

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a PLR.)

March 26, 2010

Dear Xxxxx:

This letter is in response to your letter dated April 24, 2009 in which you requested a Private Letter Ruling. 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.

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 CORPORATION 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 CORPORATION 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:

Our client, CORPORATION, a publicly traded C-Corporation, has engaged FIRM to draft a request for a private letter ruling from the Department of Revenue ('Department') concerning their card fulfillment and check image capture/item processing services, for transactions which occur in the State of Illinois. The request is made pursuant to the Department regulation found in Title 02, Part 1200 Sec. 1200.110.

### **Issues**

Our client is seeking guidance from the Department to confirm the proper tax treatment for the following issues:

1. Whether or not their card fulfillment services and check image capture/item processing services, as described below, should be subject to the retailers' occupational [sic] tax ('ROT') or the service occupational [sic] tax ('SOT'), or both.

2. If CORPORATION is deemed a serviceman with respect to these services, whether they would be considered a 'de minimus' serviceman.
3. If CORPORATION is deemed a serviceman or a de minimus serviceman, what activities, costs and services would be included in the tax base for the computing the [sic] SOT.

### **Statement of Taxpayer's Position**

We believe that CORPORATION should be treated as a de minimus serviceman in Illinois in regards to the card fulfillment and check image capture/item processing services and that SOT should apply based on the cost price for the plastic, paper or other articles of tangible personal property that are transferred incidental to the service.

The underlying facts and circumstances of the transactions described support the contention that the articles transferred are incidental to the services rendered because they have no value to the purchaser except as a result of the services provided. Accordingly the articles transferred should not be treated as sales at retail subject to ROT, but instead as a sale of a service subject to SOT based on cost price.

Accordingly, we do not believe that the card plastic, paper and other miscellaneous articles of tangible personal property are the substance or true object of the transaction, but instead are an actual and necessary part of the sale of a service.

### **Statement of Facts**

#### **CORPORATION Overview**

CORPORATION sells data processing, consulting and related services as well as software and hardware to customers in the financial and banking industry. Many of these offerings are related and customers may purchase a variety of complementary products and services.

CORPORATION's principle business is data processing for financial institutions. CORPORATION refers to this as the 'core applications'. This consists of different software applications located at CORPORATION which process transactions for financial institutions. It includes applications for deposit, checking, loans, credit and prepaid accounts among others. The core applications communicate with customer's servers to capture and process transactions. Many of CORPORATION's other software applications and services support and/or interface with the core applications.

As an example, a bank may purchase data processing from CORPORATION for its deposit and loan accounts and then also have CORPORATION maintain their account holder's credit cards, prepare bank statements, host internet banking applications, perform check image capture and item processing, perform ATM switching and authentication, and provide for the infrastructure necessary (networks, routers and communication lines) for the customer to transmit data to CORPORATION.

### **Issue No. 1 - Card Fulfillment Services**

#### **Overview**

This is the first of two service offerings that are the subject of this ruling request. CORPORATION refers to this as a card fulfillment service.<sup>1</sup> The service consists of providing customers with credit, debit, prepaid and membership cards that contain information specific to the customer's account holders, or members. The information that will ultimately be embedded in the card comes from the customer and may interface with CORPORATION's other applications. For instance, CORPORATION may maintain a list of credit card account holders, capture and process credit card or debit card transactions and update the information through the core applications. The updated information may be presented with other processed information to the customer.

## **Card Creation**

CORPORATION provides both custom and standard card plastic referred to as the 'resale' and 'personalization' business lines respectively, either of which can be requested by the customer. 'Personalization' involves the printing, embossing and encoding of the cards, but not the actual manufacture and injection molding of the plastic, which is outsourced to a vendor. The custom cards which are purchased under the 'resale' line of business consist of custom materials, color and design requested by a specific customer. The custom cards, once acquired, are subject to the same personalization services as with the standard cards (this would include printing, embossing and encoding of the magnetic strip). Customers may also provide their own card plastic and acquire the personalization services only. CORPORATION invoices the customer for the cards and personalization services generally on a per card basis.

In addition to card preparation, CORPORATION also provides the sorting, addressing and mailing of the cards to the customer's account holders or members (referred to as '3<sup>rd</sup> party recipients'). They may also buy and resale [sic] other services necessary to bring the cards into their final and usable form (e.g. inventory storage charges, account maintenance and set up fees, etc).

In order to prepare the cards, CORPORATION takes the information received from the customer and prepares a file showing the information to be embossed on the card directly. The card plastic may come in a variety of different types, with additional charges for customized plastic and/or designs. The cards in final form are shipped to 3<sup>rd</sup> party recipients as directed by the customer. Some cards may be sent to the customer directly (this would consist of sample cards for inspection on a test basis).

## **Billing**

For billing purposes, CORPORATION presents tangible personal property, services and mailing charges separately on the invoice.<sup>2</sup> This may include such items as storage of card inventory, creation of special or custom cards and mailers, destruction of existing cards, testing (which involves pulling a sample of the cards for inspection), postage and re-labeling/addressing charges. The cards themselves as well as services typically include a markup above cost, although it may be nominal.

## **Card Maintenance and Other Services**

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<sup>1</sup> Please refer to sample of representative agreements in Exhibit I.

<sup>2</sup> Please refer to the sample of representative invoices in Exhibit II.

After the cards are provided to the customer's account holders or members, CORPORATION maintains the information and may process transactions resulting from the card being presented and update the account information. This information may be provided to the customer and the 3<sup>rd</sup> party recipients in a tangible or electronic form through a statement, with other account information, or included with data which has been processed by CORPORATION. Each of these different elements may result in additional charges to the customer depending on the specifics of the card program.

### **Related Contracts and Agreements**

We have attached a representative sample of customer agreements and invoices for the card fulfillment service.

### **Tax Period at Issue - Audit/Litigation Disclosure**

There is no tax period specifically at issue. This request for guidance is **not** for a specific pending or for a current transaction. Instead this request is related to transactions for sales of these services going forward. **The subject of the request is not related to an Illinois sales and use tax audit.**

### **Acknowledgment - No Prior Ruling Issued**

CORPORATION previously requested a ruling on this matter, but the State declined to respond because of an audit which was open at the time the request was received. **This audit has since closed and has been finalized by the Department of Revenue.** Accordingly, CORPORATION is resubmitting the request for a ruling on this issue to provide guidance going forward. No prior ruling has been issued in regards to this request.

### **Issue No. 2 - Check Image Capture and Item Processing**

#### **Overview**

This is the second of two product offerings that are the subject of this ruling request. CORPORATION refers to this as a check image capture and item processing.<sup>3</sup> In general, this is a service whereby checks or images of checks are received by CORPORATION and go through a manual and automated sorting and authentication process, are captured and processed by CORPORATION, and then forwarded to the Federal Reserve, to another check processor, or to a bank to finalize the transaction.

This service also includes the electronic capture and archival of the check images into an online database for later retrieval or research, and the issuing of reports which summarize the amount of the transactions processed and any discrepancies. The check images are interfaced with CORPORATION's core applications so that they can be included in bank statements and online banking applications. In addition to these services, CORPORATION also may provide the customer with a CD containing check images, provide a research service for previous transactions, access to an online database and the electronic capture and processing of checks submitted directly by merchants who are customers of CORPORATION's client.

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<sup>3</sup> Please refer to sample of representative agreement in Exhibit I.

## Reports - Tangible and Electronic

The actual processing of checks results in several different reports available to the client. As indicated previously, the financial transactions are summarized into a daily cash letter or report which shows the items processed as well as any outstanding items or discrepancies. Typically these financial transactions are also processed by CORPORATION's core applications and posted to the customer's accounts. The resulting financial transactions may also be reflected on statements rendered by CORPORATION which are provided to the customer's depositors or through an online banking application. The check images are retained electronically, and are provided with bank statements prepared by CORPORATION for certain customers that request them.

## Other Incidental and Related Services

The service includes a variety of related and incidental components. These are related to several different aspects, namely, the method of sorting used, the number of exceptional items that must be resolved, the number of check images captured, processed and stored, and the number of incidental reports issued (such as insufficient fund notices ('NSF') documents or other notices resulting from the checks processed). There may also be additional charges for the amount of electronic data stored, for the duration of the storage/retrieval, and the time required to research processed items.

## Billing

For billing purposes, CORPORATION presents tangible personal property and each service separately on the invoice.<sup>4</sup> This can include charges related to sorting checks and resolving exceptional items, storage for maintaining check images, creation of CDs (that include check images), destruction of existing checks, and for including check images with bank statements, etc.

## Related Contracts and Agreements

We have attached a representative sample of customer agreements and invoices for the check image capture and item processing service

## Tax Period at Issue – Audit/Litigation Disclosure

There is no tax period specifically at issue. This request for guidance is **not** for a specific pending or for a current transaction. Instead this request is related to transactions for sales of these services going forward. **The subject of the request is not related to an Illinois sales and use tax audit.**

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<sup>4</sup> Please refer to the sample of representative invoices in Exhibit II.

provide guidance going forward. No prior ruling has been issued in regards to this request.

## **Explanation of Taxpayer's Grounds**

### **Overview**

Illinois imposes the SOT 'upon persons engaged in this State in the business of making sales of service, based on tangible personal property transferred incident to sales of service.'<sup>5</sup> This is in addition to the ROT which is imposed on persons engaged in the business of selling tangible personal property based on the gross receipts of the sale.<sup>6</sup>

### **Serviceman vs. Retailer**

The determination on whether to treat a particular transaction or taxpayer as a serviceman or a retailer has developed through a series of Illinois cases. The Department of Revenue ('Department') has promulgated regulations discussing specific occupations and how they should be treated for SOT and ROT purposes. The services that are the basis of this request are not specifically addressed in any regulation.

### **Basic Test and Additional Criteria**

The basic test developed in case law provides that if the property has no value to the purchaser except as a result of the services rendered and the property transferred is an actual and necessary part of the service; then the seller is in the business of rendering services and is not a retailer. Conversely, if the item sold is the objective of the transaction and the services are merely incidental to and inseparable from the property, then the vendor is engaged in selling at retail. It is also possible for a serviceman to sell property as a retailer as a separate line of business. The determining factor is whether the property transferred is an 'actual and necessary' part of the service. An example of this would be in the case of a barber shop where the products used in actually rendering the service (hairspray, hair color, etc.) are subject to SOT, but items which are sold over the counter (shampoo, conditioner, etc.) which are not a part of the service, are subject to ROT.<sup>7</sup> Criteria used in determining whether to treat a taxpayer as a retailer or a serviceman are outlined in the case *J. H. Walters & Co. v. Department of Revenue et al*, Illinois Supreme Court, 254 N.E. 2d 485 (Dec. 1969). The court discussed the following factors which should be used in making the determination;

1. The ratio between the bare cost of the materials and the ultimate sales price.<sup>8</sup>
2. The buyer's motive for selecting a particular seller.<sup>9</sup>
3. Whether the property sold was unique (or to a special order), or merely a standard item.<sup>10</sup>

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<sup>5</sup> Ill. Admin. Code tit. 86, § 140.101(a)

<sup>6</sup> Ill. Admin. Code tit 86, § 130.101(a)

<sup>7</sup> Ill. Admin. Code tit. 86, § 130.1920

<sup>8</sup> Wallender-Dedman Co. v. Department of Revenue, 15 Ill. 2d 485, 487

<sup>9</sup> Ingersoll Milling Machine Co. v. Department of Revenue, 405 Ill. 367, at 373; Material Service Corp. v McKibbin, 380 Ill. 226, 243

<sup>10</sup> American Break Shoe Co. v. Department of Revenue, 25 Ill. 2d 354, 359

4. Whether the transaction is a retail sale of property with an incidental service, or the sale of a service in which supplying materials is incidental.<sup>11</sup>

In discussing the basis of their ruling, the court described the rationale of the Department's Rule No. 6 which exempts the sale of building materials by contractors and stated 'A contractor holds himself out to the public as having the skill and knowledge necessary to the construction of certain improvements. He does not represent himself as being engaged in the business of selling building material.'<sup>12</sup> This language indicates a distinction between taxpayers which hold themselves out as retailers of tangible personal property and those that sell a service. Further, there is a distinction between property which is of a standard nature and custom property in which the application of the seller's skill or other unique attributes is true object of the transaction.

In the example cited in the case (*see Id*), the court noted that the determinant was not whether the buyer contributed to the design or not, but instead on whether they were relying on the contractor's particular skill to execute the design. In other words, a buyer could purchase building materials themselves and make the installation, but what the contractor provides is the consummate skill to make the application happen beyond merely providing the materials on a retail basis.

### **Application of the Basic Test**

When we apply the basic test and the four factors identified to the services and property sold by CORPORATION, it becomes apparent that the nature of their service is not one where the objective is the acquisition of property such as what would typically occur in a retail environment.

The property CORPORATION is transferring consists of card plastic that includes a magnetic strip, paper for reports (summarizing checks that have been processed and sorted), card mailers and similar documents, reprinted checks (these would be checks in which the captured electronic image is re-printed as an image replacement document or 'IRD' for certain banks or processors that will not accept an electronic image for processing), and CDs which include electronic images of scanned checks.

The basic test to determine if a seller should be treated as a serviceman can be broken down into two elements, both of which must be present for it to apply.

1. Does the property transferred have value to the purchaser apart from service rendered, and
2. Is the property transferred an actual and necessary part of the service rendered?

### **Basic Test - First Element**

It appears that the basic test will result in CORPORATION being treated as a serviceman. In the first element, the property transferred (cards, paper and CDs) all have nominal value, but do not have meaningful value to the purchaser apart from the services rendered. The embossing, imprinting and encoding performed on the articles

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<sup>11</sup> Mahon v. Nudelman, 377 Ill. 331, 335; Burgess Co. v Ames, 359 Ill. 427, 429

<sup>12</sup> Material Service Corp. v McKibbin, 380 Ill. 226, 242

render them unfit for any other reasonable use. CORPORATION is not providing standard card or paper stock or blank CDs which can be used for multiple purposes by a customer, and which would have some intrinsic value. Instead the articles transferred have been modified and customized beyond merely being stock items.

For instance, the card embossed and imprinted by CORPORATION is meaningless to the purchaser unless CORPORATION also performs the data processing necessary to acquire and maintain the embedded information. Likewise, the paper reports and IRDs are useless without the item processing services which give the imprinted information meaning, and the CDs with check images alone are of little value to the buyer unless CORPORATION performs the processing necessary to identify to which account the check belongs and whether it has been presented for payment or not.

### **Basic Test - Second Element**

In the second element, it is clear that the property transferred is an actual and necessary part of the services rendered. The card fulfillment service requires a tangible link for it to be usable to the customer's account holders or members. In the example of a credit card, while it is possible to make payments in certain instances (i.e. such as with an online purchase) without a physical card being presented to the seller; it is necessary to have the card on hand with its embedded security features to make the transaction safe and efficient. Transactions without the security features would quickly break down due to unauthorized transactions and fraud. As such the tangible element is an actual and necessary part of the card fulfillment service.

In a similar fashion with the check image capture and item processing service, the reports issued and IRDs provided are an actual and necessary part of the service rendered. For the financial transaction information contained within the processed checks to be useful to the customer, it must be presented in a form that is organized and presented clearly enough to process the transactions, it must also be accessible, and there must be an efficient means (i.e. the CDs containing check images) to retrieve the information for internal control purposes. Absent these tangible elements, the service would not function properly as intended and would provide little if any benefit to the customer.

### **Analysis of Additional Criteria**

As the examples cited indicate, the basic test clearly indicates that for the services to operate properly and for the customer to derive the intended benefit; the tangible elements are necessary. Further, the test shows that absent the service aspect, these articles of tangible personal property would not provide any meaningful benefit to the customer. This conclusion is also supported by an analysis of the additional four criteria as noted above in the cited case.<sup>13</sup>

### **First Factor - Application**

The first factor mentioned in the case is the 'ratio between the cost of the materials' and the ultimate retail price. The articles of tangible personal property as described (cards, paper and CDs) are insignificant in value when compared to the ultimate sales price charged or when compared to the cost of the professional data processing services

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<sup>13</sup> See Id



performed. CORPORATION does not hold itself out as a retail purveyor of paper stock, plastic cards and CDs. Instead it is a data processing firm organized as a service bureau.

### **Second Factor - Application**

The second factor cited is the buyer's motivation for selecting the particular seller, the question being, is the buyer seeking to acquire professional skill or know-how or merely certain articles of tangible personal property? In the case of CORPORATION, the company has a well established and highly regarded reputation in the banking and financial services industry as a technology leader and data processing firm. Buyers are paying a premium price to acquire the proficiency and quality that CORPORATION can provide through its advanced data processing platform and the host of related and supporting applications (e.g. banking software, statement rendering, professional consulting, online banking applications, network infrastructure, etc.). Customers are clearly seeking the experience and skill that CORPORATION can deliver for data processing services and are not merely attempting to engage a retailer to acquire tangible personal property.

### **Third Factor - Application**

The third factor cited is whether the items transferred are unique or to a special order of the customer, or if they are standard items. As noted above, customers do not engage CORPORATION to merely acquire blank cards, paper stock and blank CDs in a retail environment. Instead customers bargain for CORPORATION's integrated service and technology offerings and the significant economies of scale that CORPORATION can bring in pulling advanced data processing technology into a single platform. Accordingly, the analysis of this factor supports that customers are purchasing the professional qualities and services that CORPORATION offers and not tangible personal property which is of a standard nature.

### **Fourth Factor - Application**

The fourth factor is whether the transactions constitute a retail sale of tangible personal property with incidental services, or the sale of a service (a skilled service in particular) in which supplying materials is incidental. Our analysis supports the second contention, that the card fulfillment and check image capture/item processing services constitute a skilled service in which incidental materials are transferred.

Similarly to the application of the basic test, it appears that the property items transferred (cards, paper and CDs) do not have usable value to the customer without the embedded data processing and other professional services. This is true because the articles are not transferred absent being modified by CORPORATION beyond merely being a standard item and they contain specific proprietary information. This information does not have value apart from the service itself. The property transferred is necessary for the service to be rendered properly.

In short, the service cannot function without the property transferred, and the property in question has no useful value without the service. In any case, the property is clearly different from the same type of items typically sold in a retail environment.

### **SOT Tax Base for De Minimis Serviceman**

As a serviceman in respect to the card fulfillment and check image capture/item processing services, we believe that CORPORATION could make the election as a de minimus serviceman and apply SOT on the cost price of tangible personal property transferred incident to the sale of services. This is supported by the tax treatment applied by the auditor in a previous Illinois sales and use tax audit for the card fulfillment services.

CORPORATION is required to be registered for ROT due to separate software and hardware sales. We believe that they should be treated as a de minimus serviceman with respect to the services described, that incurs SOT on their cost price for transferred property since they meet the threshold level. We believe the election provided in the statute and regulation<sup>14</sup> is applicable as the aggregate annual cost price of the plastic cards, paper and CDs transferred incidental to the services described would fall within the 35% threshold of the aggregate annual total gross receipts from all sales of service.<sup>15</sup>

### **Definition of Cost Price**

Cost price is defined as the 'consideration paid...without any deduction on account of the cost of the supplier's property sold or any other expense incurred by the supplier.'<sup>16</sup> We take this to mean that any charges CORPORATION incurs to procure the cards, paper or CDs with the exception of finance charges and separately stated and negotiated incoming transportation costs (which are 'reflective of actual shipping costs') would be included in the tax base for computing SOT.

For the card fulfillment service, we interpret this to mean that charges from the supplier CORPORATION is engaging to provide the cards, emboss, and imprint on them, would be includable in the tax base as part of the 'cost price'. This would be computed on the cost CORPORATION paid and not on the price that CORPORATION might charge to its customer if the charges are passed through in the sales invoice to the ultimate customer.

For the check image capture/item processing service we believe a similar treatment would apply in that CORPORATION would need to collect SOT on the cost of the paper and CDs purchased and transferred incidental to the service. This would include incoming transportation charges from the supplier unless the factors noted above as apply (namely, the charges are separately stated and negotiated for and represent actual shipping costs, etc.).

### **Example for De Minimus Serviceman**

Please note the following example for the card fulfillment service.

CORPORATION pays the following to its supplier:

1. \$1,000 to procure the cards,

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<sup>14</sup> 86 Ill. Admin. Code tit 86, § 140.109

<sup>15</sup> 35 Ill. Comp. Stat. 110/3-10; Ill. Admin. Code tit. 86, § 140.105

<sup>16</sup> 86 Ill. Admin. Code tit 86, § 140.301(a)

2. A \$500 set up fee, and
3. An additional \$1,000 for embossing and printing on the cards.

CORPORATION then charges their customer the following on the sales invoice:

1. \$5,000 for data processing and account maintenance,
2. A separately stated charge of \$1,000 for set up and miscellaneous services, and
3. \$2,000 for the cards.

For the example, we believe the 'cost price' would be \$2,500 (i.e. \$1,000 to procure the cards + a \$500 set up fee paid to the supplier + \$1,000 for embossing and printing), since this represents the amount paid to the supplier to procure the cards. SOT would apply to this amount and be charged and collected by CORPORATION on their sales invoice as a de minimus serviceman.

## **Conclusion**

Our analysis supports the contention that CORPORATION should be treated as a de minimus serviceman with respect to their card fulfillment and check image capture/item processing services. The property transferred is done so as an actual and necessary element to the service and CORPORATION is not holding itself out as a retailer of plastic cards, paper and CDs. We believe SOT should be collected based on the cost price of the tangible personal property transferred incidental to the service.

## **Contrary Views**

### **Overview of ROT**

All sales of tangible personal property are presumed subject to ROT unless proven otherwise<sup>17</sup> and the Retailers' Occupation Tax Act imposes ROT on all persons that make a sale at retail of tangible personal property.<sup>18</sup> A 'sale at retail' is defined as 'any transfer of ownership or of title to tangible personal property... for use or consumption, and not for the purpose of resale.'<sup>19</sup>

### **ROT vs. SOT Application**

It has been established in case law and through a series of regulations promulgated by the Department, that a taxpayer can have different products and services, some of which are subject to ROT and others to SOT. Some of the professions which have been specifically addressed in regulations include barber shops, chiropractors<sup>20</sup>, dentists<sup>21</sup>, optometrists<sup>22</sup> and veterinarians<sup>23</sup> among others. The regulations provide specific

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<sup>17</sup> 86 Ill. Admin. Code tit 86, § 130.801

<sup>18</sup> 86 Ill. Admin. Code tit 86, § 130.101

<sup>19</sup> 86 Ill. Admin. Code tit 86, § 130.201(a)

<sup>20</sup> 86 Ill. Admin. Code tit 86, § 130.1930

<sup>21</sup> 86 Ill. Admin. Code tit 86, § 130.1950

<sup>22</sup> 86 Ill. Admin. Code tit 86, § 130.1980

<sup>23</sup> 86 Ill. Admin. Code tit 86, § 130.2165

guidance for each of the professions noted, but as a general rule the treatment followed is that items sold which are not an 'actual or necessary' component of the service rendered are subject to ROT. Making the determination in the absence of specific guidance requires certain assumptions to be made.

In the case of CORPORATION, there is an assumption that the tangible personal property items transferred are required as a part of the service and that they lack value absent the service being rendered. However, this assumption can be refuted if it could be shown that the property did have value absent the service or that it was not a required component.

There is some authority to support this position. In the case *Soho Club, Inc. dba Cabana Club v. Department of Revenue*, Ill AppCt, First Dist., No. 1-92-3399, filed Jan. 20, 1995, the court held that drinks sold to patrons of a club for a separate fee were subject to ROT because they were not included in the price of admission.

### **Contrary Position Conclusion**

In short, while we believe that CORPORATION should be treated as a serviceman with respect to the services described, this is based on certain assumptions which, if refuted, would result in a different conclusion. Namely, that the tangible personal property transferred was in fact the object sought by the buyer.

In particular with the card fulfillment service, it could be argued that the purchaser is truly seeking the acquisition of the cards and that the data processing services are incidental to the provision of the cards and not vice/versa. Further, it could be argued that the data processing services with respect to the card fulfillment service, do not have any value apart from the provision of the cards and are only sought and required to bring the cards into a useable format.

### **Items to Exclude from Public Dissemination**

Please exclude from the public version of the private letter ruling, any reference to CORPORATION or its client as indicated in the sample agreement and invoices. Also please exclude any specific reference to the attached exhibits such as invoice numbers or the name of the agreement as well as the document itself.

ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY FIRM TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

Our advice in this letter is based on the facts as stated and on authorities that are subject to change, retroactively and/or prospectively. The advice or other information in this document was prepared for the sole benefit of FIRM's client and may not be relied upon by any other person or organization. FIRM accepts no responsibility or liability in respect of this document to any person or organization other than FIRM's client.

### **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 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 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 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.

CORPORATION represents, and the Department has confirmed, that CORPORATION is registered with the Department. CORPORATION also represents that the annual aggregate cost price of tangible personal property ("plastic cards, paper, and CDs") transferred incident of the sale of the services "described" is less than 35% of the total annual gross receipts from service transactions.

CORPORATION is seeking a ruling relating to only two services -- the card fulfillment services and check imaging capture and item processing services. It appears, based on a review of the exhibits, that the services CORPORATION provides is not limited to these two services. It is unclear from your letter whether the two services are the only services encompassed within the "described" services. The 35% threshold is not determined on a service-by-service basis. It is determined on an annual aggregate basis by aggregating all tangible personal property transferred incident to all services provided by CORPORATION. If CORPORATION meets this test, it may account for its tax liability by using the third method described above and may pay Service Occupation Tax (which includes local taxes) based upon its cost price of tangible personal property transferred incident to the sale of service. See 86 Ill. Adm. Code 140.301 ("Cost Price").

As a registered serviceman, under the third method described above, CORPORATION should not be paying Use Taxes to its suppliers. A de minimis serviceman incurring Service Occupation Tax liability on his cost price should provide Certificates of Resale to his suppliers when purchasing tangible personal property that will be transferred to service customers. 86 Ill. Adm. Code 140.109(a)(1). Service Use Tax must be collected from service customers by a de minimis serviceman incurring Service Occupation Tax liability on his cost price and must be based upon the serviceman's corresponding cost price of the tangible personal property transferred. Any tax collected over this amount constitutes an overcollection of tax that must be refunded to the service customer, or if not refunded to the service customer, paid to the Department. The tax need not be separately stated on the service billing unless so requested by the service customer. 86 Ill. Adm. Code 140.109(a)(4).

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. Generally, when a primary serviceman purchases tangible personal property from a secondary serviceman, the primary serviceman shall determine his cost price either by using the separately-stated selling price of tangible personal property set forth on the invoice from the secondary serviceman or, if no selling price is separately stated, 50% of the total invoice including labor and service charges, in the absence of proof (e.g., the secondary serviceman's purchase invoices showing his cost price) of the consideration paid by the secondary serviceman for the purchase of such property.

We are unable to determine CORPORATION's cost price of the tangible personal property transferred incident to its sale of service from the information provided in your letter. You do not state whether your supplier separately states the cost of all the tangible personal property transferred to CORPORATION on the invoice. However, based on what you have stated in your letter for determining CORPORATION's cost price of the cards, the conclusion you reach based on your example appears to be incorrect. CORPORATION's cost price is the price it pays to its supplier only for the tangible personal property transferred to CORPORATION (see Section 140.145) plus the cost of any additional tangible personal property, such as ink for example, transferred by CORPORATION to the bank as part of the cards.

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 questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, 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,

Terry D. Charlton  
Chairman, Private Letter Ruling Committee

TDC:RSW:msk