ST 15-0001-GIL 01/07/15 Local Taxes
This letter discusses primary selling activities under the local sourcing rules. (See 86 Ill. Adm. Code 220.115.) (This is a GIL.)

January 7, 2015

Dear xxx:

This letter is in response to your letter dated December 16, 2014, in which you request information. 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 that 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 tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

As a general matter, your inquiry does not fit comfortably within the strictures of either a PLR or a GIL because the requester is not a taxpayer, and the request contains no specific factual information. Nevertheless, because you have inquired about rules that were only recently promulgated, and about which many stakeholders may have questions, your inquiry is sufficiently conducive to a response by GIL.

In your letter you have stated and made inquiry as follows:

XXX seeks clarification regarding the proper interpretation of the rule promulgated on July 25, 2014 that addresses "jurisdictional questions" concerning the local jurisdiction Retailers' Occupation Tax (*see, e.g.*, 86 Ill. Adm. Code 320.115), in light of the Illinois Supreme Court's recent opinion in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130 (2013).

Specifically, xxx seeks guidance from the Department on the following questions regarding the proper interpretation of 86 Ill. Adm. Code 320.115:

Question 1: How are the terms "discretion" and "authority" found in the first of the primary selling activities, subsection (c)(1)(A), to be interpreted in light of the Illinois Supreme Court's opinion in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130 (2013), and in light of the other authorities cited by the Department in sections (a) and (b) of the rule?

Question 2: How does the existence of a master sales agreement between a customer and a retailer affect the application of the first factor of the primary selling activities test? For example, when a sale to a customer has been pre-approved in whole or in part by a retailer under the terms of a master sales agreement, can sales personnel who subsequently process or "accept" purchase orders submitted by the customer satisfy the first primary selling activity?

Question 3: How is the phrase "takes action that binds it to the sale" found in the second of the primary selling activities, subsection (c)(1)(B), to be interpreted in light of the Illinois Supreme Court's opinion in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130 (2013), and in light of the other authorities cited by the Department in sections (a) and (b) of the rule?

Question 4: How does the existence of a master sales agreement between a customer and a retailer affect the application of the second factor of the primary selling activities test? For example, when there is a contractual relationship between the retailer and the customer prior to the acceptance of a purchase order, is the subsequent acceptance of a purchase order sufficient on its own to satisfy the second primary selling activity?

Question 5: How is the phrase "from which invoices are issued" found in the third of the primary selling activities, subsection (c)(1)(C), to be interpreted in light of the Illinois Supreme Court's opinion in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130 (2013), and in light of the other authorities cited by the Department in sections (a) and (b) of the rule? Is it possible, for example, for retailers to satisfy the third of the primary selling activities at a location where invoices simply leave the hands of retailers' personnel, despite that they are generated by personnel in a different location?

Question 6: How does the existence of a master sales agreement between a customer and a retailer affect the application of the presumption applying to sales over the Internet, found at subsection (d)(3) of the rule?

DEPARTMENT'S RESPONSE:

I. The Sourcing Rules

The Department adopted the sourcing rules that are the subject of this inquiry on June 25, 2014. The rules implement retailers' occupation tax statutes, which allow municipalities, counties and other municipal corporations to impose taxes on persons "engaged in the business of selling" in their jurisdictions. *See, e.g.*, 55 ILCS 5/5-1006 (authorizing counties to impose retailers' occupation tax on persons "engaged in the business of selling" within the county); 70 ILCS 3615/4.03(e) (authorizing the Regional Transportation Authority to impose a tax on persons "engaged in the business of selling" within a six-county region).

The Illinois Supreme Court held in *Hartney Fuel Oil Co. v. Hamer* that determining whether a seller is "engaged in the business of selling" in a particular jurisdiction within the meaning of the retailers' occupation tax acts requires an analysis of where the retailer engages in the "composite of activities" that comprise its business. 2013 IL 115130 ¶¶ 32-36. The local sourcing rules adopted by the Department provide guidance and direction to retailers and local taxing jurisdictions in applying the fact-specific analysis required by statute and case law.

The sourcing rules are divided into four parts. The first part provides relevant definitions. *See, e.g.*, 86 Ill. Adm. Code 320.115(a). Next, the regulations set forth the legal standard derived from the statutory language and case law interpreting that language. *Id.* § 320.115(b). Subsection (c) then applies that legal standard to retailers conducting selling activities in multiple

jurisdictions. *Id.* § 320.115(c). In particular, subsection (c) identifies those selling activities generally most important to the business of selling, *id.* § 320.115(c)(1), (c)(4), and explains the combination of selling activities that comprise the business of selling in a particular location. *Id.* § 320.115(c)(2), (c)(5), (c)(6). Lastly, subsection (d) recognizes that certain selling operations "with unique, complicated or widely dispersed selling activities" do not fit within traditional retail models. For certain retailers that fit within this category, subsection (d) provides "administrative shortcuts that balance the administrative difficulties presented by certain selling operations against the need for accurate tax assessment." 86 Ill. Adm. Code 320.115 (d)(1).

The four sections in the rule should be read together so that the legal standards set forth in subsection (b) inform the interpretation and application of the selling activities and presumptions identified in subsections (c) and (d). For example, when evaluating where a retailer engages in the selling activities identified in subsection (c), the Department, consistent with subsection (b)(6), will seek to identify the location where the substance of the activity takes place.

You have inquired about the meaning of the first three "primary selling activities," in subsection (c)(1), and how the rules apply to sales made under a "master sales agreement."

II. The Primary Selling Activities Test

Under the rule, a retailer is "engaged in the business of selling in" a particular taxing jurisdiction if it conducts at least three of five "primary selling activities" there. 86 Ill. Admin. Code § 320.115(c)(1)-(2). The primary selling activities are: employing sales personnel, entering a contract for the sale of goods, establishing terms of payment, maintaining inventory and directing/managing the business. § 320.115(c)(1). These activities are "primary" for two reasons.

First, they are nearly universal. Most sales of tangible personal property require someone doing the selling, (c)(1)(A); property to sell, (c)(1)(D); a contract for sale, (c)(1)(B); the payment of money, (c)(1)(C); and someone to direct and manage the business, (c)(1)(E). Because almost every retailer undertakes these activities, almost every retailer will be able to identify the location where these activities occur, and determine if three of these activities take place in a single location. Thus, the primary selling activities test in subsection (c) satisfies important practical criteria: it is predictable for retailers and administrable for the Department.

The primary selling activities also are "primary" because they are reasonable proxies for locations where retailers engage in multiple selling activities and take advantage of government services. *See Hartney* ¶¶ 34-36. The location of a retailer's headquarters, warehouses, and sales offices are places where, generally, retailers engage in numerous selling activities, including marketing, procurement, solicitation, negotiation, order acceptance, collection, administration, and initiation of delivery. Thus, these locations do not represent single selling activities at all, but instead serve as proxies for a composite of activities critical to the business of selling. *See, e.g., Hartney* ¶ 62. Moreover, these locations generally are physical structures where employees come and go on a daily basis, taking advantage of roads, bridges, police, fire, education, and transportation, which are the core services provided by local governments.

The other two primary selling activities – the location where sales contracts are entered, (c)(1)(B), and payment arranged, (c)(1)(C) – serve as checks on the primacy of headquarters, inventory and sales personnel. There may be atypical retailers that do not engage in multiple selling activities in their headquarters, or warehouses, or sales offices. The requirement that three primary selling activities occur in one location, however, prevents these atypical retailers from sourcing sales to locations where only insignificant selling activity occurs. Thus, the rule identifies locations where a composite of sales activity generally occur, and requires that at least three universal and critical selling activities occur in a single location.

In practice, the rule requires retailers to examine their selling operations to determine in which of three locations they conduct the composite of activities that comprise their business of selling: (1) the place from which they direct and manage their businesses; (2) the place where they store inventory, or (3) their bona fide sales offices. Each of these locations is a place where retailers are likely to engage in multiple selling activities and require the support and protection of government services. *Hartney* ¶ 36. None of these locations are likely to house only "minor steps in the business of selling." *Hartney* ¶ 61.

III. Sales Office

As noted above, the rule permits a retailer to source its sales to one of three locations: headquarters, location of inventory or sales office. However, the circumstances that allow sourcing to a sales office are more limited than those that allow sourcing to headquarters or the location of inventory. Under subsections (c)(2) and (c)(5), a retailer may source to the location of inventory or to its headquarters if it conducts at least three primary selling activities at that location *or* if a majority of primary and secondary activities occur there. However, a retailer may source to a sales office separate from its headquarters and inventory *only if* it conducts all of the first three primary selling activities in that location. The following description of the first three primary selling activities provides further guidance on when this standard may be met.

Subsection (c)(1)(A) – Location of Sales Personnel. Subsection (c)(1)(A) identifies as a primary selling activity the place where "sales personnel" are located. Sales personnel are defined as those "exercising discretion and authority to solicit customers on behalf of a seller and to bind the seller to the sale." To meet this definition, sales personnel must have actual power to determine whether or not a retailer will do business with a given customer. See http://www.merriam-webster.com/dictionary/discretion ("discretion" is "the right to choose what should be done in a particular situation"); http://www.merriam-webster.com/dictionary/authority ("authority" means "the power or right to direct or control"). Thus, the first of the primary selling activities refers to those individuals to whom the retailer has delegated significant authority to decide when, where, and to whom the retailer will sell goods, and who hold the power to "bind the seller to the sale" based on their decisions. If there is no single location where sales personnel exercise sufficient discretion and authority to both solicit customers and complete sales, then the retailer cannot rely on the first selling activity when determining where to source its sales.

Subsection (c)(1)(B) – Agreement to Sell. Subsection (c)(1)(B) identifies as a primary selling activity the "location where the seller takes action that binds it to the sale." This refers to the location where the retailer's personnel perform the final action necessary to commit the retailer to a contractually binding relationship.

Subsection (c)(1)(C) – Payment. Subsection (c)(1)(C) identifies as a primary selling activity the "location where payment is tendered or received, or from which invoices are issued with respect to each sale." This provision recognizes that a seller may receive payment at its place of business or have payment sent directly to a third party, like a financial institution. It also recognizes that payment may be made in advance of delivery, at the time of delivery, or after delivery pursuant to an invoice. If payment is "tendered or received" at a seller's business location, then a retailer may satisfy the third primary selling activity at that location. If payment is not "tendered or received" at a seller's place of business, then this selling activity occurs at the location where the retailer engages in the conduct necessary to prepare and submit an invoice.

In summary, under the rule, in order to source a sale to a sales office separate from a retailer's headquarters or the place where it keeps inventory, a retailer must meet all three of the first three primary selling activities described above. This means the retailer must employ sales personnel, solicit customers, enter agreements, accept payment or prepare invoices, and bind itself to performance in that location. § 320.115(c)(1)(A)-(c)(1)(C).

IV. Master Sales Agreements

None of the provisions in the rule specifically apply to sales made under a "master sales agreement." This is because the diversity of terms within "master sales agreements" makes it impossible to impose one-size-fits-all rules applicable to all such agreements. Rather, subsection (c) requires a retailer to evaluate all of its selling activities to determine whether any three of the five primary selling activities occurred in the same location, and, if not, whether the retailer conducts more selling activities at the location where it keeps inventory or its headquarters. A retailer selling pursuant to a "master sales agreement" therefore must include among the activities it reviews those activities associated with the negotiation, consummation and performance of the agreement. The broad inquiry required by subsection (c) precludes retailers from relying solely on the location of the personnel who receive, process or accept purchase orders under a "master sales agreement" or any other sales agreement. *See Hartney*, 2013 IL 115130 ¶ 62.

Under subsection (d)(3), certain sales of tangible personal property over the Internet are presumed to be subject to Use Tax. This presumption applies when a consumer places an order "through a consumer-based retailer website available without limitation on the world wide web." As a corollary, sales made through web-based applications accessible only to established members or customers generally would not meet the criteria set forth in subsection (d)(3). The presumption established in that section, therefore, would not apply to such sales.

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.

Sincerely,

_____

Paul Berks
Deputy General Counsel
Illinois Department of Revenue
100 W. Randolph Street, 7th Floor
Chicago, IL 60601
(312) 814-4680
Paul.Berks@illinois.gov