

JOINT COMMITTEE ON ADMINISTRATIVE RULES

ILLINOIS GENERAL ASSEMBLY

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REP. DONALD L. MOFFITT
REP. ANDRÉ THAPEDI

MINUTES

March 19, 2014

MEETING CALLED TO ORDER

The Joint Committee on Administrative Rules met on March 19, 2014 at 10:00 a.m. in Room C-1 of the Stratton Office Building, Springfield, Illinois.

Co-Chair Schmitz called the meeting to order and announced that the policy of the Committee is to allow only representatives of State agencies to testify orally on any rule under consideration at Committee hearings.

ATTENDANCE ROLL CALL

X Senator Pamela Althoff	X Representative Greg Harris
X Senator Don Harmon	X Representative Lou Lang
X Senator Tony Muñoz	X Representative David Leitch
X Senator Sue Rezin	X Representative Donald Moffitt
X Senator Dale Righter	X Representative Timothy Schmitz
X Senator Ira Silverstein	X Representative André Thapedi

APPROVAL OF THE MINUTES OF THE FEBRUARY 18, 2014 MEETING

Representative Harris moved, seconded by Senator Silverstein, to approve the minutes of the February 18, 2014 meeting. The motion passed unanimously.

POSTPONEMENT OF JCAR CONSIDERATION

Chief Procurement Officer for the Capital Development Board – Procurement Practices (Repealer) (44 Ill. Adm. Code 8; 37 Ill. Reg. 12120)

Chief Procurement Officer for the Capital Development Board – Chief Procurement Officer for the Capital Development Board (44 Ill. Adm. Code 8; 37 Ill. Reg. 12143)

Co-Chair Schmitz announced that the Committee would consider these rulemakings at its April 7 meeting.

WITHDRAWAL OF FILING PROHIBITION

Health Facilities and Services Review Board – Processing, Classification Policies and Review Criteria (77 Ill. Adm. Code 1110; 37 Ill. Reg. 3982)

Senator Althoff moved, seconded by Representative Lang, that JCAR withdraw its Filing Prohibition of these rules, contingent on and effective with the Board's adoption of the proposed rulemaking with the attached agreed-upon modifications. The Committee originally issued this Filing Prohibition at the November 19, 2013. The rulemaking passed by a rollcall vote of 9-1-2 (No – Leitch; Present – Rezin and Thapedi).

CONSIDERATION OF OTHER RULEMAKINGS

Senator Rezin requested consideration of the Department of Revenue's 10 emergency rulemakings:

Department of Revenue – Home Rule County Retailers' Occupation Tax (86 Ill. Adm. Code 220; 38 Ill. Reg. 4047); Home Rule Municipal Retailers' Occupation Tax (86 Ill. Adm. Code 270; 38 Ill. Reg. 4060); Regional Transportation Authority Retailers' Occupation Tax (86 Ill. Adm. Code 320; 38 Ill. Reg. 4073); Metro East Mass Transit District Retailers' Occupation Tax (86 Ill. Adm. Code 370; 38 Ill. Reg. 4086); Metro-East Park and Recreation District Retailers' Occupation Tax (86 Ill. Adm. Code 395; 38 Ill. Reg. 4099); County Water Commission Retailers' Occupation Tax (86 Ill. Adm. Code 630; 38 Ill. Reg. 4112); Special County Retailers' Occupation Tax for Public Safety (86 Ill. Adm. Code 670; 38 Ill. Reg. 4125); Salem Civic Center Retailers' Occupation Tax (86 Ill. Adm. Code 690; 38 Ill. Reg. 4138); Non-Home Rule Municipal Retailers' Occupation Tax (86 Ill. Adm. Code 693; 38 Ill. Reg. 4151); County Motor Fuel Tax (86 Ill. Adm. Code 695; 38 Ill. Reg. 4164)

Jim Nichelson, Director of Legislative Affairs, and Paul Berks, Deputy General Counsel, represented the Department.

Senator Rezin: Is DOR giving retailers enough time to comply with the rule changes?

Mr. Berks: The *Hartney* decision (*Hartney Fuel Oil Co. v. Hamer*, 2013 IL 115130) was issued in November 2013. Quick action was needed because the Court's invalidation of the rule deprived taxpayers of guidance, leaving only the decision and the statute. DOR needed to provide prompt guidance to fill that void. DOR immediately publicized to the retail community that the law had changed and DOR would not audit any retailers who made a good faith, prompt, reasonable effort to comply with *Hartney*. No audits have been performed, and none are planned until much later.

Senator Rezin: Can you explain how the primary and secondary factors are going to be used to source a sale?

Mr. Berks: The vast majority of taxpayers have a bright line with which to comply and need not pay attention to primary/secondary factors. For the multi-jurisdictional entities lacking this bright line, *Hartney* was clear that DOR needed to develop a fact-specific test that could be applied to each retailer independently. Using this broad Court guidance, DOR attempted to find universal factors with which all retailers could identify. Most multi-jurisdictional retailers will be able to

identify these factors and easily determine where they belong, but, for the relatively few cases in which the primary factors are evenly split, secondary factors can be used to break the tie.

Senator Rezin: Is there a safe harbor for retailers who make a good faith effort to comply?

Mr. Berks: DOR has to enforce the law uniformly. If it proves more difficult to apply these factors than anticipated, DOR can apply the rules in a reasonable way. If, however, it proves that most retailers are able to apply them properly, the law is going to be applied evenly.

Senator Rezin: If I go to Sears in Chicago, buy a refrigerator stored in Romeoville, and have it delivered to Riverside, where does the sale occur, keeping in mind that Sears is headquartered (and thus probably sets its prices) in Hoffman Estates?

Mr. Berks: In this multi-jurisdictional case, the bright line test would not apply. Looking at the primary factors, the offer and the acceptance of the terms of sale both happened in Chicago. The place of sale is Chicago. You don't have to consider the secondary factors, such as delivery location, unless the primary factors are inconclusive.

Senator Rezin: Retailers understand the one-point test is insufficient and they want to comply, but there's ambiguity because DOR isn't saying when to progress from primary to secondary factors. Does the retailer have to wait until it is audited to find out if it was correct? If it's too close for the secondary factors and it goes to determining where government services are being provided, then shouldn't areas like Bolingbrook and Romeoville, where retailers have large distribution centers, take precedence?

Mr. Berks: If a retailer make a good faith determination that there is a preponderance of primary factors in favor of one particular tax sourcing location, it should be on solid ground in not weighing the other factors. The Court said a fact-dependent, case-specific analysis is needed. Some retailers have really complicated selling operations because of the nature of their business. So if you combine a complicated selling operation with the fact-based analysis required, some sellers will have very close cases. DOR can issue Private Letter Rulings to help. No Letter requests have been received to date.

Senator Rezin: For those companies that are on the border, even after they think they comply with the primary and secondary factors (and there's 9 of them) it still looks like subsection (b) of this emergency rule allows DOR to make a different determination. Doesn't it create ambiguity if the retailer meets 3 or 4 of the primary factors and a couple of the secondary factors, but DOR can still refute the sourcing determination?

Mr. Berks: The purpose of subsection (b), which says DOR can look through the form of the transaction to its substance, is to put on notice those retailers that have structured their sales to try to take advantage of a far-off jurisdiction with a lower tax rate. That was what the Supreme Court said is not allowed. DOR is providing notice that it will be looking at the substance of sales, not at how they are structured. We are looking at where the selling activity takes place in reality, not on paper. Subsection (b) tells retailers "This is how a Court would determine a close case." *Hartney* says, in paragraphs 34-36: We don't know what the business of selling means on its face in the

statute, so we'll look at the purpose of the statute: those communities that provide service to retailers get the taxes from those retailers. Subsection (b) provides good advice to the retailer and is not some sort of DOR authorization to overrule a retailer that makes a good faith consideration. If a retailer has satisfied the factors and the selling activities are taking place in the places they've identified, DOR would not say "no, the selling activity really took place somewhere else." This is an emergency rule, and the proposed rule is still subject to notice and comment. If public comment indicates that the intent of subsection (b) is unclear, it can be clarified.

Senator Rezin: Do you think there should be a legislative fix for this issue?

Mr. Berks: Yes. The problem is that the Retailer's Occupation Tax taxes the business of selling. No one knows what that means and where that takes place. A hundred years ago when the ROT was passed, it may have been obvious where people were engaged in the business of selling, but we have a very complicated economy with many multi-jurisdictional retailers. Telling them that they have to pay the tax where they are engaged in the business of selling provides very little guidance. That put the burden first on the Supreme Court, then on DOR. If the General Assembly could provide clear statutory guidance, like destination sourcing, DOR would be jumping for joy.

Senator Rezin: If there's a change in the permanent rule, how will you treat the retailers who followed the emergency rule?

Mr. Berks: I will recommend DOR do something similar to what was done after *Hartney* and before adoption of these emergency rules: if retailers make a good faith, prompt, reasonable effort to comply, DOR will not assess them for any discrepancies. The *Hartney* ruling would apply in this case too: if DOR has promulgated a rule and the retailer relied on it, DOR can't take money back.

Senator Righter: Please clarify the Department's audit policy in these cases.

Mr. Berks: Retailers are obligated to follow the law as it was at the time they made the sale. From *Hartney* until adoption of the emergency rules, they were obligated to make a good faith effort to follow *Hartney*. Once the emergency rules were promulgated, the retailers had to make a good faith effort to comply with those rules. When permanent rules are adopted, we'll transition directly to them. We will provide an explanation to retailers similar to that provided after the *Hartney* decision that says we'll abate any back taxes or penalties if our auditors find that a retailer made a good faith effort to comply.

Senator Righter: I appreciate that, but there are 2 burdens here: the burden on the retailers to abide by the law and the burden on the government to be very clear about what the law is and what the government's expectations are. The average retailer would, after listening to this discussion, walk out of the room and say "I have no idea what I'm supposed to do". I appreciate the assurance that, if a retailer made a good faith effort, it doesn't need to worry about subsection (b), but it's been my experience that the line "I'm an auditor from the Department of Revenue and I'm here to help you" usually rings pretty hollow. It seems to me there is a better way to express DOR's resolve to crack down on tax cheats than the catch-all provision in subsection (b). Why not assign weights to the primary factors so it would be self-evident to anyone what the answer is?

Mr. Berks: First, all of this discussion pertains to the minority of retailers with multi-jurisdictional selling operations. Second, weighting schemes have been suggested in public comment and might be part of the final rule. The concern is that, when you start assigning scores to these factors, it opens up the possibility of manipulation. If you weight a factor that's easily manipulated, you open the door to what we're trying to prevent. Another issue is that uniformly weighting each factor could be inconsistent with *Hartney's* fact-dependent test. Some factors count more to some retailers' selling operations than to others (the factors relevant to Internet retailers may not be the same that are relevant to bricks-and-mortar retailers).

Senator Righter: Is there conversation going on now in DOR that involves serious consideration of the possibility of weighting factors?

Mr. Berks: The Department is considering how it can construct the permanent rule to provide retailers with greater certainty. A lot of things are being considered. There's a public hearing on March 21 at which additional suggestions are likely to be made.

Senator Rezin: Is this rule change similar to the proposed legislation floated about a year ago by the RTA?

Mr. Berks: Not really. I know it wasn't the model for this.

Senator Rezin moved, seconded by Representative Thapedi, that JCAR recommends that the Department of Revenue continue to work with the affected taxpayers and local governments in an attempt to establish in the permanent rulemaking standards for determining the situs of sales tax liability that are enforceable and that are understandable by the entities that are affected by them. The motion passed unanimously.

CERTIFICATION OF NO OBJECTION

Representative Leitch moved, seconded by Senator Righter, that the Committee inform the agencies to whose rulemakings the Committee did not vote an Objection or an Extension, or did not remove from the No Objection List, that the Committee considered their respective rulemakings at the monthly meeting and, based upon the Agreements for modification of the rulemakings made by the agencies, no Objections will be issued. The motion passed unanimously.

APRIL MEETING DATE

Co-Chair Harmon announced that the next monthly meeting is scheduled for Monday, April 7, 2014 at 10:00 a.m., Room C-1, Stratton Office Building, Springfield IL.

ADJOURNMENT

Senator Harmon moved, seconded by Representative Leitch, that the meeting stand adjourned. The motion passed unanimously.

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