



**Regional
Transportation
Authority**

175 W. Jackson Blvd,
Suite 1650
Chicago, IL 60604
312-913-3200
rtachicago.org

March 3, 2014

Paul Berks
Deputy General Counsel
Illinois Department of Revenue
100 W. Randolph Street, 7th Floor
Chicago, IL 60601

Dear Mr. Berks:

Enclosed please find the Regional Transportation Authority's comments regarding the proposed permanent amendments to the Regional Transportation Authority Retailers' Occupation Tax regulations (86 Ill. Adm. Code 320.115) which appeared in the Illinois Register on February 7, 2014.

If you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink that reads "Jordan Matyas". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jordan Matyas
Chief of Staff





**Regional
Transportation
Authority**

175 W. Jackson Blvd,
Suite 1650
Chicago, IL 60604
312-913-3200
rtachicago.org

THE RTA'S COMMENTS ON PROPOSED AMENDMENTS TO REGULATIONS RELATING TO LOCAL RETAILERS' OCCUPATION TAXES

The Regional Transportation Authority (the "RTA") is the third largest public transportation system in North America, providing more than two million rides a day throughout a six-county region that currently has a population of approximately eight million people. The RTA submits the following comments on the proposed amendments to parallel regulations relating to local retailers' occupation taxes announced by the Illinois Department of Revenue ("IDOR") on January 22, 2014 and published in the Illinois Register on February 7, 2014.

INTRODUCTION

On January 22, 2014, IDOR announced interim emergency amendments and proposed permanent amendments to replace the regulations that the Supreme Court held were invalid in its November 21, 2013 opinion in *Hartney Fuel Oil Co. v. Hamer*. In *Hartney*, the Court found the prior regulations invalid because they could be interpreted in a manner that was contrary to well-established Illinois law relating to retailer's occupation taxes. In large part, IDOR's proposed amendments reflect the long-standing law that was recently reaffirmed by the Illinois Supreme Court in *Hartney*. In some respects, however, the proposed amendments are not consistent



with existing Illinois law. This comment identifies five specific changes to the proposed amendments that are needed:

1. The section titled “Long Term or Blanket Contracts” was properly omitted by IDOR and should not become part of the regulations;
2. The distinction between “Primary” and “Secondary” factors should be removed, because the courts have repeatedly said that no single factor is always more important;
3. The section titled “Order Acceptance Not Doing Business in the Jurisdiction” should be eliminated or rephrased. The rule must be written to make clear that the place of order acceptance should never be considered as the single dispositive factor in determining tax jurisdiction;
4. The section titled “Guidance on the Application of the Composite of Selling Activities Test to Common Selling Operations” should be rephrased to emphasize that it identifies guidelines for the application of the general rule that regards the business of selling as a composite of many activities, not independent “bright-line rules” to be blindly followed; and
5. The list of business activities to consider when determining tax jurisdiction should be expanded, and it should be made clear that the list is non-exhaustive.

HISTORY AND POLICY

The statutes enacting local retailers’ occupation taxes are modeled after the statewide retailers’ occupation tax, and they have the same purpose, which is to raise revenues from retailers who benefit from the services that a unit of government provides. See *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, ¶ 35; *Svithiod Singing Club v. McKibbin*, 381 Ill. 194, 198-99 (1942).

Prior to the Illinois Supreme Court’s ruling in *Hartney Fuel Oil Co. v. Hamer*, certain retailers claimed that IDOR’s existing regulations contained a “bright-line rule” to determine the location in which to pay the retailers’ occupation tax. Many

retailers have created sham offices to manipulate where their purchase orders are “accepted” to avoid paying tax to the RTA and other local governments, despite the fact that the majority of their retail activities take place within the local governments’ geographic boundaries. For example, retailers have made arrangements with unrelated businesses in distant locations to provide telephone operators who would “accept” purchase orders in a local jurisdiction having a lower tax rate solely to claim the lower tax rate for the sales.

The Illinois Supreme Court’s opinion in *Hartney* reaffirmed long-standing Illinois law that the test for local retailers’ occupation tax jurisdiction cannot be reduced to an easily manipulated “bright-line rule.” The court found that the legislative intent for enacting the local retailers’ occupation tax statutes was “to allow local jurisdictions to tax the composite of selling activities taking place within their jurisdictions, collecting taxes in relation to services enjoyed by the retailer.” *Hartney*, 2013 IL 115130, ¶ 36. Therefore, the proper test is based on all aspects of the retailer’s “business of selling,” which the Court reaffirmed is a “composite of many activities.” *Hartney*, 2013 IL 115130, ¶ 36. Because the Court found that IDOR’s existing regulations suggested the existence of a “bright-line rule,” it found the relevant regulations to be invalid (Ill. Adm. Code §§ 220.115, 270.115, and 320.115). *Id.*, ¶ 64.

SPECIFIC CHANGES TO PROPOSED AMENDMENTS

I. The section titled “Long Term or Blanket Contracts” was properly omitted by IDOR and should not become part of the regulations.

When IDOR announced its proposed amendments on January 22, it omitted the section titled “Long Term or Blanket Contracts.” As published in the Illinois Register, this section reappeared. IDOR was correct to omit it.

The “Long Term or Blanket Contracts” section states as follows:

4) Long Term or Blanket Contracts

A) Under a long term blanket or master contract that is definite as to price and quantity, but must be implemented by the purchaser placing specific orders when goods are wanted, the location of the seller's place of business where subsequent specific orders are placed will determine where the seller is engaged in business for those orders.

B) The seller's place of engaging in the business of selling for long term blanket or master contracts that do not require the purchaser to place specific orders when goods are due shall be determined in accordance with subsections (c)(2) through (c)(4) of this Section.

Part (A) of this section arguably sets forth the very same improper “bright-line rule” rejected by *Hartney* and by over seventy years of Illinois case law. It states that if sales are subject to a long term contract that is definite as to price and quantity, then “the location of the seller's place of business where subsequent specific orders are placed **will determine** where the seller is engaged in business for those orders.” This precise question was addressed in the *Hartney* case, and the Illinois Supreme Court held very clearly that the location of the seller’s place of business where

specific orders are placed does not determine where the seller is engaged in business for those orders.

Part (B) of this section sets forth the proper test for all types of long term, blanket, or master contracts, which is the “composite of selling activities” test required by Illinois law. But part (B) appears to suggest that there are some long term contracts that are subject to a different test. Part (B) adds nothing and arguably misstates Illinois law. Perhaps it was inadvertently retained. If so, this error should be corrected.

This section also contains imprecise terms which are likely to lead to conflict and litigation. It is unclear what constitutes a “blanket contract” or a “long term contract,” for example. Also, “the location of the seller’s place of business where subsequent specific orders are placed” may not be clear under many contracts, for example contracts under which a retailer delivers goods to customers on site on an as needed basis.

For all of these reasons, the section titled “Long Term or Blanket Contracts” was properly omitted by IDOR and must be omitted from the amended regulations.

II. The distinction between “Primary” and “Secondary” factors should be removed, because no factor is inherently more important than another.

In the section titled “Application of Composite of Selling Activities Test to Multi-Jurisdictional Intrastate Retailers,” the proposed amendments list “primary” and “secondary” factors. While this section properly reflects that no single factor is dispositive in determining the proper tax jurisdiction, there is also no basis to

distinguish in the abstract between “more important” and “less important” factors in the business of selling. This violates the well-established principle that determining where a retailer does business requires a case-by-case analysis. Pre-weighting certain factors only complicates the analysis and invites manipulation.

“Place of acceptance” is a perfect example of a factor that, if generically elevated to a higher importance than other factors, creates opportunities for manipulation. In some cases, the place of acceptance may indeed be a more important factor in determining tax jurisdiction than some other factors, such as solicitation of orders. As Hartney Fuel Oil and other retailers have demonstrated, however, it is possible to arrange for the purported place of acceptance to be of little or no significance to where a retailer is conducting its business.

The amended regulations therefore should avoid pre-judging which factors are “Primary” and which are “Secondary” with respect to a retailer’s business.

Rather than attempt to attribute weight to individual factors in the abstract, the amended regulations should link the importance of factors to the purpose of the taxes. The proposed regulations already do this in the section titled “Principles Underlying Determination of Seller’s Location.” This section describes two well-established principles that are sufficient to determine the importance of the various factors. *First*, the most important selling activities for a particular retailer are those that best determine where it benefited from services provided by local governments. *Second*, the least important activities are those that serve no economic purpose other than to avoid tax liability. These principles are well-supported by Illinois law,

and they are not subject to manipulation by retailers seeking to avoid taxes where they conduct the majority of their selling activities.

III. The section titled “Order Acceptance Not Doing Business in the Jurisdiction” should be deleted or rephrased to clarify that the place of order acceptance should never be considered as the single dispositive factor.

As IDOR recognizes at several points in the proposed amendments, Illinois law could not be clearer that the place of order acceptance is not the single dispositive factor in determining tax jurisdiction. *See, e.g., Hartney*, 2013 IL 115130, ¶¶ 30-36. As the Illinois Supreme Court held in 1943 and reaffirmed in the *Hartney* opinion, retailers’ occupation taxes apply to the “business of selling,” and “[i]t is obvious that such activities are as varied as the methods which men select to carry on retail business and it is therefore not possible to prescribe by definition which of the many activities must take place [within the taxing jurisdiction] to constitute it an occupation conducted in [the taxing jurisdiction].” *Ex-Cell-O Corp. v. McKibbin*, 383 Ill. 316, 321-22 (1943) (interpreting statewide retailers’ occupation tax); *Hartney*, 2013 IL 115130, ¶ 36 (concluding that “the ‘business of selling’ under the local ROT Acts is a fact-intensive ‘composite of many activities’ consonant with our holding in *Ex-Cell-O*”).

The section titled “Order Acceptance Not Doing Business in the Jurisdiction” should be made consistent with this bedrock rule of Illinois law. In the rules as proposed, this section contains detailed conditions that must be met before the proper principle of law is applied. (*See, e.g.* Ill. Adm. Code 320.115(b)(8)(A)(i)-(iii).)

Each of these conditions allows for conflicting interpretations, and none are necessary.

The simplest solution would be to simply delete this section in its entirety as redundant. Alternatively, it could be replaced with a single sentence stating that “The place of order acceptance is not the single dispositive factor in determining local retailers’ occupation tax jurisdiction.”

If this section must be retained, then it should be moved from section (b), which contains examples of “common selling operations,” to section (c), which describes the application of the composite of selling activities test to multi-jurisdictional retailers. Having order acceptance as the only significant activity in a jurisdiction is not a “common selling operation.” In fact, it is highly unusual for a retailer to locate its “order acceptance” operation apart from all other major selling activities. In addition, this section should be rephrased, as follows, to reflect that order acceptance alone is never dispositive:

8) Order Acceptance Not Doing Business in the Jurisdiction of the Authority

~~A) Except as otherwise provided in subsections (b)(2) through (b)(7), a~~ Acceptance of purchase orders for the sale of tangible personal property in a jurisdiction does not in itself constitute engaging in the business of selling in the jurisdiction in which orders are accepted ~~if the following conditions are met:~~

~~i) the seller has no other selling activity within the jurisdiction except receipt and acceptance of purchase orders;~~

~~ii) all orders for the purchase of tangible personal property are submitted to the seller~~

~~within the jurisdiction by means of telephone or Internet; and~~

~~iii) the seller's employees or agents who accept purchase orders record information relayed by the customer (such as purchaser's name and address; price, type and quantity of items; and method of payment and delivery), but do not negotiate or exercise discretion on behalf of the seller.~~

B) The place of engaging in the business of selling for retailers who only accept purchase orders and conduct minor selling activity within a jurisdiction ~~and who meet the criteria set forth in subsection (b)(8)(A)~~, shall be determined based on the composite of selling activities engaged in outside the jurisdiction in which purchase orders are accepted, in accordance with subsections (c)(2) through (c)(4).

IV. The section titled “Guidance on the Application of the Composite of Selling Activities Test to Common Selling Operations” should be rephrased to emphasize that it lists guidelines for the application of the general rule, not independent “bright-line rules” for specific classes of retailers.

The section of the proposed amendments titled “Guidance on the Application of the Composite of Selling Activities Test to Common Selling Operations” sets forth several example retail scenarios and provides guidelines for how the “composite of selling activities” test applies to them. These examples demonstrate that the proper test under Illinois law yields intuitive and predictable results. However, they could be misinterpreted to state “bright-line rules” that exist separately from the “composite of selling activities” test. For this reason, each example in this section should contain a disclaimer, similar to the one below:

Over-the-counter Sales. When a person makes an over-the-counter sale of tangible personal property within a

jurisdiction and the purchaser takes possession of the property immediately; or the seller ships the property to the purchaser from the location where the sale was made, then the “composite of selling activities” test provides that the seller is engaged in the business of selling with respect to that sale in the jurisdiction where the over-the-counter sale occurred, absent other circumstances that support a contrary result.

V. The list of business activities to consider when determining tax jurisdiction, should be expanded and it should be made clear that the list is non-exhaustive.

It is well-established under Illinois law that there is no exhaustive list of retail selling activities to consider in determining proper tax jurisdiction. The list in the proposed rules should be expanded to include as many factors as possible that may be relevant, including but not limited to the following additional factors:

- The location where orders are processed for fulfillment after they have been accepted;
- The location where the retailer decides the terms of offers that it makes to its customers, such as appropriate pricing taking into account various factors, which may include but will not be limited to, application of discounts, surcharges and, shipping costs;
- The location where the retailer’s goods are on display to prospective customers, such as a showroom;
- The location where a retailer determines whether an order can be performed in the manner and within the timeframe required by the customer;
- The location of negotiations of substantive terms of sale, including but not limited to, price, quality, quantity, and date of performance or delivery, as applicable;
- The location where determinations of creditworthiness are made;
- The locations at which payment is tendered and received;

Further, the open-ended nature of this list should be communicated within the list itself, for example by adding the following items to the list:

- Other elements of a retailer's business of selling that are not listed above but are consistent with the principles set forth elsewhere in this rule;
- Any activity without which the sale could not occur.

Finally, this section should be amended to make clear that the location of selling activity must be determined by the totality of the circumstances, based on consideration of all relevant factors, and not based on how many factors a retailer can prove occurred in any given location.

CONCLUSION

The RTA respectfully submits that the foregoing changes to the proposed amendments should be made to ensure consistency with Illinois law.