

## **Illinois Partial Merger of Sales and Use Tax: Partly a Good Idea**

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Richard L. Cram is the director of the Multistate Tax Commission's National Nexus Program in Washington, D.C. Before that, Cram served as the director of policy and research in the Kansas Department of Revenue.

In this article, Cram explains recent Illinois legislation partially

merging sales tax and seller-collected use tax, as well as imposing sales tax economic nexus and marketplace facilitator tax collection requirements. Cram contends that this partial merger of the sales and use tax along with Illinois-origin sourcing rules for intrastate sales raises commerce clause concerns that could be resolved by making the partial merger complete and adopting destination sourcing. The views expressed herein are the author's and are not necessarily the views of the MTC.

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In a recent article, I observed that *Wayfair*<sup>1</sup> blurred the distinction between sales tax and use tax.<sup>2</sup> In overruling *Quill*<sup>3</sup> and its physical presence nexus standard, *Wayfair* considered South

Dakota's statute requiring remote sellers<sup>4</sup> exceeding either alternative economic nexus threshold of more than \$100,000 in sales or 200 or more transactions annually to remit South Dakota's sales tax on retail sales into that state. Commentators have questioned whether South Dakota's imposition of a sales tax remittance obligation on the remote seller, instead of a use tax collection obligation, raises constitutional concerns.<sup>5</sup> However, as emphasized in my article, there is no constitutional barrier prohibiting a state from merging the two taxes, to the extent they are seller-remitted and assuming that the merged tax is destination-sourced.<sup>6</sup>

*Wayfair* warned: "Complex state tax systems could have the effect of discriminating against interstate commerce."<sup>7</sup> Simplifying sales tax laws for remote sellers should help dispose of challenges that those laws discriminate against or impose undue burdens on interstate commerce. States could seize a significant opportunity to simplify their sales tax laws for remote sellers by merging sales tax and seller-collected use tax.<sup>8</sup> Remote sellers would no longer face confusion

<sup>4</sup>For purposes of this article, the term "remote seller" refers to an out-of-state retailer with no physical presence in the taxing state.

<sup>5</sup>See, e.g., David Gamage, Darien Shanske, and Adam Thimmesch, "Wayfair: Sales Tax Formalism and Income Tax Nexus," *State Tax Notes*, Sept. 3, 2018, p. 975; and Richard D. Pomp, "Wayfair: Its Implications and Missed Opportunities," *Tax Notes State*, Dec. 23, 2019, p. 1035.

<sup>6</sup>Well before *Wayfair*, professor John Swain argued that *Complete Auto* disposed of any commerce clause concerns against merging the sales tax and use tax. Swain, "The Sales and Use Tax Dichotomy and the Streamlining Movement," *State Tax Notes*, Jan. 15, 2007, p. 129.

<sup>7</sup>*Wayfair*, 138 S. Ct. at 2099.

<sup>8</sup>Consumer-remitted use tax could remain as a tax type, because it covers situations when use tax is due from the consumer, but was not legally required to be collected by the seller, such as a purchase of inventory for resale that the buyer later uses or consumes and does not resell. As to merging sales and seller-collected use tax, Swain identified some practical obstacles that states might face. Use tax revenue could be dedicated to funds supporting different purposes than those that sales tax revenue support, creating revenue impacts and tracking difficulties. See Swain, *supra* note 6, at 131-32. Discussion of such obstacles is beyond the scope of this article.

<sup>1</sup>*South Dakota v. Wayfair*, 585 U.S. \_\_\_, 138 S. Ct. 2080 (2018).

<sup>2</sup>Richard L. Cram, "No More *Dilworth* Formalism After *Wayfair*," *Tax Notes State*, Mar. 2, 2020, p. 745.

<sup>3</sup>*Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

about whether they should be registered and collecting and filing returns for sales tax or use tax.

Following its post-*Wayfair* enactment of sales tax economic nexus and marketplace facilitator tax collection requirements, Illinois enacted legislation to partially merge its sales tax and seller-collected use tax.<sup>9</sup> However, because Illinois imposes different sourcing rules, depending on whether the transaction is intrastate or interstate, this partial merger creates additional complexities for sellers. Illinois applies origin sourcing (seller's location) to intrastate retail sales of tangible personal property and destination sourcing (customer shipping address) to interstate sales.<sup>10</sup> Several commentators have identified commerce clause concerns raised by the overlay of this partial merger of tax types on top of differing sourcing rules.<sup>11</sup>

This article first reviews the basic structure of sales and use tax in Illinois, followed by a summary of the post-*Wayfair* legislation imposing sales tax economic nexus and marketplace facilitator tax collection requirements. Second, analysis of subsequent legislation and implementing regulations partially merging Illinois sales tax and seller-collected use tax shows that they impose additional complexities on remote sellers. Third, partial merger and differing sourcing rules raise discrimination concerns, which are discussed. Finally, a solution to address those concerns and achieve simplification for remote sellers is offered: total merger of the sales tax and seller-collected use tax, along with adoption of destination sourcing for both intrastate and interstate transactions.

## Pre-*Wayfair* Sales and Use Tax Structure

Illinois labels its sales tax as the retailers' occupation tax (ROT), imposed under the Retailers' Occupation Tax Act (ROTA).<sup>12</sup> The ROT is an excise tax on retail sales of tangible personal property imposed on the retailer for the privilege of making sales in the state.<sup>13</sup>

Illinois also imposes a complementary use tax under the Use Tax Act (UTA).<sup>14</sup> The use tax is imposed on the consumer for the privilege of using in the state tangible personal property purchased at retail.<sup>15</sup> The purpose of the use tax is to prevent people from avoiding tax by making out-of-state purchases on which no sales tax was paid. It also protects Illinois merchants against diversion of business to retailers outside the state.<sup>16</sup> Because it is impractical to collect the tax from the individual consumer, the burden of collecting the tax is imposed on the out-of-state retailer,<sup>17</sup> subject to constitutional limitations. The retailer "maintaining a place of business" in Illinois is required to collect the use tax from the purchaser.<sup>18</sup> The retailer is liable for remitting the use tax, unless the retailer has remitted ROT, which would offset the use tax liability.<sup>19</sup>

Before *Wayfair*, the statutory definition of the term "retailer maintaining a place of business in this State" in the UTA<sup>20</sup> required the out-of-state retailer to maintain some form of physical (including representational) presence in the state. Local jurisdictions impose local ROTs, but generally do not impose corresponding local use taxes.<sup>21</sup>

Illinois applies origin sourcing to intrastate retail sales of tangible personal property, meaning

<sup>9</sup> 2018 Public Act 100-0587; 2019 Public Act 101-0009; and 2019 Public Act 101-0031. Illinois post-*Wayfair* legislation imposing sales tax economic nexus and marketplace facilitator tax collection requirements included additional provisions intended to simplify compliance for remote sellers, such as authorization of certified service providers that can handle tax compliance responsibilities for remote sellers at no cost to those sellers. Discussion of those provisions is beyond the scope of this article.

<sup>10</sup> 35 Ill. Comp. Stat. 120/2-12 (West 2020).

<sup>11</sup> See Paul Bogdanski, David P. Dorner, and Jeremy P. Gove, "Illinois's Online Retailer Legislation Offers Simplicity at a Price," *Tax Notes State*, Aug. 12, 2019, p. 587; Stanley R. Kaminski, "Is Illinois's New Retailers' Occupation Tax Scheme Unconstitutional?" *Tax Notes State*, Sept. 21, 2020, p. 1261; Aaron Davis, "DOR Finalizes Marketplace Rules, Proposes Rules for 2021," *Tax Notes State*, Sept. 21, 2020, p. 1300; and Breen Schiller and Dennis Jansen, "INSIGHT: Destined for the Courtroom — Illinois Audit Program Won't Stop Sales Tax Litigation," *Bloomberg Tax*, Sept. 11, 2020.

<sup>12</sup> 35 Ill. Comp. Stat. 120 et seq.

<sup>13</sup> 35 Ill. Comp. Stat. 120/2.

<sup>14</sup> 35 Ill. Comp. Stat. 105 et. seq.

<sup>15</sup> 35 Ill. Comp. Stat. 105/3.

<sup>16</sup> *Klein Town Builders Inc. v. Department of Revenue*, 36 Ill. 2d 301, 303; 222 N.E.2d 482 (1966).

<sup>17</sup> *Brown's Furniture Inc. v. Wagner*, 171 Ill. 2d 410, 418; 665 N.E.2d 795 (1996).

<sup>18</sup> 35 Ill. Comp. Stat. 105/2; and 35 Ill. Comp. Stat. 105/3-45.

<sup>19</sup> 35 Ill. Comp. Stat. 105/8.

<sup>20</sup> 35 Ill. Comp. Stat. 105/2 (West 2017).

<sup>21</sup> An exception is Chicago, which imposes some use taxes on tangible personal property. See chapters 3-27 and 3-28 of the Municipal Code of Chicago.

that the state and local ROT in effect at the retailer's location applies to the sales transaction, regardless of where the consumer takes possession of the purchased item.<sup>22</sup> The in-state retailer is required to remit the state and local ROT in effect at the retailer's location. Retailers with Illinois nexus (maintaining a place of business in the state) making retail sales from outside the state to Illinois customers would only be obligated to collect the state use tax on those sales.<sup>23</sup> The rate is 6.25 percent for both the state ROT and the use tax.<sup>24</sup>

### Post-Wayfair Sales Tax Economic Nexus Legislation

In 2018 the Illinois General Assembly passed Public Act 100-0587 (H.B. 3342), which amended the definition of retailer maintaining a place of business in this state<sup>25</sup> in the UTA. Effective October 1, 2018, that definition includes a retailer making sales of tangible personal property to purchasers in Illinois from outside Illinois if (A) cumulative gross receipts from those sales are \$100,000 or more, or (B) those sales consist of 200 or more separate transactions. The act imposed sales tax economic nexus, requiring remote sellers making retail sales to customers in Illinois to collect use tax from those customers, once the remote seller exceeded either of the alternative economic nexus thresholds.

Implementation of economic nexus greatly expanded the population of remote sellers required to collect use tax on their retail sales into Illinois. However, because there are generally no local use taxes imposed in Illinois,<sup>26</sup> remote sellers were only required to collect the state use tax on those sales. This created a situation in which in-state retailers were required to collect both state and local ROTs, while remote sellers with economic nexus would be collecting only state use tax. Local governments were not pleased to miss out on the local ROT revenue from remote sales. Main street businesses required to collect both

state and local ROTs also felt unfairly treated, compared with remote sellers.

### Illinois Marketplace Facilitator Tax Collection Legislation

Another major trend in state sales tax legislation began even before *Wayfair*: enactment of requirements that marketplace facilitators collect sales tax on the facilitated sales of its marketplace sellers. The Fulfillment by Amazon program, as well as other prominent marketplace facilitators such as eBay, Etsy, and Walmart.com, have flourished for several years. Under the marketplace facilitator business model, the marketplace seller was considered the person obligated to comply with a state's sales tax laws, remitting sales tax if the seller had nexus in the state. Marketplace sales have rapidly expanded to account for over half of online retail sales.<sup>27</sup> Also, states would logically prefer to seek tax collection compliance from the much smaller population of marketplace facilitators, rather than from thousands of marketplace sellers. In 2017 a few states enacted laws requiring marketplace facilitators to either collect the sales tax on facilitated sales or report those sales to the state.<sup>28</sup> After *Wayfair*, states stampeded to enact marketplace facilitator sales tax collection laws.<sup>29</sup>

The Illinois General Assembly followed suit in June 2019, passing Public Act 101-0009 (S.B. 689), requiring marketplace facilitators exceeding either of the alternative economic nexus thresholds to commence collecting use tax on facilitated sales, effective January 1, 2020.<sup>30</sup> Public Act 101-0009 required marketplace facilitators to certify to their marketplace sellers that they are collecting and remitting use tax on facilitated sales.<sup>31</sup> Marketplace sellers would not need to count those facilitated sales in determining whether their sales have exceeded either of the economic nexus thresholds.<sup>32</sup>

<sup>22</sup> 35 Ill. Comp. Stat. 120/2-12.

<sup>23</sup> 35 Ill. Comp. Stat. 105/2; and 35 Ill. Comp. Stat. 3-45 (West 2017).

<sup>24</sup> 35 Ill. Comp. Stat. 120/2-10; and 35 Ill. Comp. Stat. 105/3-10.

<sup>25</sup> 35 Ill. Comp. Stat. 105/2.

<sup>26</sup> See *supra* note 21.

<sup>27</sup> See Marketplace Pulse, Amazon Marketplaces.

<sup>28</sup> Minnesota (H.F. 1), Rhode Island (H. 5175A), Washington (H.B. 2163).

<sup>29</sup> All states that impose sales tax have enacted marketplace facilitator tax collection requirements except for Florida, Kansas, and Missouri.

<sup>30</sup> 35 Ill. Comp. Stat. 105/2d (d)(2).

<sup>31</sup> 35 Ill. Comp. Stat. 105/2d (d)(1).

<sup>32</sup> 35 Ill. Comp. Stat. 105/2 (9).

Although Public Act 101-0009 required marketplace facilitators with economic nexus to collect use tax on facilitated sales beginning January 1, 2020, the situation with local ROTs not being collected when those sales were made from outside the state raised the same local government and main street business concerns that Public Act 100-0587 did: Only state use tax and no local tax would be collected.

### Leveling the Playing Field for Illinois Retail Act – A Partial Merger of Sales and Use Tax

To address those concerns, the General Assembly passed in June 2019 Public Act 101-0031 (S.B. 690), the Leveling the Playing Field for Illinois Retail Act. Public Act 101-0031 added to the ROTA a definition for “remote retailer,” an out-of-state seller without physical presence in Illinois.<sup>33</sup> This definition would not include any out-of-state seller that fulfills its orders from inventory located in Illinois.<sup>34</sup> Public Act 101-0031 provided that effective July 1, 2020, a remote retailer exceeding either of the alternative economic nexus thresholds would be considered as “engaged in the occupation of selling at retail in Illinois” for purposes of the ROTA,<sup>35</sup> and required to remit the applicable state and local ROTs on retail sales to Illinois purchasers. Public Act 101-0031 also required destination sourcing of remote retailer sales, making the state and local ROTs applicable to those sales, based on the shipping address of the Illinois customer or location where the customer took possession.<sup>36</sup> Out-of-state sellers with physical presence in Illinois (such as storing inventory used in fulfilling the sale in the state), as well as in-state sellers, would continue to collect the state and local ROTs on their intrastate sales to Illinois customers based the origin sourcing rules (the in-state selling location or inventory location, whichever is applicable).<sup>37</sup>

Public Act 101-0031 ended as of June 30, 2020, the requirement that commenced October 1, 2018,

in Public Act 100-0587, for remote sellers with economic nexus to collect use tax on sales made from outside the state to Illinois purchasers.<sup>38</sup> Effective July 1, 2020, remote retailers and marketplace facilitators without physical presence in Illinois and with economic nexus were required to remit state and local ROTs on those sales, based on the rate in effect at the customer’s shipping address.

Public Act 101-0031 represented a partial merger of the Illinois seller-collected use tax and ROT, to the extent that effective July 1, 2020, remote retailers and marketplace facilitators without physical presence in the state and with economic nexus would be remitting state and local ROTs, instead of collecting use tax on sales to Illinois customers. Public Act 101-0031 addressed the problem created under Public Act 100-0587 whereby remote sellers with economic nexus would be collecting only state use tax, while in-state sellers would be collecting both state and local ROTs.

In November 2019 the General Assembly passed Public Act 101-0604 (S.B. 119), amending Public Act 101-0031 to move the start date from July 1, 2020, to January 1, 2021. Remote sellers with economic nexus would be collecting use tax on their Illinois sales from October 1, 2018, through December 31, 2020. Beginning January 1, 2021, they would be required to remit state and local ROTs. Likewise, marketplace facilitators without physical presence in Illinois and with economic nexus would be collecting use tax on sales to Illinois customers from January 1, 2020, through December 31, 2020. Thereafter, they would be required to remit state and local ROTs on such sales.

### Implementing Regulations

The Department of Revenue promulgated regulations<sup>39</sup> to implement Public Act 101-0009, which imposed a use tax collection duty on marketplace facilitators effective January 1, 2020. New section 150.804 of the regulations explains that it applies for the 2020 calendar year. New

<sup>33</sup> 35 Ill. Comp. Stat. 120/1.

<sup>34</sup> Illinois Department of Revenue, Information Bulletin FY 2021-2 (Sept. 2020).

<sup>35</sup> Amending 35 Ill. Comp. Stat. 120/2.

<sup>36</sup> Amending 35 Ill. Comp. Stat. 120/2-12.

<sup>37</sup> 35 Ill. Comp. Stat. 120/2-12 (1), (2).

<sup>38</sup> Public Act 101-0031 amendments to 35 Ill. Comp. Stat. 105/2 (9).

<sup>39</sup> Illinois DOR Notice of Adopted Amendment to 86 Ill. Adm. Code 150, adding new section 150.804, published at 44 Ill. Reg. 14744 (effective Aug. 26, 2020).

section 150.804 provides that during that period, a marketplace facilitator without physical presence and with economic nexus is considered the retailer of facilitated sales to Illinois purchasers and is required to collect and remit use tax on those sales. However, if the facilitated sale is considered to be an intrastate sale subject to ROT, such as when the marketplace seller has inventory in Illinois and the sale is fulfilled from that inventory, then the marketplace seller, not the marketplace facilitator, is considered the retailer and is required to remit state and local ROTs on the transaction.<sup>40</sup> In that situation, the regulation authorizes the marketplace facilitator to collect the tax from the purchaser on behalf of the marketplace seller, then remit it to the marketplace seller, who is ultimately responsible for remitting it to the state.<sup>41</sup>

The new regulation provides guidance to help marketplace sellers and facilitators understand and comply with Public Act 101-0009. Nonetheless, the law and regulation present multiple opportunities for confusion. First, does the marketplace seller have inventory located in the state that was used by the marketplace facilitator to fulfil the sale, and if so, does that trigger a ROT remittance obligation on the marketplace seller instead of a use tax collection obligation on the marketplace facilitator? Second, what if the marketplace facilitator has already collected and remitted to the DOR use tax on such a transaction, when the marketplace seller should have remitted state and local ROTs?<sup>42</sup>

The DOR has proposed regulations to implement Public Acts 101-0031 and 101-0604.<sup>43</sup> New section 131.101 of the proposed regulations makes clear that the intent of these two acts was to level the playing field by “imposing State and local retailers’ occupation taxes on Illinois retailers, remote retailers and marketplace facilitators alike.”<sup>44</sup> The process for determining

which sourcing rules apply after these laws become effective January 1, 2021, is complex.

New section 131.107 of the proposed regulations adds six “new types of retailers with different tax liabilities to the State’s existing sales tax structure”<sup>45</sup>:

- 1) Remote retailers incurring State and local retailers’ occupation tax using destination sourcing for sales made to Illinois purchasers;
- 2) Marketplace facilitators incurring State and local retailers’ occupation tax using destination sourcing for sales made over the marketplace on behalf of marketplace sellers to Illinois purchasers;
- 3) Marketplace facilitators incurring State and local retailers’ occupation tax using origin sourcing for their own sales that are fulfilled from inventory located in Illinois and incurring State and local retailers’ occupation tax using destination sourcing for all other sales of its own;
- 4) Out-of-State retailers with a physical presence in Illinois incurring a Use Tax collection obligation for sales made outside Illinois and shipped or delivered to Illinois purchasers; such retailers also incur State and local retailers’ occupation taxes using origin sourcing for any sales made in Illinois;
- 5) Illinois retailers, including brick and mortar retailers, incurring no State or local retailers’ occupation taxes for sales made over a marketplace (the marketplace facilitator will now incur State and local retailers’ occupation tax liability based on destination sourcing for these sales); and
- 6) Illinois retailers, including brick and mortar retailers, incurring State and local retailers’ occupation taxes based on origin sourcing for sales made in Illinois.

This proposed regulation clarifies that effective January 1, 2021, the obligation to remit state and local ROTs will apply to all retail sales of tangible personal property to Illinois customers, whether those sales are intrastate or interstate, or made by a direct seller or marketplace facilitator

<sup>40</sup> *Id.* at new section 150.804 i) 4).

<sup>41</sup> *Id.* at new section 150.804 i) 5).

<sup>42</sup> See Jeff Friedman, Schiller, and Jansen, “Something Smells: Illinois Still Needs to Solve Its Marketplace ROT Problem,” *Bloomberg Tax*, Nov. 12, 2020.

<sup>43</sup> Illinois DOR Notice of proposed amendments to 86 Ill. Adm. Code 131. See additional guidance in Information Bulletin FY 2021-2, *supra* note 34; and Leveling the Playing Field Retailer Flowchart.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

with physical presence or economic nexus, except for one situation: an “out-of-state retailer with physical presence in Illinois”<sup>46</sup> that makes a sale from outside the state.<sup>47</sup> In that situation, the seller is only required to collect use tax. Thus, complete merger of ROT and seller-collected use tax has not been achieved, although the circumstances when the use tax applies, as opposed to the ROT, have been significantly reduced.<sup>48</sup> To determine the correct local rate for sales subject to state and local ROTs, the seller must know whether the transaction with an Illinois customer is considered intrastate, to which origin sourcing would apply, or interstate, to which destination sourcing would apply.<sup>49</sup>

### Commerce Clause Issues With Partial Merger of Sales and Use Tax And the Differing Sourcing Rules

Commentators have noted<sup>50</sup> that Public Acts 101-0009, 101-0031, and 101-0604 create a situation in which the differing sourcing rules cause different local tax rates to apply, depending on whether the Illinois customer makes a purchase from a seller or marketplace facilitator with physical presence in the state versus a remote seller or marketplace facilitator lacking physical presence in the state but with economic nexus, and depending on whether the sale involves shipping the item from outside the state by a seller with physical presence in the state. For the seller or marketplace facilitator with physical presence in the state making an intrastate sale, the local

ROT in effect at the seller’s or facilitator’s in-state location will apply. For a remote seller or marketplace facilitator without physical presence shipping the item from outside the state, the local ROT in effect at the customer’s shipping address will apply. For an out-of-state seller that has physical presence in Illinois (such as inventory in an Illinois warehouse) shipping the item from outside the state to the Illinois customer, no local tax will apply: only the state use tax.<sup>51</sup>

Why did Public Act 101-0009 not completely merge the ROT and seller-collected use tax? If in-state sellers and remote retailers, as well as marketplace facilitators with economic or physical presence nexus in the state, are all required to remit state and local ROTs on their sales to Illinois customers, then out-of-state sellers with in-state presence that are shipping items to Illinois customers from outside the state should also be required to remit state and local ROTs on those sales.

As commentators have mentioned,<sup>52</sup> under *Associated Industries*,<sup>53</sup> when the local ROT rate in effect at the seller’s location in Illinois is lower than the rate in effect at the customer’s shipping address, this creates a potential commerce clause violation, favoring the Illinois seller who collects the lower local rate in effect at the seller’s location and discriminating against a remote seller with economic nexus required to collect the higher local rate in effect at the customer’s shipping address.

In *Associated Industries*, Missouri imposed a flat statewide use tax of 1.5 percent on items purchased outside the state for use, storage, or consumption in the state. The tax was intended to “compensate” for local sales taxes.<sup>54</sup> Local jurisdictions imposed local sales taxes at various rates, some lower and some higher than the flat statewide use tax rate. A Missouri trade association and business challenged this scheme as discriminating against interstate commerce. They argued that when the applicable local sales tax rate for an intrastate sale is lower than the

<sup>46</sup> *Id.*, Leveling the Playing Field Retailer Flowchart.

<sup>47</sup> *Id.* A remote seller whose sales into Illinois fall below the alternative economic nexus thresholds would not be required to collect any tax, although the consumer would be liable for use tax.

<sup>48</sup> Commentators point out that this anomaly creates a loophole for potential abuse, incentivizing remote sellers to create in-state physical nexus for themselves, so that their sales made from outside the state are only subject to use tax. See Davis, *supra* note 11. One commentator has suggested that owners of marketplace facilitators could also exploit this loophole by setting up “related companies” and making sales through those entities that would only be subject to use tax. See Keith Staats, “Oops, They Did It Again,” Illinois CPA Society (Winter 2019).

<sup>49</sup> Even the origin sourcing rule is complex for marketplace facilitators. See Leveling the Playing Field Retailer Flowchart, *supra* note 43; and 86 Ill. Adm. Code 270.115. If the marketplace facilitator fulfills the facilitated sale from inventory in Illinois and has no other selling activity in the state, then the local retailers’ occupation tax in effect at the inventory location applies. If the marketplace facilitator has selling activity in the state, then the local retailers’ occupation tax in effect at the location of the selling activity applies.

<sup>50</sup> See *supra* note 11.

<sup>51</sup> Proposed amendments to 86 Ill. Admin. Code 131, new section 131.107 4). See *supra* note 21, the local use tax exception.

<sup>52</sup> See *supra* note 11.

<sup>53</sup> *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994).

<sup>54</sup> *Id.* at 643.

statewide 1.5 percent use tax rate, an out-of-state business suffers discrimination by being required to collect a higher statewide use tax than an in-state business collecting the lower local sales tax on the sale to the same customer. Although the Missouri Supreme Court upheld the use tax scheme, the U.S. Supreme Court reversed it, determining that in those jurisdictions in which the local sales tax rate was less than the statewide use tax rate, the statewide rate violated the commerce clause, discriminating against out-of-state businesses that would be required to collect at the higher rate.

One commentator<sup>55</sup> suggests that the solution to this constitutional concern would be to require destination sourcing for both intrastate and interstate sales, so that identical local rates would apply, whether the Illinois purchaser bought the product from an in-state or remote seller. This would also achieve simplification, in that one set of sourcing rules (destination sourcing) would apply whether the transaction is considered intrastate or interstate.<sup>56</sup>

Likewise, total merger of ROTs and seller-collected use tax would eliminate situations in which the sales transaction is subject only to state use tax (no local use tax having been imposed) if the seller has in-state physical presence but ships the product to the customer from outside the state. Total merger of the taxes would also achieve simplification and eliminate confusion for all: State and local ROTs would apply whether the transaction is intrastate or interstate and whether

the seller or marketplace facilitator has physical presence or only economic nexus.

### Conclusion

Although Illinois's post-*Wayfair* legislation takes a step in the right direction by at least partially merging the ROT and seller-collected use tax, the failure to totally merge those taxes, along with the retention of origin sourcing for intrastate sales, adds significant complexity to the sales tax system for remote sellers. In most situations involving interstate sales and sellers with nexus, seller-remitted state and local ROTs apply to the transaction. However, one situation remains when only seller-collected state use tax applies: The seller has an in-state presence but ships the product to the customer from outside the state. Also, with differing sourcing rules applying to interstate vs. intrastate sales, different local ROT rates apply to the same purchase transaction, depending on whether the seller is in state or out of state. As *Wayfair* warns, this added complexity raises the question whether these laws impose undue burdens on or discriminate against interstate commerce. As *Associated Industries* illustrates, situations in which lower local tax rates apply to intrastate transactions than interstate transactions raise commerce clause questions. Total merger of the ROT and the use tax as well as adoption of destination sourcing for intrastate sales offers Illinois a solution to address these concerns and achieve simplification. ■

<sup>55</sup> Kaminski, *supra* note 11.

<sup>56</sup> Such a solution may be easier said than done, given in-state retailers' resistance to destination sourcing, which requires them to apply the local tax applicable to the shipping address or delivery location when the customer does not take possession at the retailer's location. However, two states are transitioning from origin sourcing of intrastate sales to destination sourcing as part of their enactment of sales tax economic nexus and marketplace facilitator tax collection laws. See Colorado 2019 H.B. 19-1240 and New Mexico 2019 H.B. 6. Section 310 of the Streamlined Sales and Use Tax Agreement requires its member states to adopt destination sourcing for intrastate sales, unless the state elects to use origin sourcing in the limited circumstances provided in section 310.1. Texas (2019 H.B. No. 1525) and Alabama (2018 H.B. 470) have taken an alternative approach to simplification as part of their enactment of sales tax economic nexus laws. While retaining origin sourcing for intrastate sales, those states provide a flat tax rate for remote sellers with economic nexus to collect on sales into those states, including a refund mechanism for consumers when the flat rate exceeds the state and local tax rate that would otherwise apply to the transaction. See Alabama DOR Simplified Sellers Use Tax; and 34 Tex. Admin. Code Rule section 3.334 (effective May 31, 2020).