

This letter concerns the taxation of a material handling system. See 86 Ill. Adm. Code 130.2115. (This is a PLR.)

March 3, 2006

Dear Xxxxx:

This letter is in response to your letter dated February 23, 2004, 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.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to ABC for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither ABC nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

We are writing on behalf of the above named taxpayer, hereinafter referred to as ABC, to request a Private Letter Ruling. This Request for Private Letter Ruling (PLR) is being petitioned as the result of contradicting information found regarding the application of Retailers Occupation Tax (ROT) or Service Occupation Tax (SOT) to ABC product, material handling systems.

ABC has remitted ROT relative to a transaction with XYZ, CITY/STATE for a material handling system installed in a distribution facility in CITY, Illinois in 2002. Although ABC has remitted ROT, XYZ has questioned whether ROT or SOT should be applied. The sale of a second material handling system to XYZ is currently underway and the same question between the two parties has arisen. At this time, both ABC and XYZ are seeking guidance as to the application of ROT or SOT on the transactions.

FACTS

ABC's designs and manufactures material handling systems for distribution, manufacturing, parcel, freight, and baggage handling applications. The sale involves property and services that range from initial concept discussion with the customer or their consultant through design, manufacture, installation, training, commissioning and ongoing support for their material handling systems. ABC' customers cover various industries; therefore their products must be flexible and allow for the combination of various components to create the most efficient system for each client application.

Material handling systems are normally added after a building is completed and has already existed. The supporting components are normally bolted to the floors and ceilings and can be repaired or serviced while the system remains at its original location or is removed or replaced. Systems are intended to be flexible to allow for future expansions, variances in product sizes and types, and changes for modernizing and updating of equipment.

ABC' costs of machinery ranges from 55% to 70% of the total cost to design, manufacture, and install the material handling system. Of the 55% to 70% of machinery cost mentioned above, approximately 57% is directly related to material costs. The remaining costs represent labor and overhead. Though each material handling system is customized to meet the needs of each individual facility, most conveyor systems contain the same base components and are similar to other systems manufactured for distribution purposes. One of the more common customization requests is that the conveyor system be movable. For example, a conveyor system installed to meet product demands on a seasonal basis.

AUTHORTIES OF SUPPORT AND OPPOSITION

We have found letter rulings both in support and opposition with ABC, however, the facts varied slightly. We request the information be reviewed and clarified as to the correct tax classification that must be applied to XYZ transactions.

General Information Letter issued in August, 2001 (ST 01-0172-GIL) identified the conveyor systems as tangible personal property subject to the ROT for the reasons sited below:

- I. The conveyor systems can be removed without damage to the item or to the real estate and;
- II. The seller can repossess the item in the event of non-payment.

Both of the above statements can be applied to ABC product.

General Information Letter issued October 22, 2002 (ST 02-0223-GIL) identified the 'machinery or conveyor belts used to move the dinners through the freezing process' during the manufacture of frozen dinners as exempt from the ROT for purposes of 'manufacturing or assembling of tangible personal property for wholesale or retail sale'.

General information Letter issued July 21, 2003 (ST 03-0117-GIL) was unable to identify the conveyor that led paper through a shredding process as subject to or exempt from ROT as there was insufficient information. However, the reader is led to believe the Department of Revenue did consider the material handling system to be tangible personal property thereby subject to the ROT.

Machinery and equipment that is used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease is exempt from Retailers' Occupation Tax. The manufacturing process is the production of any article of tangible personal property, whether such article is a finished product or an article for use in the process of manufacturing or assembling a different article of tangible personal property, by procedures commonly regarded as manufacturing, processing, fabricating, or refining which changes some existing material or materials into a material with a different form, use or name. These changes must result from the process in question and be substantial and significant. See Section 130.330(b)(2).

Private Letter Ruling dated August 25, 2003 (ST 03-0019-PLR) determined that a conveyor system utilized by a distributor of steel products would receive Service Occupation Tax treatment. Since this is the most recent determination, the Department has made on this issue, we have outlined the similarities and difference that ABC product maintains with this PLR.

As stated in ST-03-0019-PLR	Similarities	Differences
Seller's reputation in the industry as a 'world-wide leader' in its field.	Our client is an industry leader in designing and engineering material handling systems.	
Conveyors' structural design features demonstrate that they are not permanently affixed to the warehouse. The legs are connected in turn to base-plate anchors with holes drilled in them. The conveyors may be removed with no damage to the underlying realty as long as the bolts are unfastened and the anchors-pulled out.	Bolts, screwed into the anchors' holes, are used to secure the material handling system to the floor. The material handling system is not permanently affixed to the realty.	

<p>Seller's costs incurred for design and engineering services, fabrication labor, and installation represent approximately 85-90 percent of the conveyors' purchase price to AAA, while direct material costs represent approximately 10-15 percent.</p>		<p>Our client's production costs are estimated at 50% to 70% of the total cost to design, manufacture and install the material handling system. Of the 50% to 70% of machinery cost mentioned above, approximately 57% is directly related to material costs. The remaining costs represent labor and overhead.</p>
<p>The seller is not registered as an Illinois retailer, since it makes no retail sales. The seller is considered a service provider (service-person), as this line of business focuses upon providing engineering and design services to its customers.</p>		<p>Our client is registered as a retailer with the state of Illinois. To date our client has remitted ROT on all sales transactions occurring in the State of Illinois.</p>
<p>The conveyors have value only to AAA.</p>		<p>Although, a customer does not request the movement of a material handling system from one location to another frequently, this has been done. The same order flow, customer base, warehouse layout, floor plan, and production requirements are not necessary. It should also be noted that in the event of default of payment ABC will repossess the material handling systems and resell it to another customer.</p>

<p>The seller is in the business of designing and engineering special-order property, not in making sales, at retail.</p>		<p>Our client maintains a product catalog from which a material handling system can be purchased. The customer can assemble a small to medium size material handling system without design or engineering specifications provided by our client.</p>
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Pursuant to an IDOR regulation, special-order machinery is produced when

1. The purchaser employs the seller specifically for its engineering and design skills to produce a machine to meet the purchaser's particular and unique needs;
2. The machine has use or value only for the specific purpose for which it is produced and
3. The machine has use or value only to the purchaser.

Our client does not meet all three requirements noted above.

The purchaser employs the seller specifically for its engineering and design skills to produce a machine to meet the purchaser's particular and unique needs.

ABC does maintain engineering and design that is capable of designing **unique** systems; the XYZ distribution facility did not require **unique** engineering or design.

The machine has use or value only for the specific purpose for which it is produced.

A material handling system can only be used as a material handling system. If a material handling systems is segregated into various components, the rollers on a stand-alone basis are of little value.

It should be noted that minor modifications to a system can be made to transport various types of product. For example, a material handling system that currently transports 10-pound packages can be modified to transport 25-pound packages with a small variation to the computer program. A modification related to the rate of speed at which a product travels through the conveyor system allows for heavier or lighter packages to be carried by the same belts and rollers. However, the material handling system is not specific to a customer as the system in *Velten & Pulver, Inc. V. Department of Revenue, Illinois Supreme Court, November 26, 1963, 194, N.E.2d 253, 29 Ill2d 524* was specific to the baking industry. A material handling system that is currently being utilized by a warehouse facility can be removed and reassembled for use in a manufacturing facility.

The machine has use or value only to the purchaser.

The XYZ sales agreement, which is similar to other sales agreements specifically states:

XYZ may terminate this Agreement if ABC defaults in the terms hereof in a material respect. If XYZ fails to pay the purchase price, or any installment or installments thereof, when due and payable, or if XYZ shall become insolvent or a Receiver or Trustee is appointed for its assets or business, or if any voluntary or involuntary petition under any section of the Bankruptcy Act of the United States shall be filed by or against XYZ, or if XYZ shall make an assignment for the benefit of creditors, or be adjudicated a bankrupt, then in such event ABC may cease further deliveries of equipment and further installation of such equipment and **remove all such equipment from XYZ premises.** (emphasis added)

Consideration of the issue that the default of a payment by the customer would cause ABC to remove the material handling system from the location and sell the system to another customer would lead one to the conclusion that the machine has use to more than one purchaser. Although, the default of payment for a material handling system does not occur frequently, systems have been removed and resold.

Velten & Pulver, Inc. V. Department of Revenue, Illinois Supreme Court, November 26, 1963, 194, N.E.2d 253, 29 Ill2d 524

We have reviewed the facts and circumstances outlined in Velten & Pulver, Inc. v. Department of Revenue (Velten). Velten specialized in designing, fabricating and installing conveyor systems specifically for the bakery industry. The Plaintiff provided testimony on his behalf

'that the equipment when installed had value, other than salvage, only to the purchaser, and that one of the primary reasons plaintiff has been so successful is because it, unlike suppliers of standard bakery equipment, is able to construct a conveyor system to fit the existing physical plant and thereby eliminate the need for major plant alterations'.

As a result of the above, the State of Illinois imposed the SOT on Velten. Again, we need to reiterate the points that the material handling systems manufactured by ABC have more than one purpose.

REQUEST FOR DETERMINATION

We would greatly appreciate the Department review the facts presented and provide guidance related to this transaction. We believe ABC does not meet the requirements outlined in IDOR - Special Order Machinery. As a result, ABC should continue to remit ROT to the State of Illinois.

If you have any questions, please feel free to contact me. Thank you for your time and consideration in this matter.

DEPARTMENT'S RESPONSE:

Issues regarding material handling systems are unique in that they require a fact intensive study of the materials involved, obligations of all parties involved, and an exacting examination of the transaction itself. The Department has found that its auditors are in the best position to make a determination of the tax liabilities concerning these types of transactions. Although the Department has now decided to decline to issue private letter rulings in these situations, we are confident that sufficient information has been provided to issue a private letter ruling in this instance. The Department's determination herein is based solely on the representations presented in your letter. This letter is binding as to ABC only and does not include the possible tax liability for any purchaser to this transaction.

The seller of a special order item is considered to be engaged primarily in a service occupation, rather than in the business of selling tangible personal property, if the test set out in 86 Ill. Adm. Code 130.2115(b)(1) is met:

- A) The purchaser employs the seller primarily for his engineering or other scientific skill to design and produce the property on special order for the purchaser and to meet the particular needs of the purchaser;
- B) the property has use or value only for the specific purpose for which it is produced; and
- C) the property has use or value only to the purchaser.

The material handling system referenced in your letter is not a special order item and is subject to Retailers' Occupation Tax liability. As documented in your letter, the material handling system could be removed and resold to another customer. The system is not specific to a particular customer, and thereby, gives the system value to more than one customer.

The Department next examines whether ABC is acting as a construction contractor. A construction contractor is considered the end-user of tangible personal property permanently affixed to real estate in Illinois. See 86 Ill. Adm. Code 130.1940(c). As pointed out in your letter, the material handling system could be removed and resold, and further, moved from location to location without significant alteration to the handling system or future location. In addition, the seller retains a security interest in the equipment. The documentation submitted reveals that the material handling system is not permanently affixed to the real estate, and for that reason, ABC is not acting as a construction contractor, but is in fact selling tangible personal property at retail.

Having considered the documentation submitted, and after examination of the facts unique to this transaction that are referenced in your letter, the Department agrees with your assessment that this transaction is subject to Retailers' Occupation Tax liability.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at 782-2844. If you have further questions related to the Illinois sales tax

laws, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Edwin E. Boggess
Associate Counsel

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