

## The Fix Is In?

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In this installment of Insights From Former Insiders, the authors argue that while Illinois lawmakers recently enacted a measure to address potential

discrimination against remote retailers in another recent remote sales tax statute, the remedy is still discriminatory and will very likely result in litigation.

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In 2019 Illinois enacted P.A. 101-0031, which required, among other things, remote retailers<sup>1</sup> to charge sales tax based on the tax rate where their customer is located (that is, destination). As enacted, P.A. 101-0031 had an effective date of July 1, 2020 and was intended to apply only to remote retailers that (1) would make direct sales to Illinois customers (that is, sales into Illinois not made through marketplace facilitators), and (2) had economic nexus<sup>2</sup> with Illinois. All other vendors, such as brick-and-mortar and remote retailers making indirect Illinois sales through marketplace facilitators, were not subject to P.A. 101-0031, and thus would continue to charge tax on their Illinois sales using the origination tax rate. Although P.A. 101-0031 is titled the Leveling the Playing Field for Illinois Retail Act, the consensus in the taxpayer community was that P.A. 101-0031 failed to level the playing field and, in fact, discriminated against remote retailers.

The discriminatory effect of P.A. 101-0031 is easily illustrated by comparing the sales tax rate due on a widget sale to a Chicago customer by a remote retailer with that by an Illinois-based retailer. P.A. 101-0031 requires a remote retailer to charge its Chicago customer a 10.25 percent sales tax (the rate in Chicago), while an out-of-state retailer making a sale through a marketplace facilitator would only have to charge a 6.25 percent state use tax rate. Also, a brick-and-mortar retailer located in Illinois, but outside Chicago in a low-rate taxing jurisdiction, would only have to

<sup>1</sup> Illinois defines a remote retailer as "a retailer that does not maintain 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 is located here permanently or temporarily or whether such retailer or subsidiary is licensed to do business in this State." 35 ILCS 120/1.

<sup>2</sup> No physical presence and 200 annual transactions or \$100,000 in gross annual receipts. 35 ILCS 120/2(b).

charge that same Chicago customer tax based on the rate at the retailer's location, which could also be as low as 6.25 percent. What's more, P.A. 101-0031 saddles remote retailers with the administrative hardships and costs of having to determine the sales tax rate for the approximately 7,000 local taxing jurisdictions in Illinois.<sup>3</sup>

Recognizing that some elements of P.A. 101-0031 applicable to remote retailers were likely to be challenged as unconstitutionally discriminatory before taking effect, the Illinois General Assembly during the fall veto session enacted P.A. 101-0604 (effective December 13, 2019). P.A. 101-0604 is intended, in part, to "fix" those portions of P.A. 101-0031 that the taxpayer community believed discriminated against remote retailers. Under P.A. 101-0604, remote retailers with economic nexus in the state that make either (1) direct sales to Illinois customers, or (2) indirect sales to Illinois customers through unrelated marketplace facilitators, will be required to charge sales tax using the destination tax rate in place where their products end up. P.A. 101-0604 also pushed back the effective date for these new tax collection requirements for remote retailers from July 1, 2020, under P.A. 101-0031 to January 1, 2021.

Interestingly, however, even under the corrective law, Illinois-based retailers and retailers making sales through their own or an affiliated marketplace facilitator will still be required to charge tax using the *origination* tax rate. For instance, P.A. 101-0604 defines marketplace facilitator as a person who, under an agreement with an unrelated third-party marketplace seller, directly or indirectly through one or more affiliates, facilitates a retail sale by (1) listing or advertising tangible personal property, and (2) collecting payment from the customer, which it transmits to the marketplace seller regardless of whether the marketplace facilitator receives compensation or consideration. A marketplace seller means a person who sells goods through a marketplace operated by a third-party marketplace facilitator.

Based on the P.A. 101-0604 definitions of marketplace facilitator and marketplace seller, not

all sellers will be treated equally. For instance, a marketplace seller selling through its own marketplace will charge tax using the origination tax rate (generally the location from where the product is shipped), while a marketplace seller selling through a third-party's marketplace will be required to charge tax using the destination tax rate where the consumer takes possession of the product. For example, if P. Townshend Enterprises has economic nexus with Illinois and sells guitars from Leeds, Alabama, directly into Chicago via its website or through a third-party marketplace facilitator, then under P.A. 101-0604, P. Townshend will be required to charge sales tax using the 10.25 percent Chicago sales tax rate. In comparison, if Big Guitar Co., also based in Leeds, makes the same guitar sale into Chicago through an affiliated marketplace facilitator, it will be required to charge only the state's 6.25 percent use tax rate. And for purposes of this example, if an Illinois-based retailer made the guitar sale, it would use origin-based sourcing under P.A. 101-0604.

Based on the foregoing example, while P.A. 101-0604 did address a major concern with P.A. 101-0031, P.A. 101-0604 is likely also subject to a constitutional challenge as being discriminatory against interstate commerce.<sup>4</sup> Under well-established constitutional standards, out-of-state and in-state retailers must be treated similarly.<sup>5</sup> Under P.A. 101-0604, local retailers and retailers making sales through *affiliated* marketplace facilitators will be advantaged over remote retailers making direct sales into Illinois or sales through *unaffiliated* marketplace facilitators. The latter will be grossly disadvantaged by having to determine the rates for roughly 7,000 Illinois taxing jurisdictions, and will very likely have to charge their customers more sales tax, because the in-state retailers and retailers selling through affiliated marketplace facilitators will,

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<sup>3</sup>Brian Costin, "Illinois Has Nearly 7,000 Units of Local Governments," Illinois Policy.

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<sup>4</sup>Perhaps seeing the likely implications of an inconsistent taxing regime, the General Assembly also added in P.A. 101-0604 use tax language back into the law for out-of-state sellers with economic nexus. This action will ensure that at least some tax revenue will continue to flow into government coffers from Illinois sales made by out-of-state sellers if a constitutional challenge to P.A. 101-0604 is successful.

<sup>5</sup>See, 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).

respectively, likely ship their goods from low-rate taxing jurisdictions or from outside the state.

One way to fix Illinois's sourcing laws for online and other remote sales would be for the state to go to a purely destination-based sales tax for all retailers, which would certainly level the playing field. However, a destination-based tax system would have to overcome significant political hurdles, since many in-state and out-of-state marketplace facilitators have invested millions establishing warehouses in Illinois cities in order to ship goods to Illinois customers at favorable tax rates based on their sales' origination.<sup>6</sup> A destination-based tax would potentially unwind these tax benefits and significantly affect the revenues of the localities fortunate enough to have these warehouses and distribution facilities. Shifting to a pure destination-based tax regime would also affect the state's mom and pop stores making remote sales to customers in other Illinois cities. These businesses would likely have to make significant investments in sophisticated tax software or hire third parties to fulfill their tax responsibilities to the state and its many local taxing jurisdictions.

The future is hard to see, especially in Illinois, but you do not have to be Nostradamus to predict that there is likely to be litigation surrounding Illinois's remote seller and marketplace facilitator laws under P.A. 101-0604. Creating a level playing field is difficult, as there will be winners and losers if the state actually moves from an origin-based sales tax to one based on destination. However, what is clear is that this past fall the legislature did not level the playing field as it intended, and may have actually created (perhaps unintentionally) a home-team advantage. ■

<sup>6</sup> Many companies located warehouses or distribution facilities in specific local jurisdictions in Illinois to take advantage of a lower retailers' occupation tax rate. One of the benefits of this practice was lowering their products' overall cost to Illinois consumers, sometimes by as much as 4 percent. The highest general sales tax rate in Illinois is 10.25 percent and the lowest retailers' occupation tax rate is 6.25 percent. (Some Illinois jurisdictions have a sales tax rate as high as 11.25 percent on food and beverage for immediate consumption.)

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