 2020 IL App (1st) 191680-U, Fifth Division, June 30, 2020, holding that the circuit court did not err in finding that plaintiff's sales of certain appliances are subject to the Illinois Retailers' Occupation Tax (hereafter "ROT") despite plaintiff's installation of those appliances. The appellate court also held that the Illinois Department of Revenue's (hereafter "Department") imposition of the ROT on such sales did not violate the Uniformity Clause of the Illinois Constitution.

By way of background, Best Buy Stores, L.P. (hereafter "Best Buy" or "Plaintiff") is a retailer that sells consumer electronics and appliances. As part of its business, Best Buy sometimes installs appliances in the purchasers' homes. Upon purchasing an appliance at Best Buy, the customer has 3 choices: 1) pick up the appliance at the Best Buy store and make their own arrangements for transportation and installation; 2) have Best Buy deliver but not install the appliance; or 3) have Best Buy deliver and install the appliance. If no installation, Best Buy collects and remits ROT to the Department. If Best Buy delivers and installs the appliance, Best Buy determines if the installed appliance is "incorporated into, and permanently affixed to, real estate." If the appliance is incorporated into, and permanently affixed to real estate, Best Buy does not collect ROT. Some of the items Best Buy considers to be incorporated into and permanently affixed to real estate include: built-in dishwashers, over-the-range microwaves, wall ovens, cooktops installed in counters, range hoods, built-in refrigerators, and gas range/gas dryers.

The Department issued Best Buy a notice of proposed liability, dated January 25, 2016, resulting from the Department's audit of Best Buy's July 2012 through December 2013 periods and proposing \$210,676 in

additional tax, penalties and interest. The additional tax resulted from the appliances that Best Buy had installed by not collected or remitted ROT. Best Buy requested an abatement of penalties. The Department agreed to abate the penalties and issued a new Notice of Liability on April 4, 2017 for \$192,147 of tax and interest. Best Buy paid the liability and filed a complaint under the Protest Monies Act, 30 ILCS 231/1.

Best Buy and the Department filed cross-motions for Summary Judgment. Best Buy's motion asserted that: 1) it was not required to collect and remit sales tax on the appliances it sells and installs because it is a construction contractor and not a retailer for those sales; 2) a sales tax liability is unwarranted because the appliances it installs are incidental to the installation contract and the appliances are incorporated into real estate; and 3) imposing sales tax on these types of transactions would violate the uniformity clause of the state constitution. On July 29, 2019, the circuit court issued a written order granting the Department's motion for summary judgment and denying Best Buy's motion. The circuit court explained that under Illinois' long-standing law, Best Buy is a "retailer" even when it contracts with a purchaser to install the appliance Best Buy sells. The circuit court also rejected Best Buy's claims that the appliances are furnished and installed as an incident to the construction contract and that the installed appliances were incorporated into the real property structure as an integral part thereof. Lastly, the circuit court rejected Best Buy's constitutional challenge.

Best Buy appealed the circuit court order claiming that the circuit court erred in denying its motion for summary judgment by: 1) improperly applying the "substance of the transaction test" to its installed-appliance transactions; 2) disregarding Illinois tax law, regulations, and Department guidance; 3) finding that the built-in appliances at issue can never be incorporated into real estate as an integral part thereof; and 4) erroneously rejecting Best Buy's claim that the Department's assessment of the sales tax in this case violates the Uniformity Clause of the Illinois Constitution.

In affirming the circuit court's decision, the appellate court first determined if Best Buy was acting as a retailer or construction contractor to determine whether ROT should be collected on the sale of the appliances at issue. In determining the primary occupation of Best Buy for the transactions at issue, the appellate court applied the following "substance of the transaction" test:

"If the article sold has no value to the purchaser except as a result of services rendered by the vendor and the transfer of the article to the purchaser is an actual and necessary part of the service rendered then the vendor is engaged in the business of rendering service and not in the business of selling at retail. If the article sold is the substance of the transaction and the service rendered merely incidental to an inseparable part of the transfer to the purchaser of the article sold, then the vendor is engaged in the business of selling at retail." Citing *H.D., Ltd. v. Department of Revenue*, 297 Ill. App. 3d 26,34 (1998) (quoting *Spagat v. Mahin*, 50 Ill. 2d 183, 189 (1971)).

The appellate court explained that a taxpayer must show that the tangible property it sold to its customer had "no value to the customer except as a result of the services" the taxpayer rendered. *Id.* at 35. The appellate court determined that the appliances Best Buy sold and installed had substantial value to its customers even without the installation services, which established Best Buy as a "retailer" and resulted in the transactions at issue being subject to the ROT.

The appellate court added that for the same reason, the sale of the built-in appliances were not merely incidental to a construction contract. Adding that each appliance has value even in the absence of installation and that a customer can purchase an appliance without installation.

The appellate court also found that the built-in appliances at issue were not permanently affixed to an integral part of the real estate as Best Buy's Installation Contracts specifically state that for all installations, the customer must have an existing appliance that Best Buy will be replacing which undermines any characterization of either permanency or integrality of the appliance being installed.

The appellate court also determined that the Best Buy's reliance on Regulation Section 130.1951 is meritless as that section only applies to enterprise zones and fails to define when a built-in appliance is "physically incorporated into the real estate." See 86 Ill. Adm. Code 130.1951 (2000). Moreover, the appellate court gave no persuasive weight to the various unrelated private letter rulings, general information letters and compliance alerts Best Buy cited.

Finally, the appellate court found that the Department's imposition of the ROT on installed appliance sales did not violate the Uniformity Clause of the Illinois Constitution as the Act at issue meets both prongs of the Searle Test in that it: 1) is based on a real and substantial difference between people taxed and those not taxed, in this case retailers and construction contractors; and 2) bear some reasonable relationship to the object of the legislation or to public policy, in this case the intent of the Act at issue is to tax the last transfer of tangible property for a consideration. *Searle Pharmaceuticals, Inc. v. Department of Revenue*, 117 Ill 2d 454, 469 (1987). The appellate court added that there is a real and substantial difference between a retailer such as Best Buy, which primarily sells appliances to the end user and whose installation services are merely incidental to the sale of the appliance, and a construction contractor which provides a service for which the appliance is merely incidental.

Based on the above, the appellate court held that the circuit court did not err in finding that Best Buy's sale of certain appliances were not exempted from the ROT, despite Best Buy's subsequent installation of those appliances, and that the Department's imposition of the ROT in these sales does not violate the Uniformity Clause of the Illinois Constitution.

Please note that 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). Although this is a Rule 23 order and may not be cited as precedent, the fact that various private letter rulings, general information letters and a compliance alert were issued over the years on this issue, would cause one to believe that this is not the last we have heard on this issue as other taxpayers may have somewhat similar issues. As of the drafting of this article, Plaintiff has not sought to appeal this matter to the Illinois Supreme Court.