

If a retailer receives a reimbursement or rebate for a discount given to a purchaser on a sale, the amount of that reimbursement or rebate is considered part of the gross receipts received by the seller and is subject to Retailers' Occupation Tax. An incentive payment to a retailer that is not related to an individual sale is not considered part of gross receipts. *Chet's Vending Service Inc. v. Department of Revenue*, 71 Ill. 2d 38 (1978). See 86 Ill. Adm. Code 130.2125. (This is a PLR.)

August 16, 2018

Re: COMPANY
Private Letter Ruling Request

Dear Xxxxx:

This letter is in response to your letter dated March 26, 2018, 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.

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:

As counsel for, and on behalf of COMPANY ("COMPANY"), we, pursuant to 2 Ill. Admin. Code §1200.110, hereby formally request a Private Letter Ruling ("PLR"), confirming that, based upon the facts as represented below:

- (i) A retailer should not include vendor incentive payments in its gross receipts subject to ROT where the payments are not tied to the individual sale of a single product and are received in exchange for agreeing to sell a minimum number of units. The vendor incentive payments can, but are not required to, reduce the selling price of the product. Rather, the vendor incentive payments are used solely for promotional activities; and
- (ii) A retailer should not include vendor incentive payments in its gross receipts subject to ROT where the payments are not tied to the individual retail sale of a single product and are received in exchange for selling a vendor's product. There is no requirement to sell a minimum number of units. The vendor incentive payments can, but are not required to, reduce the selling price of the product. Rather, the vendor incentive payments are used solely for promotional activities; and
- (iii) A retailer should not include vendor incentive payments in its gross receipts subject to ROT where the payments are not tied to the individual retail sale of a single product and are received in exchange for selling a vendor's product. The vendor incentive payments can, but are not required to, reduce the selling price of the product. Further, the retailer is not restricted on its use of the vendor incentive payments; and
- (iv) A retailer should not include vendor incentive payments in its gross receipts subject to ROT where the payments are received based on the number of units purchased from the vendor (volume based incentive).

COMPANY is not currently under audit by the Department regarding this issue. In addition, COMPANY is not aware of any authority contrary to the views expressed in this PLR request. Furthermore, we ask that our client's name, address, and any contracts or exhibits attached be kept confidential and deleted from the publicly disseminated version of a PLR issued in response to this request. A Power of Attorney authorizing us to represent COMPANY before the Department in connection with this PLR is attached.

FACTS

COMPANY is a membership warehouse club that is dedicated to bringing a wide selection of quality brand-name merchandise at the best possible prices. COMPANY provides a wide selection of merchandise, plus the convenience of specialty departments and products. COMPANY is able to deliver low prices to its customers, in part, due to its large membership base which provides tremendous buying power.

COMPANY differentiates itself from other supermarkets and competitors by carefully choosing and committing to a limited number of vendors and products for placement in its warehouses. For example, COMPANY warehouses carry about XXXX different products compared to the 30,000 found at most supermarkets. COMPANY often promotes new and existing products by giving free samples and/or informational materials and performing in-store demonstrations. COMPANY also offers product discounts, coupons, rebates and/or incentives to its customers (collectively referred to as “Incentive Program”). In the past, physical coupons were provided to COMPANY customers in monthly mailers and in in-store booklets. Customers were required to present the physical coupon at the point of sale in order to claim the discount. COMPANY has digressed from this method and currently provides discounts through instant rebates which automatically reduce the purchase price of an item at the point of sale without the requirement of a physical coupon. Outlined below are COMPANY’s alternative Incentive Programs being contemplated (Attachments 1-4) in further detail.

Attachment 1 –Vendor Funding Contract

Attachment 1 proposes COMPANY and the vendor agreeing that COMPANY will sell, with a specified time period (which COMPANY may unilaterally extend for up to 30 additional days), a minimum number of product units. The vendor will provide funding to COMPANY on a “per unit sold” basis, but the vendor does not require COMPANY to use the funds to reduce the selling price of the product. Rather, COMPANY is only required to use the vendor funds “solely for promotional activities.” To the degree COMPANY opts to use some or all of the vendor payment for a temporary price reduction, they do so subject to a maximum amount of price reduction per unit that is agreed to between COMPANY and the vendor.

The vendor may also opt for a maximum coverage for each contract where it can impose a unit and/or dollar cap on the program. The vendor payment can be made in a variety of ways, including a deduction from the vendor payment.

Attachment 2 –Vendor Funding Contract

Attachment 2 sets forth a proposed agreement that is similar to that included in Attachment 1, with one difference – there is no requirement to sell a minimum number of units.

Attachment 3 –Vendor Funding Contract

Attachment 3 has terms similar to the agreements in Attachments 1 and 2, with the exception that attachment 3 is silent on the permitted usage of vendor funds. There is a requirement to sell a specified minimum number of units during the

contract period. There is also a maximum temporary price reduction per unit provision as described above. However, there is no requirement of a reduction in the selling price.

Attachment 4 –Purchase Discount Contract

Attachment 4 contemplates COMPANY moving to a program where COMPANY commits to purchase a certain minimum numbers of units by a certain date from the supplier in exchange for a per unit discount. The parties agree that per unit discount would continue on all amounts above the minimum purchased as well, unless specifically not agreed to. The program has set beginning and end dates, though COMPANY would retain the right to extend the end date for up to 30 additional days. As this is a minimum purchase agreement, COMPANY would not be obligated to sell the product at a specified price during the term of the promotion. The vendor payment to COMPANY could come in a number of different forms, but as under the current system, the most common method contemplated would be in the form of an offset to the payment to the vendor for the underlying product. This situation is most akin to a purchase discount based on volume.

ILLINOIS LAW & ANALYSIS

The Retailer's [sic] Occupation Tax is imposed upon persons engaged in the business of selling tangible personal property as retail. 35 ILCS 120/2. The ROT is imposed on a retailer's "gross receipts" from sales of tangible personal property. 35 ILCS 120/2-10. The Act defines the term "gross receipts" from sales of tangible personal property as the "total selling price" of such sales. 35 ILCS 120/1. The term "selling price" is defined as the "consideration for a sale valued in money whether received in money or otherwise, ... and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever. ..." *Id.* The Department defines gross receipts as "all consideration actually received by the seller, except traded-in tangible personal property." 86 Ill. Adm. Code §130.401.

The Department's regulations discuss the impact of applying a discount coupon, rebate or incentive to the selling price of tangible personal property. See 86 Ill. Admin. Code Section 130.2125. Where a seller receives full or partial reimbursement for a discount coupon, it incurs ROT on the receipts received from the purchaser plus the amount of any reimbursement from the manufacturer received for the discount coupon. *Id.* However, where a seller receives payments from a vendor or manufacturer for handling charges or administrative expenses in processing coupons, such payments are not subject to tax is [sic] they are clearly distinguished from coupon value reimbursement." 86 Ill. Admin. Code Section 130.2125(b)(2)(B).

In the context of automobile sales, the Department provides additional guidance on the treatment of incentive payments. The regulations identify five examples of incentive payments which are not subject to ROT. Ultimately, the taxation of an automobile dealer incentive depends on whether the payment received from a source other than the purchaser is conditioned upon the retail sale of an automobile. 86 Ill. Admin Code § 13.2125(f) (emphasis added) [sic]. Thus, if a dealer receives a payment in exchange for the purchase of an automobile from a manufacturer, and that payment is not conditioned upon the sale of that automobile, the amount of payment is not subject to ROT. *Id* at example 2.

Similarly, dealer hold-back payments are not subject to ROT. An example of a dealer-hold back is where the manufacturer will make quarterly payments to the dealer for a designated percentage of the invoice price of each vehicle purchased from the manufacturer. In this example, the payment is not conditioned on the retail sale, but rather on the quantity that the retailer purchases from the manufacturer. 86 Ill. Admin Code § 13.2125(f)(Example 3) [sic].

Where a vehicle manufacturer agrees to pay an incentive, for each vehicle that a dealer purchases during a specified promotional period, such payment is not subject to ROT. 86 Ill. Admin Code § 13.2125(f)(Example 4) [sic]. This is because the payment is conditioned on the purchase by the dealer from the manufacturer, and not the retail purchase. *Id*.

If a bonus incentive payment is made by a manufacturer and the payment is conditioned on a performance measure, such as obtaining a benchmark customer service index score, then the incentive payment is not conditioned on the retail sale and is not subject to ROT. See 86 Ill. Admin Code § 13.2125(f)(Examples 5, 6) [sic].

While the Department's regulations on incentive, volume, and performance-based payments deal exclusively with the automobile industry, the examples are analogous to COMPANY's proposed Incentive Programs and should be applied here. In *Chet's Vending Service, Inc. v. The Department of Revenue*, 71 Ill. 2d 38 (1978) the Illinois' Supreme Court held subsidy and guarantee payments made by a third party, that were in addition to the monthly receipts collected by the retailer, were not subject to ROT. The taxpayer was engaged in the business of catering food and beverages to employees at industrial locations. There were two types of contracts under dispute between the taxpayer and the Department. In the first contract, the taxpayer supplied food and beverage service to employees and paid ROT based on all moneys received from the sales to employees. In addition to this payment, the taxpayer received a "fixed fee" or monthly subsidy payment from its third party employer. Under the second contract, if the taxpayer's receipts from sales to employees did not cover its costs, the third party employer made up the difference by making a "guarantee payment" at month end.

Under both contracts, the Court found there was “no basis for relating any portion of the fixed fee or guarantee payment to any individual sale as part of the “selling price.” *Chet’s Vending Service, Inc.*, 71 Ill. 2d 38, 42 (1978). To hold otherwise would have required the Court to find that the sales at each customer location during a calendar month was one single sale between the employees purchasing meals and the employer making the additional month end payment. The Court noted that it was “wholly irrelevant” that the contracts may have had the purpose of reducing the cost or increasing profit. *Id.* at 43.

In *Ogden Chrysler Plymouth, Inc. v. Bower*, 348 Ill. App. 3d 944 (2d. Distr. 2004), the court held that a manufacturer’s reimbursement payment, which was tied to a specific purchase price, was subject to ROT. DaimlerChrysler Motors Corporation (“Chrysler”) implemented a program where active or retired Chrysler employees could purchase or lease a vehicle at the factory invoice cost. *Id.* at 947. In exchange for participation in the program, a dealer received from Chrysler 6% of the employee purchase price plus \$75. *Id.* When a vehicle came into the dealer’s stock, neither the dealer nor Chrysler was able to determine whether the vehicle would be sold under the program. *Id.* The purchase price is non-negotiable and the payment made by Chrysler does not affect the purchase price. *Id.*

Following an audit, the Department assessed the dealer for its failure to pay ROT on payments received from Chrysler pursuant to the program. The department contended that it was able to tie specific vehicle sales to the compensation received from Chrysler and thus, the payments were subject to ROT. *Id.* at 951. The taxpayer argued that the consideration received from the dealer was not part of the bargain or exchange between the purchaser dealer and that the dealer received consideration from two independent and unrelated transactions. *Id.*

In relying on *Chets’ Vending*, the Appellate Court found no merit in taxpayer’s argument and found that the transactions were not independent, but rather, each purchase was tied to a specific payment from Chrysler to the dealer. Additionally, the payment amount from Chrysler to the dealer corresponded to a specific purchase price. *Id.* at 954. Accordingly, the dealer’s payments received from Chrysler were subject to ROT. *Id.*

The Department’s regulations and the *Chet’s Vending* and *Ogden* decisions establish the rule that if the payment, or consideration, that is received from a third party is not conditioned on the individual retail sale of the subject item, then such receipts should be excluded from ROT. (See also *Cigarette buy-down Cases*, II. GIL 04-217-GIL (11/19/2004) where the Department found that incentive programs which require the manufacturer to reimburse the retailer for the difference between the price charged and the retail price of an item, that reimbursement is included in the gross receipts for the sale of that product if the discount is provided to the customer for a specific product). Therefore, applying

this rule to the Attachments at issue, COMPANY arrives at the following conclusions for each of its Incentive Programs:

Attachment 1 –Vendor Funding Contract

Under this contemplated Program Incentive, COMPANY contends ROT would not be due on any vendor payments because the payments are not conditioned on any individual sale. The payment is conditioned on COMPANY selling a minimum number of units. Conversely, the payment is not conditioned on any individual retail sale. Moreover, the vendor payment is to be used “solely for promotional activities.” While the payment may be used to reduce the price of the retail sale, it is under no obligation to do so. Accordingly, COMPANY believes the vendor payment is not subject to ROT under *Chet’s Vending*. Similarly, this Program Incentive is analogous to examples 2 and 4 in 86 Ill. Admin Code 130.2125(f) where a retailer’s receipt of an incentive payment was not subject to ROT where the payment was conditioned on the number of units sold by retailer (example 2) or purchased from the vendor (example 4).

Attachment 2- Vendor Funding Contract

COMPANY contends that ROT would not be due on any vendor payments received based on the same analysis applicable to Attachment 1.

Attachment 3 –Vendor Funding Contract

COMPANY contends that ROT would not be due on any vendor payments received based on the analysis applicable to Attachments 1 and 2 above. Additionally, the incentive payment in Attachment 3 differs from the payments in the attachments discussed, and is even more attenuated from the purchase of a single item, because the attachment is silent on COMPANY’s permitted usage of vendor funds. Simply, COMPANY has unlimited discretion in how it uses the vendor incentive payments. COMPANY may, but it is not required to reduce the retail purchase price, subject to maximum price reductions.

Attachment 4 –Purchase Discount Contract

COMPANY contends that ROT would not be due on any vendor payments received under Attachment 4 because the vendor payment is based entirely on the volume of items it purchases within a specified period of time. This situation is identical to the one described in Example 4 of the Department’s regulation 86 Ill. Admin Code § 130.2125(f). Moreover, Attachment 4 is not conditioned on any individual sale and the payment should not be subject to ROT. See *Chet’s Vending Service, Inc.*, 71 Ill. 2d 38 (1978). For example, if COMPANY receives a \$500 vendor payment for purchasing 100 items from the vendor, it is irrelevant whether COMPANY subsequently sells all 100 items or none of the items at retail. Regardless of its final retail sale of the items, COMPANY is entitled to the

\$500 vendor payment. Accordingly, the payment is not conditioned on any individual retail sale.

REQUEST FOR RULING

Pursuant to 2 Ill. Admin. Code Section 1200.110, COMPANY respectfully requests that the Department of Revenue issue a private letter ruling declaring:

- (i) COMPANY should not include vendor incentive payments in its gross receipts subject to ROT where the payment is not conditioned on an individual retail sale; rather, the payment is conditioned on COMPANY selling a minimum number of product units, the payment is to be used for promotional activities, and the payment is not required to be used to reduce the selling price of an item;
- (ii) COMPANY should not include vendor incentive payments in its gross receipts subject to ROT where the payment is not conditioned on the sale of a specific item or minimum number of product units; rather, the payment is to be used for promotional activities and it is not required to be used to reduce the selling price of an item;
- (iii) COMPANY should not include vendor incentive payments in its gross receipts subject to ROT where the payment is not conditioned on the sale of a specific item or minimum number of product units; under this incentive program, COMPANY is not restricted in how it uses the payment; and
- (iv) COMPANY should not include vendor incentive payments in its gross receipts subject to ROT where the payments are received based on the number of units purchased from the vendor (volume based incentive).

If you concur, please issue your favorable ruling to the undersigned. If you do not concur, please advise so that we may discuss your reasoning before an adverse ruling is issued.

DEPARTMENT'S RESPONSE:

A retailer incurs Retailers' Occupation Tax on its gross receipts from sales, which is defined as the total selling price of a sale. Under Section 1 of the Retailers' Occupation Tax, selling price means the consideration for a sale valued in money, whether received in money or otherwise, including cash, credits, property, other than as provided in the statutory definition, and services. 35 ILCS 120/1. The source of the consideration received by a retailer is immaterial in

determining the gross receipts subject to tax. See *Ogden Chrysler Plymouth, Inc. v. Bower*, 348 Ill.App.3d 944 (2004). Also see 86 Ill. Adm. Code 130.2125(a).

Use Tax is generally imposed on the selling price of tangible personal property purchased at retail. The Retailers' Occupation Tax Act and the Use Tax work together in a complementary manner. Whether discount coupons utilized by a purchaser for the purchase of tangible personal property constitute consideration for a sale depends upon whether the retailer receives any reimbursement for the amount of the discount. If the retailer receives full or partial reimbursement for the amount of the discount, the amount of the discount that is reimbursed is considered to be part of the selling price of the sale. The purchaser incurs tax on the entire selling price, including the amount of the discount paid to the retailer by the issuer of the coupon.

If a retailer allows a purchaser a discount from the selling price on the basis of a discount coupon for which the retailer receives no reimbursement from any source, the amount of the discount is not subject to Retailers' Occupation Tax liability. If a retailer allows a purchaser a discount from the selling price on the basis of a discount coupon for which the retailer will receive full or partial reimbursement (from a manufacturer, distributor or other source), the retailer incurs Retailers' Occupation Tax liability on the receipts received from the purchaser and the amount of any coupon reimbursement. 86 Ill. Adm. Code 130.2125(b).

In *Chet's Vending Service Inc. v. Department of Revenue*, 71 Ill. 2d 38 (1978), the court reviewed whether the "fixed fee" monthly subsidy or the "guarantee" paid by an employer to a caterer making food and beverage sales to the employer's employees were subject to Retailers' Occupation Tax. The Department argued that the payments by the employer "represent[ed] a 'two-party split' of the consideration for the transfer of tangible personal property between the employer and employee and that the payments received from both must be combined in computing the retailers' occupation tax." *Id.* at 42. The court, however, disagreed.

"The evidence shows no basis for relating any portion of the fixed fee or guarantee payment to any individual sale as part of the "selling price." To construe the terms "selling price" and "gross receipts" in the manner for which [the Department] contends would require us to hold that the manual or cafeteria-type sales at each industrial location during a calendar month were one sale to both the employer and the employees, the "selling price" of which was the aggregate of the sums received from the employees and the monthly payment received from the employer. . . . We have considered the arguments of the parties concerning the nature of the payments and conclude that whether the payments were made for the purpose of enabling plaintiff to reduce the cost of the food and beverages which it sells to the employees or to guarantee it a profit from its operation is wholly irrelevant. Under the clearly defined terms employed in the statute, the payments were not includable in plaintiff's "gross receipts.""

Id. at 42-43. The test enunciated by the court is whether there is any basis for "relating" any portion of the third-party payment to any individual sale.

In 2008, the Department amended 86 Ill. Adm. Code 130.2125 to specifically address automobile rebates and dealer incentives and provided a number of examples on the application of the rules. Incentives provided by manufacturers that are conditioned on additional sales or conditioned on meeting certain manufacturer required marketing standards, facility standards, or sales and service department satisfaction goals are not subject to tax. *See* 86 Ill. Adm. Code 130.2125(e)-(f). Although the rules apply to automobile rebates and incentives, the rules provide guidance when reviewing other rebate and incentive situations.

It is the Department's decision that, based on the facts provided by the Company, the vendor incentive payments described in your letter and Attachments 1 through 4 received by the Company are not related to individual sales of tangible personal property and are not included in gross receipts.

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 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:bk1