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A taxing endeavor: Understanding how to apply Illinois sales tax

By John J. Tufano, Jr.

As businesses wade through the trenches of a stagnant economy, balancing budget sheets becomes that much more testing. Aside from calculating costs, compensation, and pricing structures, Illinois companies, now more than in years past, are paying closer attention to ways in which changes in state taxes dictate their viability. In early 2011, Illinois businesses absorbed tax legislation that, beginning on January 1, 2011, increases corporate income tax from 4.8 percent to 7.0 percent. While the state attempts to cover budget deficits by deepening its tax pool, companies subject to the increase may require significant financial adjustments to remain profitable. For those believing that the new state income tax was a deterrent to doing business in Illinois, beware, because a second tax is gaining steam: enter the peculiar Illinois sales tax.

Illinois is among a handful of states in which sales tax applies where an offer is accepted, rather than where a product is delivered to the customer. Since a sales transaction can occur at a location entirely different from a company's corporate office, this quirk in the law arguably creates an opportunity for companies to redirect the site of these transactions to satellite locations. While one-person offices outfitted only with a computer and telephone might seem more punishment than paradise, for a number of businesses, these satellite offices may offer competitive havens away from counties with higher tax rates.

The Illinois sales tax is a combination of "occupation" taxes that are imposed on sellers' receipts and "use" taxes that are imposed on amounts paid by purchasers.¹ A component of the sales tax, the retailers' occupation

tax ("ROT"), is a significant source of local and county revenue. Illinois code provides that "home rule unit" counties may impose a local ROT on all persons engaged in the business of selling tangible personal property in that county. Counties apply the ROT on gross receipts from sales made in the course of such business. Illinois law states that a seller's act of accepting a purchase order to make a sales contract, and not merely soliciting orders, is the central factor that determines whether a seller is engaged in the business of selling tangible personal property.²

For most neighborhood supermarkets and big-box electronic stores, a buyer accepts an offer at the point of purchase. At such cash-and-carry retailers, a person enters the store, pays for items, and leaves with the goods purchased. The seller and buyer conduct a sales transaction at the register, exchanging money for goods. Concerning products ordered through phone, fax, or e-mail and delivered later, the sale can be accepted elsewhere, morphing the cash register in a brick and mortar store in to a sales representative with an internet connection or a phone line in a satellite office.

A series of cases appearing this year in Cook County highlight the challenges of determining what constitutes a sale and in which county a sale occurs for sales tax purposes. Two complaints filed recently are grabbing headlines at a frequency that will likely increase as more cash-strapped counties scramble for new revenue sources.

The Regional Transportation Authority ("RTA") and the city of Chicago are suing the city of Kankakee, the village of Channahon, and other parties, challenging tax incentive programs that benefit Kankakee

and Channahon by attracting companies to conduct sales transactions away from their Cook County bases.³ The RTA and Chicago claim lost tax revenues in the tens of millions of dollars per year, tax pools allegedly siphoned away from Cook County—where a significant number of Chicago companies are headquartered—to smaller, neighboring counties, which house sparse, discreet, but arguably legally sufficient sales offices for Cook County businesses.

The RTA alleges that independent third-party "consultants" establish a phone number at a satellite office located beyond Cook County for a company based in Cook County. These satellite offices are the locations at which sales transactions are "accepted." For ROT purposes, a company is arguably "doing business" in the satellite office location, not Cook County. The Cook County companies allegedly receive kickbacks from Kankakee and Channahon; portions of the sales taxes paid to a satellite office's municipality are paid back to the "consultant" and/or the Cook County business. At 9.75 percent, Cook County and the city of Chicago lay claim to one of the highest sales tax percentages in the country, while Kankakee, at 6.25 percent, is among the lowest in Illinois.

Kankakee and Channahon claim that their tax agreements with these companies are legal, products of nothing more than market competition. As consumers freely shop around for better prices or purchase an identical product in a lower taxed county, so too can companies. While neither Kankakee nor Channahon officially released the names of companies with whom they share tax incentive agreements at the time that these complaints were filed, both cities claim that

their tax programs are within the bounds of Illinois law. Not only do they argue against the plaintiffs' claims of filtering tax dollars, Kankakee and Channahon assert that their programs attract out of state businesses, corporate presences that otherwise would not exist within Illinois. While both sides are positioned upon arguable grounds that sales tax should be redirected in their favor, it is clear that, whichever the outcome, the certainty of municipality budgets hangs in the balance.

Earlier this year, a similar case highlighted the financial impact of a dispute over the location to which sales tax attaches.⁴ Hartney Fuel, headquartered in Cook County, supplies diesel fuel, gasoline, and bulk lube oil to purchasers through a sales representative

at a designated sales office in Mark, Illinois, a town in Putnam County of 500 residents. The Illinois Department of Revenue audited the company and determined that its sales were subject to state and local taxes in Cook County, the location of Hartney Fuel's main office. The *Hartney Fuel* court reasoned that goods were received and accepted at the sales office in Putnam County, not the Cook County headquarters. Since, for local tax purposes, a sale is situated where it is accepted, the *Hartney Fuel* court found that Putnam County, not Cook County, was entitled to the ROT.

The RTA complaint and the *Hartney Fuel* decision expose the difficulty in interpreting and applying the Illinois sales tax in the current environment. For those with satellite

office operations through which sales transactions are sourced, it is important to keep apprised of developing case law that clarifies those efforts. The increasing spotlight upon Illinois sales tax serves as a reminder for businesses to evaluate the ways in which they conduct sales transactions and to which counties they pay the ROT. ■

1. 35 ILCS 120/1-14. Retailers' Occupation Tax Act, ch. 120, par. 440.

2. ILL. ADMIN. CODE tit. 86 § 220.115(c)(1).

3. *The Regional Transportation Authority v. City of Kankakee, et al.*, (Circuit Court of Cook County, 11 CH 29744, August 29, 2011).

4. *Hartney Fuel Oil Co. v. Department of Revenue*, Tenth Circuit of Illinois, Nos. 08-MR-11, 08-MR-13, 08-MR-15, Jan. 26, 2011.

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