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The Illinois Department of Revenue (Department) recently proposed amendments to its regulations governing the taxability of shipping and handling charges. The Proposed Amendments to 86 Ill. Admin Code §§ 130.415 and 130.410 (Proposed Amendments) are intended “to incorporate the holding of the Illinois Supreme Court in Kean v. Wal-Mart Stores, Inc., 235 Ill. 2d 351 (2009) … [and to] clarif[y] when transportation and delivery charges are considered part of ‘gross receipts’ subject to the Retailers’ Occupation Tax Act or the Use Tax Act.” The Proposed Amendments state that they are retroactive to November 19, 2009, the date of the Kean decision.

Delivery charges taxable when they are “inseparably linked” to the taxable sale of property

In Kean, the Court held that delivery charges for products purchased over the internet and shipped to Illinois customers are taxable when “an ‘inseparable link’ exists between the sale and delivery of the merchandise plaintiffs purchased.” 235 Ill. 2d at 376. Citing Kean, the Proposed Amendments adopt that rule (Prop. 86 Ill. Admin. Code § 130.415(b)(1)(B)(i)) and provide two examples of an “inseparable link”:

- When delivery charges are not separately identified to the customer in the contract or invoice;
- or
- When delivery charges are separately identified to the customer, “but the seller does not offer the purchaser the option to receive the tangible personal property in any manner except by delivery from the seller (g., the seller does not offer the purchaser the option to pick up the tangible personal property).”

Prop. § 130.415(b)(1)(B)(ii)

The Proposed Amendments provide that if a product can be sold without rendering the delivery service, the service is not taxable. Prop. §130.415(b)(1)(B)(ii). Although this language is not limited to a circumstance in which a pickup option is offered, all of the examples provided by the Department focus on that fact pattern. Notably, the pickup option need not be at an in-state location. This is consistent with the Department’s recent private letter rulings concluding that when a pick up option is offered, even if it is out-of-state, the delivery charges are not taxable. ST-15-0011-PLR (7/16/15); ST-15-0012-PLR (7/27/15).

In a change from the Department’s prior practice, the Proposed Amendments provide that separately stated shipping charges not found to be inseparably linked to the sale of goods are not taxable even if they include a profit component (i.e., exceed the actual cost of shipping). Cf. the current regulation, at 86 Ill. Admin. Code §130.415(d), with Prop. §§ 130.415(b)(1)(C) and (b)(1)(D)(iv).

Practice Note:

Sub-part (b)(1)(B)(ii) of the Proposed Amendments supports the conclusion that offering customers
free standard shipping evidences that any other shipping service for which a seller charges customers (i.e., expedited shipping) are separately contracted for and thus nontaxable. *Arco Industrial Gas Division, The BOC Group, Inc. v. Department of Revenue*, 223 Ill. App. 3d 386, 392 (4th Dist. 1991), which is cited in the Proposed Amendments, also supports this conclusion. Several defendants have successfully raised this defense in response to Illinois False Claims Act litigation alleging a failure to collect tax on shipping charges.

**Taxability and rate depend on the underlying property**

The Proposed Amendments go on to provide that in the event delivery charges are “inseparably linked” to the sale of property, their taxability and rate depends on the taxability of the property sold:

<table>
<thead>
<tr>
<th>Property Sold &amp; Delivered</th>
<th>Delivery Charges</th>
</tr>
</thead>
<tbody>
<tr>
<td>All exempt</td>
<td>Not taxable</td>
</tr>
<tr>
<td>Part exempt; part taxable</td>
<td>Not taxable if selling price of nontaxable property &gt; selling price of taxable property</td>
</tr>
<tr>
<td>All property subject to high or low tax rate</td>
<td>Follows tax rate of property</td>
</tr>
<tr>
<td>Some property subject to high tax rate and some subject to low rate</td>
<td>Low rate if selling price of low rate property &gt; selling price of high rate property</td>
</tr>
<tr>
<td>Exempt, high and low rate property</td>
<td>Not taxable if selling price of exempt property &gt; selling price of taxable property; low rate if selling price of low rate property &gt; selling price of high rate property</td>
</tr>
</tbody>
</table>

Prop. § 130.415(b)(1)(E).

**Incoming transportation generally remains a taxable cost of doing business**

The Proposed Amendments maintain the longstanding rule that a seller’s incoming transportation or delivery costs or costs to move property to ready for customer delivery are taxable costs of doing business. The rule applies even if the seller passes on these costs to a buyer by separately stating them on an invoice. 86 Ill. Admin. Code § 130.415(e); Prop. § 130.415(b)(2).

**Taxability of handling charges follows shipping charges**

The Department also proposes similar amendments to the regulation relating to the taxation of handling charges. Prop. § 130.410(c).

**Practice Note:**

To the extent the Proposed Amendments were issued by the Department to assist companies who have been named in lawsuits filed under the Illinois False Claims Act alleging an intentional failure to collect and remit tax on shipping and handling charges, it may be too late. The Proposed Amendments come almost six years after *Kean*, and after hundreds of companies have been forced to defend against these claims, regardless of their audit history with the Department, and regardless of their shipping policies. It remains to be seen whether the Department’s effort to impose the Proposed Amendments retroactively will be adopted, or whether the retroactivity will be helpful to companies who are forced to defend against this litigation. The Proposed Amendments also are inconsistent with position that many of the Department’s auditors have taken, both before and after *Kean*, that...
taxpayers need to collect tax on separately stated shipping and handling charges only to the extent that the charges are a source of profit for the company.

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