

ST 15-0019 GIL 03/18/2015 NEXUS

This letter responds to a questionnaire regarding nexus. See *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992). (This is a GIL.)

March 18, 2015

Dear XXXX:

This letter is in response to your letter dated November 21, 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 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](http://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:

We are writing to ask you to complete the questionnaire for the **2015 COMPANY State Tax Department Survey** on behalf of your state. Attached is an Excel spreadsheet containing the questions for 2015. One column of the spreadsheet has all of your state’s responses for 2014. An adjacent column is there for you to record your responses for 2015. To avoid any errors, please fill out the 2015 column even if the answer has not changed from 2014.

If you would like to add or change information you have previously recorded in the comments section, please make those modifications in red font. If you have any questions about this or if there is any way I can help you to complete this year’s questionnaire, please contact me at [NAME@EMAIL](mailto:NAME@EMAIL) or [XXX- XXX-XXXX].

The survey covers many of the gray areas of state tax law. Your responses will provide useful guidance for taxpayers in complying with your state's laws.

**The questionnaire should be completed based on state law as of December 31, 2014.**

Some new questions have been added to this year's questionnaire. The new questions and subsections are denoted in blue font.

As in previous years, the questionnaire asks you about nexus-creating activities for income tax and sales tax purposes, deductions for state and local income taxes, conformity to federal I.R.C. §338(h)(10) elections, conformity to the I.R.C. §108 exclusion of income from discharge of indebtedness, the tax treatment of intangible holding companies, and whether your state employs a throwback and/or throwout rule. In addition, it asks you to indicate the extent of your state's conformance to the Streamlined Sales and Use Tax Agreement.

Your responses, along with the responses we receive from other states, will be published by COMPANY, a leading publisher of international, federal, and state tax analysis. More information about COMPANY can be found at [EMAIL](#).

**Please return your questionnaire to us by January 31, 2015.** Your completed excel spreadsheet should be emailed to me at [NAME@EMAIL](#).

I look forward to working with you.

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In your questionnaire, you have stated, in part, as follows:

**XI. Sales Tax Nexus Policies**

- A. Please identify any statute, regulation, or administrative pronouncement that sets forth your state's sales tax nexus policy.**
- B. Nexus Enforcement Policies (New for 2015)**
- C. Sourcing and Method of Delivery**
- D. Social Media Coupons**

**XII. Sales Tax Nexus Creating Activities**

Please indicate "Yes" or "No" to show whether each of the following activities or relationships performed by an out-of-state corporation would,

by itself, create substantial nexus with your state for purposes of triggering the imposition of sales tax collection requirements on the corporation.

When determining whether the listed activity/relationship would create substantial nexus, assume that each item is the only activity/relationship the corporation has in your state. Also assume that the out-of-state corporation has no property or employees located in your state.

A “Yes” response means that an out-of-state corporation's performance of the listed activity/relationship would, by itself, create substantial nexus and trigger the imposition of sales tax collection requirements on the corporation. A “No” response means that an out-of-state corporation's performance of the listed activity/relationship would not, by itself, trigger nexus for purposes of your state's sales tax.

For the questions that you believe require more than a “Yes” or “No” answer, please set forth in the comments section the factors that your state would consider in making a nexus determination.

- A. General Activities**
- B. Remote Sales**
- C. Temporary or Sporadic Presence**
- D. Activities of Unrelated Parties**
- E. Financial Activities**
- F. Activities with Affiliates**
- G. Internet Activities**
- H. Activities Related to Digital Property**
- I. Distribution and Delivery**
- J. Third-Party Solicitation Activities and Attributional Nexus**
- K. Transactions Involving Franchise Agreements**
- L. Service Providers**
- M. Cloud Computing**
- N. Registration with State Agencies/Departments (New for 2015)**
- O. Drop Shipment Transactions (New for 2015)**
- P. Conformity to Streamlined Sales and Use Tax Agreement (SSUTA) Provisions (as of Jan. 1, 2015)**

#### **DEPARTMENT'S RESPONSE:**

We are unable to respond to your nexus survey in the format provided. Determinations regarding nexus are very fact specific and cannot be addressed in the context of a General Information Letter. However, we can provide you with basic guidelines that may be used to determine whether a seller would be considered “an Illinois retailer” subject to Retailers’ Occupation Tax liability or “a retailer maintaining a place of business in Illinois” subject to Use Tax collection duties from their Illinois customers.

## NEXUS

An "Illinois Retailer" is one who makes sales of tangible personal property in Illinois. 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. Our regulations were recently amended in response to the Illinois Supreme Court's decision in *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130. The regulations specify the selling activities that trigger Retailers' Occupation Tax liability in Illinois.

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 United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910. The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Zehnder*, 171 Ill.2d 410, (1996).

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 and have a duty to self-assess and remit their Use Tax liability directly to the State.

Beginning July 1, 2011, the definition of a "retailer maintaining a place of business" was amended to include additional types of retailers. A retailer maintaining a place of business also includes a retailer having a contract with a person located in this State under which:

- A. The retailer sells the same or substantially similar line of products as the person located in this State and does so using an identical or substantially

similar name, trade name, or trademark as the person located in this State;  
and

- B. The retailer provides a commission or other consideration to the person located in this State based upon the sale of tangible personal property by the retailer. See 35 ILCS 105/2(1.2).

These provisions only apply if the cumulative gross receipts from sales of tangible personal property by the retailer to customers in this State under all such contracts exceed \$10,000 during the preceding 4 quarterly periods. Please note that in *Performance Mktg. Ass'n, Inc. v. Hamer*, 998 N.E. 2d 54 (2013) the Illinois Supreme Court struck down 35 ILCS 105/2(1.1) and 35 ILCS 110/2(1.1), a “click-thru nexus provision” enacted in 2011. However, new provisions became effective January 1, 2015. The following provisions address the court’s concerns in *Performance Mktg. Ass'n, Inc. v. Hamer*, 998 N.E. 2d 54 (2013).

Beginning January 1, 2015, a retailer maintaining a place of business also includes a retailer having a contract with a person located in this State under which the person, for a commission or other consideration based upon the sale of tangible personal property by the retailer, directly or indirectly refers potential customers to the retailer by providing to the potential customers a promotional code or other mechanism that allows the retailer to track purchases referred by such persons.

Examples of mechanisms that allow the retailer to track purchases referred by such persons include but are not limited to the use of a link on the person's Internet website, promotional codes distributed through the person's hand-delivered or mailed material, and promotional codes distributed by the person through radio or other broadcast media. These provisions apply only if the cumulative gross receipts from sales of tangible personal property by the retailer to customers who are referred to the retailer by all persons in Illinois under such contracts exceed \$10,000 during the preceding 4 quarterly periods ending on the last day of March, June, September, and December. A retailer meeting these requirements shall be presumed to be maintaining a place of business in Illinois but may rebut this presumption by submitting proof that the referrals or other activities pursued within this State by such persons were not sufficient to meet the nexus standards of the United States Constitution during the preceding 4 quarterly periods. See ILCS 105/2(1.1).

### COMPUTER SOFTWARE AND DIGITAL GOODS

Generally, retail sales or transfers of “canned” computer software are taxable in Illinois regardless of the means of delivery. For instance, the sale or transfer of canned computer software downloaded electronically would be taxable. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See 86 Ill. Adm. Code 130.1935(c). Custom computer programs or software must be prepared to the special order of the customer.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Please note that it is very common for software to be licensed over the internet and the customer to check a box that states that they accept the license terms. Acceptance in this manner does not constitute a written agreement signed by the licensor and the customer for purposes of subsection (a)(1)(A) of Section 130.1935. To meet the signature requirement for an exempt software license, the agreement must contain the written signature of the licensor and customer.

A license of canned software is subject to Retailers' Occupation Tax liability if all of the criteria set out in 86 Ill. Adm. Code 130.1935(a)(1) are not met.

The Department does not consider the viewing and downloading of video, text and other data over the internet to be the transfer of tangible personal property. Therefore, such viewing and/or downloading activity over the internet would not be subject to liability under the Retailers' Occupation Tax Act, Use Tax Act, Service Occupation Tax Act, or Service Use Tax Act. Please note, however, the transfer of any canned software (or update of canned software) is considered the transfer of tangible personal property and will be subject to Retailers' Occupation Tax and Use Tax liability, regardless of the means of delivery. See 86 Ill. Adm. Code 130.1935(a). The transfer or sale of canned software downloaded electronically would be taxable.

## SOCIAL MEDIA COUPONS

We are currently examining this topic.

## SERVICE PROVIDERS

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (*i.e.* servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities.

## STREAMLINED SALES AND USE TAX AGREEMENT (SSUTA)

Illinois is not a member of the SSUTA. Public Act 92-221, effective August 2, 2001, created the Simplified Sales and Use Tax Administration Act, which authorized Illinois to enter into multistate discussions to review and/or amend the Streamlined Sales and Use Tax Agreement and which authorized the Illinois Department of Revenue to enter into the Streamlined Sales and Use Tax Agreement. Illinois has not enacted the conforming legislation required to be in compliance with the Agreement. However, beginning on September 1, 2009, Illinois began taxing candy, soft drinks, and grooming and hygiene products using definitions similar to SSUTA definitions.

## DROP SHIPMENTS

The Department's regulations regarding Drop Shipments can be found at 86 Ill. Adm. Code 130.225. A drop-shipment situation is normally one in which out-of-State purchaser (Purchaser) makes a purchase for resale from a company (Company) which is registered with Illinois and has that Company drop-ship the property to Purchaser's customer (Customer) located in Illinois. For purposes of this discussion, it is assumed that Purchaser is an out-of-State company that is not registered with the State of Illinois and does not have sufficient nexus with Illinois to require it to collect Illinois Use Tax.

Company, as a seller required to collect Illinois tax, must either charge and collect tax or document appropriate exemptions when making deliveries in Illinois. In order to document the fact that its sale to Purchaser is a sale for resale, Company is obligated by Illinois to obtain a valid Certificate of Resale from Purchaser. See 86 Ill. Adm. Code 130.1405 for the requirements of a Certificate of Resale.

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

Very truly yours,

Cara Bishop  
Associate Counsel

CB:kd