

Illinois's Online Retailer Legislation Offers Simplicity at a Price

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In this article, the authors discuss two revenue bills concerning online retailers recently passed by the Illinois General Assembly.

While the legislation eases the compliance burden on remote retailers, the laws raise practical concerns and likely constitutional issues.

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During the spring 2019 session, the Illinois General Assembly passed two laws aimed directly at online retailers, Public Act 101-0009 (S.B. 689) and Public Act 101-0031 (S.B. 690). S.B. 689 makes a marketplace facilitator — a business that contracts with sellers to promote their sale of wares on its marketplace — responsible for collecting and remitting Illinois use tax for sales made on their platforms by marketplace sellers. S.B. 690 requires remote retailers — sellers without a physical presence in Illinois that do not use a marketplace facilitator — to collect and remit Illinois's retailers' occupation tax including any applicable local tax (collectively, sales tax) based on the destination of the Illinois sale. Before this change, remote retailers with Illinois nexus generally collected only state use tax at the rate of 6.25 percent, because, outside Chicago, there is no local use tax in Illinois.

Marketplace Sellers

Beginning January 1, 2020, S.B. 689 requires marketplace facilitators and their affiliates with *Wayfair*¹ nexus in Illinois (\$100,000 in sales or 200 separate transactions) to collect use tax on Illinois sales facilitated through their marketplaces. A marketplace is defined as a physical or electronic place, platform, or forum, by which a marketplace seller sells or offers to sell items. A marketplace facilitator facilitates sales by listing items for sale and processing the sale or payment for the marketplace seller. The marketplace facilitator is the party responsible for maintaining books and records for sales

¹ *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080 (2018).

made through a marketplace and remitting the collected tax to the state.

However, marketplace sellers are required to provide the marketplace facilitator with the information (low rate of tax, high rate of tax, or purchaser exemption) necessary for the marketplace facilitator to correctly collect and remit tax on the items sold through the marketplace. Sales made through a marketplace facilitator's platform do not count as the marketplace seller's sales for purposes of Illinois's *Wayfair* nexus dollar or transaction thresholds. Accordingly, a marketplace seller will not have to also file Illinois sales or use tax returns on its own behalf, unless its sales not made through a marketplace facilitator independently establish Illinois nexus.

Leveling the Playing Field

Beginning July 1, 2020, remote retailers that have *Wayfair* nexus with Illinois are required to collect state and local sales tax on their sales to Illinois customers. Sales will be sourced for tax purposes to the destination, which is the location where the tangible personal property is shipped or delivered, or where the purchaser takes possession of the property. This means that remote retailers will collect tax based on the total Illinois sales tax rate for where the goods are shipped to or otherwise received by the remote retailers' customers. However, goods that are purchased from a retailer in Illinois, or from an out-of-state seller with a place of business or inventory in the state, will generally remain subject to tax using the total tax rate for the jurisdiction from which the goods are purchased or shipped.

S.B. 690 allows remote retailers to satisfy their Illinois sales tax collection and compliance burdens using certified service providers (CSPs). CSPs are companies that collect and remit sales and use tax on behalf of remote retailers. To ease the tax compliance burden on remote retailers and CSPs (Illinois has hundreds of local taxing jurisdictions with their own tax rates), the legislature tasked the Illinois Department of Revenue (DOR) with creating and maintaining electronic, downloadable databases that:

- define product categories and identify the taxability of each category;
- list all sales tax rates by jurisdiction; and
- assign a rate of tax based on Illinois delivery address using a nine-digit ZIP code identifier.

The DOR is required to establish standards for certifying CSPs. Use of a CSP absolves a remote retailer from any exposure for having collected or charged the incorrect amount of use tax. CSPs will be compensated for their services by giving them the right to receive the 1.75 percent vendor discount on Illinois sales — the discount remote retailers would have received if they collected the sales tax and timely remitted it to the state. The 1.75 percent fee paid to CSPs is set by statute and appears to be nonnegotiable.

Insights

Through the passage of S.B. 689 and S.B. 690, the legislature is presumably trying to align the state with the standards delineated by the U.S. Supreme Court in *Wayfair* by creating a minimally burdensome tax collection and remission process for remote retailers. The provisions in S.B. 690 providing for CSPs and the DOR-maintained taxability and tax rate databases should simplify a remote retailer's Illinois tax compliance burden and further the goal of minimizing the use tax collection and remission process for remote retailers.

However, Illinois's new tax scheme for remote retailers, which changes the remote seller sourcing rules to the destination location, instead of where the "business of selling" occurs, could lead to harsh results, and possibly run afoul of the U.S. Constitution's commerce clause. For instance, consider three neighbors that live on the same Chicago street. Each neighbor purchases the identical product from a different retailer. Neighbor 1 buys from a remote retailer; neighbor 2 buys through a marketplace facilitator; and neighbor 3 buys from a retailer based in Mark, Illinois. The remote retailer (or its CSP) will be required to collect sales tax using the 10.25 percent total state and local rate for Chicago. The retailer shipping goods from its location in Mark will only be required to collect sales tax using the

total state and local rate for Mark, currently 6.25 percent.² Finally, the marketplace facilitator will only be required to collect Illinois use tax at the state tax rate of 6.25 percent.

Thus, rather than leveling the playing field, as the legislature intended, the new remote retailer law appears to provide an advantage to in-state retailers and marketplace facilitators, by either encouraging Illinois customers to buy locally, forcing remote retailers to create a place of business in the state to avoid the possible tax rate differential illustrated above, or encouraging Illinois customers to buy through marketplace facilitators.

The U.S. Supreme Court has consistently held that states cannot engage in economic protectionism by burdening out-of-state competitors.³ Regardless of the legislature's intent, the remote seller law produces a result that is tantamount to economic protectionism, through the imposition of destination-based sourcing solely on remote retailers. Only remote retailers will face the choice of either bearing the economic burdens complying with the state's hundreds of local tax rates or giving up their 1.75 percent vendor discount by hiring a CSP to fulfill their Illinois tax reporting responsibilities. In-state sellers will not face this choice, because they will largely be required to collect Illinois tax at the rate for the locality from which they make sales or ship goods in Illinois. Marketplace facilitators will also avoid this choice because they will be allowed to collect tax using the rate of 6.25 percent state use tax rate.

The Supreme Court has held that a state may not tax a transaction "more heavily when it crosses state lines than when it occurs entirely within the State."⁴ However, as shown in the example, the same sale to a customer residing in Chicago, Illinois, can have a different and much higher tax liability, merely because the item is purchased from a remote retailer in interstate

commerce. This result, which potentially subjects goods purchased out of state to a higher tax levy than goods purchased locally, appears to discriminate against interstate trade and therefore runs afoul of the commerce clause.

In the end, if Illinois truly wants to level the playing field for retailers, it may have to bite the bullet and adopt destination-based sourcing for all sales, as most other states have done. That potential fix, however, may not sit well with some localities in Illinois with large warehouses or major retailers, because these localities could see their sales tax revenues decrease under a destination-based sales tax sourcing regime. ■

²The Mark retailer may also be required to collect the 1 percent Chicago use tax if it has nexus with Chicago.

³See, e.g., *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994) (holding that Missouri's 1.5 percent additional use tax on goods purchased outside the state violated the commerce clause).

⁴*Id.*, citing *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984).