



Taxpayers' Federation of Illinois

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Statement of Carol S Portman, President
at the Illinois Department of Revenue
Hearing on Proposed Regulations Regarding Local Tax Sourcing
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The determination of where a particular transaction occurs is frequently simple and straight-forward. However, that is not always the case. Sales taxes are expected to generate \$7.6 billion in state tax revenue during the current fiscal year; if even 10% of those transactions fall into the “it’s complicated” category, that’s \$760 million in state tax revenue, or \$15.2 billion in taxable sales. That is *not* a de minimus amount; this is not a de minimus issue.

The Taxpayers’ Federation of Illinois appreciates the hard work and careful thought that went into the drafting of these proposed regulations. Nevertheless, TFI believes that the regulations can and should go farther in providing guidance and certainty to the State’s tax collectors, tax payers, and the many local jurisdictions relying on tax revenues to fund their ongoing operations.

We particularly applaud the portion of the regulations entitled “Guidance on the Application of the Composite of Selling Activities Test to Common Selling Operations.” This application of the concepts outlined elsewhere in the regulations to specific situations is very useful. We believe that the Department should expand this section, modernize some of the fact patterns, and provide as much detailed guidance as possible. Our written comments will suggest specific revisions and additions to this subsection, which we view as critical to making these regulations function.

For those situations that don’t qualify as “common selling operations,” the regulations are less helpful. We believe that what is essentially a 9-factor test, with no prioritization, weighting, or tie-breaking mechanism, simply will not work. We urge the Department to rethink this portion of the regulations.

Our suggestions for improvements are two-fold: reduce the list of relevant factors and provide some sort of prioritizing/weighting/tie-breaking guidance. We are not asking for a return to a one-factor test, merely useable, workable rules that lead to predictable outcomes. Taxpayers who abuse or mis-use this guidance would be subject to the Department’s full arsenal; the fear that someone might be able to structure their activities in a way that minimizes their (or their customers’) tax liability does not justify paralysis. Or a vacuum.

Perhaps the best way to evaluate the effectiveness of these proposed regulations is to apply them to real-world situations. In our December 12, 2013, testimony following the *Hartney* decision, submitted jointly with the Illinois Retail Merchants’ Association, the Illinois Manufacturers Association, and the Illinois Chamber of Commerce, we set out 7 examples based on real-world fact patterns and asked for help in determining how each should be treated. I’ve tried to figure out how those examples would fare under these proposed regulations, with mixed results:

- 2 of our examples are clearly answered by the proposed regulations as currently written.
- 2 more should be answered by the proposed regulations, if the guidance were modernized only slightly.
- The other three were not answered, at all.

One of our examples, in particular, illustrates the failings of these proposed regulations.

A customer places a large order of widgets with retailer's sales representative. Although the sales rep is at one of the retailer's sales offices, the retailer's home office in a different jurisdiction approves the sale, processes the order, evaluates the business's credit-worthiness, checks inventory availability, stores inventory, fulfills orders, etc. The next day, the customer decides to order additional widgets, places an order online, and the identical process follows, but without the sales rep. Assume the local tax rates differ for each location. Would different tax rates apply to these two transactions, even though from the customer's perspective they are virtually identical?

In this example, two of the four primary factors (employee with discretion to bind seller and location where offers are prepared and made) are at the sales rep's location, while the other two (purchase order is accepted and inventory is located) are at the headquarters. Looking to the 5 secondary factors, one (marketing/solicitation) is where the sales rep is located, two (delivery and transfer of title) are where the customer is located, and two (documents received and administrative functions) are at the headquarters. That's a score of 3 to 4 to 2. Does headquarters win on sheer numbers, would it matter that the sales rep-related costs are higher than those associated with the headquarters functions for this particular sale, or is it necessary to invoke the final factor, and look to the governmental benefits at each of these locations? And how is that done? These questions are all unanswered, and we have not even started to evaluate the transaction on the second day.

We have other questions—will the Department ramp up its letter ruling process in order to respond to what will surely be a flood of requests? How does the six-month limitation on local tax “claw-back” factor into this? We also realize that it may not be possible to answer 100% of the questions out there. We do believe, however, that it is possible to go farther than these proposed regulations do in their current form, and that it is incumbent upon the Department to take those steps.

Again, thank you for the opportunity to talk with you today.