

ST 06-0057-GIL 04/14/2006 SERVICE OCCUPATION TAX

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL.)

April 14, 2006

Dear Xxxxx:

This letter is in response to your letter dated February 16, 2006, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

I am a bookkeeper for an advertising agency with a main office in Wisconsin and an additional office in Illinois. We charge our Illinois clients a sales tax since there is a service that results in a tangible product. In some instances, that tangible product may only be a computer disc filled with information destined for our client's printer; this would be when the client will have the printing of an item (for example, a brochure) done elsewhere and is only using our services to create the concept and layout of the brochure.

Regardless of whether we actually do the production of the end product or not, we charge a sales tax on the labor and service involved in creating it. Is this a correct practice? Should labor or time spent for a service in developing an end product be charged tax?

We have a client who is contesting the tax charged on the labor, and they are requiring that we give them documentation showing that it should indeed be charged before they repay us the amounts. Therefore, I am requesting a letter in response to this query, indicating whether or not we should be charging tax on labor .

If you have any questions or need further details on this situation, please do not hesitate to contact me.

DEPARTMENT'S RESPONSE

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. As you will see, there are no provisions for charging tax on labor.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon how the serviceman calculates his or her liability. There are four ways that the tax can be calculated: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on the cost price if they are registered de minimis servicemen; or, (4) Use Tax on the cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

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