ST 02-0122-GIL 06/04/2002 MEDICAL APPLIANCES

The definition of a medical appliance is "an item which is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body." See 86 Ill. Adm. Code 130.310. (This is a GIL.)

June 4, 2002

Dear Xxxxx:

This letter is in response to your letter that we received on March 14, 2002. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be accessed at http://www.revenue.state.il.us/Laws/regs/part1200/.

In your letter, you have stated and made inquiry as follows:

This is to request for information regarding the tax treatment of **prescriptive colored contact lenses** in the State of Illinois as sold by an out-of-state business. Please direct us to the specific sales and use tax administrative ruling, code, statute, or regulation that stipulates and discusses the following:

1. Tax Treatment of Prescriptive Colored Contact Lenses
2. Sales to Optometrists / For Use in Connection with their Service
3. Sales to Optometrists/Ophthalmologists For Resale
4. Sales to Dispensing Opticians
5. Sales to Distributors For Resale
6. Maximum State Sales and Use Tax Rate

If you would please send a written response to the following address, we would greatly appreciate it.

We thank and appreciate your expediting this matter.

For the purpose of this response we are assuming you are registered to collect Illinois tax. Please refer to 86 Ill. Adm. Code 130.310, "Food, Drugs, Medicines and Medical Appliances." This regulation describes how sales of products that qualify as drugs, medicines and medical appliances can be subject to the low 1% rate under the Retailers' Occupation Tax Act. Local sales taxes may also apply, depending upon where sales are made. Those that do not qualify for the low rate are taxed at the State rate of 6.25%, plus applicable local taxes. The same rate distinctions apply under the Service Occupation Tax Act. See 86 Ill. Adm. Code 140.126, enclosed.

The definition of a medical appliance is "an item which is intended by its manufacturer for use in directly substituting for a malfunctioning part of the body." Examples of qualifying items include prescription eyeglasses or prescription contact lenses. These items directly replace a malfunctioning part of the body, and as part of this replacement function, are physically associated with a person.

When health care professionals such as optometrists render service, they are not subject to Retailers' Occupation Tax liability. Please refer to 86 Ill. Adm. Code 130.1980, enclosed. They are, however, subject to liability under the Service Occupation Tax Act to the extent they transfer tangible personal property incident to their rendering of service. Under the Servide Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service. Servicemen incur either Service Occupation Tax (SOT) liability or Use Tax liability in these transactions. The tax consequences depend upon the method used to calculate the liability. Servicemen may calculate their tax base in one of four ways: 1. Separately stated selling price; 2. 50% of serviceman's entire bill; 3. SOT on his cost price if he is a registered de minimis serviceman; or, 4. Use Tax on his cost price if he is an unregistered de minimis serviceman that is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Please see 86 Ill. Adm. Code 140.101, the Basis and Rate of the Service Occupation Tax.

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. A serviceman who incurs Service Occupation Tax on his selling price should collect Service Use Tax from his service customers and provide Certificates of Resale to his suppliers when purchasing tangible personal property that will be transferred to service customers. Please refer to 86 Ill. Adm. Code 140.106, enclosed.

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, enclosed. 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). 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 collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

De minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act may use the final method of determining tax liability. 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, enclosed. These de minimis servicemen do not provide Certificates of Resale to suppliers.

What this all means for a supplier of prescription contact lenses is that if the optometrist is at or above the 35% threshold, the optometrist should purchase the eyeglass components with a resale certificate and the optometrist should pay Service Occupation Tax on his selling price at a 1% rate (see Section 140.106). If the optometrist is below the 35% threshold, he may pay Service Occupation Tax at the 1% rate on either his cost price as described in Section 140.109, or on his selling price as described in Section 140.106. If he is a de minimis serviceman incurring Service Occupation Tax liability on his cost price, he should provide his suppliers with Certificates of Resale. If the optometrist is de minimis and not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act, he should pay Use Tax to his Illinois registered supplier at the rate of 1%. See 86 Ill. Adm. Code 140.126(c)(3). If contact lenses are sold to distributors or others for the purpose of resale, no tax will have to be charged on that sale if purchaser provides the vendor with a Certificate of Resale that contains the information set out in 86 Ill. Adm. Code 130.1405.

Please be informed that optical labs, opticians, and others who grind lenses to order for licensed optometrists are secondary servicemen in multi-service situations. Multi-service situations exist where a primary serviceman subcontracts work to a secondary serviceman. See 86 Ill. Adm. Code 140.145. In multi-service situations, a primary serviceman's cost price is determined either by the separately stated selling price of the tangible personal property transferred from a secondary serviceman, or if the secondary serviceman does not separately state the cost of goods, it is presumed that the primary serviceman's cost price is 50% of the secondary serviceman's total charge. See 86 Ill. Adm. Code 140.301(a).

When both primary servicemen and secondary servicemen are registered, primary servicemen may give a Certificate of Resale to registered secondary servicemen for any tangible personal property purchased. See Section 140.145(c). Primary servicemen would remit Service Occupation Tax and also collect Service Use Tax from their customers based upon the separately stated selling price of the property or 50% of the bill to the service customers.

Public Act 89-675, effective August 14, 1996, states that if an unregistered de minimis serviceman subcontracts service work to an unregistered de minimis secondary serviceman, the primary serviceman does not incur a Use Tax liability if the secondary serviceman (i) has paid or will pay Use Tax on his or her cost price of any tangible personal property transferred to the primary serviceman and (ii) certifies that fact in writing to the primary serviceman. This certification option is only available in multi-service situations when both the primary and secondary servicemen are unregistered and de minimis, 35 ILCS 110/2 and 115/2.

If primary servicemen are registered and de minimis, they may choose to remit Service Occupation Tax to the Department based upon their cost price of tangible personal property purchased from secondary servicemen. It shall be presumed that the cost price to the serviceman of the property transferred to him by his or her subcontractor is 50% of the total bill from the secondary serviceman in the absence of proof of the consideration paid by the subcontractor for the purchase of such property. Registered de minimis primary servicemen provide the secondary servicemen with Certificates of Resale if the secondary servicemen are registered, and collect Service Use Tax from customers on their cost price.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b).

Very truly yours,

Karl W. Betz
Associate Counsel

KWB:msk
Enc.