Illinois Independent

Tax Tribunal

Wayfair LLC	)
Petitioner	)
	)
v.	)
	)
Illinois Department of Revenue,	)
Respondent	)

BRIEF OF THE PETITIONER
IN OPPOSITION TO
RESPONDENT'S CROSS-MOTION FOR SUMMARY JUDGMENT

The Petitioner, Wayfair LLC ("Wayfair"), opposes the cross-motion of the Illinois Department of Revenue (the "Department") for summary judgment and submits this memorandum in support of its opposition[1] and its own motion for summary judgment.

ARGUMENT

A. Introduction.

In a rather surprising concession, the Department now agrees with Wayfair's longstanding position that Wayfair cannot be liable for the Retailer's Occupation Tax ("ROT"). The reason for this about face is that, as the Department admits in its brief, it could not make out a case that Wayfair was subject to the ROT because it was not engaged in selling activities in any locality in Illinois. Dept. Br. at 5. [2]

The Department goes to great lengths in its brief to claim that it assessed a use tax, and not the ROT, in the amount of $164,643.46, running away from detailed stipulations its own counsel, in consultation with the auditor and audit division, negotiated for weeks before signing. *See*

[1] Wayfair adopts all defined terms, Procedural History, and Statement of Facts as stated in the October 4, 2022 Brief of the Petitioner in Support of its Motion for Summary Judgment ("Wayfair Br.").

[2] We refer to the "The Illinois Department of Revenue's Brief in Support of Its Cross-Motion for Summary Judgment and In Response to The Petitioner's Motion for Summary Judgment" as "Dept. Br."

Emails from J. Odigie, Counsel for the Department, to J. Szal (various dates), and Email from J. Odigie to Judge Brian Barov (July 18, 2022), together attached as **Exhibit A**.[3]

The parties agree that the sole issue is whether Wayfair owes a use tax on sales that were accepted prior to February 1, 2016 (i.e., orders submitted by Illinois customers and accepted by Wayfair) and delivered after February 1, 2016. Dept. Br. at 4; Stip. ¶ 1. The Stipulations make clear that Wayfair did not maintain a place of business so that it was not required to collect the use tax until after February 1, 2016. Stip. ¶¶ 16-17, 36.

The Department now relies on the audit report to assert that the amount in dispute for pre-nexus sales of $164,643.46 is a use tax. Yet, the Department ignores the very basis the auditor asserts for the assessment of the tax for pre-nexus orders delivered after Wayfair had nexus. In the Audit Narrative, Section X, the auditor states as follows:

> The taxpayer filed with ICB and objected to the Pre-Nexus sales liability. The taxpayer was seeking to remove the liability in the amount of $164,643 as it relates to sales made prior to 2/1/2016. The taxpayer did not have a presence in IL before 2/1/2016 therefore was not obligated to collect tax on those sales, but *per the ROT Act*; any tax liability incurred in respect to a sale of tangible personal property made in the regular course of business shall be computed by applying to the gross receipts from such sale, the tax rate in effect as of the date of delivery of such property.

(emphasis added).

The Department is faced with the proverbial pounding the square peg in a round hole. The obligation of a retailer such as Wayfair to pay the use tax can only be based on the statute and regulations. The statute and regulations impose an obligation to collect the use tax from the true taxpayer, the purchaser, only *after* the retailer has nexus. *See* 35 ILCS 105/3-45 ("the tax imposed by this Act shall be collected from a retailer maintaining a place of business in this State . . ."). Indeed, the Department agrees that while the ROT is a tax on the retailer, the use tax is a tax on the purchaser; the retailer's duty is "to collect the Use Tax from customers" and to remit the use tax to the Department. Dept. Br. at 6. It is only when a retailer has nexus and yet does not collect the tax from the true taxpayer, the purchaser, that it can be held responsible for payment of the tax. 35 ILCS 105/8 ("Any retailer required to collect the tax imposed by this Act shall be liable to the Department for such tax"). In other words, Wayfair's liability for the use tax on sales is based only on its duty to collect the use tax in the first place. If Wayfair did not have a duty to collect the use tax, then it does not have the liability for the use tax in the first place.

There is no dispute: Wayfair did not collect the use tax from its purchasers for sales prior to February 1, 2016, because it did not have nexus at the time. Stip. ¶¶ 17, 36. Despite the Department's concession that the retailer's obligation is to collect a tax that is actually imposed on the purchaser, the Department nevertheless asserts that Wayfair is obligated to pay the purchaser's use tax on sales accepted and approved prior to February 1, 2016, based on the company's post-

[3] For that reason alone, despite the Department's pages of meritless arguments that the Audit Division was not involved in the stipulation process and its specious accusations that the Department was not afforded sufficient opportunity to negotiate an accurate stipulation, the Department should be held to the Stipulations its counsel signed.

sale nexus. The Department fails to tie the time for determining nexus to the retailer's requirement under the statute and regulations; namely to collect the use tax. As an implicit acknowledgement of the flaw in the Department's approach, the Department asserts as a basis for liability of Wayfair that the "Use Tax is incurred at the time of delivery." Dept. Br. at 5. That may be the case for the purchaser, but that is certainly not the case for the retailer's obligation to begin collecting the use tax in the first instance.

The date for determining the **starting point** for a retailer's obligation to collect use tax on all its sales is when the retailer acquired nexus and not when it delivered the merchandise. Whether making a sale in a store or online, collection occurs when the sale is made, and not when the products sold are delivered. In order to pigeonhole liability for Wayfair for the tax of $164,643.46 for pre-nexus sales, the auditor understood she had to assess a ROT, a retailer's liability for which is based on its nexus footprint at the time of delivery, because this was the only tax type for which Wayfair could have had nexus as it relates to the revenue from the items that make up this contested portion.

B. A Retailer's Duty Regarding The Use Tax To Collect The Use Tax Begins Only When It Maintains A Place Of Business In Illinois.

The parties agree that the issue in this case is one of timing: *when* did Wayfair's duty to collect the use tax begin. Dept. Br. at 6. The parties are also in agreement that, with regard to the use tax, the retailer's obligation is to collect the tax but not to pay the tax unless it fails to collect tax it was required to collect. Dept. Br. at 16. The Department ignores these concession sand mistakenly asserts that the issue is "[w]hen is Use Tax incurred, thereby triggering Wayfair's obligation to collect the tax from the purchaser." Dept. Br. at 12. The Department turns on its head the nature of the retailer's obligation once it maintains nexus. Only after the retailer is required to collect the use (i.e., only after it has nexus) is the retailer required to pay the use tax. In contrast, if the retailer has nexus such that it is subject to the ROT rather than the use tax, the retailer is obligated to pay the ROT even if the retailer is not required to collect the ROT from its customer.

This difference between the nature of the retailer's duty—to collect the tax or pay the tax—based upon the type of tax dictates the conclusion in this case. The ROT is a sales tax on the retailer on *its* receipts from the activities of conducting the business or occupation of selling in Illinois. 86 Ill. Adm. Code 130.101(a)(1) (tax becomes due as of the date the seller receives the receipts for the sale from the purchaser); 86 Ill. Adm. Code 130.201. In contrast, the retailer's opportunity to discharge its duty to collect the use tax arises when the retailer enters into the sales transaction with its customer. That happens at point of sale. In the case of online sales that is at the point that the retailer issues an invoice to its customer that submitted an order, and not at the point of delivery.

To understand that issue, and this distinction, consider the following analogy. Imagine standing on a sidewalk when a storm front approaches, raining on the opposite side of the street but not yet on you. As you cross the street, you put on your rain coat to avoid getting wet. Similarly, once a retailer crosses the proverbial street to go into the rain (i.e., to maintain a place of business), it then is obligated to put on its coat (i.e., to collect the use tax on the transaction). Just as before crossing to the rainy side of the street there is no need to don the coat, before a retailer establishes nexus the retailer has no obligation to collect tax on sales to its Illinois customers.

Indeed, under those circumstances a better analogy would be jaywalking – illegally collecting tax before it crosses the street (i.e., has nexus). 35 ILCS 105/7 (creating misdemeanor on retailers who falsely advertise about tax collection); 35 ILCS 105/14 (making it a felony for a person who willfully violates the Use Tax Act, such as by conducting business as a retailer or collecting taxes without being licensed).

As to the circumstances that must occur before an out-of-state retailer's obligation to collect the tax from the customers is triggered, the title of 86 Ill. Adm. Code 150.801 says it all. The title is: "*When* Out-of-State Retailers Must Register and Collect Use Tax." (emphasis added.) As stated in 86 ILAC 150.801(b) and (c) a retailer "maintaining a place of business in this State as that term is defined in 86 ILAC 150.201(i) . . . must act as a Use Tax collector for this State." Where the retailer does not maintain a place of business in Illinois, the retailer is not required (and is not authorized unless it volunteers) to collect the tax.

A retailer like Wayfair acts as a tax collector for the state only when it enters into a transaction with its customer. This is Wayfair's only opportunity to collect the tax. As made clear in the Stipulations, the transaction occurs when the customer submits orders on Wayfair's website, which are accepted by Wayfair at its headquarters in Boston. Stip. ¶ 19. The sales price, including the taxes thereon and other payment information, is submitted with the order for acceptance by Wayfair, and Wayfair authorizes and processes payment only in the amount submitted with the order, so that any attempt to include tax after the order was submitted was not authorized. Stip. at ¶¶ 20 and 22.

The Department's brief acknowledges that Illinois imposes the burden on the retailer to collect the use tax, but not to pay the tax, because of "the impracticability" of the Department "collecting Use Tax from the individual purchasers." Dept. Br. at 12. In other words, the Department imposes the burden of collecting and remitting the use tax, even though the retailer is not legally the taxpayer for these taxes, when it is possible for the retailer to do so. The only time that it is possible for Wayfair, like other retailers whether at the cash register or by online acceptance of credit cards, to collect the tax is at the time of submission of orders. Stip. at ¶¶ 20 and 22.[4]

The Department's brief ignores (indeed it disavows) the Stipulations and its own regulations as cited in Petitioner's brief. Nowhere does the Department's brief address the fact that the time of collection for Wayfair is when the online order is submitted. Nor does the Department's brief address Wayfair's citation to 86 Ill. Admin. Code 150.1305(b). Wayfair Br. at 7. That section makes clear that a retailer is obligated to report the Use Tax as a separate line item *on the receipt* issued to its customer in order to notify the customer that tax has been collected. Indeed, failure to separately show the tax on the receipt gives rise to a misdemeanor. 86 Ill. Admin. Code 150.515(a). *See also* 86 Ill. Admin. Code 150.1305(a) (retailer's records must

[4] The Department's citation to the claimed practice of Amazon to "estimate" the sales tax due on delivery and use that as a basis to charge the customer (Dept. Br. at 17, note 11) is specious for two reasons. First, it has no evidentiary value. It is merely a recitation with regard to taxes in general of what appeared on a web page of a completely different business with different operations and tax obligations, and not a reference to tax obligations for deliveries of items in Illinois after nexus is established. Second, the Department's own regulations do not permit estimation of the tax. 86 ILAC 150.510 requires the use tax to be "collected exactly at the applicable rate whenever practicable."

show that he provided a receipt to the customer of the tax collected). In short, the critical time for the retailer's discharge of its duty with regard to the use tax is the time it accepts and approves the sale. *Accord* General Information Letter ST 98-0090 (Mar. 24, 1998) (in determining where and when a sale occurs, "the most important element of selling is the seller's acceptance of the purchase order").

Regulations hold the same force as statute, and for that reason must be interpreted using the rules of statutory construction. *Kean v. Wal-Mart Corporation, Inc.*, 919 N.E.2d 926, 936 (Ill. 2009). The mandate that any tax due be listed on the receipt at the time the receipt is issued *must* be given its full effect. One must read these regulations regarding the duty to collect and the obligation to give a receipt in light of the facts that the time Wayfair collected the sales price and provided a receipt to its customers happened before Wayfair had nexus in this case. Doing so leads to only one conclusion: Wayfair neither had the duty to collect the use tax on the pre-February 1, 2016 sales nor consequently liability for the use tax imposed on the purchasers.

C. The Regulations Upon Which The Department Relies Do Not Support The Department's Argument That The Time For Measuring The Start Date For Collection Of The Use Tax Is At Delivery.

Although the Department asserts that the ultimate issue in this case is "timing" of when Wayfair is obligated to collect the tax, Dept. Br. at 12, the Department sidesteps that issue by making arguments that address **when the purchaser is subject to the use tax**, which the Department argues is based upon when the purchaser is in possession of the property. Dept. Br. at 12. The Department backs into its argument as it relates to retailers by asserting that since the time the purchaser takes possession of the property and thus becomes obligated to pay use tax as a consumer is "upon delivery" to the purchaser, the "retailer's obligation to collect and report such tax is based upon when delivery is made to the customer." *Id.* Not only is there no statutory support for this backdoor effort, the Department's argument is inherently incorrect. The retailer's obligation to collect tax is not tied to the point that the purchaser is liable for the use tax. The retailer's obligation to begin collecting the use tax under the statute is tied to when it establishes nexus by maintaining a place of business in Illinois. 35 ILCS 105/3-45; 86 Ill. Adm. Code 150.801 "When Out-of-State Retailers Must Register and Collect Use Tax."

The Department's citation to 86 Ill. Admin. Code Sections 150.115(a) and 150.120 in support of its argument that tax collection occurs on the date of delivery is equally misplaced. These two regulations address, respectively, the date for determining the use tax rate in effect for the purchase and whether the purchase is taxable or exempt. Neither regulation speaks to the date for determining if the retailer had a duty to collect tax in the first place. Both regulations address the tax that is due from the true taxpayer—the purchaser.

Moreover, the Department recognizes that consistent with Subsection 150.115(a), had the retailer received payment of tax at the lower rate in effect prior to the rate change, the retailer would be obligated only to remit the amount it received. The retailer charged its customer for the amount billed, including any taxes, on the invoice, and the customer authorized payment in that amount. Putting these together, Wayfair legally cannot charge the customer's credit card for Illinois tax at the time of delivery. Stip. at ¶ 23 (a stipulated fact with which the Department agreed, does not disavow, and yet conspicuously ignores in its own motion).

Further, Subsection 150.120 states "When something that has been exempted becomes liable as to purchases that are made on or after some particular date, the date *for this purpose* shall be deemed to be the date of the delivery of the property." (emphasis added.) This section does not apply a general rule. It is self-limiting, setting a standard that only applies in one circumstance. The phrase "for this purpose" can only mean that if the retailer was obligated to collect the use tax in the first place, the determination of when the products are taxable is made at the time of delivery. *See* 86 Ill. Adm. Code 150.120. That circumstance, of course, is not relevant here where there was not a duty in the first place.

The Department claims that the Sales Tax Holiday statutory provision proves the Illinois legislature knows how to deviate from a general rule. Dept. Br. at 14. In making this argument, the Department did not read the statute in its entirety. The sales tax holiday statute cited by the Department, 35 ILCS 120/2-8, implements the ROT. The Department has already conceded that the ROT is not applicable and for that reason this statute is irrelevant. The sales tax holiday only applies to retailers who have nexus, are subject to the ROT, and are already obligated to collect in the first instance during the holiday weekend itself.

To understand how misplaced the Department's arguments are, one should consider the broader context that governs the Use Tax Act. A retailer who has nexus with Illinois has dual obligations: 1) to collect any applicable taxes on sales of property to Illinois residents, 86 Ill. Adm. Code 150.801; and 2) to be informed about how to do so, including by becoming aware of any upcoming changes to those obligations such as changing tax rates or changing exemptions. *See, e.g., Hollinger Intern., Inc. v. Bower*, 363 Ill. App. 3d 313, 328-29 (2005) (penalty waiver; business taxpayer expected to exercise ordinary business care to comply with tax obligations where the law is clear, common knowledge, and access to which is readily available); *Du Mont Ventilation Co. v. Department of Revenue of Illinois*, 99 Ill. App. 3d 263, 266 (1981) (penalty waiver, decision acknowledging taxpayers are required to use ordinary care and business prudence to be informed of changes to tax laws that affect their compliance obligations).

A retailer that has the duty to collect the use tax learns of the tax rate to charge its customers, and the taxability of its products, through its duty to keep informed. Statutory changes to tax rates and taxability of products are governed by the state's Effective Date Act. 5 ILCS 75/1, 5 ILCS 75/2. The purpose of the Effective Date Act is "to ensure that parties have sufficient notice and opportunity to conform their conduct to the law ….". *People ex rel. Alvarez v. Howard*, 2016 IL 120729, ¶ 22, 72 N.E.3d 346, 353 (Ill. 2016) (citing Ill. Const. 1970, art. IV, § 10; *Mulligan v. Joliet Regional Port District*, 123 Ill.2d 303, 315, 527 N.E.2d 1264 (1988)). Changes to tax rate or tax exemption must be implemented by statute, which then go into effect in accordance with the Effective Date Act. The delayed effective date of changes to tax rate or cancellation of exemptions provides affected retailers (i.e., those with nexus) 6 to 12 months' advance notice of upcoming changes to rate or exemption, and time to implement the changes. Reading the regulations cited by the Department in light of the Effective Date Act, a retailer with nexus can then collect the correct tax at the point of sale, even though delivery may occur at later in point of time.

In short, the Department's arguments are all smoke and mirrors. The regulations cited have nothing to do with *when* the obligation to collect the tax in the first place arises. The Department's efforts focus on the statutes that govern *how* to comply. Those questions have nothing to do with whether the retailer is obligated to collect the use tax in the first place. Establishing nexus is what

obligates the retailer to collect the use tax. Without nexus, the applicable tax rate or the tax-exempt status of what the retailer sells are irrelevant.

D. The Department's Repudiation Of The Negotiated Stipulation Gives Wayfair The Right To Attorneys' Fees Under The Taxpayer's Bill Of Rights.

Based on the auditor's findings as quoted above, Wayfair appealed the auditor's Sales Tax Audit Summary of August 25, 2020 to the Informal Conference Board ("ICB"). Stip. ¶¶ 3-6. Believing that the Department had proposed the assessment of a ROT, the ICB concluded that Wayfair was obligated to pay the ROT. *See* ICB Action Decision attached as **Exhibit B** (quoting 86 Ill. Adm. Code 130.101(a) as the sole basis for its decision). The Department then issued a Notice of Tax Liability based on that finding. Stip. at ¶¶ 7-9. During the summer of 2022, the Department spent weeks negotiating the executed Stipulation with Wayfair. Indeed, the deadline to submit the Stipulations was extended multiple times to allow the Department's counsel to consult with the Audit Division for accuracy of the Stipulations. *See* **Exhibit A**. Now, on the last date for the Department to respond to Wayfair's motion for summary judgment, nearly six months after negotiating those stipulations and following numerous extensions of time granted by the Tribunal, the Department asserts an entirely new argument, that it never assessed a ROT to begin with, contrary to the conclusion in the Audit Narrative. The Department now claims it merely assessed a use tax.

Wayfair expended significant legal fees in addressing the Department's claim that it had assessed a ROT and lost the benefit of being able to substantively challenge such a claim in a proceeding before the ICB. The ICB likely would have rejected the assessment of a use tax, based on the fact that Wayfair did not have nexus at the time of sale. If so, Wayfair would not have incurred the attorneys' fees it has incurred for litigating before the Tribunal.

A taxpayer like Wayfair is entitled to recover the fees paid to its attorney or accountant where the Department has made an assessment or denied a claim without reasonable cause. 20 ILCS 2520/7. "The determination of reasonable cause involves review of the legal theory relied upon by the Department to support its action and the facts relied upon by the Department to support that theory." *Hercules, Inc. v. Dep't of Revenue of State of Ill.*, 347 Ill. App. 3d 657, 664, 807 N.E.2d 993, 999 (2004).

By conceding that Wayfair was not and could not have been subject to the ROT, the Department effectively has conceded that its assessment of the ROT lacked reasonable cause. It also effectively conceded that the ISB's denial of Wayfair's claim lacked reasonable cause, as that denial was premised on the basis that the state assessed the ROT. Lastly, by repudiating its stipulation, the Department directly caused Wayfair to incur substantial additional costs to challenge the erroneous assessment and to negotiate in good faith with the Department.

Recovery of these costs is Wayfair's right as a taxpayer, and cannot be waived. Should the Tribunal find in Wayfair's favor, awarding such fees is mandatory. *Id.* ("the fees … shall be recoverable against the Department").

CONCLUSION AND RELIEF REQUESTED

The parties now agree that Wayfair was not engaged in the business of selling in Illinois, and therefore Wayfair is not liable for the assessment of the Retailers' Occupation Tax of $164,643.46 on pre-nexus sales. Likewise, because Wayfair did not maintain a place of business in Illinois at the time the pre-nexus sales were accepted and approved, Wayfair was not required to collect the use tax and did not collect the use tax. Thus, it is not liable for any use tax it did not collect.

For all the reasons addressed above, Wayfair requests that this Tribunal abate the portion of the assessment that relates to sales accepted and approved prior to February 1, 2016, in the amount of $164,643.46, plus interest thereon. The Department's concession that Wayfair could not be subject to the ROT followed more than two years of appeals during which Wayfair incurred substantial legal fees challenging the Department's assessment of those very taxes also counsels in favor of an award of attorneys' fees.

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