

The Service Occupation Tax is a tax imposed upon servicemen engaged in the business of making sales of service in this State, based on the tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code Part 140. (This is a GIL.)

September 30, 2010

Dear Xxxxx:

This letter is in response to your letter dated July 13, 2010, 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:

We, BUSINESS, are writing the Illinois Department of Revenue to determine if one of our tax clients, the 'Company', is responsible for collecting sales tax or if our client can claim an exemption from collecting sales tax for the provision of its medically-related services. In addition, in the event that our client's services are sales tax-exempt, we are writing to determine whether or not the Company will still need to register for a sales tax account.

The Company is a for-profit corporation that provides services to patients diagnosed with the possibility of contracting an eye disease which could lead to loss of vision. In order to qualify for the Company's services, patients will undergo an examination by their doctor and their doctors will prescribe the patients to utilize the Company's medical equipment if the patients are at risk of an eye disease. The medical equipment is an ophthalmic device that will continually monitor and detect any visual distortion that may lead to eye diseases.

Once patients qualify as candidates of the medical equipment, their doctors will order the equipment directly from our client and the Company will ship the equipment to the doctor's office through a third-party private carrier such as UPS or FedEx. Each piece of equipment is calibrated with patient-specific information in regards to his or her

current vision. Since each medical device is uniquely designed for a specific patient, the machine cannot be used by anyone else besides the patient.

Once patients obtain the equipment from their doctor, patients will use the device in their own homes by looking into the device in which time the medical device scans and collects raw data from the patients' eyes. The raw data is then transferred over the internet to the Company, where it will then be converted to usable data and analyzed by computers located at its headquarters in an outside state. Both patients and doctors are able to view the results of each scan through an online interface. This allows for doctors to monitor the progression of their patients' eyes in between examinations.

If the data is out of the ordinary for the patients' given profile, namely the patients' eyes have worsened, the Company will then have their experts in another state analyze the computed data to ensure there are indeed variations outside the patients' parameters for eye wellness. The Company will also employ a call center in an outside state that will then notify the doctor and the patient of the results and worsening condition. Only patients diagnosed with the possibility of contracting an eye disease are allowed to partake in the services provided by our client.

The Company charges a monthly service fee for its data processing services, calling services, and online hosting services as well as an initial one-time fee that includes qualifying the patient for the service. Doctors do not receive a commission or referral fee on the monthly service charges, but will receive a portion of the initial one-time fee that will reimburse the doctors for the initial examination of their patients.

Patients are not subject to a contract to use the equipment and at the end of usage, the medical equipment will be returned to the Company. During usage in the patients' homes, the medical device remains the property of the Company. On our client's invoices, it will charge only a monthly service fee and will not mention anything in regards to the sale or rental of the medical equipment.

Currently, the Company does not have any employees or contractors in Illinois. The only times our client has any presence in Illinois is through salesmen from outside Illinois who will from time to time enter the state to give demonstrations on the Company's product to doctors and physicians at trade shows and medical conventions. No sales are made when the salesperson enters Illinois. Sales are only made when a doctor prescribes the medical device to its patients and order the device from our client.

The Company will have no property in Illinois besides the patients' medical device. The property is only in Illinois because it is needed to compile the data used in the Company's data processing service. There will be no rent charged or contract related to keeping the medical equipment at the patients' homes.

Our client is headquartered in another state and purchases the medical devices from its Israeli-based subsidiary. At the moment, the Company has employees in one outside state, but will not have employees within Illinois in the future. The Company currently pays the use tax rate as dictated by the state the Company's place of business state on all medical equipment of similar function that reside in the United States.

Therefore, we are asking the Illinois Department of Revenue to make a ruling based on the information provided if our client has sufficient nexus and is subject to sales tax for its services. If the services are not taxable, then please determine if the Company will

still be required to register for a tax account for sales tax purposes. In your determination, please provide all necessary tax laws, regulations, case studies, and necessary citations that support the Illinois Department of Revenue's decision.

If you have additional questions regarding our client and its operations, please contact us.

DEPARTMENT'S RESPONSE:

Although we cannot give you a specific answer in the form of a General Information Letter, we hope you find the following helpful.

NEXUS

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910. The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause.

A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Wagner*, 171 Ill.2d 410, (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State.

RETAILERS' OCCUPATION TAX AND USE TAX

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. 35 ILCS 120/2; 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. 35 ILCS 105/3; 86 Ill. Adm. Code 150.101.

These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department. Note, in Illinois, under the Use Tax Act, persons who purchase tangible personal property from out-of-State retailers, and either ship or bring that property into Illinois would incur Use Tax liability. The purchaser must self assess the tax and remit it directly to the Department of Revenue. The purchaser would get credit against his or her Illinois Use Tax obligations for taxes properly due and paid in another state. See 86 Ill. Adm. Code 150.310(a)(3).

SERVICE OCCUPATION TAX

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 serviceman's entire bill; (3) Service Occupation Tax on the serviceman's cost price if the serviceman is a registered *de minimis* serviceman; or (4) Use Tax on the serviceman's cost price if the serviceman is a *de minimis* serviceman and is 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.

Information or data that is electronically transferred or downloaded is not considered the transfer of tangible personal property in this State. See 86 Ill. Adm. Code 130.2105(a)(3). However, canned computer software is considered taxable tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, electronic means or other media. See 86 Ill. Adm. Code 130.1935. If the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c). If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax.

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,

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