

A manufacturer or wholesaler whose products are sold by numerous distributors in Illinois may assume the responsibility of collecting and remitting Retailers' Occupation Tax on behalf of all sales made by those distributors under the provisions of 86 Ill. Adm. Code 130.550. See 86 Ill. Adm. Code 130.550. (This is a GIL.)

September 30, 2008

Dear Xxxxx:

This letter is in response to your letter received in this office on April 9, 2008, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am in-house legal counsel for COMPANY, a STATE corporation with offices, facilities and employees located only within the STATE. I am writing to request a private letter ruling on some questions concerning applicability of sales and/or use tax to 'free gifts' and discounted promotional sales in direct sales distribution model.

Introduction

Company is a direct selling company which contracts with various independent contractor distributors throughout the United States, including within your state, who sell the company's products consisting primarily of home craft items, including decorative stamps, papers and inks for scrapbooking. Sales by the independent contractor distributors (called 'Consultants') are made through a 'party plan' program and to individual customers.

If greater clarity could be achieved on the following two questions, it would be a help to the state, consumers within the state, COMPANY, and its distributors based in your state. (1) Under the circumstances stated in the factual background section below, should tax be charged on free incentive-based product, and if so, on what value or base? (2) For retail sales made at a discount in accordance with a sales promotion (i.e.,

buy \$X of product, get Y% off another product) can tax be charged on the actual discounted price? These questions, along with additional secondary questions, are restated near the end of this letter in greater detail, following the factual background and law which will provide a context in which the questions can be addressed.

Factual background

COMPANY Consultants take orders and collect money from their customers and then in turn submit orders to the Company prepaid, including the sales/use tax that they have collected from their customers. In order to assist its independent contractor Consultants with sales and use tax collection and compliance, the Company collects the sales/use tax due from sales by Consultants and remits the sales/use tax collected to the various state and local revenue departments or tax authorities under sales/use tax accounts the company has established with the states and local jurisdictions. For undiscounted items, the Company calculates sales tax based on the retail value of the goods (the Company's 'suggested retail price') when Consultants submit their orders.

Orders are submitted via Internet, fax and mail, with close to 100% being submitted via Internet. Most orders are submitted to the Company by Consultants. A small fraction of total orders are submitted directly by customers of Consultants, through e-commerce enabled websites provided by the Company which Consultants have the option of participating in. The Company's ordering system automatically calculates sales tax for the orders. Orders are filled and shipped either to the Consultant, to the party hostesses, or directly to the customers. Occasionally but rarely an independent contractor distributor will make a sale from inventory, although holding inventory is not a normal practice for the company's distributors and it [sic] discouraged.

The company has various incentive programs or offers where Consultants, their sales party hostesses, or customers receive free product tied to a particular sales goal. For example, when the sales total of a sales party reaches \$150 (excluding shipping & handling charge and tax), the party hostess receives a credit of \$25 towards a product order; if a sales party reached \$350, the free product credit would be \$60; and so on. There is no charge for these 'hostess gifts' - no shipping & handling charge is applied. Credits apply toward the suggested retail price. In other promotions, a particular product item is given for free if a sales objective is met. In yet other promotions, customers are offered a product or products at progressively-greater discounts based on the value of their order. For example: buy \$25 of product, and receive 25% off a featured product; buy \$50 of product, and receive 50% off a featured product; buy \$75 of product, and receive 75% off a featured product; buy \$100 of product, and receive a featured product for free, except for the Company's standard shipping and handling charge, based on the product's retail value of \$22.95. The company charges a shipping and handling fee for each order. For normal delivery, the shipping and handling charge is 7.95% of the pre-tax subtotal or \$4.75, whichever is greater. Expedited delivery options are available, all of which are calculated as a straight percentage of the total order with a fixed alternative minimum fee.

Questions

The two primary questions, with related secondary questions, for which my company requests a general information letter are:

1. Should the Company and its direct selling independent contractor distributors located in your state be charging sales tax on free, incentive-based product?

a. If so, on what value or base?

b. Does whether sales tax applies to 'free' items depend on whether the free item is provided to the consumer as part of a 'buy X, get Y free' promotion where the recipient is paying for product as part of one order, versus a 'hostess rewards' order where a sales party hostess is entitled to receive free product just for hosting a successful sales party, even if she doesn't purchase any additional product? Note that in the latter situation, the free hostess items are provided as part of a larger 'Home Gathering' sale order placed by the sales consultant.

c. Some 'free' items are shipped free of charge (i.e., hostess rewards), and for some 'free' items the standard Company shipping and handling charge applies, based on the product's suggested retail price. Would it be correct to charge tax only on the actual 'shipping and handling' charge? (When the Company's shipping and handling charge applies to an order (which is all orders except for a hostess rewards order and possibly occasional short-duration promotions), it is not optional, and is calculated by a simple formula as described above.)

2. For retail sales made at a discount in accordance with a sales promotion (i.e., buy \$X of product, get Y% off another product) can tax be charged on the actual discounted price?

a. Does the answer to the question above depend on how much the price is discounted?

b. Does the answer to the question above depend on any other pertinent factor based on the facts described in this letter?

Thank you in advance for looking at these questions. If this letter is not in such form as would allow your department to issue a private letter ruling, please inform me so I may amend it. Please contact me with any questions.

DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). Your letter does not meet the requirements of the regulation. Therefore, it is the Department's position that we must decline to issue a Private Letter Ruling. However, we hope the following will be helpful in addressing your questions.

The Retailers' Occupation Tax Act, 35 ILCS 120/1 *et seq.*, imposes a tax upon persons engaged in the business of selling tangible personal property at retail. The State tax rate is 6.25% of gross receipts for most items, and a lower rate of 1% for qualifying food, drugs and medical appliances. Local occupation taxes may also be applicable.

Gross receipts subject to Retailers' Occupation Tax are defined as all the consideration actually received by the seller. If a seller provides a discount to a purchaser and does not receive a reimbursement or rebate for that discount, only the (discounted) amount received by the seller is taxable. If a seller receives a reimbursement or rebate for a discount, the amount of that

reimbursement or rebate is considered part of the taxable gross receipts received by the seller. See 86 Ill. Adm. Code 130.2125.

When a retailer issues a coupon to a purchaser which entitles the purchaser to a free item conditioned on the purchase of a separate item (two-for-one, buy one get one free, etc.), the retailer's gross receipts are measured only by the amount actually received from the purchaser (the cost of one item). The result is that tax can only be charged on the amount actually received from the purchaser. The retailer, in this situation, cannot charge tax based upon the value of the free item received because technically the item was not free and no gift was intended. The retailer was simply offering a special price for both items sold.

The Department's regulations provide that credits awarded to a host or hostess for sponsoring a party for friends at which a seller may show and solicit orders for her merchandise, and which are awarded based upon the amount of sales generated at the party, are included in gross receipts subject to tax when applied toward purchases of the seller's merchandise. The value of the reward credit equals the dollar amount credited when the reward credit is applied. See 86 Ill. Adm. Code 130.401(c).

When you provide free merchandise to consultants or customers, as a donor, you owe Use Tax on the cost price of the merchandise that you give away to the consultants or customers. See 86 Ill. Adm. Code 150.305(c). Your consultants or customers do not incur a tax liability. As a result, when you purchase tangible personal property that you will give to your consultants or customers, you may not provide your suppliers with a Certificate of Resale because no resale is made. Rather, the supplier must charge, and you must pay, tax on your cost price of the tangible personal property. If the vendor or supplier is an unregistered out-of-state retailer, you must self-assess Use Tax on the cost price of the merchandise and pay that tax directly to the Department of Revenue.

For information regarding the Department's regulation on the treatment of transportation and delivery charges under the Retailers' Occupation Tax Act please see 86 Ill. Adm. Code 130.415. Transportation and delivery charges, also designated as shipping and handling charges, are not taxable if it can be shown that the charges are agreed to separately from the selling price of the tangible personal property sold and the charges are actually reflective of the costs of shipping. To the extent the transportation and delivery charges exceed the costs of shipping, the charges will be subject to tax. As noted in subsection (d) of Section 130.415, if the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability.

The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice.

Please be advised that where retailers send merchandise to party hosts or hostesses who then distribute the merchandise to purchasers, shipping and handling charges are generally considered part of the retailer's costs of doing business and are subject to tax. Please refer to Section 130.410.

You note in your letter that "COMPANY Consultants take orders and collect money from their customers and then in turn submit orders to the Company prepaid, including the sales/use tax that

they have collected from their customers. In order to assist its independent contractor Consultants with sales and use tax collection and compliance, the Company collects the sales/use tax due from sales by Consultants and remits the sales/use tax collected to the various state and local revenue departments or tax authorities under sales/use tax accounts the company has established with the states and local jurisdictions." Information concerning the "Filing of Returns for Retailers by Suppliers Under Certain Circumstances" may be found at 86 Ill. Adm. Code 130.550. This regulation explains that manufacturers, importers or wholesalers can enter into an "agency agreement" with the Department, whereby they register, file returns and remit Retailers' Occupation Tax on behalf of their local distributors. Please note that such arrangement must be accepted by the Department and is subject to any written objections of the retailers that would be affected.

The Agency Agreement (RR-80) may be used to obtain approval of such an arrangement with the Department. Under this type of agreement, the manufacturers, importers or wholesalers sell products to local distributors and collect tax from the distributors based upon the selling price to the ultimate consumers. The applicable tax is not based upon the sale to the local distributors. The appropriate tax must be collected for the sale to the distributors' ultimate customers, which includes State and any applicable local tax. In general, the determination of any local tax liability will depend on the location where the purchase order is accepted from the ultimate customer. See 86 Ill. Adm. Code 270.115.

When manufacturers, importers or wholesalers operate under this type of agency agreement, the local distributors need not register, file returns or remit taxes since the manufacturers, importers or wholesalers have agreed to this responsibility. The local distributors should, however, retain a copy of the agreement. If they fail to provide such documentation upon demand by the Department, they will be required to register, file returns, and remit the appropriate amount of tax directly to the Department. Distributors who prefer to register and remit their own taxes may opt out of the agency agreement.

Taxpayers may acquire form RR-80 (Agency Agreement) by contacting the Department's Central Registration Unit, attention Manager, located at Illinois Department of Revenue, 101 West Jefferson, Springfield, Illinois 62702.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Associate Counsel

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