



Leveling the Playing Field for Illinois Retail

The US Supreme Court's *Wayfair v South Dakota* decision recognizes that out-of-state or "remote" retailers can be engaged in the occupation of selling in a state even though they do not have a physical presence there. As a result, Illinois can now require that remote retailers collect and remit State and local Retailers' Occupation Tax (ROT) rather than use tax. By doing so, Illinois will substantially increase revenues from Internet sales by fully leveling the playing field between remote sellers and Illinois sellers, allowing units of local government to realize revenue from their locally-imposed retailers' occupation tax, and increasing compliance while reducing the enforcement burdens of the Department of Revenue (IDOR).

The proposal has two parts:

1. Remote Retailers: It provides an easy and free method for remote retailers to collect and remit the state and local retailers' occupation tax (ROT) instead of the use tax (as is currently required) by allowing for IDOR certified service providers (CSPs).
2. Marketplaces: It requires marketplace facilitators to collect and remit the state and local retailers' occupation tax (ROT) on sales made by marketplace sellers through the marketplace.

The proposal does not change anything about taxes on Illinois retailers that sell products directly, whether online or offline.

We estimate this proposal will raise **\$460 million annually**, with \$368 million to the state and \$92 million to localities by formula, *plus* any additional local ROT where applicable.

Proposal Overview

	<u>Now</u>	<u>Proposed</u>	<u>State Revenue Impact</u>	<u>Local Revenue Impact</u>
Remote Retailer	Use Tax	ROT at destination	Significant increase. Due to improved compliance.	Significant increase. Due to improved compliance, localities will receive more through the 1.25% distribution, as well as additional local ROT where applicable.
Marketplace sales by non-IL retailers (>96% of marketplace sales)	Use Tax, <u>low compliance</u> .	ROT at destination	Significant increase. Due to improved compliance.	Significant increase. Due to improved compliance and additional local ROT where applicable.
Marketplace sales by IL-based retailer (<4% of marketplace sales)	ROT at origin, <u>low compliance</u> .	ROT at destination	Significant increase. Due to improved compliance.	Negligible change overall. You can't lose what you weren't getting.
No Change IL retailer shipping to IL customer from an IL warehouse.	No Change ROT at origin	No Change ROT at origin	No change.	No change.
No Change Main street retailer selling from a store.	No Change ROT at origin	No Change ROT at origin	No change.	No change.

Remote Retailers

Currently, remote retailers making sales to Illinois customer either totaling \$100k or 200 separate sales during a 12 month period must collect and remit state use tax on sales to those Illinois customers. The use tax is 6.5%, with 5% going to the state and the other 1.25% being transmitted to localities based on a population formula. In the meantime, local retailers are subject to ROT, which is often higher than the use tax, because of additional locally-imposed components of the ROT. The average combined rate in Illinois is 8.74%.

Under this proposal, remote retailers that meet the current 200 transaction/\$100,000 in gross receipts threshold would be required to collect ROT, both state & local, rather than use tax. Since remote retailers do not have a physical presence in Illinois, the applicable local ROT rate would be determined by the delivery or pick-up location (destination). Applying ROT to these sales will ensure that a product purchased from a remote retailer is subject to the same tax as the same product bought in a local brick and mortar shop.

Given the multitude of local taxing jurisdictions that impose a local ROT, this proposal provides an easy and free-of-charge way for remote retailers to comply with Illinois law by authorizing certified service providers (CSPs) approved by the Department of Revenue to collect and remit the state and local tax due from remote retailers. The CSPs would retain the 1.75% vendor's discount as payment for providing these tax filing and remittance functions on behalf of remote retailers.

By requiring Remote Retailers to collect and remit ROT and providing an authorized and free way for them to do so, we can:

- Level the tax rate playing field;
- Increase revenues for the state and local governments;
- Improve compliance with Illinois law by identifying more remote retailers required to file Illinois returns;
- Ease administration for IDOR by standardizing the filing requirements for tens of thousands of remote retailers through CSPs.

Marketplaces

Marketplace facilitators are companies that operate a marketplace on which third party sellers can sell their products (e.g., Amazon, Wal-Mart, eBay, Etsy). Marketplace facilitators enable small and medium-sized businesses across the US and the world to sell their products to Illinois customers. Currently, pursuant to IDOR regulations, the third-party sellers (and not the marketplace facilitators) are responsible for collecting and remitting tax due on sales to Illinois customers. However, compliance is extremely low, since IDOR does not have the resources to track down or audit the hundreds of thousands of individual merchants.

This proposal shifts the burden of compliance, requiring the marketplace facilitator to collect and remit ROT on behalf of the third-party sellers doing business on the marketplaces. To date, 26 states and the District of Columbia have passed similar laws to solve the compliance problem and capture revenue.

How would the State of Illinois benefit from the marketplace proposal?

This proposal:

- Requires marketplace facilitators to collect and remit ROT on behalf of third-party sellers, regardless of where the product comes from;
- Ensures compliance, by enabling IDOR to audit the marketplaces, rather than pursuing the impossible task of auditing hundreds of thousands of individual businesses around the country and the world; and
- Raises both state and local ROT revenue.

How would Illinois localities benefit from the marketplace proposal?

Marketplace facilitators will be required to collect ROT based on the customer's location for all sales through their marketplace, regardless of where the product comes from or who is selling it.

Today, sales made through a marketplace by out-of-state third party sellers are subject to use tax. The proposal subjects them to ROT at destination.

This is a double win for localities, because:

- **Higher rate on most sales.** On any given marketplace, the vast majority of sales come from out-of-state merchants. We estimate that more than 96% of marketplace-facilitated sales to Illinois customers come from outside the state. Subjecting these sales to ROT at destination rather than the use tax will boost local revenue.
- **Compliance ensures collection:** By enabling IDOR to audit the marketplaces, rather than pursuing the impossible task of auditing hundreds of thousands of individual businesses around the country and the world, we ensure that the municipalities actually receive the revenue they are owed by out-of-state merchants who sell through marketplaces.

Today, sales made through a marketplace by in-state third party merchants are subject to ROT at origin. The proposal subjects them to ROT at destination. While this is a shift, it is not a loss for localities, because:

- **You can't lose what you weren't getting:** Current compliance rates by these sellers are low, so while they may owe ROT at origin today, it is not clear that tax is actually being collected and remitted.
- **Numbers are small.** We estimate that less than 4% of all sales made to Illinois customers through a marketplace are from Illinois-based merchants. Even if every one of them was collecting ROT at origin, the loss would be far outweighed by the destination-sourced ROT from the more than 96% of marketplace-facilitated sales from out of state merchants AND the increase in local tax collected on direct sales from remote sellers, as outlined in the first portion of the proposal.

With improved compliance and a uniform rate, both the state **and** localities will benefit from the marketplace law.

Estimated Revenue Impact

Estimated Revenue Increase		
	Year 1	Year 2
Remote Retailer	\$130 million	\$260 million
Marketplace Sales	\$100 million	\$200 million
Total	\$230 million	\$460 million

Remote Retailers

Remote retailers selling directly to customers represent more than 40% of all on-line commerce. According to a study by MultiState Associates, a very conservative estimate for the first part of our proposal is that it would generate \$260 million annually for Illinois.

Marketplaces

For the second part of our proposal, it is helpful to look at Pennsylvania and New York. Pennsylvania's population is nearly identical to that of Illinois. Pennsylvania originally estimated it would collect \$50 million annually due to marketplace legislation. Through the first 9-months of its fiscal year, the state collected more than \$150 million and is on track for more than \$200 million. Since the two states are very similar in population size, a \$200 million fiscal estimate is eminently reasonable for Illinois.

For another example, Illinois' population is 34.7% smaller than New York's. New York is estimating \$390 million annually from its marketplace bill. If we subtract 34.7% to allow for population difference, Illinois is looking at \$255 million.

Based on the experience in Pennsylvania and the projections in New York, the marketplace provision should bring between \$200 million - \$255 million for Illinois. To remain conservative, we estimate \$200 million.

Importantly, neither Pennsylvania nor New York have paired their marketplace laws with a concurrent provision incenting certified service providers (CSPs) (e.g. Intuit, Tax Cloud, etc) to enroll and collect on behalf of non-marketplace sellers under \$1 million in annual nationwide sales.

Overall Proposal

Our proposal captures both direct sales from remote retailers and sales through marketplaces. It achieves increased compliance by utilizing and incenting CSPs to find and enlist remote retailers throughout the world to collect and remit the ROT, as well as requiring marketplace facilitators to collect and remit on behalf of marketplace sellers. As such, compliance should be nearly complete and bring the revenue estimate to \$460 million annually: \$260 from remote retailers and \$200 from marketplaces.

Since the state-imposed ROT is 6.25%, with 5% going to the state and 1.25% distributed to localities by formula, the state would receive 80% of the revenue increase and localities would receive 20%. In addition, localities would collect the locally-imposed components of the ROT where applicable. The table below breaks out the state and local portions of the estimated revenue increase under our proposal.

State & Local Portions of Revenue Increase				
	Year 1*		Year 2	
	State	Local	State	Local
Remote Retailer	\$104 million	\$26 million + local ROT (where applicable)	\$208 million	\$52 million + local ROT
Marketplace Sales	\$80 million	\$20 million + local ROT	\$160 million	\$40 million + local ROT
Total	\$184 million	\$46 million + local ROT	\$368 million	\$92 million + local ROT

* January 1, 2020 effective date means that the first year of collection captures only half of the Illinois fiscal year.

FAQs

But what about that warehouse in my town? Will I lose the revenue it is generating from sales to Illinois customers?

No. This proposal does NOT change the sales tax for Illinois retailers making direct, Internet or mail-order sales to Illinois customers outside of a marketplace. If it's an Illinois-vendor to Illinois-customer sale, it is still taxed at origin.

Why change the sourcing for marketplace sales by in-state merchants?

The proposal requires marketplace facilitators to collect and remit ROT on behalf of third-party sellers, regardless of where the product comes from. First, this applies a consistent tax regime across marketplace sellers, ensuring a level playing field. Second, this helps marketplace facilitators, which handle millions of transactions, comply with the law. At the time of the sale, the marketplace facilitator does not necessarily know where the product will be shipped from, but it does know where the product is going. This makes collection of ROT at destination the logical tax regime for all marketplace sales.

The marketplace provision in this proposal ensures that local governments will receive the full amount of ROT on all purchases by their residents from any merchant selling through a marketplace – revenue that is not currently being captured due to low compliance rates.

How did you come up with <4% and >96% of marketplace sales being by IL sellers / non-IL sellers?

It is a conservative estimate based on the state population. Illinois is approximately 3.9% of the US population. So it is reasonable to assume that the number of marketplace sellers based in Illinois will be proportional. That does track with the seller numbers for at least one marketplace facilitator. In addition, some marketplace sellers are international, so IL sellers make up an even smaller percentage of all marketplace sellers. Rounding 3.9% up to 4% is a very conservative estimate that likely overstates the actual number of transactions.

I thought Illinois was already doing something about remote sellers, why do we need this?

Last year, Illinois passed an economic nexus provision in anticipation of the U.S. Supreme Court's decision in *Wayfair v. South Dakota*.

- Effective October 1, 2018, retailers making sales to Illinois customer either totaling \$100k or 200 separate sales during a 12 month period must collect and remit state use tax on sales to those Illinois customers.
- When the legislature passed the FY19 budget, they estimated \$150 million in new revenue from this economic nexus provision. The Illinois Municipal League estimated revenue at \$207 million per year.
- The use tax rate is 6.25% and of that, 1.25% is allocated among the locals.
- The latest revenue update from the Illinois Municipal League indicates a steady uptick in revenue from use tax collections:

Use Tax payments arising as a consequence of the *Wayfair* decision have continued to pick up – albeit at modest levels. While there still is uncertainty about how these payments will come in going forward, data received from IDOR suggests that the increase associated with *Wayfair* has recently risen to about \$0.13 per capita. Combining the impact of *Wayfair* with a forecasted growth of 7% in online sales yields a MFY 2020 forecast of \$32.75 per capita.

This proposal would build on the economic nexus law, further increasing revenue by applying the ROT to remote sellers, and improving compliance through collection by CSPs (for Remote Retailers) and marketplace facilitators (for Marketplace sales).

How is this proposal different from the economic nexus bill passed last year?

This proposal builds on the economic nexus law. First, it would level the playing field by making remote retailers subject to ROT, instead of use tax. Second, it would authorize certified service providers (CSPs) approved by the Department of Revenue to collect and remit the state and local tax due from remote retailers. Third, it would require marketplace facilitators (i.e. eBay, Amazon, Wal-Mart, Etsy) to collect and remit ROT on the sales made by third-party merchants through marketplaces, regardless of where the product comes from.