

CITY OF CHICAGO
INFORMATION BULLETIN – NEXUS AND SAFE HARBOR
ISSUED JANUARY 21, 2021

The City’s Departments of Finance and Law have received numerous inquiries on the topic of nexus, following the United States Supreme Court’s decision in *Wayfair v. South Dakota*, 585 U.S. ___, 138 S. Ct. 2080 (2018). *Wayfair* overruled *Quill v North Dakota*, 504 U.S. 298 (1992), replacing *Quill’s physical presence test* with a case-by-case analysis of whether the business is “purposely availing itself” of the privilege of doing business in the taxing jurisdiction. We are issuing this information bulletin to provide a summary of our analysis of the nexus issue in light of *Wayfair*, along with a safe harbor that we will employ.

1. Federal Law Issues

In *Wayfair*, the Court addressed the constitutionality of a South Dakota statute that required out-of-state sellers who had \$100,000 in sales to South Dakota customers or 200 sales transactions with South Dakota customers to collect and remit South Dakota’s use tax on sales to South Dakota customers. The Court upheld the statute, holding that physical presence was not required to show nexus for the purpose of tax collection. 138 S. Ct. at 2099.

Wayfair does not establish a specific economic threshold for finding nexus. The Court noted that Commerce Clause jurisprudence has “eschewed formalism for a sensitive, case-by-case analysis of purposes and effects.” 138 S. Ct. at 2094. The Court explained that “[t]his nexus requirement [for imposing a collection requirement on remote sellers] is ‘closely related’ to the due process requirement that there be ‘some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax’ and that “it is settled law that a business need not have a physical presence in a State to satisfy the demands of due process.” 138 S. Ct. at 2093. (Citations omitted.) The Court went on to say, “[w]hen considering whether a State may levy a tax, Due Process and Commerce Clause standards may not be identical or coterminous, but there are significant parallels.”

In considering the South Dakota statute, the Court applied the “purposefully availing” standard, holding that “nexus is established when the taxpayer [or collector] ‘avails itself of the substantial privilege of carrying on business’ in that jurisdiction.” 138 S. Ct. at 2099, quoting *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1, 11 (2009). The Court found that the quantity of business that was required under the South Dakota statute “could not have occurred unless the seller availed itself of the substantial privilege of carrying on business in South Dakota” and that the respondents had an extensive “virtual presence.” *Id.*

In sum, *Wayfair* held that whether there is sufficient nexus to impose a collection duty on an out-of-state seller must be decided on a case-by-case basis, with the key inquiry being whether the seller is “purposely availing itself” of the privilege of doing business in the taxing jurisdiction.

2. State Law Issues

Chicago is a home rule unit under Article VII, Section 6(a) of the 1970 Illinois Constitution, which gives it the right generally to exercise all powers and functions relating to its government and affairs, including the power to tax. While the State can preempt a home rule unit’s authority, it has not done so with regard to certain Chicago tax ordinances that impose an obligation on various sellers, lessors or other businesses to collect and remit taxes imposed on their customers.

The Illinois Supreme Court has held that a home rule unit can require an Illinois seller outside of its boundaries that does business within its boundaries to collect its taxes. *Mulligan v. Dunne*, 61 Ill. 2d 544, 557-58 (1975). The issue in *Mulligan* was whether a Cook County tax on the retail sale of alcoholic beverages that required out-of-county wholesalers to collect the tax on sales to retailers in Cook County was an improper exercise of extra-territorial jurisdiction. The Illinois Supreme Court held that a home rule unit does not act extra-territorially where a wholesaler located outside of its boundaries does business within the local unit’s boundaries. *Id.* at 558.

Mulligan does not address the federal constitutional issues that arise with respect to an out-of-state seller. But *Mulligan* recognized that business activity directed at customers within a home-rule jurisdiction is enough to justify imposing a tax collection obligation on a seller. In this regard, *Mulligan* is consistent with *Wayfair’s* holding that deliberate or purposeful business activities within a jurisdiction are relevant in determining whether a tax collection obligation may be imposed.

3. Analysis

The State of Illinois has enacted legislation that mirrors the dollar and transaction thresholds in the South Dakota statute upheld by the Supreme Court in *Wayfair*. 35 ILCS 105/2(9). This legislation applies to state use tax. It does not apply to local home rule taxes. Therefore, it does not limit the analysis of what constitutes nexus for the purpose of determining whether the City can require an out-of-state entity to collect a City tax.

In performing its analysis, the City will consider whether an out-of-state entity meets the thresholds that apply to the state use tax; however, that factor will not necessarily be treated as determinative, unless the safe harbor set forth below in Section 4 applies. If the safe harbor does not apply, other factors that the City may consider include: agreements that the entity has with other businesses in Chicago; activities that the

entity's employees or other agents perform on the entity's behalf in Chicago; any physical presence that the entity has in Chicago; advertising directed at Chicago customers; and any other facts that support or oppose the conclusion that the entity has purposefully availed itself of the privilege of carrying on business in Chicago.

4. Safe Harbor

To promote certainty, the City will employ a safe harbor. Specifically, an out-of-state entity that received under \$100,000 in revenue from Chicago customers during the most recent consecutive four calendar quarters will not be expected to collect the following taxes from its Chicago customers during the current calendar quarter: (i) Chicago's amusement tax, Chapter 4-156 of the Municipal Code of Chicago ("Code") as applied to amusements that are delivered electronically, such as video streaming, audio streaming and on-line games; and (ii) Chicago's personal property lease transaction tax, Code Chapter 3-32, as applied to nonpossessory computer leases. This safe harbor is extended with the following conditions and qualifications:

- a. It will apply only to an entity that has no other significant contacts with Chicago, such as those listed in Section 3 above.
- b. It will apply on a prospective basis, beginning July 1, 2021. No refunds or credits will be granted for taxes paid or remitted before that date.
- c. If an out-of-state business initially qualified for the safe harbor but no longer does, it must (i) register with the City's Department of Finance within 60 days, (ii) begin collecting Chicago taxes within 90 days, and (iii) continue collecting Chicago taxes for at least twelve months.
- d. The safe harbor concerns only the issue of whether a provider has a duty to collect taxes from its customers; it does not affect the issue of whether a customer has a duty to pay those taxes.

5. Conclusion

Unless the safe harbor set forth in Section 4 above applies, the City expects any business that does business in Chicago to comply with its tax ordinances. Whether the City has the authority to require a given business to collect its taxes is a combined question of law and fact. Most of the applicable law is expressed in federal and state case law, some of which is discussed above. The facts must be analyzed on a case-by-case basis. The Departments of Finance and Law are happy to discuss individual cases with any business or its authorized representatives, including accountants and attorneys. Where appropriate, this may include the issuance of a private letter ruling, pursuant to Uniform Revenue Procedures Ordinance Ruling #3.