Insights: Publications

Chicago Department of Finance Issues Nexus Guidance

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On January 21, 2021, the Chicago Department of Finance ("Department") issued an anticipated Information Bulletin ("Nexus Bulletin") [1] providing guidance on nexus and establishing a prospective "safe harbor" for certain taxes, including electronically delivered amusements under the Chicago's Amusement Tax ("Amusement Tax") Ordinance[2] and nonpossessory computer leases taxed under the Chicago Personal Property Lease Transaction Tax ("Transaction Tax") Ordinance. [3]

In short, effective July 1, 2021, if an out-of-state entity receives under $100,000 in revenue from Chicago customers during the most recent consecutive four calendar quarters, it is not required to collect Chicago Transaction Tax or Amusement Tax during the current calendar quarter. However, the safe harbor only applies to an entity that has no other significant contacts with Chicago, including agreements with other businesses in Chicago; the performance of activities by the entity's employees or agents on the entity's behalf in Chicago; physical presence in Chicago; advertising directly to Chicago customers; or any other facts that support the conclusion that the entity purposefully availed itself of the privilege of carrying on business in Chicago.

Prior to this Bulletin, there was limited guidance as to the applicable nexus standard for Chicago taxes, including whether the City follows *Quill's* physical presence standard for sales tax or Illinois' bright-line economic nexus standard for use tax adopted following the Supreme Court's decision in *Wayfair*.[4] In Transaction Tax Ruling No. 12, the Department clarified its intent to tax a Chicago lessee of electronically delivered software by stating that the Transaction Tax applies "whenever the customer's license, rental or use of the provider's computer takes place in Chicago." However, the Ruling punted on the issue of nexus, stating that nexus "is beyond the scope of this ruling" and instead advised taxpayers to seek a private letter ruling from the Department. Following that direction, taxpayers submitted "numerous inquiries on the topic of nexus." [5] In fact, in a private letter ruling issued prior to the *Wayfair* decision but only recently released to the public, the Department clarified that they "do not believe that *Quill* applies," but yet did not require a taxpayer without a physical presence in the City to collect Transaction Tax because this is an "unsettled area of law." [6]

Despite the Department acquiescing to the limited guidance available, the Department did not release any formal guidance post-*Wayfair* and became increasingly aggressive in its audit activity, including frequently seeking to collect the Transaction Tax on licenses of software by a vendor with no physical presence in Chicago to customers that "access" the software in Chicago. [7] As a home rule locality, Chicago has the right generally to exercise all powers and functions relating to its government and affairs, including the right to tax[8]. For this reason, in both audit and litigation, the Department generally takes the position that it is not bound by the state's authority. The Department takes a consistent position in the Nexus Bulletin, clarifying that Illinois' bright-line economic nexus threshold for the Illinois use tax "does not apply to local home rule taxes." [9]

Although the Nexus Bulletin is significant in that the Department has finally clarified its nexus position, the practical

impact may be limited. Because the safe harbor only applies where an entity does not have any "significant contacts with Chicago," the purview of the safe harbor may be narrow. Additionally, the safe harbor only concerns whether a *provider* has a duty to collect taxes from its customers, not whether a *customer* has a duty to pay those taxes.[10] Further, in an obvious attempt to bar any refunds or credits for tax erroneously remitted, the City clarifies that the safe harbor only applies prospectively beginning July 1, 2021. Most significantly for taxpayers currently under audit, the Department remains silent on the application of *Quill* to prior periods, potentially leaving the nexus issue open in prior periods.

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[1] Chicago Information Bulletin – Nexus and Safe Harbor (Jan. 21, 2021).

[2] In June 2015 the Department issued Amusement Tax Ruling No. 5 ("Ruling No. 5"), which clarified that the City's amusement tax applies to charges paid for the privilege of watching electronically delivered television shows, movies, or videos and for the privilege of listening to electronically delivered music and participating in games, online or otherwise, when delivered to a customer in the city. Chicago Amusement Tax Ruling No. 5 (eff. July 1, 2015). On Nov. 21, 2017, the City Council amended the ordinance to add as a taxable category of activity "paid television programming, whether transmitted by wire, cable, fiber optics, laser, microwave, radio, satellite or similar means." Municipal Code of Chicago ("M.C.C.") § 4-156-010.

[3] In June 2015, the Department issued Transaction Tax Ruling No. 12 ("Ruling No. 12"), which stated that a "nonpossessory computer lease" includes "cloud computing, cloud services, hosted environment, software as a service, platform as a service, and infrastructure as a service." Further, in October 2015, the Chicago City Council amended the Ordinance to include a lower Transaction Tax rate of 5.25% for "the nonpossessory computer lease of a computer", effective January 1, 2016. Due to a substantial number of requests for further guidance by taxpayers and practitioners, the Department issued an Informational Bulletin in November 2015, conceding that many companies "may not have been aware of the scope of the Tax[,]" and that it had received regular requests for guidance on the application of the Lease Tax to various products developed since the Transaction Tax was first enacted. These changes to the Amusement Tax are addressed in an earlier post in HMB's Illinois Practitioner Series.

[4] We previously addressed the City's failure to clarify a nexus standard in an earlier post in HMB's Illinois Practitioner Series. *Quill v North Dakota*, 504 U.S. 298 (1992); *Wayfair v. South Dakota*, 585 U.S. __, 138 S. Ct. 2080 (2018)(establishing a nexus standard that focuses on whether the taxpayer "avails itself of the substantial privilege of carrying on business" in that jurisdiction).

[5] Chicago Information Bulletin – Nexus and Safe Harbor (Jan. 21, 2021).

[6] Chicago Dep't of Finance PLR (Nov. 28, 2017), available at https://news.bloombergtax.com/daily-tax-report-state/ruling-shields-moxie-software-from-chicagos-cloud-tax.

[7] For purposes of the Transaction Tax, the place of the lease or rental is treated as the location of the terminal or other device by which a user accesses the computer. M.C.C. § 3-32-010(l).

[8] Article VII, § 6(a) of the 1970 Illinois Constitution.

[9] Effective October 1, 2018, a retailer making sales of tangible personal property to purchasers in Illinois from

outside Illinois is considered to be maintaining a place of business in Illinois if: (A) the cumulative gross receipts from sales of tangible personal property to purchasers in Illinois are $100,00 or more; or (B) the retailer enters into 200 or more separate transactions for the sale of tangible personal property to purchasers in Illinois. 35 ILCS 105/2.

[10] Significantly, the City has recently been aggressive in its audit of Chicago licensees of electronically transferred software. Although an audit may come as a surprise to licensees, the incidence of and obligation to pay Transaction Tax is on the lessee of the personal property. M.C.C. § 3-32-030(A).

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