



STATE OF ILLINOIS

**DEPARTMENT OF REVENUE**

101 WEST JEFFERSON STREET  
SPRINGFIELD, ILLINOIS 62702

Springfield Office: 217 785-7570  
Chicago Office: 312 814-3190

BRIAN HAMER  
Director

PAT QUINN  
Governor

January 22, 2014

Vicki Thomas, Executive Director  
Joint Committee on Administrative Rules  
700 Stratton Building  
Springfield, Illinois 62706

Dear Ms. Thomas:

Please accept for review by the Joint Committee on Administrative Rules (JCAR) the enclosed emergency rules of the Illinois Department of Revenue (Department). These rules are being filed simultaneously with the Administrative Code Division of the Illinois Secretary of State in accordance with 1 Ill. Admin. Code §§ 100.600 and 100.610.

Introduction

On November 21, 2013, the Illinois Supreme Court invalidated the Department's rules governing retailers' occupation taxes imposed by local jurisdictions. *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130. This emergency rulemaking fills the void left by the *Hartney* decision, providing an immediate legal framework to businesses and government officials, while the Department works with all affected stakeholders to draft and promulgate permanent rules.

Illinois retailers require expedited guidance to enable them to collect and remit the correct retailers' occupation taxes for the jurisdictions in which they are engaged in the business of selling. Local governments, likewise, need certainty to forecast the revenue streams on which they rely to fund critical public services. Absent emergency rules, retailers are at immediate risk of collecting too little from their customers and facing liabilities to local taxing jurisdictions that they will never recoup. And local taxing jurisdictions, in turn, risk undercollecting the taxes needed to fund government operations. General rulemaking procedures would leave taxpayers and local taxing jurisdictions with inadequate guidance for an unacceptable duration. Emergency rules, therefore, are necessary.

## Circumstances Requiring Emergency Rulemaking

In *Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130 (November 21, 2013), the Illinois Supreme Court invalidated the Department's rules for determining which local retailers' occupation taxes apply to multi-jurisdictional retailers. *Hartney*, 2013 IL 115130 ¶ 64 (holding invalid 86 Ill. Admin Code §§ 220.115, 270.115 and 320.115). This rulemaking replaces the invalid regulations with new regulations responsive to the Supreme Court's decision.

Absent administrative rules, retailers attempting to comply with the law must rely exclusively on the statutory language and judicial decisions interpreting the statutes. But the statutes at issue are broadly worded to permit various local taxing jurisdictions to impose retailers' occupation taxes on any business "engaged in the business of selling tangible personal property" in their territories. And the Illinois Supreme Court has concluded that identifying the location of "the taxable 'business of selling' . . . requires a fact-intensive inquiry to determine 'each case according to the facts.'" *Hartney*, 2013 IL 115130 ¶ 32 (quoting *Ex-Cell-O Corp. v. McKibbin*, 383 Ill. 316, 321-22 (1943)). Consequently, without regulatory guidance, Illinois retailers must determine their tax rates by conducting their own "fact intensive" analysis of where they engaged in selling activities. Some retailers with business activities in more than one taxing jurisdiction in Illinois may have difficulty identifying the correct tax rates.

In fact, many groups and individuals representing Illinois retailers have complained that, after *Hartney*, retailers lack sufficient guidance to calculate their local tax liabilities accurately. They have advocated that the Department resolve this uncertainty through the rulemaking process. *See, e.g.*, Illinois Chamber of Commerce, Illinois Manufacturer's Association, Taxpayers' Federation of Illinois, Illinois Retail Merchants Association, "Joint Statement Before the Illinois Department of Revenue Regarding Sales Tax Sourcing Regulations," December 12, 2013 ("All sellers . . . are still required to collect tax after *Hartney*, and they should be given instructions that allow them to do so with a reasonable modicum of certainty.").

Equally important is that errors by retailers in calculating their local taxes directly impact the revenues of municipalities, counties and other taxing districts throughout the State. This is so because retailers recoup the retailers' occupation tax from their customers at the time of a sale. Therefore, a retailer that misidentifies its taxing jurisdiction may over-collect or under-collect the tax due. Local government bodies that rely on retailers' occupation taxes to fund government services (including transportation, education and public safety) lose the predictability necessary to forecast their revenue streams and plan public expenditures when the retailers responsible for remitting taxes are unsure of their legal obligations.

In short, the Department of Revenue is issuing these emergency rules to allow Illinois retailers to

order their business affairs so as to collect the correct amount of taxes from their customers, and remit the correct amount to the local jurisdictions in which they are engaged in the business of selling. These emergency regulations, therefore, serve the needs of both retailers and local governmental bodies, which, in the wake of *Hartney*, seek the guidance and predictability that these regulations provide.

### Substance of the Emergency Rulemaking

The Court in *Hartney* identified two flaws in the Department’s regulations. First, the regulations failed to “amply prescribe the fact-intensive inquiry contemplated by” the statute and the Court’s cases interpreting the statutory language. 2013 IL 115130 ¶ 61. Second, the regulations “impermissibly constrict[ed] the scope of” the statute by “allowing for only one, potentially minor step in the business of selling to conclusively govern tax situs.” *Id.* This rulemaking addresses the flaws in the prior regulation identified by the Supreme Court in *Hartney*.

The proposed rule contains three substantive parts. The first part of the rule, codified at 86 Ill. Admin. Code § 220.115(b),<sup>1</sup> identifies the core principles underlying the retailers’ occupation tax acts. First, the tax is imposed on the “occupation of selling” and not on specific sales. Second, determining where the occupation of selling takes place requires a fact-specific inquiry focused on where the retailer undertakes the selling activities that comprise its business. Third, the underlying purpose of the retailers’ occupation tax acts is to allow local jurisdictions to impose taxes on those retailers that take advantage of the public services they provide. These three principles repeatedly have been articulated and relied upon by the Illinois Supreme Court, and they inform the legal standard governing local retailers’ occupation taxes. 86 Ill. Admin. Code § 220.115(b).

The regulation’s second part, codified at 86 Ill. Admin. Code § 220.115(c), applies this fact-specific legal standard to the most common selling operations in the State. Based on experience and expertise, the Department estimates that more than 90% of Illinois retailers will find sufficient guidance in this part of the regulation to enable them to determine with certainty the jurisdictions in which they are subject to retailers’ occupation taxes. 86 Ill. Admin. Code § 220.115(c).

The regulation’s third part, 86 Ill. Admin. Code § 220.115(d), provides further guidance on applying the statute to the minority of Illinois retailers with less common selling operations; namely, unique retailers with selling activities in multiple Illinois jurisdictions. Taxpayer representatives have expressed concern that without regulatory guidance, the statute and case law could be understood to subject these retailers to “case-by-case weighing of a near limitless number of factors,” making it

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<sup>1</sup> There are ten separate regulations that govern the sourcing of local retailers’ occupation taxes. Each regulation refers to a different type of taxing jurisdiction with authority to impose a retailers’ occupation tax (i.e. county, municipality, transit authority, etc . . .). For convenience, this letter refers only to the proposed regulation governing county retailers’ occupation taxes. The proposed emergency regulations governing the other taxing jurisdictions are identical.

difficult for them to “understand what local taxes, if any, apply to their transactions.” The third part of this emergency regulation addresses this concern.

The regulation identifies four primary selling activities that, as a general matter, will dictate where a multi-jurisdictional retailer is engaged in the business of selling. Those activities are, in short: offer, acceptance, inventory, and sales personnel. These factors are derived from Illinois case law applying the retailers’ occupation tax act; the tax acts of those states that, like Illinois, source sales based on factors other than destination; and the common sense recognition that virtually every sale of tangible personal property involves, in some way, these critical selling activities: an offer to sell, acceptance of that offer, the goods that are the subject of the sale and the personnel that negotiate and consummate the sale. The location of these primary selling activities will, in most cases, reveal where the retailer is engaged in the business of selling. 86 Ill. Admin. Code § 220.115(d)(2)(A)-(d)(2)(D).

To the extent the primary selling activities fail to reveal the location of the business of selling, this emergency regulation provides five additional, secondary factors that also may be considered to determine the correct taxing jurisdiction. These factors, too, derive from Illinois case law applying the retailers’ occupation tax act and the statutory law of sister states. 86 Ill. Admin. Code § 220.115(d)(3)(A)-(d)(3)(E). These factors are: the location of the seller’s administrative functions, where solicitation takes place, contracts are received, title passes, and goods are delivered.

Lastly, for the rare retailer with selling activities dispersed to so many places that the seller’s location remains ambiguous even after consideration of all the relevant selling activities, the regulation will be applied consistent with the underlying statutory purpose and the judicial decisions interpreting the statute. In other words, because the retailers’ occupation tax acts were intended to impose tax liability on those that take advantage of government services, the regulation will be interpreted in accordance with this principle. 86 Ill. Admin. Code § 220.115(d)(4)(A). Similarly, the regulation precludes allowing “only one, potentially minor step in the business of selling to conclusively govern tax situs,” *Hartney*, 2013 IL 115130 ¶ 61, by expressly providing that it is the substance of the selling activities, and not their form, which controls, 86 Ill. Admin. Code § 220.115(d)(4)(B).

### Conclusion

In summary, the Supreme Court’s decision in *Hartney* left a gap in the legal framework governing local retailers’ occupation taxes. In response, the Department is promulgating these emergency rules, which provide important guidance on an expedited basis to thousands of Illinois retailers and local taxing jurisdictions. The rule corrects the flaws in the prior regulation that the Supreme Court identified in *Hartney*, and eliminates the uncertainty facing the overwhelming majority of Illinois retailers and taxing jurisdictions.

There may be some retailers that will be unsatisfied with the guidance provided here; for them,

only a bright line rule or one-factor test will suffice. However, the retailers' occupation tax acts prevent the Department from complying with the wishes of these taxpayers. The statutes impose liability in the location where the seller is engaged in the business of selling. The "business of selling" is the "composite of many activities." Thus, the statute precludes linking a local jurisdiction's taxing authority to a single, dispositive factor. *Hartney*, 2013 IL 115130 ¶ 61 (invalidating regulation because "by allowing for only one, potentially minor step in the business of selling to conclusively govern tax situs, this regulation impermissibly constricts the scope of intended taxation"). Many states have avoided the uncertainty that is inherent in a retailers' occupation tax by adopting a streamlined sales tax regimen that links sales tax to the place where the tangible personal property is delivered. If Illinois wishes to pursue such a policy, it must be initiated by the General Assembly, rather than the Department.

Sincerely,

Brian A. Hamer, Director  
Illinois Department of Revenue

cc: Senator Don Harmon  
Senator Pamela Althoff  
Senator Tony Muñoz  
Senator Sue Rezin  
Senator Dale A. Righter  
Senator Ira Silverstein  
Representative Timothy Schmitz  
Representative Gregory Harris  
Representative Louis I. Lang  
Representative David L. Leitch  
Representative Donald L. Moffitt  
Representative André Thapedi