

ST 16-0024-GIL-06/03/2016 NEXUS

A retailer maintaining a place of business in Illinois must collect tax from users in accordance with the Retailers' Occupation Tax Act and the Use Tax Act by adding the tax to the selling price of tangible personal property, when sold for use. See 86 Ill. Adm. 150.401. (This is a GIL.)

June 3, 2016

RE: General Information Letter ("GIL")
Sales and Use Tax - Nexus

Dear XXXXX:

This letter is in response to your letter dated April 13, 2016, 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 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:

This letter constitutes a request for a General Information Letter ("GIL"), under Ill. Admin. Code tit. 2, § 1200.120, with respect to whether the activities (described below) create a use tax collection obligation in Illinois.

STATEMENT OF FACTS

Our client ("the Company") is an online retailer that provides certain services and retail products to consumers located throughout the United States through a free membership program. The Company's employees handpick products for the Company's customers based on the customer's stated preferences. Once the recommended items are selected by the employee, the customer has an opportunity to approve the items to be delivered. This is accomplished through a preview email sent to the customer, at which point the customer can cancel or substitute any selected items in the order. Each customer must have a valid credit card on file, and prior to the shipment of any products to the customer, the Company verifies

the available credit on the customer's card. The selected products are then shipped to the customer via common carrier (FedEx and USPS).

When the customer receives the products, the customer has a certain number of days to examine them before the customer's credit card is charged. As long as the customer acts within the specified time period, the customer can return any products that the customer does not wish to keep via a prepaid return slip. The Company charges the customer's credit card for the products that the customer fails to return within the specified time period. Returns requested by the customer after this time period may be exchanged for store credit only. Returns requested more than 30 days after arrival are subject to a restocking fee.

The terms and conditions of each customer's agreement provide that the risk of loss for any products purchased by the customer passes to the customer when the Company delivers such items to the common carrier for initial shipment. In the same manner, title to each product is deemed to pass to the customer immediately upon delivery by the Company to the common carrier for shipment. The Company has no possession of the products while they reside with the customer in any states.

Participation in the Company's membership program is complimentary and the membership may be canceled at any time. The customer pays no monthly membership fees (or any other service fees) to the Company. The Company only charges its customers for completed sales of products under the terms explained above.

As part of the membership program, the Company occasionally includes small tchotchkes in its shipments which are provided free-of-charge to its members. These items are not for sale by the Company and the customers do not pay any fees for the retention of these items.

The Company does not presently have any employees, offices, warehouses, or other facilities or business property located in the state. On a very limited basis, the Company's employees travel to the state to passively participate in trade shows. The Company does not display its products at any trade shows and is not a vendor at these events. Rather, the employees are present merely as attendees to view the products on display. This activity occurs on average three days per year.

The Company markets its products through search engine optimization and online display advertisements such as Google, Facebook, and Twitter. The Company does not utilize click-through Internet advertising. The Company does not pay commissions to its online display advertisers (Google, Facebook and Twitter) for completed sales resulting from those ads. Additionally, the Company does not market its products through any of the following methods: telephone solicitations; live events; direct mail advertising; television, radio, or other broadcasting; local newspapers, magazines, or other print media; regional or national newspapers, magazines, or other print media; or through the distribution of catalogs.

The Company also utilizes a customer incentive program whereby it offers its members credits for referring other individuals to the Company through the use of a website link, which the existing member can share with an acquaintance on Facebook, via Twitter, or via email from the customer's Company account page. Existing members receive a specified one-time credit towards their monthly order when an acquaintance signs up for a membership through the website link and purchases a product.

At present time, the Company is not an affiliate of any other company doing business in the state; nor do any other companies doing business in the state solicit sales, process completed sales, make repairs, handle complaints from customers, or perform any other actions on behalf of the Company in the state.

ISSUES

Based on the Company's activities described above, does the Department consider Company to have a use tax collection obligation in Illinois?

STATEMENT OF LAW

35 Ill. Comp. Stat. § 105/2 provides:

"Use" means the exercise by any person of any right or power over tangible personal property incident to the ownership of that property, except that it does not include the sale of such property in any form as tangible personal property in the regular course of business to the extent that such property is not first subjected to a use for which it was purchased ...

"Sale at retail" means any transfer of the ownership of or title to tangible personal property to a purchaser, for the purpose of use, and not for the purpose of resale in any form as tangible personal property to the extent not first subjected to a use for which it was purchased, for a valuable consideration

...

"Retailer" means and includes every person engaged in the business of making sales at retail as defined in this Section.

"Retailer maintaining a place of business in this State", or any like term, means and includes any of the following retailers:

1. A retailer having or maintaining within this State, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this State under the authority of the retailer or its subsidiary, irrespective of whether such place of business or agent or other representative is located here permanently or temporarily, or whether such retailer or subsidiary is licensed to do business in this State. ...
 - 1.1 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. The provisions of this paragraph 1.1 shall 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 this State 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 the requirements of this paragraph 1.1 shall be presumed to be maintaining a place of business in this State 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.

35 Ill. Comp. Stat. § 105/3 provides in part:

A tax is imposed upon the privilege of using in this State tangible personal property purchased at retail from a retailer ...

35 Ill. Comp. Stat. § 105/3-45 provides in part:

Retailers shall collect the tax from users by adding the tax to the selling price of tangible personal property, when sold for use, in the manner prescribed by the Department. The Department may adopt and promulgate reasonable rules and regulations for the adding of the tax by retailers to selling prices by prescribing bracket systems for the purpose of enabling the retailers to add and collect, as far as practicable, the amount of the tax.

Ill. Admin. Code tit. 86, § 150.201 provides in part:

“Retailer” means and includes every person engaged in the business of selling tangible personal property for use, and not for resale in any form. ...

“Retailer maintaining a place of business in the State”, or any like term, shall mean and include any retailer:

Having or maintaining within this State, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this State under the authority of the retailer or its subsidiary, irrespective of whether that place of business or agent or other representative is located here permanently or temporarily, or whether the retailer or subsidiary is licensed to do business in this State;

...

It does not matter that an agent may engage in business on his or her own account in other transactions, nor that the agent may act as agent for other persons in other transactions, nor that the agent is not an employee but is an independent contractor acting as agent. The term “agent” is broader than the term “employee”. “Agent” includes anyone acting under the principal’s authority in an agency capacity.

Ill. Admin. Code tit. 86, § 150.801 provides in part:

(c) Every retailer maintaining a place of business in the State must act as a Use Tax collector for this State. Examples of cases in which a retailer will be required to collect and remit the Use Tax though not incurring any Retailers' Occupation Tax liability with respect to the transaction are these:

....

(2) Out-of-State retailers, who have any kind of place of business in Illinois or any kind of order-soliciting or order-taking representative either stationed in Illinois or coming into Illinois from time to time, must collect and remit the Use Tax, as such, from Illinois purchasers for use even though the seller is not required to pay Retailers' Occupation Tax when he does nothing in Illinois except to solicit orders.

TAXPAYER'S POSITION

The State of Illinois imposes an obligation to collect tax upon any retailer "maintaining a place of business in Illinois".¹ A retailer maintaining a place of business in the state means and includes: a retailer having or maintain within the state an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within the state under the authority of the retailer.² Illinois requires such a retailer to register with the state as an Illinois use tax collector.³ Ultimately, whether such a retailer is required to collect Illinois use tax from its customers is dependent upon whether that retailer has sufficient nexus with the State of Illinois so that the retailer will be subject to Illinois's sales and use tax laws.

The state's ability to impose nexus is limited by the Commerce Clause of the United States Constitution and the United States Supreme Court's interpretation of that Clause. The United States Supreme Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), made clear that a seller must have physical presence in a state before that state has jurisdiction to compel the seller to collect sales or use tax.⁴ Here, the Company is an out-of-state online retailer that sells products to customers located throughout the United States. The Company does not own or lease any business property or otherwise maintain a place of business in Illinois, nor does the Company engage the services of any agent in Illinois, accept any purchase orders in Illinois, or ship merchandise from inventories located within the State of Illinois.

All of the services that the Company provides, such as handpicking products for its customers, occur out-of-state. Additionally, the Company ships all of its products purchased by Illinois customers from out-of-state via common carrier. The United States Supreme Court in *Quill Corp. v. North Dakota* reaffirmed their holding in *Nat'l Bellas Hess, Inc. v. Illinois Dep't of Revenue*, 386 U.S. 753 (1967) that an out-of-state vendor whose only connection with the state was delivering goods to customers via common carrier into the state lacked the substantial nexus with the taxing state required under the Constitution.⁵ The Illinois Supreme Court specifically rejected the notion that a retailer's physical presence within the taxing state

¹ 35 Ill. Comp. Stat. § 105/2 and Ill. Admin. Code tit. 86, § 150.201.

² *Id.*

³ Ill. Admin. Code tit. 86, § 150.801(c).

⁴ *Quill Corp. v. N.D.*, 504 U.S. 298 (1992).

⁵ *Id.*

must be “substantial,” but rather the physical presence must be demonstrably more than a ‘slightest presence.’⁶

The Company’s limited presence in the state is restricted to the specific activities discussed in the following paragraphs. It is the Company’s belief that these activities are so limited that they would fail to satisfy the physical presence test outlined by the Supreme Court. Similarly, the Company does not believe Illinois’ current sales and use tax laws would enforce a collection obligation based on the Company’s limited in-state presence.

Limited Employee Presence at Trade Show Events

The Company’s employee presence in the state is limited solely to employees who on average attend trade shows in the state only three days out of the entire year. These employees do not solicit or make any sales during their attendance at these trade shows; they are there solely to view the products on display. In *Brown’s Furniture, Inc. v. Wagner*, 171 Ill. 2d 410 (1996) the Illinois Supreme Court held that there was sufficient physical presence in the state to establish substantial nexus for imposing a use tax collection responsibility on an out-of-state furniture company that made on average between 15 and 18 trips into the state a month.⁷ Unlike the Company’s employees attending trade shows, this was far more than three days out of the entire year. The Company’s employees are traveling into the state so infrequently for non-solicitation purposes that it would be difficult to describe this activity as “demonstrably more than a slightest presence.”

Limited Presence of Merchandise During Customer Examination Period

The Company allows its customer to receive the Company’s products and have a certain number of days to examine them before the customer’s credit card is charged. The customer is only charged for products that the customer fails to return within the specified time period. Nevertheless, the customer’s credit is verified prior to shipment of the products and the risk of loss and title to the products pass when the Company delivers them to the common carrier (FedEx or USPS) for shipment to the customer. In Illinois, a “sale at retail” means “any transfer of the ownership of or *title* to tangible personal property to a purchaser, for the purpose of use ... for a valuable consideration.”⁸ The Company believes that when the title and risk of loss are contractually deemed to pass to the customer upon shipment of the products to the customer, and such items belong to the customer and are exclusively in the sole possession of the customer during the examination period, these factors indicate that the property possessed by the customer would not create a physical presence for the Company in Illinois during the limited examination period.

Customer Incentive Program

In Illinois, a retailer is presumed to be a “retailer maintaining a place of business in this State” if the retailer has a contract with a person located in the State under which the person, for a consideration based on the sale of tangible personal property by the retailer, refers customers to the retailer by providing potential customers a promotional code or mechanism allowing the retailer to track such referred purchases, and as a result of such referrals the cumulative gross

⁶ *Brown’s Furniture, Inc. v. Wagner*, 171 Ill. 2d 410 (1996).

⁷ *Id.*

⁸ 35 Ill. Comp. Stat. § 105/2 (emphasis added).

receipts from sales of tangible personal property by the retailer exceed \$10,000 during the preceding four quarterly periods.⁹ A retailer may rebut this presumption by submitting proof that the referrals or other activities pursued in the State by such persons do not create sufficient nexus with the state during that time period.¹⁰ (“Click-thru Presumption”).

The Company utilizes a customer incentive program allowing members to receive a specified on-time credit towards a monthly order for referring an acquaintance to the Company through the use of a website link when such acquaintance signs up for a membership and purchases a product (“Customer Incentive Program”). The Company believes this program is distinguishable from the specific arrangements addressed in the state’s Click-Thru Presumption for several reasons. There is no formal contract between the Company and its current members that utilize the Customer Incentive Program (“participants”). The Company does not consider the participants agents of the Company nor are the participants otherwise acting under the authority of the Company to solicit sales or perform any other activities on behalf of the Company. Since the participants are not under a contract to make referrals on behalf of the Company, and the participants do not actively solicit business on behalf of the Company, the Company believes the Click-Thru Presumption should be successfully rebutted.

CONCLUSION

The Company does not believe that its limited activities within Illinois are sufficient to meet the nexus standards of the United States Constitution or satisfy the “retailer maintaining a place of business” criteria in the State of Illinois.

We would request the Department review the facts presented in this request and provide a GIL with regard to whether the Company’s activities create sufficient nexus with Illinois to require a use tax collection obligation. Due to the significant impact the Department’s determination could have on similarly situated members of the online retail industry, we would respectfully request that Department give thorough consideration to the issues and arguments provided herein.

Prior to the issuance of the GIL, we request an opportunity for a conference with the Department at a convenient time to discuss the facts and issues contained in this letter and respond to any questions the Department may have concerning this request.

DEPARTMENT’S RESPONSE:

Determinations regarding nexus are very fact specific and cannot be addressed in the context of a General Information Letter. We believe that nexus determinations are best made by auditors who are able to conduct the fact-intensive investigation that is required to make these determinations.

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.

⁹ *Id.*

¹⁰ *Id.*

Very truly yours,

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Associate Counsel

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