

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 serviceman depending upon his or her activities. See 86 Ill. Adm. Code 140.101. (This is a GIL.)

May 12, 2009

Dear Xxxxx:

This letter is in response to your letter dated April 28, 2009, 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.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:

I am writing for my client. CLIENT is a small graphic design company. They design primarily printed products such a [sic] letterhead, business cards, and catalogs for their customers. From their inception in 2007 until now they have not been subject to Illinois sales tax because they have only provided services to their clients. In short they designed the particular product and the client contracted with a printer or other production company to produce the final product.

As a convenience to their customers CLIENT would like to begin producing the final product for their clients by subcontracting the work to a printer or other graphics art production company.

All of the items CLIENT produces for their clients are customized specifically for their clients are a [sic] not appropriate for parties other than their customer. We believe that they would not be subject to tax under the graphics arts production exemption if they were produced directly by CLIENT.

Question #1: Does the Retailer [sic] Occupation Tax, Use Tax, Service Occupation Tax or similar tax apply to the materials that CLIENT subcontracts to a printer or other production company and resells to CLIENT's customer?

Analysis: Relying on Illinois Administrative Code 130.120 (c)(3) [sic] 'If the tax exemption described in this Section would otherwise apply, the person supplying the printed item or other item that is produced through the graphic arts' process to the user will not lose that exemption because of the fact that he farms the work of producing the item out to someone else.' We believe that the taxes referred to do not apply in this instance.

Question #2: Does it make any difference if production of a particular item is subcontracted to an out of state printer or other graphic arts production company?

Analysis: We could not find anything in the regulations that specifically addresses this issue, but believe that the fact that the item is produced out of state will not affect the tax treatment.

Thank you for your assistance.

DEPARTMENT'S RESPONSE:

For your information, please refer to 86 Ill. Adm. Code 130.2000, which is the regulation for "Persons Engaged in the Printing, Graphic Arts or Related Occupations, and Their Suppliers." As a general rule, when products are items of general utility and serve substantially the same function as stock or standard items, the products will be subject to the Retailers' Occupation Tax when sold. Items which serve substantially the same function are those which, when produced on special order, could be sold as produced to someone other than the original purchaser at substantially the same price.

Items that would not be considered stock or standard items and would not be sold to someone other than the purchaser for substantially the same price would not be subject to the Retailers' Occupation Tax when sold, but would be subject to the Service Occupation Tax. Special order or custom print items are generally not considered stock or standard items and are generally not sold to someone other than the purchaser for substantially the same price. Therefore special order or custom print items are generally subject to the Service Occupation Tax.

Under the Service Occupation Tax, servicemen are taxed on tangible personal property transferred as an incident of sales of service. See 86 Ill. Adm. Code 140.101, which sets forth the basis and rate of the Service Occupation Tax. Under the Service Use Tax Act, a tax is imposed on the privilege of using, in Illinois, tangible personal property that is received anywhere as an incident to a purchase of service from servicemen. See 86 Ill. Adm. Code 160.101, which describes the nature of the tax.

Generally, under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident to sales of service. The liability of servicemen in these transactions may result in either Service Occupation Tax liability or Use Tax liability for servicemen depending upon which tax base the servicemen choose to calculate their tax liability. Servicemen may calculate their tax base 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 the Retailers' Occupation Tax Act. Normally, most printers handle their liabilities under one of the de minimis methods.

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. Under a second method, if servicemen do not wish to separately state the selling price of the tangible personal property transferred, the servicemen must use 50% of the entire bill to service customers as the tax base. Both of the above stated methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for 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 the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). This class of registered de minimis servicemen is 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. 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.

De minimis servicemen that are not otherwise required to be registered under the Retailers Occupation Tax Act may use the final method of determining tax liability. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's 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. The servicemen are not authorized to collect "tax" from their service customers nor are the servicemen liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction-by-transaction basis.

Generally, servicemen not engaged in this State in the business of making sales of service incur no Service Occupation Tax liability. However, the servicemen's customers may incur a Service Use Tax liability on the tangible personal property that is received in Illinois as an incident to purchases of service.

When a serviceman contracts out all or a portion of the service that he will provide, he is acting as a primary serviceman in a multi-service situation. As a primary serviceman, he engages the services of a secondary serviceman in order to obtain all or part of the product and services desired by the service customer. See 86 Ill. Adm. Code 140.145 to determine the tax incurred in these situations.

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

Very truly yours,

Richard S. Wolters
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