

This letter discusses Nexus, Retailers' Occupation Tax, Use Tax, Service Occupation Tax, Exempt Organizations, Local Taxes, Construction Contractors, and Shipping. See, 86 Ill. Adm. Code 130.101 et seq. (This is a GIL.)

March 23, 2009

Dear Xxxxx:

This letter is in response to your letter dated September 18, 2008, in which you request information. We apologize for the delay in responding to your inquiry. 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.tax.illinois.gov](http://www.tax.illinois.gov) 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:

A company (called Company X in this memo) will be selling audio/video systems to customers in your state and is interested in knowing your state's sales and use tax treatment of the transactions described below. Please answer the questions and send your response to me by email.

**Facts:**

1. Company X sells audio and video systems to customers in your state. There are 2 types of sales as described in a. and b. below.

a. **Sales of equipment without installation.** Company X sells only the equipment and Company X's customer is responsible for having the equipment installed. The customer receives possession of the equipment by means of standard freight shipped from Company X's facility. (Standard freight can include UPS, Federal Express, truck freight, etc.). In some instances the manufacturer drop ships the equipment to the customer. The manufacturers who drop ship the equipment are located in a number of different states.

b. **Sales of equipment which includes installation of the equipment by Company X.** Company X's employees may do the installation, or it may hire another person (Subcontractor) to install the equipment. If a subcontractor is used, the subcontractor

bills Company X for such installation services and Company X bills its customer for both the equipment and installation. The installation may occur in new buildings, new additions to existing buildings, in existing buildings and outside facilities such as football and baseball fields, race tracks, etc.

The equipment is shipped to the customer's location from Company X's facility by means of standard freight. (Standard freight can include UPS, Federal Express, truck freight, etc.). In some instances the manufacturer drop ships the equipment to the customer's location. The manufacturers who drop ship the equipment are located in a number of different states.

2. **Equipment sold:** The equipment sold by Company X in the two types of sales mentioned above includes such items as wireless microphones, transmitter, speakers, amplifier, battery charger, receiver, projection and video equipment, screen and cables for connecting some equipment.

For sales by Company X which include installation in buildings, the speakers may be mounted to walls or the ceiling or they may be free-standing without being attached. The projector and video equipment are usually mounted to the ceiling or walls. The screen is usually attached to the ceiling or wall. The cables connecting the equipment might be inside the walls, above the ceiling, below the floor, in conduit outside of walls, or may be outside of walls, below the ceiling or above the floor without being in conduit. For example, an installation by Company X might involve some sections of the cable being inside walls, above the ceiling or below the floor and other sections of the cable being outside of walls, above the floor and below the ceiling. Company X does not provide any electrical wiring as part of the sale.

There are other times when the sale of the equipment is for portable use and no cables are installed inside walls and no permanent mounting of any kind is provided.

For installations of outside facilities (e.g. football and baseball fields, race tracks), the speakers are usually attached to poles. Sections of the cable connecting the equipment may be underground and other sections of the cable may be above ground in conduit which is attached to poles, the grandstand and other structures.

3. **Warranty:** Company X provides a warranty with the sale of the equipment in both types of sales mentioned above and will replace parts and/or the complete equipment covered by the warranty, without any charge to the customer.

4. **Repairs:** Company X will repair the equipment that it sold in both types of sales mentioned above and will charge the customer, unless it is covered by a warranty.

5. **Training:** In both types of sales mentioned above, Company X will train the customer on how to use the equipment. (Note: if Company X's sale is to a general contractor who in turn sells to its customer, Company X will train the general contractor's customer)

6. **Customers:** Customer X's customers in both types of sales mentioned above include churches, the state of Illinois, cities, villages and counties in Illinois, public grade and high schools, private grade and high schools, Illinois state universities and colleges, private universities and colleges, and various types of for-profit businesses (e.g. hotels, law firms, retirement homes and assisted living homes, funeral homes, restaurants, company conference board rooms, etc.).

In some instances where Company X both sells and installs the equipment, Company X has a contract with the general contractor for the sale and installation of the equipment and is paid by the general contractor. The general contractor then has a contract with its customer (e.g. church, hotel, theater) to construct a building or outdoor facility, including the sale and installation of the audio/video equipment.

**Questions:**

**1. Sale of equipment without installation to a customer (church, hotel, theater)**

a. If Company X sells to a customer in your state the equipment mentioned in Fact 2 above without installation by Company X, and the customer obtains possession of the equipment in your state, is the sale subject to (a) your state's sales or use taxes, and (b) any local sales or use taxes (e.g. county or city sales and use taxes)?

b. If the customer is a public grade or high school, private grade or high school, church, state college or university, state of Illinois, city, village or township, or a non-profit organization which is exempt under section 501(c)(3) of the Internal Revenue Code, is the sale exempt from (a) your state's sales or use taxes, and (b) any local sales or use taxes (e.g. county or city sales and use taxes)? If the answer is yes, what kind of documentation is needed by Company X to prove that the sale is exempt?

c. If Company X's invoice to the customer includes a separate charge on the invoice for shipping the equipment, is the shipping charge subject to your state's sales and use taxes?

d. If the charge for training is listed as a separate charge on the invoice, is the training charge taxable?

e. Is Company X's purchase of the equipment exempt from your state's sales and use taxes?

f. If under warranty Company X replaces without charge part or all of the equipment sold to a customer, is Company X's purchase of such parts or equipment exempt from your state's sales and use taxes?

g. If Company X repairs equipment, including cables, is Company X's charge (which may include charges for repair parts, labor and travel) to the customer subject to your state's sales and use taxes?

**2. Sale of equipment with installation to a customer (e.g. church, hotel, theater)**

a. If Company X sells to a customer in your state the equipment mentioned in Fact 2 above, including installation thereof by Company X, is the sale subject to (a) your state's sales or use taxes, and (b) any local sales or use taxes (e.g. county or city sales and use taxes)?

b. If the customer is a public grade or high school, private grade or high school, church, state college or university, state of Illinois, city, village or township, or a non-profit organization which is exempt under section 501(c)(3) of the Internal Revenue Code, is

the sale exempt from your state's sales and use taxes? If the answer is Yes, what kind of documentation is needed by Company X to prove that the sale is exempt?

c. If the charge for training is listed as a separate charge on the invoice, is the training charge taxable?

d. Is Company X's purchase of the equipment exempt from your state's sales and use taxes?

e. If under warranty Company X replaces without charge part or all of the equipment sold to a customer, is Company X's purchase of such parts or equipment exempt from your state's sales and use taxes?

f. If Company X repairs equipment, including cables, is Company X's charge (which may include charges for repair parts, labor and travel) to the customer subject to your state's sales and use taxes?

### **3. Sale of equipment with installation to a general contractor**

Company X, instead of selling to the ultimate customer (e.g. church, school, hotel, theater), has a contract with a general contractor for the sale and installation of the equipment mentioned in Fact 2 above. Company X invoices the general contractor for the sale, including installation of the equipment and is paid by the general contractor. The general contractor has a contract with the customer (e.g. church, school, hotel, theater) to construct or remodel a building or outdoor facility which includes the installation of the audio/video equipment.

a. Is the sale by Company X to the general contractor subject to (a) your state's sales or use taxes, and (b) any local sales or use taxes (e.g. county or city sales and use taxes)?

b. If the general contractor's customer is a public grade or high school, private grade or high school, church, state college or university, state of Illinois, city, village or township, or a non-profit organization which is exempt under section 501(c)(3) of the Internal Revenue Code, is the sale by Company X to the general contractor exempt from your state's sales and use taxes? If the answer is yes, what kind of documentation is needed by Company X to prove that the sale is exempt?

c. If the charge for training is listed as a separate charge on the invoice to the general contractor, is the training charge taxable? (Note: Company X provides the training to the general contractor's customer (e.g. church, hotel, theater).

d. Is Company X's purchase of the equipment exempt from your state's sales and use taxes?

e. If under warranty Company X replaces without charge part or all of the equipment sold to the general contractor, is Company X's purchase of such parts or equipment exempt from your state's sales and use taxes?

f. If Company X repairs equipment, including cables, is Company X's charge (which may include charges for repair parts, labor and travel) subject to your state's sales and use taxes?

As mentioned above, it would be appreciated if you would respond by email.

Thanks for your assistance.

## **DEPARTMENT'S RESPONSE:**

Unfortunately, we are unable to respond to each specific question in your letter. However, we believe the following will generally respond to your inquiries and may be helpful.

### **Nexus**

The Department declines to make nexus determinations in the context of Private Letter Rulings or General Information Letters because the amount of information required to make those determinations is often best gathered by an auditor. The following information outlines the principles of nexus. We hope it is helpful to you in determining your client's tax obligations.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in Quill Corp. v. North Dakota, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. Quill at 1910. The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please see Brown's Furniture, Inc. v. Wagner, 171 Ill.2d 410, (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State. In such instances, those customers must remit their Illinois Use Tax along with a completed Form ST-44, Illinois Use Tax Return unless they are otherwise registered or are required to be registered with

the Department and remit their Illinois Use Tax with a Form ST-1, Illinois Sales and Use Tax Return. Many retailers that do not have nexus with the State have chosen to voluntarily register as Use Tax collectors as a courtesy to their Illinois customers so that those customers are not required to file returns concerning the transactions with those retailers.

## **Retailers' Occupation Tax and Use Tax**

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. 35 ILCS 120/2; 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department

## **Local taxes**

In general, the imposition of the various local sales taxes in Illinois takes effect when "selling" occurs in a jurisdiction imposing a tax. The Department's opinion is that the most important element of selling is the seller's acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See the Department's regulation at 86 Ill. Adm. Code 270.115(b), which can be found on the Department's website. The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions the local tax will be incurred.

If a purchase order is accepted outside the State, but the property being sold is located in an inventory of the retailer which is located in an Illinois jurisdiction that has imposed a local tax (see, for example, Section 270.115(b)(3)), then the location of the property at the time of sale will determine where the seller is engaged in business for the purpose of determining the imposition of applicable local sales taxes. In situations in which the retailer has nexus, but both the purchase order acceptance and the location of the property being purchased are outside of the State of Illinois, such sales would only be subject to the Illinois Use Tax at the rate of 6.25%. Although the regulation cited above (86 Ill. Adm. Code 270.115) deals with the municipal home rule taxes, the principles outlined in this regulation apply to all local taxes administered by the Department. Tax rates for local taxes that the Department administers are available on the Department's web site.

For information regarding local taxes not administered by the Department, you may contact local jurisdictions.

## **Construction Contractor**

A contract to incorporate tangible personal property into real property is considered a construction contract. The tax liabilities regarding construction contractors in Illinois may be found at 86 Ill. Adm. Code 130.1940 and 130.2075 on the Department's Internet website. The term construction contractor includes general contractors, subcontractors, and specialized contractors such as landscape contractors.

In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, these contractors incur Use Tax liability for such purchases based upon their cost price of the tangible personal property. See 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075.

Therefore, any tangible personal property that a construction contractor purchases that will be permanently affixed to or incorporated into real property in this State will be subject to Use Tax. If such contractors did not pay the Use Tax liability to their suppliers, those contractors must self assess their Use Tax liability and pay it directly to the Department. If the contractors have already paid a tax in another state regarding the purchase or use of such property, they will be entitled to a credit against their Illinois Use Tax liability to the extent that they have paid tax that was properly due to another state. See 86 Ill. Adm. Code 150.310.

It is important to note that since construction contractors are the end users of the materials that they permanently affix to real estate, their customers incur no Use Tax liability and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to “reimburse” the construction contractor for his or her tax liability. Please note that this reimbursement cannot be billed to a customer as “sales tax,” but can be listed on a bill as a reimbursement of tax. The choice of whether a construction contractor requires a tax reimbursement from the customer or merely raises his or her price is a business decision on the construction contractor’s part.

In addition, because your client will be selling audio/video systems, you may wish to review the Department’s regulation at 86 Ill. Adm. Code 130.1940(c)(3) which speaks to construction contractors who contract for the improvement of real estate consisting of, among other things, voice, data and video systems.

## **Exempt Organizations**

Organizations that are recognized as non-profit under Internal Revenue Code Section 501(c)(3) or which would otherwise qualify for tax-exempt status on its purchases of tangible personal property for use or consumption cannot make tax-free purchases unless it has an active exemption identification number issued by the Department. See 35 ILCS 120/1g; 35 ILCS 120/2- 5(11); and 86 Ill. Adm. Code 130.2007. Such organizations must obtain an exemption identification number (an “E” number) to qualify. See 86 Ill. Adm. Code 130.2007.

Organizations that make application to the Department of Revenue and are determined to be exclusively religious, educational, or charitable, receive an “E” number. The “E” number evidences that the Department recognizes the organizations as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of their organizational purposes. If an organization does not have an E number, then its purchases are subject to tax.

Companies selling tangible personal property to these organizations must be provided with an “E” number for the sales to be tax exempt, unless another exemption can be documented. It is important to note that only sales of tangible personal property invoiced to the organization itself are exempt. Sales made to an individual member or client of an exempt entity are generally subject to tax.

## **Sales of Service**

Regarding the provision of services (such as training and repairs), you should be aware that Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (*i.e.* servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the serviceman depending upon his activities. The serviceman's liability may be calculated in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's 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 the sale of service. The tax is then calculated on the separately-stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. 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. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

## **Warranty**

The taxation of warranties and maintenance agreements is discussed in Section 140.141 of the Department's administrative rules under the Service Occupation Tax Act. See 86 Ill. Adm. Code

Sec. 140.141. The taxability of agreements for the repair or maintenance of tangible personal property depends upon whether charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. In those instances, no tax is incurred on the maintenance services or parts when the repair or servicing is performed. A manufacturer's warranty that is provided without additional cost to a purchaser of a new item is an example of an agreement that is included in the selling price of the tangible personal property.

If agreements for the repair or maintenance of tangible personal property are sold separately from tangible personal property, sales of those agreements are not taxable transactions. However, when maintenance or repair services or parts are provided under those agreements, the service or repair companies will be acting as service providers under provisions of the Service Occupation Tax Act that provide that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code Sec. 140.301(b)(3). The sale of an optional maintenance agreement or extended warranty is an example of an agreement that is not generally a taxable transaction.

### **Shipping Charges**

You may wish to review the Department's shipping charges rules at 86 Ill. Adm. Code 130.415 which can be viewed on the Department's Internet website. These rules provide guidance regarding shipping charges general drop shipment situations.

### **Drop Shipments**

You may wish to review the Department's drop shipment rules at 86 Ill. Adm. Code 130.225 which can be viewed on the Department's Internet website. These rules provide guidance in general drop shipment situations.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Debra M. Boggess  
Associate Counsel

DMB:msk