

This letter concerns tax imposed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code Part 140. (This is a GIL.)

May 13, 2009

Dear Xxxxx:

This letter is in response to your letter dated April 3, 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](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:

This letter is to request a ruling on the taxability of certain items.

### **Facts**

Company 'A' has one or more service locations located both in and outside your state. Company 'A' rents tangible personal property in your state and also provides the following services within your state:

- **Cement Services** - used in well construction to isolate tubulars and fluids within the wellbore and to provide structural support to wellbore components;
- **Stimulation Services** - used to accelerate the natural production of fluids from producing subterranean formations;
- **Nitrogen Services** - used in well construction, pipeline and industrial services to circulate and stimulate well bores, foam cement slurries, purge and test pipelines and pressure vessels; and/or
- **Wireline Services** - used throughout well construction to survey well properties and perform mechanical procedures required to identify and isolate producing formations.

Company 'A' bills all material and labor charges separately.

## **Questions**

1. What is the taxability of the above-referenced services in your state?
2. What is the taxability of the materials used by Company 'A' in performing the above-referenced services? (Some materials are purchased in your state while others are purchased outside your state and brought into your state for use.)
3. Should Company 'A' be collecting sales tax on separately stated material charges used in providing their services or should they be accruing use tax on these materials purchased for use in your state?
4. Do the taxability responses from (1 through 3) above reflect the tax opinions of local tax authorities in your state?
5. Do the taxability responses from (1 through 3) above change if the service is provided within your state but, the service call originates from a service facility outside your state?

Please send your taxability response along with supporting authority to:

### **NAME/ADDRESS**

I appreciate your assistance in this matter. Please contact me with any questions.

## **DEPARTMENT'S RESPONSE:**

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property at retail to purchasers for use or consumption. See 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. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service. If tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Service Use Tax liability for the serviceman depending upon his activities. However, if no tangible personal property is transferred incident to the sales of service, the Service Occupation Tax and Service Use Tax do not apply. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service.

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 servicemen 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.

In addition to the Service Occupation Tax, servicemen may be subject to other locally-imposed taxes, such as the Home Rule Municipal Service Occupation Tax, etcetera. See 86 Ill. Adm. Code 280.101. The Illinois Department of Revenue administers local retailers' occupation taxes and service occupation taxes. The State tax and local taxes are both reported on Form ST-1, Sales and Use Tax Return.

A contract to incorporate tangible personal property into real property, such as cementing well casings or plugging oil wells with cement, is considered a construction contract. 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.

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 Illinois, lessors of tangible personal property under a true lease, except for automobiles leased for terms of one year or less, are considered to be the end users of the property to be leased. See 86 Ill. Adm. Code 130.220 and 130.2010. As the end users of tangible personal property located in Illinois, lessors incur Use Tax on the lessors’ cost price of the property. Since lessors are considered the end users of the property and have paid the Use Tax, no Retailers’ Occupation Tax is imposed upon the rental receipts, and the lessees incur no Use Tax liability for the rental charges. In Illinois, a true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease.

As mentioned, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3).

Even though lessees do not incur any tax liability in a true lease situation, it is typical of true leases to contain contractual provisions stating that the lessees will reimburse the lessors for their tax costs. This is not a matter of Illinois tax law but of private agreement between lessors and lessees. If the lessees agreed to such provisions, they are bound to satisfy that duty because of a contractual agreement, not because of Illinois tax law.

The State of Illinois imposes no Retailers’ Occupation Tax or Use Tax on rental receipts. Moreover, since a lessee under a true lease incurs no tax liability on the lease of tangible personal property, the lessee generally incurs no such tax liability on any related lease charges such as late payment fees, disposition fees, lease termination fees, service fees, or legal fees.

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,

Richard S. Wolters  
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