

This letter discusses various issues, including donor/donee situations, drop shipments and claims for credit. See 86 Ill. Adm. Code 150.305(c), 130.225 and 130.1501. (This is a GIL.)

March 3, 2011

Dear Xxxxx:

This letter is in response to your letter dated March 8, 2010, in which you requested a Private Letter Ruling. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

On behalf of our client, we respectfully request a private letter ruling surrounding the Illinois Retailer's [sic] Occupation Tax (ROT) implications with regard to the sale of tangible personal property, where the shipping information is unknown at the time of sale. In order to facilitate your review of the information necessary to respond to the requested ruling, we have presented the request in the following manner:

- I. Facts
- II. Issue
- III. Pertinent Authority
- IV. Analysis
- V. Specific Rulings Requested

I. FACTS

CLIENT is a STATE S-corporation headquartered in CITY/STATE. CLIENT has become an industry leader in the development and implementation of turnkey, PhRMA compliant, customized medical education programs for major pharmaceutical companies. These programs compliment and enhance existing marketing efforts and are supported by world class customer service, graphic design and production. Under these programs, CLIENT generally provides medical text books and publications to pharmaceutical companies and their representatives. Primarily, the end users of these

medical reference materials are physicians, located inside and outside of Illinois, to whom the materials are provided by the pharmaceutical representatives free of charge. CLIENT has 13 employees, all based out of their STATE location.

Books are principally sold to CLIENT's customers in two ways: library sales and bulk sales.

Library Sales

In a library sales program, a pharmaceutical company contacts CLIENT to prepare a library of medical books, periodicals, publications, etc. on a certain topic, such as pediatric oncology. The books, periodicals, publications etc. will ultimately be sent to designees of the pharmaceutical companies. Upon receipt of the contact CLIENT will issue a proposal outlining the cost of the project, including, but not limited to, book cost, management fees, component fees, any additional material fees, and shipping costs. If accepted, the pharmaceutical company will then issue a purchase order for the project to CLIENT, who will in turn issue a matching invoice. At the time the order is accepted and invoiced, the shipping information is not generally known, nor is the exact amount or type of book that will be purchased for the library. These programs may remain open for several months or even years. All books are drop shipped directly by the publisher to the designees of the pharmaceutical company. The publisher receives the shipping information directly from CLIENT's customers (e.g., the pharmaceutical company).

Bulk Sales

Under a bulk sale program, CLIENT prepares an order of a set number of books to be purchased for its customer. In a typical bulk book program, the quantity of books and the final price of the contract is known at the time of sale, but the shipping information is again unknown at that time. CLIENT places an order with its publisher and the books are often shipped directly to the designers of the pharmaceutical company by a third party drop shipper, generally the publisher of the books. Occasionally, CLIENT is provided the shipping directions at the time of the order.

Under both programs, CLIENT may inscribe the books with its customer's logo, or will have a book plate printed which will be attached to the book or publication containing the customer's information.

II. ISSUE

Can CLIENT use the customer's billing address as the situs of the sale when the shipping information is not known at the time of original invoicing?

III. PERTINENT AUTHORITY

The Illinois Retailer's [sic] Occupation Tax (ROT) is imposed on persons engaged in selling tangible personal property at retail and persons selling services in the state. 35 Ill. Comp. Stat. § 120/2. The term 'sale at retail' is defined as follows:

any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use or consumption, and not for the purpose of resale in any form as tangible personal property to the extent not first

subjected to a use for which it was purchased, for a valuable consideration.

35 Ill. Comp. Stat. § 120/1; 86 Ill. Admin. Code 130.201(a)(1)

'Transfer' is defined as the 'transfer of the title to property or of the ownership of property whether or not the transferor retains title as security for the payment of amounts due him from the transferee.' 35 Ill. Comp. Stat. § 115/2.

Under Illinois law, it is the Department's opinion, in general, that the seller's acceptance of the purchase order or other contracting action in the making of the sales contract is the most important single factor in the occupation of selling. 86 Ill. Admin Code. 220.115(c). While the law generally clarifies which items are subject to ROT and when the sale takes place, it is not clear on how tax is to be charged when the shipment information is not known at the time of the sale.

IV. Analysis

CLIENT generally issues one invoice to its customers and receives payment at the start of either a Library or Bulk Book program, prior to fulfillment of the book order, in the amount of the proposed price. The ultimate destination of the books is generally not known until a subsequent request is made to ship individual books. Furthermore, the request for shipment is not made to CLIENT, but rather through a secure website, which is accessed by CLIENT's customer or their designee and the third party drop shipper. Each program varies in size and destination, and ultimately there could be thousands of variations in quantity, type of book and length of the program. Often, a library program can stretch out over months or even years.

Practically speaking, it would be impossible for CLIENT, a small company, to issue an invoice at every shipment (which again could easily reach in the thousands per program) invoicing the customer for tax only. The undue burden this would create for a 13-person company would be too great to overcome in such a competitive business. Further, it would be difficult to accurately substantiate, on audit, the taxability of certain products for both CLIENT and its customers where invoices would be issued after the fact in the amount of tax only. Auditors would be left to review hundreds of invoices for sales tax only, while attempting to tie these tax only invoices back to the original invoice, from the time at which the sale was made.

It is incomprehensible, then, that a state would place such an undue burden on the sellers so as to require the seller to issue invoices subsequent to the sale for tax only. It is our request that where the shipping information is not known at the time the original invoice is issued, that the taxpayer be allowed to look to some alternative information in order to properly source the transaction.

It is our contention that the sale is complete when the order is accepted by CLIENT's personnel. Shortly after this time, an invoice is issued to the customer for the full amount of the program. It is at this time that Illinois ROT is required to be charged. However, the shipping information is clearly unknown at this point in time. Thereafter, title to the books and other materials sold by CLIENT are transferred to CLIENT's customers. At that time, the customer has sole discretion over any subsequent disposition of the books. The fact that the customer can order the publishers or CLIENT

to inscribe its name in the books before the books are shipped reinforces the fact that the customer has title over the books prior to shipment.

While Illinois law does not provide clear sourcing guidelines for ROT when the shipping information is unknown at the time of invoicing, there is clear language in the Streamlined Sales and Use Tax Agreement ('SSUTA' or the 'Agreement'). Under the Agreement, when the shipping destination is not known at the time an invoice is issued, 'the sale is sourced to a location indicated by an address for the purchaser that is available from the business records of the seller that are maintained in the ordinary course of the seller's business when use of this address does not constitute bad faith.' Streamlined Sales and Use Tax Agreement, Section 310 – 'Uniform Sourcing Rules'. Under this rationale, since CLIENT issues its customers initial invoices without the benefit of knowing the shipping information, it should charge sales tax based on the billing location of the customer.

Currently, 23 of the 45 states which impose a sales or use tax follow the rules outlined within the Agreement. In addition, all other non-Streamlined Sales Tax member states in which CLIENT operates have accepted this methodology as a reasonable means of determining the proper tax due. Although Illinois is not a member of the Governing Board, it has been an active participant in Streamlined Sales Tax Project meetings for years, including those years in which these sourcing rules were developed. For purposes of interstate sales of tangible personal property, Illinois applies destination sourcing, which is the concept adopted by Section 310 of the Agreement. We submit the Streamlined Sales Tax Project language as strongly persuasive authority where Illinois law is silent as to the sourcing treatment on transactions where the shipping information is unknown at the time of original invoicing. We further submit that the fact that all other non- Streamlined Sales Tax members [sic] states in which CLIENT is doing business have accepted this methodology as reasonable to also be strongly persuasive.

Currently, CLIENT sells medical reference and education books to several pharmaceutical companies located across the country. While there are times when the CLIENT is aware of the ship to address at the time of invoice, in most instances, CLIENT issues an invoice to the customer prior to knowing where the books would ultimately be shipped. CLIENT is in agreement that ROT should be charged based on the destination of where the books are shipped when such information is known at the time of invoice; however, CLIENT contends that it is impossible to charge ROT on a destination basis when such information is unknown at the time of invoice. As such, CLIENT asserts that another methodology must be employed to address these circumstances.

Whereas Illinois does not provide specific guidance, but utilizes the destination based approach to sourcing interstate sales of tangible personal property, it is logical to follow Section 310 of the Agreement, particularly where Illinois has no guidance to the contrary. As a result, when the ship to address is not known at the time of the sale, the bill to address would be the default. CLIENT does not dispute the fact that tax is owed on books that are ultimately shipped into Illinois. CLIENT is merely arguing that it is not its duty to collect this tax when the shipment information is not known at the time of sale; under Illinois law, when CLIENT invoices its customer. It is unimaginable that the State would ever place such an undue burden on a Seller so as to force them to collect tax based on shipments that take place well after the sale has occurred. Based on the number of shipments in the facts at hand, this would be unduly burdensome to CLIENT.

V. Specific Rulings Requested

Based on the analysis above, the following are specific, limited, rulings being requested by CLIENT at this time:

- A. CLIENT contracts with Customer X, a large Illinois-based pharmaceutical company, for the sale of a SUBJECT Library Program in the amount of \$500,000. This price will include CLIENT's costs for the books, shipping fees, estimated tax, management fees and incidentals. Once the Purchase Order is accepted, CLIENT issues Customer X an invoice in the amount of \$500,000. CLIENT then prepares a library of books on SUBJECT and will place the books it chooses on an online ordering system. At this point, Company X offers these books as a promotional item, generally to doctors whom recommend their products. The doctors have the ability to order whichever book they want from the library through the use of this online ordering system. The doctors receive the books free of charge. On a daily basis, these orders are uploaded directly to its publishers, who process the order information, and then drop-ship the book directly to the doctor, who may be located anywhere in the United States. The library program includes a total of nearly 5,000 books and remains open for 2 years until all books are ordered and shipped.

Since the shipping information is unknown at the time the invoice is issued, CLIENT should charge Illinois ROT on the full invoice amount of \$500,000, where the best information available to CLIENT at the time of invoicing is the billing location of Customer X.

- B. Same facts as scenario A, except Company X is located in STATE.

Since the shipping information is unknown at the time the invoice is issued, CLIENT should charge STATE sales tax on the full invoice amount of \$500,000, where the best information available to CLIENT at the time of invoicing is the billing location of Customer X.

Based on the foregoing analysis, CLIENT respectfully requests that the Department issue a letter ruling in which it allows CLIENT to use the customer's billing address as the situs of the sale when the shipping locations of CLIENT's sale of medical reference books, which are ultimately shipped inside and outside of Illinois, are not known at the time of original invoicing.

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As you review the request, please feel free to contact me if you have any questions or require clarification in regard to any of the facts. Should you disagree with the above requested ruling, please call me to discuss your concerns prior to issuing a final ruling.

DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of

the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored.” 2 Ill. Adm. Code 1200.110(a)(4).

The Department has decided that it will not issue a Private Letter Ruling in regards to your request. The following general information should provide you with sufficient guidance regarding your request.

An “Illinois Retailer” is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a “retailer maintaining a place of business in Illinois” is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer’s Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer’s Illinois customers will still incur Use Tax liability on the purchase of the goods that are used in Illinois and have a duty to self-assess and remit their Use Tax liability directly to the State.

Illinois taxes the retail sale and use of tangible personal property under two separate but related statutes. The Retailers' Occupation Tax Act imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. These taxes comprise what is commonly known as "sales" tax in Illinois.

Note, when property is purchased and then given away in Illinois, the donor has made a taxable use of the property by making such gift. Therefore, it is the donor of the gift who is deemed the end user of the property and who is subject to the Use Tax, rather than the donee. See 86 Ill. Adm. Code 150.305(c) and see also 86 Ill. Adm. Code 130.2125(c) concerning “Gift Situations.” The donor may satisfy this Use Tax obligation either by paying tax to his supplier or by self-assessing Use Tax and paying directly to the Department as discussed above.

For general information regarding drop shipments, you may wish to review the Department’s drop shipment rules at 86 Ill. Adm. Code 130.225, which can be viewed on the Department’s website. These rules provide guidance in general drop shipment situations.

In your letter, you ask whether your client may use the customer’s billing address as the situs of the sale when the shipping information is not known at the time of original invoicing. Please note that if a retailer makes a sale of tangible personal property to someone in Illinois and does not know at the time of the sale where the tangible personal property will be delivered, it is generally presumed that it will be used in Illinois and, thus, would be subject to Illinois tax. If, however, the retailer later discovers that the tangible personal property was not delivered in Illinois, the retailer may file a claim for credit for the tax paid.

Please refer to the Department's regulation at 86 Ill. Adm. Code 130.1501, which describes the procedures used to obtain a credit for sales tax that is erroneously paid. Please note that only persons who have actually paid tax to the Department can file a claim for credit. Since retailers generally pay the tax to the Department, usually only retailers can file a claim for credit. In order to submit claims for credit, taxpayers must first establish that they have either borne the burden of the tax or that they have unconditionally repaid the amount of tax to the vendees from whom they have collected the tax. The taxpayers must apply for the credit in the manner described in the rule. Under Illinois sales tax laws, retailers are not required to file claims for credit. The Department has no authority to compel sellers to file a claim for credit. Whether or not sellers refund the taxes paid and file claims for credit with the Department is a private matter between sellers and purchasers.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Debra M. Boggess
Associate Counsel

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