Regulations Should Be Drafted to Focus on In-State Activities

From its inception, the use tax was meant to complement the retailers' occupation tax. Thus, application of the retailers' occupation tax should be favored over application of the use tax. This position finds support in both the history of the two taxes and the way the taxes have been interpreted by the Illinois Supreme Court.

One proposition that has been overlooked, perhaps because it is too difficult to deal with, and perhaps because it is in no one's interest to admit, is that a retailer may be engaged in the occupation of retail sales in multiple locations.

A New Rule is Needed for Application of the Illinois Retailers' Occupation Tax. 35 ILCS 120/1 *et. seq.*

The Illinois Supreme Court's decision in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130 was based upon *Ex-Cell-O Corp. v. McKibbin*, 384 Ill. 316 (Ill. 1943), which dealt with an interpretation of the State Retailers Occupation Tax. Since *Hartney* found that the regulations concerning the local ROTs were not valid, it follows that the rules that apply to the State ROT must also comply with *Hartney* and therefore be consistent with the rules that govern local ROTs.

Under section 130.610, the State ROT is applicable where the property is located outside the State at the time of sale so long as acceptance occurs in Illinois. See 130.610 (b)(3) and (c)(1)(A). This appears to be the type of single factor test that is impermissible under *Hartney*. That of course assumes that *Hartney* is read as requiring a balancing of activities both inside and outside of Illinois. However, another interpretation of *Hartney* is that only the activities within Illinois have to be considered in determining where a business is located for purposes of ROTs. This means that for purposes of the State ROT, it is only necessary to determine that there is *enough* activity in the State to justify imposition of the State ROT. And, under such an interpretation, it could be determined that acceptance is enough to impose the State ROT. A third interpretation is that *Hartney* simply did not address this issue. If that is the case, the Department should be free to look to other decisions to obtain guidance. Regardless, the regulations that apply to the State ROT and those that apply to local ROTs should adopt a consistent approach.

Title 86 Part 130 Section 130.605 makes a sale subject to the State ROT if the property is located in the State at the time of the sale (or is subsequently produced in Illinois) and then delivered in Illinois to the purchaser. This is essentially the same as proposed rules. See Proposed Rule 220.115 (c)(3). Yet, if a balancing test between in-State and out-of-State factors are considered for purposes of the local ROTs and the foregoing provision is used for determining application of the State ROT, it may be possible to come to the anomalous conclusion that a retailer owes the State ROT but no local ROT. This remains a single factor test.

As discussed below, there are multiple reasons to conclude that implementation of the various ROTs should be based solely on activities engaged in within the State and without regard to activities occurring outside the State.

Use Tax is Supplemental to Retailers' Occupation Tax

To begin with, the state retailer's occupation tax was initially adopted in 1933. The use tax was not adopted until 1955. This in itself is evidence that the use tax was meant to back up the ROT.

The Illinois Supreme Court has continually recognized that the use tax was adopted to supplement the retailers' occupation tax and that the purpose of the use tax was to prevent avoidance of the retailers' occupation tax. *Performance Marketing Accoc. v. Hamer*, 2013 IL 114496, P3; *Irwin Indus. Tool Co. v. Ill. Dep't of Revenue*, 238 Ill. 2d 332 (Ill. 2010)("The primary purpose of the use tax is to prevent avoidance of the retailers' occupation tax by those making out-of-state purchases and to protect Illinois retailers against diversion of business to out-of-state retailers.*";* "a use tax is generally levied to compensate the taxing state for its incapacity to reach the corresponding sale, it is commonly paired with a sales tax and is applicable only when no sales tax has been paid or subject to a credit for any such tax paid." *); McLewan v. Department of Revenue*, 184 Ill.2d 341, 368 (1998); *Brown's Furniture, Inc. v. Wagner*, 171 Ill. 2d 410, 418, 665 N.E.2d 795, 216 Ill. Dec. 537 (1996); *Dick's Vending Service, Inc. v. Department of Revenue*, 53 Ill.2d 375, 383 (1973); *Kelein Town Builders, Inc. v. Department of Revenue*, 36 Ill.2d 301, 303 (1967).

Focus of ROT has Always Been on Enough Activity Within the State

From the inception of the retailers' occupation tax, the question with regard to the location of activities was whether there was enough activity in the State to justify imposition of the ROT; it was not a question of whether there was *more* activity within another state. See e.g. *Allis-Chalmers Mfg. Co. v. Wright*, 383 Ill. 363 (Ill. 1943) (determining whether retailer was subject to ROT based upon "its relationship to the business conducted in this State…."); *Ex-Cell-O Corp. v. McKibbin*, 384 Ill. 316 (Ill. 1943)(determination of whether retailer was subject to ROT was based upon "whether he has, by adopting such method of business, established himself in business in this State.") cf *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, P58 ("Determining that *enough* of the business of selling is taking place….").

Sections of the Proposed Rules Already Make Determination Based Solely on In-State Activity

Section (c)(3) of the proposed rules which is based on the location of inventory within the State is a single factor test that does not consider the other primary factors listed in section (d)(2). Indeed, it appears to be based on the premise that all other selling activity occurs outside of the State. When such other activity occurs within the State, the location of the inventory is to be considered and balanced against such other activity under (d).

Public Policy Favors Weighing of Only In-State Activities

The Illinois Supreme Court has recognized that the purpose of the Retailers' Occupation Tax was to relieve a portion of the tax burden of those municipalities providing services to retailers within their jurisdiction. See *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, P34. If this is the reason for imposing the RTA tax – which Hartney claims it is -- it must be concluded that the benefits received must be neither direct nor great. For example, the Feed Loft is a retailer that is located in the Will County portion of Channahon. It sells numerous products that are more rurally oriented than other products found in the RTA's jurisdiction, including horse feed, goat feed, and game-bird feed. There is no public transportation within Channahon. Thus, neither the employees nor customers of the Feed Loft use public transportation to get to the Feed Loft. Yet, sales at the Feed Loft are subject to the RTA ROT simply by the virtue of being located in Will County. It thus must be concluded that neither a direct nor significant amount of services are required to impose a local ROT. Thus, as a threshold measure, imposition of local ROT taxes can be imposed by the most minimal of services provided to a retailer so long as they are consistent with due process. In other words, if a retailer is conducting any of the primary factors identified in the proposed rules within a municipality, it must be concluded that it is benefitting from sufficient government services within the municipality to impose a local ROT. This does not however mean that, as between municipalities within Illinois, the amount of services provided to a retailer cannot be weighed against one another.

To the extent that ROT taxes can be imposed, they should be favored over use taxes for at least three reasons.

First, it has been continually recognized that it is impractical to rely upon consumers paying use taxes. *Performance Mktg. Ass'n v. Hamer*, 2013 IL 114496 P4; *see also Miller Bros. Co. v. Maryland*, 347 U.S. 340, 343 (U.S. 1954) ("The collection of the use tax from inhabitants is a difficult administrative problem…"). While a retailer that maintains a place of business in Illinois is required to collect use taxes for sales outside of Illinois, there is likely to be some inevitable loss of revenue due from use tax. One source estimated that the total uncollected use tax in Illinois for 2012 was over $1 billion. http://www.governing.com/blogs/by-the-numbers/state-use-tax-collection-revenues.html.

Second, the use tax is subject to a set off for any tax paid by the purchaser in another state. 35 ILCS 105/3-55(d). Thus, driving retailers to another state can lead to an overall reduction in revenues to the State of Illinois because sales in other states may be taxed within the other state thereby leading to a credit against the Illinois use tax and thereby a reduction to overall revenues. *See Irwin Indust. Tool Co. v. Illinois Department of Revenue*, 238 Ill.2d 332, 347 (2010)(There is a federal system where the state of purchase may impose a tax and no other state taxes the transaction unless no prior tax has been imposed or if the tax rate of the prior taxing state is less, in which case the subsequent taxing state imposes a tax measured only by the differential rate).

Third, revenues to local municipalities will not be jeopardized if the focus is only on activities conducted in Illinois. In contrast, the rules as now written are unclear as to activities outside the state should be weighed against those occurring within the state.

Suppose a retailer has a showroom in Chicago where orders are accepted. Suppose further that the corporate offices and the warehouse where the inventory is kept are located in Indiana. Under the current proposed rules, it may well be determined that Indiana is the location where the retailer is doing business rather than in Illinois. See Proposed Rule 220.115(d)(2). This would mean that the difficulties with collecting use taxes, the possible set-offs, and the potential loss of local ROT revenues would all come into play.