ST 00-0111-GIL 06/28/2000 LOCAL TAXES

The Department looks to 86 Ill. Adm. Code 270.115 as guidance in determining the situs of the retail sale for Retailers' Occupation Tax and Home Rule Municipal Retailers' Occupation Tax purposes. (This is a GIL).

June 28, 2000

Dear Xxxxx:

This letter is in response to your letter dated March 21, 2000. We apologize for the delay in our response. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at http://www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter, you have stated and made inquiry as follows:

We are submitting this request for a general information letter on behalf of a client (the 'Company'). The subject matter of this inquiry is the application of county and municipal retailers' occupation taxes (collectively referred to as 'local sales taxes') to sales by the Company to customers located in Illinois under the circumstances described below.

Factual Background

The Company is a national mail order vendor of merchandise. The Company has no offices, stores, warehouses, or other facilities located in Illinois. The Company maintains its headquarters outside of Illinois. Its telemarketing facility is located outside of Illinois, as is its warehouse/fulfillment center, from which it ships orders to customers.

The Company makes sales to customers throughout the United States, including to customers located in Illinois. Orders are received by the Company over the telephone, through the mail, by facsimile, and by email. Orders are subject to acceptance by Company personnel located outside of Illinois. Once an order is accepted, the order information is entered into a computer terminal and transmitted to the Company's warehouse/fulfillment center outside of Illinois. From there, the ordered merchandise is sent directly to the customer by common carrier. Payment for the merchandise either accompanies the order form or is by customer credit card charge. The customer also pays for shipping and insuring the merchandise during shipment.

To provide its customers with a greater variety of products, the Company has recently entered into a form of 'drop shipment' arrangement with a third-party vendor (the 'Vendor'). The Vendor maintains a warehouse in COUNTY, Illinois. Under the arrangement with the Vendor, some products ordered by customers of the Company will

be shipped directly from the Vendor's warehouse in Illinois to the customers by common carrier.

The Company will continue to receive orders as before. All orders received by the Company will continue to be accepted outside of Illinois. Orders for merchandise maintained in the Company's out-of-state warehouse/fulfillment center will continue to be shipped from there by common carrier to the customer. However, when a customer (from within or outside Illinois) orders a product from the Vendor's inventory, after the order is accepted by the Company, the order information will be transmitted electronically to the Vendor and the product will be shipped from the Vendor's warehouse in Illinois to the customer by common carrier. Under the arrangement with the Vendor, an agent of the Company will be present on the docks of the Vendor's warehouse in order to sign the shipping manifest immediately before the common carrier takes possession of the merchandise to be shipped to the customer. At the time that the agent signs the shipping manifest, title to the merchandise will pass momentarily to the Company (from the Vendor) and, immediately thereafter, will pass to the customer at the moment the common carrier signs for and takes possession of the merchandise. The Company will, in effect, purchase the product from the Vendor, after which the Company will, in turn, sell the product to the ultimate customer. Under the arrangement, the Company will pay the Vendor an agreed amount for the products it purchases at wholesale from the Vendor and the Company will continue to be paid for the product by the ultimate customer. The customer will continue to pay for shipping and insuring the merchandise during shipment.

Question

The Company would like to know what its *local* sales tax obligations are with respect to sales to customers located in Illinois of products that are shipped from the Vendor's warehouse in Illinois.

Discussion

For the reasons outlined below, we believe that the Company ought not be required to collect any local sales taxes on sales made to customers located in Illinois.

Because purchase orders are not accepted by the Company in Illinois and because the Company does not maintain an inventory in Illinois from which it fills Illinois orders, it is not an 'Illinois retailer' within the meaning of 86 Ill. Adm. Code 130.605(a). Therefore, it is not liable for the Illinois retailers' occupation tax. The arrangement with the Vendor should not change this conclusion. The Company has registered with Illinois as an Illinois use tax collector and collects the Illinois use tax on sales made to Illinois customers.

Local sales taxes are generally triggered when 'selling' activity occurs in a local jurisdiction imposing a sales tax. The regulations provide that for a seller to incur local

sales tax liability in a given county or municipality, the sale must be made in the course of such seller's engaging in the retail business within such county or municipality. See 86 Ill. Adm. Code 220.115(b)(1); 86 Ill. Adm. Code 270.115(b)(1). The regulations further state that it is the Department of Revenue's opinion that the seller's acceptance of the purchase order is the most important single factor in the occupation of selling. See 86 Ill. Adm. Code 220.115(c)(1) and 86 Ill. Adm. Code 270.115(c)(1). Thus, where a purchase order is accepted in a jurisdiction that imposes a local sales tax, that tax will be triggered.

Where the purchase order is accepted outside of Illinois, the regulations look to where the property is located at the time of sale. Specifically, the regulations provide that if a purchase order is accepted outside Illinois, but the tangible personal property that is sold is in an inventory of the retailer located within a county or municipality at the time of its sale and then is delivered in Illinois to the purchaser, the place where the property is located at the time of the sale will determine where the seller is engaged in business for local sales tax purposes with respect to such sale. See 86 Ill. Adm. Code 220.115(c)(2) and 86 Ill. Adm. Code 270.115(b)(3). Thus, where a purchase order for a sale of tangible personal property is accepted out-of-state and the property sold is located in a jurisdiction that imposes a local tax, then that particular jurisdiction where the property is located is considered the seller's place of business for that particular sale.

The Department of Revenue has issued several general information letters and private letter rulings dealing with situations where an out-of-state retailer engaged a 'drop-shipper' to deliver products to customers in Illinois. In these drop-shipment arrangements, an out-of-state retailer purchases property for resale from a drop-shipper located in Illinois and arranges to have the drop-shipper deliver the product directly to the retailer's customer. Typically, the out-of-state retailer collects the sales price for the product from the ultimate customer. The out-of-state retailer then pays the drop-shipper an agreed amount pursuant to the terms of its contract for the wholesale purchase of the product. In these rulings, where the drop-shipper maintained inventory in Illinois, the Department of Revenue concluded that while the property sold by the out-of-state retailer was located in Illinois it was not inventory of the retailer, but instead was inventory of the 'drop-shipper.' As a result, the Department of Revenue concluded that since the out-of-state retailer neither accepted purchase orders in Illinois nor maintained an inventory in Illinois from which it sold tangible personal property to customers in Illinois, the out-of-state retailer had no obligation to collect local sales taxes. See e.g. Illinois Letter Ruling, St 97-0018 (Aug. 5, 1997).

Applying these regulations and principles to the Company's sales to customers in Illinois, we believe that the Company's local sales tax obligations are as follows:

(1) With respect to products that are shipped from the Company's out-of-state warehouse/fulfillment center, since the purchase orders are accepted outside of Illinois, these sales would not be subject to any local sales taxes.

(2) With respect to products that will be shipped directly from the Vendor's warehouse in Illinois, because the Company does not accept purchase orders in Illinois and because the Company itself does not maintain an inventory in Illinois, these sales would also not be subject to any local sales taxes since none of the 'selling' activity occurs in any local jurisdiction in Illinois. As in the drop-shipment rulings, the products to be shipped by the Vendor, although located in Illinois, are inventory of the Vendor and are not inventory of the Company. The fact that title to the products will momentarily pass to the Company (from the Vendor) when the Company's agent signs the shipping manifest (before immediately thereafter passing to the customer) does not change the fact that the Company will not maintain an inventory anywhere in Illinois within the meaning of the sales tax regulations.

Conclusion

With respect to sales made to Illinois customers, we believe that the Company's sole responsibility is to collect the Illinois use tax. Because it does not accept purchase orders in any local jurisdiction within Illinois, nor does it maintain an inventory in any local jurisdiction within Illinois, we believe that the Company will not have any responsibility to pay or collect any local sales taxes under the new arrangement with the Vendor.

Please provide us with the Department of Revenue's position on this issue. If you anticipate reaching a different conclusion from that set forth above, we respectfully request the opportunity to meet with you to discuss the matter further before you issue the general information letter.

Thank you, in advance, for your assistance in this matter.

Regarding jurisdiction issues and the imposition of local taxes in Illinois, see the enclosed copy of 86 Ill. Adm. Code 270.115 of the Home Rule Municipal Retailers' Occupation Tax. As you know, the Department looks to Section 270.115 as guidance in determining the situs of the retail sale for Retailers' Occupation Tax and Home Rule Municipal Retailers' Occupation Tax purposes. Local taxes are triggered when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order or other contracting action in the making of the sales contract. Consequently, if a purchase order, which is an acceptance of the seller's complete and unconditional offer to sell is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. In cases in which purchase orders are accepted outside Illinois, local taxes will be incurred when the tangible personal property which is sold is located in an inventory of the retailer in a local jurisdiction at the time of sale (or is subsequently produced by the home rule municipality), then delivered in Illinois to the purchaser.

From the information presented, your client does not maintain an inventory in Illinois from which the orders are filled. Rather, orders are filled from a supplier's inventory located in Illinois.

Therefore, no local taxes are incurred by your client, since no “selling” occurs in Illinois. However, since your client has a representative in Illinois, nexus is created, which triggers a Use Tax collection obligation.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.