

Sellers of special order machines are considered to be engaged primarily in a service occupation, rather than being engaged in the business of selling tangible personal property, if the test set out in 86 Ill. Adm. Code 130.2115(b) is met. See 86 Ill. Adm. Code 130.2115. (This is a GIL.)

July 29, 2010

Dear Xxxxx:

This letter is in response to your letter dated October 19, 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.

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

I am the president of COMPANY located in CITY IL. My company designs and manufacturers [sic] control panels used in every type of industrial application imaginable. Additionally, we produce automatic movable bridge control systems for bascule, vertical lift and swing bridges. The type of work that COMPANY does is unique and there are only a few companies in the United States that I feel could be considered as competitors. The design work and fabrication involved with products manufactured is complex and never initiated until the customer is satisfied with all drawings for the project.

COMPANY does not maintain any inventory of completed or partially completed products. Everything manufactured by us is not initiated until our bid has been accepted by the future purchaser. Since we are a unique company with a very special type of product, our customer base is not limited to IL customers.

On taxable job orders shipped into Illinois we are charging sales tax i.e. Retailers [sic] Occupation Tax at the CITY rate of 9.75%. Many of these sales would be considered repeat or second orders or they might be similar to products designed, manufactured and sold in the past. Engineering skills required would not be considered design engineering but rather production engineering.

I am currently being questioned by a few customers who have retained COMPANY to design and manufacture unique control panels or specific bridge control systems about the tax rate being charged. This therefore is the purpose of my letter to you.

I have been told that tax should only be charged on material cost because COMPANY is producing a special order item on which Retailers [sic] Occupation Tax would not apply. These types of questions/concerns never surfaced before but due to the current economic conditions all companies are reviewing all cash outlays. I am therefore writing to you for a Private Letter Ruling and guidance as to the correct taxability on certain transactions.

I have read Section 1200.110 on Private Letter Rulings and will comply with those instructions. I am currently not under audit or any type of investigation nor have I been contacted by anyone from the IL Dept. of Revenue. I have spent considerable time reviewing your web page and have reviewed numerous letter rulings but I cannot find a letter detailing a circumstance/situation similar to mine. I have reviewed Section 130.2115 Sellers of Machinery, Tools and Special Order items and conclude that this section **does apply** to various sales of custom order panels and control systems designed and manufactured by COMPANY.

Situation: COMPANY receives a job order from a contractor to design and manufacture a control panel for a lift bridge which is owned and operated by a railroad. Also received are drawings of the building that is to house the Lift Bridge Control System and requirements as to specifications that must be met in order to operate the lift bridge. It now becomes COMPANY's responsibility to design, build and program the Control System so that it not only works satisfactorily and opens and closes the bridge but also is able to be installed in the building that contains everything for the operation of the bridge.

Bridge buildings are designed and built for specific locations to operate the opening and closing of the bridge safely and efficiently. Such buildings are unique to the type of bridge (vertical lift, bascule or swing) and their location on or near the bridge. Bridge buildings are not similar to houses where a customer can purchase a blueprint and then build the house at any given location. Each bridge building is different so that the control panel designed and manufactured by COMPANY for the bridge building at a specific location cannot be placed in another bridge building somewhere else. The control panel's use or value is only for the specific bridge building that it was designed and manufactured for. Equally important is that all components of the control panel must be able to be placed into the bridge building to insure proper operation.

The type of bridge (vertical lift, bascule or swing) also presents numerous engineering problems because each type of bridge is so different and the type and design of the control panel that works with the vertical lift will not work with the swing and vice versa. The factors that must be considered by the engineer for the designing of the control system are monumental.

Many of the components of COMPANY's control panel manufactured would be considered standard ie. messenger cabinets, motors, motor control centers, speed switches, encoders, control consoles, PLC enclosures, data logging hardware & software, rack angles, vent-filter kits, grid straps, wire, screws etc but without the design and engineering that is necessary to complete the finished panel it would not be functional to the customer at their given location.

COMPANY maintains a staff of electrical, chemical, mechanical and computer engineers who evaluate the requirements of the control panel being purchased and design a panel which will not only conform to the requirements but can also be installed in the bridge building. In this particular situation it took ## labor hours to manufacture the Lift Bridge Control System. However, it took ## hours for engineering to design and produce drawings for the system plus an additional ## for CAD hours. Prior to finalizing the drawings the control tower where the system will be installed is visited to insure the cabinets and motor control center will fit securely in this location. In this situation the material cost was \$\$ and the labor cost was \$\$ for a total of \$\$.

Section 103.2115 describes in great detail when a transaction would not be subject to Retailers [sic] Occupation Tax. In this situation COMPANY was hired for our engineering skill to produce the Lift Bridge Control System. Total hours charged to engineering and CAD are a clear indicator of this. Secondly, the Lift Bridge Control System has use or value only to the railroad and can only be used in this location because it was specifically manufactured to be installed in the control tower at this location. Control towers for various types of bridge systems are never identical.

Since control towers and bridge systems are unique the same type of system is never produced more than once so multiple orders would not occur.

I would therefore greatly appreciate a response to my request so that I am confident I am in compliance with any and all IL Laws. If you need any additional information please contact me and I will gladly respond. Thank you for your consideration in this matter.

#### **DEPARTMENT'S RESPONSE:**

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). The Department recently met and determined that it would decline to issue a Private Letter Ruling in response to your request. The fact situation presented in this letter does not apply to the request being made, since the project discussed in the fact situation presented consists of sales of items shipped out of Illinois, and, apparently, to a sales tax exempt customer. We hope, however, the following will be helpful in addressing your questions.

The issue of whether a person incurs a Retailers' Occupation Tax or Service Occupation Tax liability depends upon the nature of the items being produced and the nature of the design work involved. If the item being produced is substantially similar to stock or standard items, even though custom-made, the sale of that item would result in Retailers' Occupation Tax liability. The test for special order items that result in Service Occupation Tax liability is set forth in subsection (b) of the Department's rule "Sellers of Machinery, Tools and Special Order Items" at 86 Ill. Adm. Code 130.2115. The seller of a special machine, tool, die, jig, pattern, gauge or other similar item is engaged primarily in a service occupation, rather than in the business of selling tangible personal property, and so does not incur Retailers' Occupation Tax liability with respect to the sale, if the following tests for exemption are all met in the transaction:

- A) The purchaser employs the seller primarily for his engineering or other scientific skill to design and produce the property on special order for the purchaser and to meet the particular needs of the purchaser;
- B) the property has use or value only for the specific purpose for which it is produced; and
- C) the property has use or value only to the purchaser. 86 Ill. Adm. Code 130.2115(b).

For example, if a manufacturer of customized movable bridge control systems is employed to provide engineering or other scientific skill to design and produce a customized movable bridge control systems on special order for the purchaser in order to meet the particular needs of the purchaser, and the movable bridge control system has no value to others than the purchaser for the purpose for which it is produced, then the manufacturer will generally incur Service Occupation Tax liability on the sale of the movable bridge control system, rather than Retailers' Occupation Tax liability.

These inquiries are very fact-specific. The seller must determine in each situation whether the sale qualifies for exempt under the provisions of 130.2115(b).

As to the requirement that the seller be employed primarily for his engineering or other scientific skill to design and produce the property, it is sufficient if the seller is responsible for making a substantial contribution to the designing of the property that is to be produced on special order. See subsection (b)(2) of Section 130.2115. A manufacturer who takes a customer's blueprints and prepares its own drawings that set out the materials, dimensions, and the method of manufacture necessary to create a customized movable bridge control system and then uses those drawings to manufacture the bridge control system is generally responsible for making a substantial contribution to the designing of the property that is to be produced on special order as long as the manufacturer is contractually responsible for the engineering of the bridge control system. This is not affected by the fact that the manufacturer may subcontract out the engineering work to another as long as the manufacturer is contractually responsible for the engineering work.

In the case where sellers of special order property are not subject to Retailers' Occupation Tax in accordance with Section 130.2115, the purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen use to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on 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 sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred.

If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base.

Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide

their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. 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. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are 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. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. 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. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their 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. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not 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. See 86 Ill. Adm. Code 140.109.

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.

Sincerely,

Samuel J. Moore  
Associate Counsel

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