

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

March 2, 2017

Dear Xxxxx:

This letter is in response to your letter dated November 10, 2016, in which you requested 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 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 questionnaires for the **2017 ABC Survey of State Tax Departments** on behalf of your state. Attached is an Excel spreadsheet containing the questions for 2017. One column of the spreadsheet has all of your state’s responses for 2016. An adjacent column is there for you to record your responses for 2017. To avoid any errors, please fill out the 2017 column even if the answer has not changed from 2016.

Additionally, we ask that you note where you have intentionally left questions blank. We are required to follow-up regarding any unanswered question; and making note of intentionally unanswered questions allows us to process and analyze the data faster. This can be accomplished by typing “blank” or “no response” in the answer column or simply noting in your e-mail that questions were left blank intentionally.

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 questionnaires should be completed based on state law as of January 1, 2017. If you would like to add or change information you have previously recorded in the comments section, please make those modifications in red font.

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

Please return your questionnaires to us by January 31, 2017. Your completed Excel spreadsheets should be e-mailed to me.

Your responses, along with the responses we receive from other states, will be published by ABC, a leading publisher of international, federal, and state tax analysis. More information about ABC can be found at www.XXXXX.com.

If you have any questions about this or if there is any way I can help you to complete this year's questionnaires, please contact me.

I look forward to working with you.

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

XIII. 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**
- C. Sourcing and Method of Delivery**
- D. Sharing Economy (New for 2017)**

XIV. 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 out-of-state corporation. When determining whether the listed activity/relationship would create substantial nexus, assume that each item is the only activity/relationship the out-of-state 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 out-of-state 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**
- O. Drop Shipment Transactions**

XV. Refund Claims, Qui Tam and Class Action Lawsuits

- A. Refund Claims (New for 2016)**
- B. Qui Tam and Class Action Lawsuits**

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 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 35 ILCS 105/2(1.1).

THE SHARING ECONOMY

The Hotel Operators' Occupation Tax Act ("HOOT") imposes a tax upon persons engaged in the business of renting, leasing or letting rooms in a hotel, as defined in the Act. HOOT defines "hotel" to include any building or buildings in which the public may, for consideration, obtain living quarters, sleeping or housekeeping accommodations. See 35 ILCS 145/2(1). HOOT defines "rent" as "the consideration received for occupancy, valued in money, whether received in money or otherwise, including all receipts, cash, credits and property or services of any kind or nature." See 35 ILCS 145/2(6). The definition of "rent" must be read in conjunction with the term "occupancy." HOOT defines "occupancy" as "the use or possession, or the right to the use or possession, of any room or rooms in a hotel for any purpose, or the right to the use or possession of the furnishings or to the services and accommodations accompanying the use and possession of the room or rooms." See 35 ILCS 145/2(3).

Therefore, in the context of the provision of short-term accommodations that are rented through the use of a third party platform, like Airbnb, the third party platform is not liable for HOOT. Rather, the tax obligation is on the owner/host of the accommodations which are being rented.

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.

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 serviceman 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.

CLOUD COMPUTING/SOFTWARE AS A SERVICE

Currently, computer software provided through a cloud-based delivery system – a system in which computer software is never downloaded onto a client's computer and is only accessed remotely – is not subject to tax. The Department continues to review cloud-based arrangements. If, after review, the Department determines that these transactions are subject to tax, it will only apply this determination prospectively.

A provider of software as a service is acting as a serviceman. If the provider does not transfer any tangible personal property to the customer, then the transaction generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax. If a provider of a service provides to the subscriber an API, applet, desktop agent, or a remote access agent to enable the subscriber to access the provider's network and services, it appears the subscriber is receiving computer software. Although there may not be a separate charge to the subscriber for the computer

software, it is nonetheless subject to tax, unless the transfer qualifies as a non-taxable license of computer software. If the provider is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act and qualifies as a de minimis serviceman, the provider could elect to pay Use Tax on its cost price of the computer software.

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 an 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.

REFUND CLAIMS

Claims for credit and refunds are available when a person shows that he paid tax to the Department as a result of a mistake of fact or law. Only the remitter of the tax erroneously paid to the Department is authorized to obtain a refund. In order to obtain a credit, one must first demonstrate that he or she has borne the burden of the tax erroneously paid (e.g. the tax was refunded to the party who paid the tax). Claims for credit shall state the requirements that are contained in subpart (b) of the regulation. See 86 Ill. Adm. Code 130.1501(b).

QUI TAM AND CLASS ACTION LAWSUITS

Pursuant to the Illinois False Claims Act, 740 ILCS 175, a private party acting as a relator on behalf of the State, may bring a lawsuit against a taxpayer for underpaying sales tax. Further, Illinois courts have recognized class action suits for recovery of wrongly paid taxes. See *Geary v. Dominick's Finer Foods, Inc.*, 129 Ill. 2d 389 (1989); *Harrison Sheet Steel Co. v. Lyons*, 15 Ill. 2d 539 (1959).

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,

Cara Bishop
Senior Counsel