

ST 15-0005-PLR 01/21/2015 LOCAL TAXES: The occupation of selling is comprised of the composite of many activities extending from the preparation for, and the obtaining of, orders for goods to the final consummation of the sale by the passing of title and payment of the purchase price. Thus, establishing where "the taxable business of selling is being carried on" requires a fact-specific inquiry into the composite of activities that comprise the retailer's business. 86 Ill. Adm. Code 270.115. (This is a PLR.)

January 21, 2015

Dear Xxxx:

This letter is in response to your letter dated July 28, 2014, in which you request information, and the follow-up letter you sent on October 31, 2014, providing us additional 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 who is the subject of the request for ruling and only to the extent the facts recited in the PLR is 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.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

In conformity with the requirements of 2 Ill. Adm. Code 1200.110, I respectfully request a Private Letter Ruling ("PLR") on behalf of COMPANY. (COMPANY or the "Company"). A Power of Attorney authorizing my representation of COMPANY is attached. (See Attachment A)

Neither COMPANY nor any related taxpayer is currently under audit by the Illinois Department of Revenue (the "Department" or "IDOR") or involved in litigation with IDOR concerning the issues that are the

subject of this ruling request. COMPANY, previously submitted the same or a similar issue to the Department, in a request for a private letter ruling dated MONTH 1, 200x. On MONTH 2, 200x, the Department issued a private letter ruling to COMPANY in care of its representative REPRESENTATIVE. (See Attachment B) Subsequent to the issuance of the Department's private letter ruling, on MONTH 3, 200x the undersigned, as COMPANY's representative, sought a clarification of Department's MONTH 2, 200x private letter ruling. On MONTH 4, 200x the Department issued another private letter ruling to COMPANY's to the undersigned as COMPANY's representative. (See Attachment C)

The facts presented in the prior requests for the private letter ruling were premised upon the anticipated relocation of certain of the Company's selling activities, including the credit review and analysis function and purchase order review and acceptance function, from LOCATION A to LOCATION B. Subsequent to receipt of the Department's MONTH 4, 200x private letter ruling, COMPANY determined that it would maintain these functions at the LOCATION A facility rather than moving these selling activities to LOCATION B. The shift of these functions to LOCATION B would have required the relocation of long-time employees of COMPANY, including the Credit Manager and Billing Manager. The Credit Manager and other staff expressed a reluctance to move from their homes in the LOCATION A area to the LOCATION B area. To avoid the potential risk of losing long-time employees, and after further investigating the costs of shifting these functions to LOCATION B, the company decided to maintain these operations at the LOCATION A location.

COMPANY has been audited by the Illinois Department of Revenue for sales and use tax compliance on two occasions subsequent to the issuance of the private letter rulings. In the course of each audit, the Department's auditors were made aware of the fact that contrary to the letter ruling, certain of the Company's selling activities, including the credit review and analysis function and purchase order review and acceptance remained in LOCATION A and were never shifted to LOCATION B. During each audit, the Department's auditors examined the manner in which COMPANY sourced its sales, for the purposes of applying the correct rates of locally-imposed taxes. In each instance, the Department concluded that COMPANY properly sourced its sales by sourcing over-the-counter sales to the location at which the sales occurred, and after a review of the company's selling activities the Department concluded that COMPANY properly charged and collected local retailers' occupation taxes on other sales at the LOCATION A rate. This ruling request applies to all periods after the Illinois Supreme Court's decision in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130. This ruling request was precipitated by *Hartney* decision. COMPANY seeks confirmation that for periods after the *Hartney* decision the Company's over-the-counter sales should continue to be sourced to the Illinois

location at which the sale occurs and, confirmation that when the selling activities of the Company are evaluated in light of the rules developed by the Department after the Hartney decision sales other than over-the-counter sales remain properly sourced to LOCATION A.

All interested parties are identified, as are the business reasons for the transaction. An analysis of the relation of the material facts to the issues is set forth below. A complete statement of the facts and other information pertinent to the request for ruling is set forth below.

STATEMENT OF FACTS

The company is a full-line supplier of pipe, valves, fittings, plumbing, hydronics, HVAC and pumps, to industrial, commercial, and institutional customers in northern Illinois, STATE 1, STATE 2, STATE 3 and STATE 4, [sic] The company has locations in 21 cities (10 of which are in Illinois – LOCATION 1, LOCATION 2, LOCATION B, LOCATION A, LOCATION 3, LOCATION 4, LOCATION 5, LOCATION 6, LOCATION 7 and LOCATION 8) throughout its market territory. (See Attachment D for a list of all locations, the square footage of each facility and the number of employees at each location.) The Company does not manufacture any of the products it distributes.

The Company makes a combination of in-person over-the-counter sales to customers and telephone sales. Most sales involve telephone orders. The phone order process revolves around a phone system that links all the Company's locations, and that enables customers to call and have immediate access to the appropriate product specialist, no matter where the customer may call from, and no matter where the job may be located.

The process usually begins when a customer simply calls in an order. However, in some cases, the process begins when a customer gives a written purchase order to one of the Company's salespeople, who then calls the order in to the office. In other limited cases, the process begins when a customer works directly with the product manufacturer, who faxes the Company a request for a purchase order for the particular product, which the Company then resells directly to the customer.

Once a call is received at a location, an inside salesperson fills in a series of fields on a special screen on a computer connected to the Company's computer network. The salesperson inputs: the customer name, contact name, purchase order number, job number, job name, item description, mill specifications, quantity requested, price, payment method, delivery method, and freight option. If the customer has an open account with the Company, the order is subject to a credit review by the Credit Manager in the LOCATION A office.

Once the Credit Manager completes his or her review and conditionally accepts a customer order the order is routed electronically to a computer terminal in the LOCATION A office where the order is reviewed by the Billing Manager to verify that it meets the company's pricing and profit standards. If it does, the margin condition is waived and our client accepts the order. If it does not, the Billing Manager adjusts the price, releases the margin condition and then accepts the order.

STATEMENT OF AUTHORITIES

On November 21, 2013, the Illinois Supreme Court ruled on the local tax sourcing case *Hartney Fuel Oil Co. v. Hamer*, 2013IL 115130 (Ill. 2013). In *Hartney*, the court first ruled against the Illinois Department of Revenue and in favor of Hartney. The Supreme Court held that Hartney was not liable for back taxes because it complied with the Department's sourcing regulations. However, the court then held that the Department's sourcing regulations were invalid as exceeding the Department's statutory authority.

On January 22, 2014 the Department adopted emergency rules that were published at 38 *Illinois Register* 4047-4164. The Department also proposed permanent rules on February 7, 2014 that were published at 38 *Illinois Register* 3502-3521. The Department withdrew the proposed permanent rules and re-proposed new permanent rules.

The proposed permanent rules were adopted through the normal rulemaking process of the Illinois Administrative Procedure Act and were published in the *Illinois Register* on July 11, 2014. The emergency rules and the original proposed permanent rules were identical with one exception. A provision dealing with long-term or blanket contracts was contained in the emergency rules, but was not contained in the revised proposed rules that were refiled after the withdrawal of the original proposed rules and was not included in the adopted rules. The proposed permanent rules were modified in a number of respects by the Department in response to public comment.

We note that COMPANY is subject to a number of the locally-imposed retailers' occupation taxes at its various Illinois locations. The other locally-imposed retailers' occupation tax regulations are identical in substance to the Home Rule Municipal Retailers' Occupation Tax rules. In the interest of brevity, in this ruling request we cite only to the Home Rule Municipal Retailers' Occupation Tax rules, but seek rulings applicable to all of the locally-imposed retailers' occupation taxes.

The adopted regulations for Part 270 consist of a definitions subsection (a) and three additional subsections. Subsection (b) includes a discussion which explains that a retailer's selling activities determine the taxing

jurisdiction because the tax is imposed on the business of selling and not specific sales. This subsection makes clear that the jurisdiction in which the sale takes place is not necessarily the jurisdiction where tax is owed.

Subsection (c) establishes five primary factors to determine the location where the company engages in selling activity. This subsection provides that a retailer engaging in three of the five primary factors at a location must source the sales to that location. Subsection (c) of the rules also contains the application of the primary selling activities to common selling operations – over-the-counter sales, vending machine sales, and sales from vehicles carrying an uncommitted stock of goods. Finally, subsection (c) establishes six secondary selling activities to be reviewed if a company does not have three of the five primary factors in any one location.

Subsection (c)(4) provides that if the retailer is not engaged in selling in a jurisdiction under an evaluation using the primary or secondary factors, it is presumed to be engaged in selling at the location of its headquarters, absent clear and convincing evidence to the contrary. In Subsection (d), the rules conclude with a set of presumptions applying to certain selling operations. In the case of in-state inventory/out-of-state selling activity if selling activities occur outside the state, but the property sold is in a seller's Illinois inventory, the location of the inventory is the location of local tax sourcing. In the case of sales over the Internet, the Department will presume that the retailer's predominant selling activity takes place outside the state of Illinois, but the presumption may be overcome if the tangible personal property is in Illinois inventory at the time of sale and the customer takes possession of the property at the retailer's place of business in Illinois.

In the analysis portion of this private letter ruling request we evaluate the selling activities of COMPANY in the context of the regulations.

ANAYLSIS

Section 270.115(a) of the rules begins with a definition of selling activities and states that the term "selling activities":

. . . refers to those activities that comprise 'an occupation, the business of which is to sell tangible personal property at retail.' 'Selling activities' includes 'the composite of many activities extending from the preparation for, and the obtaining of, orders for goods to the final consummation of the sale by the passing of title and payment of the purchase price. *Ex-Cell-O Corp. v. McKibbin*, 383 Ill. 316, 321 (1993).

Section 270.115(b) begins with the premise that a retailer's selling activities determine the taxing jurisdiction and, therefore, the proper local tax rate. Section 270.115(b)(1) explains that the jurisdiction in which the sale takes place is not necessarily the jurisdiction where the tax is owed. Rather, it is the jurisdiction where the seller is engaged in the business of selling that can impose the tax. Section 270.115(b)(2) affirms that establishing where the taxable business of selling is being carried on requires a fact-specific inquiry into the composite of activities that comprise a retailer's business.

Section 270.115(b)(5) states that a seller incurs local sales tax liability ". . . if its predominant and most important selling activities take place in the municipality." The Department's regulations, through a series of bright line tests and the elucidation of a series of factors to be used in analysis of the selling activities are designed to determine the location of a retailer's "predominant and most important selling activities."

As noted above, COMPANY has two types of sales – over-the-counter sales at its various locations, and sales via the telephone.

A. Over-the-Counter Sales

Section 270.115(c) of the Department's rules is entitled "Application of Composite of Selling Activities Test to Retailers Conducting Selling Activities in Multiple Taxing Jurisdictions." A bright line test is established for "over-the-counter" sales.

Section 270.115(c)(3)(A) addresses over-the-counter sales and states:

If a person is present at a place of business owned or leased by a retailer and there enters into an agreement with the retailer's sales personnel to purchase tangible retailer's personal property, and makes payment for that property at the same place of business, then the retailers' occupation tax for that sale is incurred at the retailer's place of business where the sale occurred regardless of whether the purchaser takes immediate possession of the tangible personal property, or the retailer delivers or arranges for the property to be delivered to the purchaser.

As explained in the Statement of Facts, COMPANY makes over-the-counter sales from each of its Illinois locations. Any time a customer appears at the counter of an Illinois location and makes a purchase, the customer is charged the tax rate in effect at that location. For example, an over-the-counter sale at the LOCATION 6 location is subject to the

City of ZZZZ general merchandise tax rate which is currently 9.25%. If an over-the-counter sale is made in LOCATION 5, the general merchandise rate of 7.5% is charged, while over-the-counter sales in LOCATION 8 are taxed at the rate in effect in LOCATON 8.

The Department's regulation defining over-the-counter sales sets forth situations in which a purchaser either takes possession of the property immediately, or the seller ships the property to the purchaser. In the case of over-the-counter sales made by COMPANY, in some instances a customer will immediately take possession of the items purchased at the time of the purchase, but in many instances the customer will request that COMPANY deliver the property to the customer's location – generally a job site. In such instances, the items purchased may be delivered from another COMPANY Illinois location that has the items in stock to the selling location and from there delivered to the customer. Alternatively, the location that has the items in stock may deliver the products directly to the customer. Additionally, in certain other limited instances it is possible that the items could be drop-shipped from a manufacturer.

As a result, the Company's particular facts fit squarely into the Department's regulation. Consistent with the regulation, all over-the-counter sales by COMPANY should continue to be sourced to location of that sale, including instances in which the items purchased are filled from inventory from other locations or drop shipped from a manufacturer.

B. Telephone Sales

As explained above, most sales made by the Company involve telephone orders. As a result, the Department rules provide that the sourcing of these sales is to be evaluated in light of Section 270.115(c) of the Department's rules. These sales do not fall within the scope of the bright line tests established in Section 270.115(c)(3).

Section 270.115(c) is entitled "Application of Composite of Selling Activities Test to Multi-Jurisdictional Intrastate Sales." Section 270.115(c)(1) sets forth a series of five "primary" factors to be used in determining the proper sourcing of sales of multi-jurisdictional sellers. Section 270.115(c)(2) states that a retailer "engaging is [sic] three or more primary selling activities in one location in the State after a particular sale shall remit the retailer's occupation tax imposed by the taxing bodies with authority to impose retailers' occupation tax on those engaged in the business of selling in that location." When the Company's selling activities are evaluated in light of the primary factors, it is clear that sourcing of telephone sales to the Company's LOCATION

A location properly reflects the location where “[its predominant and most important selling activities take place. . . .”¹ [sic]

Section 270.115(c)(1) lists the "primary factors." The primary factors consist of: 1) location of sales personnel exercising discretion and authority to solicit customers on behalf of a seller and to bind the seller to the sale; 2) the location where the seller takes action that binds it to the sale, which may be acceptance of purchase orders, submission of offers subject to unilateral acceptance by the buyer or other actions that bind the seller to that sale; 3) location where payment is tendered and received, or from which invoices are issued with respect to each sale; 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, and 5) the location of the retailer's headquarters, which is the principal place from which the business of selling tangible personal property is directed or managed. In general, this is the place at which the offices of the principal executives are located. When executive authority is located in multiple jurisdictions, the place of daily operational decision-making is the headquarters.

With regard to the first primary factor, the sales personnel exercising discretion to solicit customers are present throughout the Company's locations. Those sales personnel exercising discretion and authority to bind the Company are located in LOCATION A.

With regard to the second primary factor, all orders are reviewed at the LOCATION A location by a Billing Manager to determine whether a proposed offer meets the Company's pricing and profit standards prior to submission to a potential customer and a Credit Manager at the LOCATION A location who evaluates the credit worthiness of customers.² LOCATION A is the location where the Company takes action that binds it to the sale. Purchase order acceptance occurs at LOCATION A, as does final review and approval of all ongoing credit arrangements, as well as final review and approval of offers subject to unilateral acceptance by the buyer.

¹ 86 Ill. Adm. Code 270.115(b)(5)

² It should be noted that due to the volume of sales made by the Company, the LOCATION A employees do not literally review every individual sales transaction. Initial orders by new customers are reviewed for adherence to these policies and so long as subsequent transactions entered into with established customers adhere to these standards no manual intervention is required. Similarly, LOCATION A employees do not literally review every individual sales transaction for continuing credit worthiness. An initial evaluation is made and appropriate credit lines are established for new customers. Existing customers are monitored to ensure compliance with credit limits and satisfactory payment, and within limits established through the Company's automated systems this is done electronically for individual transactions.

With respect to the third primary factor, invoices are issued from LOCATION A directing payments to be made to the lockbox of the Company's bank.

As to the fourth factor, inventory can be located at any of the Company's Illinois locations. The primary factor in determining the location from which inventory is shipped in situations in which the items purchased are available at multiple locations of the Company is the location of the customer. Inventory is shipped from the location closest to the customer. Shipping from the location closest to the customer allows for more timely delivery and is more economical for the customer because shipping charges are lower. In certain situations, a particular item may not be available at all locations. In such instances, the item will be shipped from the closest location from which the items [sic] is available.

As to the fifth factor, executive authority is located at multiple Company locations, as is daily operational decision-making. Although as noted above, the daily operational decision making relating to the Company's selling activities is headquartered at LOCATION A.

A review of the facts discloses that three of the five primary factors occur at the Company's LOCATION A location. Employees with discretion to bind the Company are located in LOCATION A and purchase orders are accepted at LOCATION A. Offers to customers are reviewed by the LOCATION A office for conformity to pricing and profit standards. Credit reviews of customers and potential customers are the responsibility of employees of the LOCATION A office.

As stated by Paul Berks, the Department's Deputy General Counsel in his testimony on the Department's emergency rules before JCAR on March 19, 2014 in response to a question by Senator Rezin:

If a retailer makes a good faith determination that there is a preponderance of primary factors in favor of one particular tax sourcing location, it should on solid ground in not weighing the other factors. The Court said a fact-dependent, case-specific analysis is needed. Some retailers have really complicated selling operations because of the nature of their business. So if you combine a complicated selling operation with the fact-based analysis required, some seller will have very close cases. DOR can issue Private Letter Rulings to help. No letter requests have been received to date.

Even though sourcing of telephone sales to LOCATION A is required pursuant to the primary factors and a review of the secondary factors is in our estimation unnecessary, a review of the secondary factors

reaffirms that LOCATION A is the appropriate location for the sourcing of telephone sales. The secondary factors are: location where marketing and solicitation occur; location where the seller engages in activities necessary to procure goods for sale; location of the retailer's officers, executives or employees with authority to set prices or determine other terms of sale if determinations are made in a location different than that identified in subsection (c)(1)(A); location where purchase orders or other contractual documents are received when purchase orders are accepted, processed, or fulfilled in allocation or locations different from where they are received; location of where title passes; and location where the retailer displays goods to prospective customers, such as a showroom.

As discussed above, marketing and solicitation can, and does, occur at all of the Company's locations. The Company engages in activities necessary to procure goods for sale at multiple locations. As explained above, in the analysis of the first primary factor, Section 270.115(c)(1)(A), LOCATION A is the location of the Company's officers, executives and employees with authority to set prices or determine terms of sale. Purchase orders are rarely received in paper form, but all purchase orders whether in paper or electronic form are reviewed, evaluated and accepted in LOCATION A. Title to property purchased by customers passes F.O.B. destination. The Company does not display goods or maintain showrooms but rather, as discussed, engages in over-the-counter sales at its various locations.

RULINGS REQUESTED

For all periods after the Illinois Supreme Court's decision in *Hartney Fuel Oil. v. Hamer*, COMPANY seeks the following rulings:

- 1) Confirmation that the Company's over-the-counter sales should continue to be sourced to the Illinois location at which the sales occur (the location at which a customer physically appears to make a purchase) regardless of whether the customer takes immediate possession of the property purchased, the property is shipped to the purchaser from inventory maintained at the selling location, or the property is shipped from another Company location or the property is drop shipped from a manufacturer.
- 2) Confirmation that all other sales of the Company should continue to be sourced to LOCATION A because when the Company's selling activities are evaluated in light of the principles of *Hartney* and Section 270.115(c) of the Department's regulations, it is clear that ". . . its

predominant and most important selling activities take place. . ." in LOCATION A.

The taxpayer is unable to locate any authority contrary to the views set forth above. In the event that the Department wishes additional information, please contact the undersigned at your convenience. My direct telephone number is # and my e-mail address is [ADDRESS](#). In the event that the Department disagrees with the analysis set forth above, anticipates an adverse ruling or anticipates declining to issue a binding private letter ruling, Taxpayer respectfully requests a meeting to discuss this matter prior to the issuance of any final ruling by the Department.

DEPARTMENT'S RESPONSE:

In response to the Illinois Supreme Court decision in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, 376 Ill. Dec. 294 (2013), the Illinois Department of Revenue revised the administrative rules that govern the sourcing of local retailers' occupation taxes. See 86 Ill. Adm. Code 270.115. The rules provide that:

The occupation of selling is comprised of "the composite of many activities extending from the preparation for, and the obtaining of, orders for goods to the final consummation of the sale by the passing of title and payment of the purchase price". *Ex-Cell-O Corp. v. McKibbin*, 383 Ill. 316, 321 (1943). Thus, establishing where "the taxable business of selling is being carried on" requires a fact-specific inquiry into the composite of activities that comprise the retailer's business. *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130, paragraph 32 (citing *Ex-Cell-O Corp. v. McKibbin*, 383 Ill. 316, 321-22 (1943)).

Based on a review of the activities described in your letter and the supplemental information provided to the Department and an analysis of the Department's regulations found at 86 Ill. Adm. Code 270.115, the Department finds that COMPANY's over-the-counter sales should be sourced to the LOCATION A location at which the sale occurs (the location at which a customer physically appears to make a purchase). Further, based on this review and analysis, the Department finds that, with respect to the sales other than the over-the-counter sales discussed above, COMPANY is engaged in three or more primary selling activities in LOCATION A and therefore these sales should be sourced to LOCATION A. See 86 Ill. Adm. Code 270.115(c)(2). For this reason, we have not analyzed the secondary factors in the context of your selling operations.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm.

Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Chairman, Private Letter Ruling Committee

RSW:DMB