

STATE OF ILLINOIS
DEPARTMENT OF REVENUE

NOTICE OF FILING

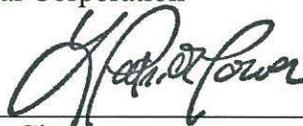
To: Illinois Department of Revenue
Attn: Brian Hamer, Director
101 West Jefferson Street
Springfield, IL 62702

Joint Committee on Administrative Rules
Attn: Vicki Thomas, Executive Director
700 Stratton Building
Springfield, IL 62706

You are hereby notified that on or about the **5th day of February 2014**, I filed via U.S. Mail to the above referred-to Agencies, the City of Kankakee's Response and Objections to the Illinois Department of Revenue's New Local Sales Tax Sourcing Regulations, attached.

City of Kankakee, an Illinois
Municipal Corporation

By: _____

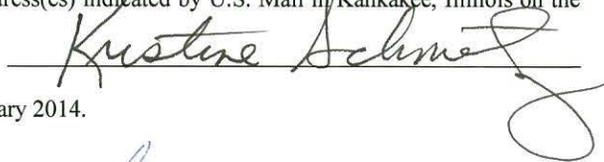


Assistant City Attorney
City of Kankakee, Illinois

STATE OF ILLINOIS)
)ss
COUNTY OF KANAKKEE)

Proof of Service

The undersigned, being first duly sworn, state that I served a true and correct copy of the foregoing Notice, together with a copy of each document referred to therein, upon the person(s) indicated at their address(es) indicated by U.S. Mail in Kankakee, Illinois on the 5th day of February 2014.



SUBSCRIBED AND SWORN TO before me this 5th day February 2014.


Notary Public

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**THE CITY OF KANKAKEE'S RESPONSE AND OBJECTIONS TO THE
ILLINOIS DEPARTMENT OF REVENUE'S
NEW LOCAL SALES TAX SOURCING REGULATIONS**

The City of Kankakee hereby files its response and objections to the Illinois Department of Revenue's ("DOR") emergency and proposed local sales tax sourcing regulations ("proposed regulations"). Kankakee asserts that these proposed regulations (1) exceed the authority of the DOR by giving the DOR unfettered discretion in the sourcing sales for local sales tax purposes by allowing the DOR to source such sales to any location it desires through the use of subjective and open-ended criteria that only the DOR can clearly apply, and (2) violates the spirit and purpose of the local sales tax acts and the Administrative Procedures Act, and seriously threaten the public interest, by adopting open-ended, confusing and elusive criteria to source sales that provide absolutely no objective guidance to retailers and consumers in Illinois. Moreover, the DOR's proposed regulations go much farther than required by the decision in *Hartney Fuel Oil Co. v. Department of Revenue*, since such rules fail to provide any clarity in the law or take on the challenge of creating workable and clear fact based objective standards for retailers to adhere to in sourcing their sales. Rather, the proposed regulations create a maze of subjective and open-ended criteria that provides no practical guideposts that Illinois retailers can follow to accurately and confidently source sales their sales for local sales tax purposes. Kankakee's specific objections are detailed below:

1. The proposed sourcing regulations fail to provide any clear, workable, and objective guidelines for retailers to accurately and confidently determine the proper local sales tax rate to impose on a sale (see analysis of regulations attached).
2. Rather than clarifying the law or implementing a fact-based objective test that could be used by retailers as a roadmap in properly sourcing their sales, these new regulations

make the sourcing of sales even more confusing and obtuse by using a nine factors subjective analysis (“nine-factor analysis”) that the DOR can apply to reach any result it desires.

3. While the *Hartney* decision struck down the DOR’s previous regulation because such regulation used only “one” objective factor to source sales, the Court did not say that a clear and objective fact based test was prohibited, such as a test that contains possibly two or three objective fact based factors to precisely source sales. Yet, the proposed regulations fail to take on this challenge and totally abandon any semblance of an objective test that would provide guidance to retailers or municipalities in Illinois in sourcing their sales.

4. The new nine-factor analysis of the proposed sourcing regulations offers no helpful guidance to retailers to source their sales, since no combination of such factors clearly determines the sourcing location.

5. The ability of the DOR to pick and choose which factors of the new nine-factor analysis are most important to each retailer makes sourcing of sales in Illinois subject to the whim and preferences of the DOR.

6. The fact that the nine-factor analysis is just criteria to be consider in sourcing a sale, and not an objective test, means that even if a retail sales location satisfies most of these factors, the DOR can still re-source such sales to another location with fewer factors that the DOR subjectively determines are more important to the retailer. Therefore, the nine-factor analysis can never be practically used by retailers to confidently source their sales.

7. Because the proposed regulations allow the DOR the right to source sales based on the municipality in which the DOR believes the retailer “enjoys” the most government protections and benefits, such discretionary power is not only improper but will make the

sourcing of a sale for many retailers impossible to determine at the time of the sale with any degree of certainty.

8. Because the nine-factor analysis of the proposed regulations can be applied differently from retailer to retailer and from sale to sale, it provides no practical guidance to retailers in Illinois.

9. The proposed regulations will make it impossible for municipalities to budget or plan for sales tax revenues since there is no clear sourcing test for sales and the DOR can re-source sales at its sole discretion based entirely on where the DOR believes the retailer receives the most government protections and benefits.

10. The purpose of regulations is to make the law more understandable and to provide practical and workable solutions for persons to properly follow the law. Here, the proposed regulations do just the opposite.

11. The proposed regulations (without statutory authority) also improperly allow the DOR to disregard the valid office locations of legal sales and purchasing companies, and to re-source such companies' sales to their affiliates' office locations in other municipalities, which the DOR apparently believes are more deserving of the local sales tax revenues.

12. Finally, the proposed regulations will cause widespread confusion among many consumers who will now be charged a tax based on some distant location determined by the DOR, rather than the location in which the sale actually occurred.

For the aforesaid reasons, the City of Kankakee requests that the DOR withdraw the proposed regulations or that the Joint Committee on Administrative Rules ("JCAR") reject the proposed regulations. Alternatively, Kankakee requests the DOR withdraw or JCAR reject the sections of the regulations dealing with (1) the nine-factor analysis; (2) the discretionary power

of the DOR to use government protections and benefits to source sales; and (3) the DOR's ability to disregard the sales office locations of valid and legal sales or purchasing companies. These sections of the proposed regulations should be replaced with an objective fact based test where a retailer can objectively and precisely determine the proper sourcing of its sales by meeting two or three clear and certain factors out of a short list of relevant factors, so that the retailer will no longer have to guess at the proper sourcing locations of its sales.

February 5, 2014

Respectfully submitted,

City of Kankakee, an Illinois
Municipal Corporation

By: 
Assistant City Attorney
City of Kankakee, Illinois

**ANALYSIS OF ILLINOIS DEPARTMENT OF REVENUE'S
NEW EMERGENCY AND PROPOSED LOCAL TAX SOURCING REGULATIONS**

I. General Observations – e.g. 86 Ill. Admin. Code Section 220.115, et seq.

A. The Illinois Department of Revenue's ("Department") new emergency and proposed regulations do not attempt to provide any clear or objective guidance to Illinois retailers to enable them to properly source their sales for local sales tax purposes, other than for over-the-counter sales when delivery occurs from the same location. Moreover, under these regulations, the location of the "actual sale" is no longer determinative of where a sales should be sourced for local sales tax purposes. As a result, these regulations will likely cause widespread confusion among many consumers who will no longer be charged sales taxes based on the location of their purchases, as well as making it extremely difficult, if not impossible, for many retailers to accurately determine at the time of sale the proper local sales tax rate they are required to collect.

B. Sales by retailers in Illinois (other than the over-the-counter sales referred to above) are now subject to local sales tax based on where the retailer's "predominant and most important selling activities take place." While this term is not defined, in making this determination, the regulations use a multiple factor analysis involving four primary criteria and five secondary criteria (the "nine-factor analysis").¹ However, the regulations also state that, depending on each factual situations, other factors could also be considered.

¹ There nine factors are: (1) location of officers, executives, and employees with discretion to negotiate on behalf of, and to bind, the seller; (2) location where offers are prepared and made;(3) location where purchase orders are accepted or other contracting actions that bind the seller to the sale are completed; (4) location of inventory if tangible personal property that is sold is in the retailer's inventory at the time of its sale or delivery; (5) location where marketing and solicitation occur; (6) location where purchase orders or other contractual documents are received; (7) location of the delivery of the property to the purchaser; (8) location where title passes; (9) location of the retailer's ordering, billing, accounts receivable and other administrative functions.

Note: The nine-factor analysis is not an objective test, but a subjective and open-ended analysis based on the location of the nine factors and their relative importance to each retailer as determined by the Department, so it can change from retailer to retailer and from sale to sale. As a result, no combination of such factors definitively determine the sourcing of a sale; rather these factors are merely to be “considered” in determining the sourcing location. Consequently, the regulations fail to provide clear and certain parameters that would allow retailers to conclusively determine the proper sales location for local tax sourcing purposes.

C. For those sales by retailers where the Department determines that the issue of sourcing is a “close question,” the Department retains the right in these regulations to evaluate the nine factors on its own and determine the sales tax sourcing location based on where the retailer “enjoyed the greater part” of governmental protections and benefits.

Note: It is assumed that this means the Department, upon audit, can re-determine local sales tax sourcing and re-allocate sales to the municipality from which the Department believes the retailer derived the most government protections and benefits, such as police, fire, and other government services.

D. The regulations do provide special bright-line rules for (1) sales where all selling activities occur outside of Illinois, (2) sales from vending machines, and (3) sales of coal or minerals.

E. Non-Illinois retailers with no Illinois location other than a sales office in Illinois, can apparently treat that sales office location as the sourcing location for local sales tax if it has “some” other selling activity in the jurisdiction in which the sales office is located or the person accepting the sales orders can and does negotiate or exercise discretion on behalf of the seller.

However, if such non-Illinois retailer has an affiliate with an Illinois office that is involved in the sale at issue, the regulations suggest that the nine-factor analysis must be applied to such sales.

Note: It appears that the non-Illinois retailer referred to above does not have to satisfy any of the nine-factors in the regulations, since those factors refer to retailers with activities in multiple jurisdictions in Illinois.

II. Specific Observations – Multi-Jurisdictional Interstate Retailer

A. Illinois retailers with multiple sales offices, showrooms, or call centers will have great difficulty accurately sourcing sales under the new regulation's elusive nine-factor analysis, and many retailers will likely have to make a calculated guess as to the proper tax rate to charge. Because of this, such retailers will face the substantial risk of being assessed back taxes if they guessed wrong, especially since the Department's retains the ability on audit to re-source such sales in so-called "close questions" cases based on the government protections and benefits received by the retailer.

B. All Internet or phone sales of retailers with multiple Illinois locations will similarly be sourced using the nine-factor analysis, and are likewise subject to the Department's special discretionary government protections and benefits analysis, thereby making the sourcing of such sales indeterminate at the time of sale. Therefore, contrary to the Department's suggestion, these regulations will likely impact thousands of Illinois retailers.

C. Illinois retailers with sales order acceptance offices in Illinois will also have immense difficulty determining the correct sourcing of their sales because their sales are no longer sourced at the sales location but are now subject to the uncertainty created by the regulations nine-factor analysis, and the ability of the Department to reallocate the sourcing of sales to municipalities, based on government protections and benefits provided to the retailer.

D. The sourcing of sales occurring at store locations where the goods purchased are delivered from warehouses at different locations will also be uncertain, since such in-store sales will now be sourced under these regulations based on the nine-factor analysis and like the other sales mentioned above are subject to the Department's right to re-source sales to a municipality based on where the Department believes the most government protections and benefits are received by the retailer.

Note: For retailers with large retail stores, this could be a major issue when it comes to their in-store and phone sales when items being purchased are delivered to or picked up by the customer from a warehouse situated in a different location.

E. Sales companies and purchasing companies that are under common ownership with their suppliers or purchasers may no longer be able to use their sole office location as the selling location for sourcing sales, unless that location, when combined with their affiliates locations, satisfies the nine-factor analysis of the regulations for the specific sales at issue. This aspect of the regulation will surely make the sourcing location of their sales incapable of determination at the time of sale.

Note: This appears to be designed as an attempt to prevent sales or purchasing companies from sourcing their sales to their sales office for local sales tax sourcing purpose.

III. Comments to Sourcing Regulations

A. While the fundamental purpose of a regulation is to provide clear guidance and standards to taxpayers as to the application of the law, these new sourcing regulations fail to provide any clear, meaningful, or objective guidance to retailers as to the proper sourcing of

sales for local sales tax purposes. Rather, by referring to nine different criteria as mere considerations to review in determining the proper sourcing of a sale, the regulations create an open-ended, vague, uncertain, and elusive analysis that will make it impossible for a retailer with multiple sales offices, traveling salesmen, or Internet, phone, or warehouse sales to determine with any confidence where its sales should be sourced. To add even more confusion and uncertainty, by using subjective terms such as whether the factors are “unclear” or present a “close question” as to the sourcing of a sale, the Department is able to retain the power to re-source sales upon audit to those municipalities where the Department believes the retailer enjoys the greater part of government protections and benefits.

B. Because these sourcing regulations are not designed to provide a precise, practical or objective test for retailers to follow in sourcing their sales, retailers will be forced to simply make their best guess as to the proper tax to collect, and hope that their sales will not ultimately be re-sourced by the Department upon audit.

C. The maze of confusion and uncertainty created by this nine-factor analysis will make it extremely challenging and a financial nightmare for many retailers to comply with these sourcing rules without taking on a substantial risk for back taxes that can be determined due by the Department upon audit. Similarly, the regulations will make it very difficult for municipalities to plan and budget for sales tax revenues, since under these regulations there are no clear guideposts to determine where a sale should be sourced. Furthermore, because the Department retains the power to reallocate sales on audit based on which municipality it believes provides the most protections and benefits to the retailer, even if a municipality were able to reasonably speculate as to whether a sale should be sourced to such municipality, there is no

certainty or guarantee that the Department will not re-source such sale based on its government protections and benefits received analysis.

IV. Examples of How the Regulation Works

A. Retailer A, a computer retailer with a call center in Chicago and its headquarters in Mundelein, will be subject to the nine-factor analysis of the regulations. Because the call center only receives and accepts phone and Internet orders of the retailer, it would not be a sales office under the regulations. Since Mundelein is the only other Illinois location of Retailer A, the sales will be sourced to Mundelein. However, if the call center conducts other types of selling activities, then the nine-factor analysis is used to determine if Mundelein or Chicago should be sourced the sale, but the Department can also reallocate such sales based on the amount of government protections and benefits received by the retailer from Chicago versus Mundelein. Therefore, it is uncertain which tax rate will ultimately be applied, and as a result and under such circumstances, Retailer A will be forced to guess as to which municipality's tax rate to collect.

B. Retailer B is a plumbing supply company that has its sole sales office in Stickney, its headquarters and administrative office in Rockford, and a warehouse in Naperville. All salesman sales, Internet sales, and phone sales are received and accepted in Stickney. However, while Retailer B's three salesmen operate solely out of the Stickney sales office, the salesmen usually negotiate the sales at the customers locations. Moreover, no inventory sold is stored at the Stickney sales office. Because the Stickney sales office only possibly satisfies three of the four primary criteria, and since it is uncertain which selling activities are most important to Retailer B, the additional five criteria of the regulations presumably would also be "considered." Depending on the location of the customer, a couple of these criteria could occur in Naperville,

and two or three could occur in Rockford. As a result, it is far from certain which location should be sourced the sale. Moreover, if the Department determines that this presents a “close question” as to the sourcing issue, the Department can look into where the most important selling activities to Retailer B occur, taking into account the municipality from which Retailer B derives the most government benefits and can then source the sale to that location. Therefore, it is impossible to know for certain which municipality should be sourced the sale, and at best Retailer B will have to make a calculated guess as to which local sales tax to collect of the three municipalities in which it is operating.

C. Retailer C is an business equipment dealer that has two staffed sales offices, one in Springfield and one in East St. Louis. It’s headquarters and administrative office is in Bloomington. It has no warehouse. Because the sales offices do not meet all of the four primary factors of the regulation, the sourcing of the sales is “unclear,” and therefore the additional five factors must be considered (or other factors if the Department determines other criteria are necessary). Under this nine-factor analysis, it is determined that both the Springfield and East St. Louis sales offices have employees that can bind the retailer and that offers are also prepared and accepted from these sales offices. However, other selling activities such as the marketing of products, the processing of the orders, setting pricing guidelines, billing, and title transfer occur at the Bloomington headquarters of Retailer C. As a result, under the regulations it is uncertain which location -- Springfield, East St. Louis, or Bloomington -- should be properly sourced the sale. This confusion is exacerbated by the fact that even though the sales actually occurred in Springfield and East St. Louis, Bloomington provides the most government protections and benefits to Retailer C. Therefore, the Department could allocate all sales to Bloomington.

Again, because of this uncertainty, Retailer C is forced to guess as to the proper sales tax rate to charge its customers for sales made at its Springfield and East St. Louis locations.

D. Retailer D has a retail furniture outlet in a shopping mall in Orland Park and a warehouse in Tinley Park where it assembles and delivers products to purchasers (or where the purchasers can pick up furniture purchased). Retailer D also has its headquarters and administrative office in Mokena. In-store and phone purchases from the Orland Park store are accepted in Orland Park. However, the furniture is either in stock in the warehouse in Tinley Park or delivered to the warehouse for assembly before delivery to, or pick-up, by the purchaser. The Mokena headquarters does all of the marketing, billing, accounts receivable, credit review, and pricing of furniture, and all of the primary officers have their main offices at the Mokena headquarters. Because the furniture is not picked up or delivered by the Orland Park store, the sale does not qualify as an over-the-counter sale, and the nine-factor analysis of the regulations applies. Under these regulations, two of the primary factors are present for some sales at the Orland Park store; while for other sales, sometimes three of the factors are present, and for still other sales, all four of the factors may be present. However, employees at the warehouse and at the headquarters also perform important selling activities for Retailer D. It is thus unclear under the regulations where to properly source the sales. The Tinley Park warehouse is the location of assembly and delivery of furniture and where title passes to the product. However, employees at the headquarters do all of the work associated with the billing, accounts receivable, and marketing, as well as approving general pricing. Moreover, it is a toss-up whether Orland Park, Tinley Park, or Mokena provides the most government services to Retailer D, so it is uncertain as to which local tax rate actually should be applied. Thus, as in the other examples, Retailer D can

only speculate as to the local tax rate to charge its customers and then take the risk upon audit that it guessed correctly.

E. Retailer E is a lighting supply company that has a showroom in Chicago where it receives and accepts orders for merchandise both by walk in purchasers and over the phone. All sales are forwarded to its headquarters in Highland Park for processing. Merchandise is shipped from an out of state location directly to the purchaser. Under the nine-factor analysis, at least two of the criteria are usually present at the Chicago location since the orders are received in Chicago, and sometimes offers are made or solicitation is done at the Chicago location. However, employees at the headquarters location in Highland Park usually set the price range of the items, formally accept the order, perform the credit review and billing procedures, process orders, and handle some customer service related issues. Under the nine-factor analysis, both Highland Park and Chicago have a claim to the sales under the regulations since factors appear at both locations. It is uncertain which factors are the most important to Retailer E, and it is unclear which municipality the Department will determine on audit provided the most government protections and benefits to Retailer E. Because of this uncertainty, as in the other examples, Retailer E will have to make a calculated guess as to the local tax rate to charge its customers for its sales, and will be subject to a possible assessment of back taxes, interest and penalty if upon audit the Department determines Retailer E guessed wrong.