

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.)

June 22, 2011

Dear Xxxxx:

This letter is in response to your letter dated May 3, 2011, 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:

Our client, TAXPAYER, has requested that FIRM represent it in requesting a private letter ruling on specific issues surrounding the application of service occupation tax ('SOT') and its complement the service use tax ('SUT') to certain transactions. Enclosed please find an executed Power of Attorney Form IL 2848. We are requesting a ruling for the issues and transactions described herein as it applies to the period January 1, 2010 to date, as well as to current transactions.

Prior to issuing this private letter ruling request, the issues to be addressed in this letter were presented to the Illinois Informal Conference Board ('ICB') under a prior audit. The ICB ruled in favor of the taxpayer, however, since the ICB rulings are not binding on future audits we are requesting [sic] private letter ruling.

In accordance with Illinois Administration [sic] Code 1200.110, we affirm that there is neither an audit ongoing nor litigation pending with the Illinois Department of Revenue. To the best of our knowledge and to the knowledge of the taxpayer, the Department has not previously ruled on the same or a similar issue for the taxpayer or a predecessor, nor has the taxpayer or any representatives previously submitted the same or a similar issue to the Department but withdrew it before a letter ruling was issued.

In the event the State issues a ruling that is published or otherwise made known to the public, we request that the State remove or modify any identifying characteristics of facts about the taxpayer or any of the other parties mentioned in our request.

Company Background:

TAXPAYER is a print broker headquartered in the STATE. TAXPAYER's final products sold to its customers consist of items such as letterhead, folders, paper stock, business cards, card stock, notepads, pens, etc. These products have been personalized to include customer logos and/or other identifying marks.

TAXPAYER has established a physical presence in Illinois through the existence of offices, a warehouse and various company personnel. The Taxpayer is currently registered as a de minimis serviceman for Illinois sales tax purposes. Therefore, TAXPAYER is subject to the service occupation tax and its complement the service use tax.

Illinois Activity and Facts:

Illinois Administration [sic] Code 35 Sections 115/3-10 provides that a serviceman can elect to be subject to SOT on the selling price of the tangible personal property transferred incident to a sale of service. A serviceman can be considered a 'de minimis serviceman' if the sales of a service in which the aggregate annual cost price of tangible personal property is less than thirty-five percent (35%) of the aggregate annual total gross receipts from all sales of service.

A separate provision exists with a threshold of 75% for servicemen engaged in the business of graphic arts production TAXPAYER considers it engaged in the graphic arts. The Company's financial statements indicate that its aggregate cost of goods sold is less than the 75% threshold required to be a de minimis serviceman engaged in graphic arts production. Therefore, TAXPAYER has registered as a de minimis serviceman in Illinois. In addition to registering as a de minimis serviceman, the Taxpayer has chosen to handle its SOT liability by using the "traditional" method. This method provides that Illinois sales tax is applied to 50% of the entire invoice issued to its customers.

Also, TAXPAYER has customers with whom it contracts for the custom manufacture and mailing of direct mail pieces. The customers are not located in Illinois and are therefore not registered for sales tax purposes in Illinois. These contracts are executed at TAXPAYER's headquarters in CITY/STATE. Pursuant to these types of contracts, TAXPAYER coordinates the custom manufacture of these direct mail pieces which are personalized to include the customer's name and logo. TAXPAYER will also coordinate the fulfillment function which includes personalizing, bursting, trimming, bagging, tagging, sorting and mailing.

While these contracts are executed in STATE, fulfillment of the contracts takes place in Illinois. In Illinois TAXPAYER engages the services of third party Illinois printers and third party Illinois fulfillment houses. The mailers are mailed throughout the United States with only a small percentage of them being mailed to Illinois addresses, if any. TAXPAYER's customer relies upon them to contract with all third parties and coordinate the entire process. At no time is TAXPAYER's customer contracting either directly or indirectly with any of the third parties. Additionally, TAXPAYER's customer exercises

no direct control over the selection of the subcontractors or the work the subcontractors will perform.

Rulings Requested:

TAXPAYER is seeking the following rulings from the State of Illinois with regard to its registration for Illinois's [sic] service occupation tax and its complement the service use tax:

1. Confirmation that the classification as a de minimis serviceman for Illinois service occupation tax and its complement service use tax purposes as distinguished in 86 Illinois Administration [sic] Code 130.2000 – *'Persons Engaged in the Printing, Graphic Arts or Related Occupations'* is appropriate.
2. As a result of the de minimis serviceman classification TAXPAYER has elected the 'traditional' method of reporting its SOT liability based upon 50% of its entire service bill to its customer. TAXPAYER is seeking affirmation that this election is appropriate based on its classification.
3. TAXPAYER seeking [sic] a ruling on the applicability of the Illinois inter-state [sic] commerce exemption as described in Illinois Regulation Section 130.605 to the direct mail transactions described in the above section entitled *'Illinois Activity and Facts'*.

Discussion:

The Taxpayer has taken the position that based on its activities within Illinois, they qualify to be registered as a serviceman and meet the threshold to be considered a de minimis serviceman. Additionally, TAXPAYER asserts that the Illinois inter-state [sic] commerce exemption is an applicable exemption to be applied to its transactions. The discussion below further explains and supports the Taxpayer's position.

De minimis Classification

It is the Taxpayer's position that the determination of whether it should be registered as a retailer or serviceman can be made within the context of 86 Illinois Administration [sic] Code 130.2000 – *'Persons Engaged in the Printing, Graphic Arts or Related Occupations.'* This regulation distinguishes between those individuals in the graphic arts business that sell tangible personal property and those that provide services. Illinois Administration [sic] Code 86 section 130.2000(c)(1)states: [sic]

A photostater who is employed to reproduce material for his customer by the photostating process, or a printer who is employed to print material for his customer in accordance with copy supplied to the printer by the customer or otherwise in accordance with the customer's specifications and special order, or a person who otherwise engages primarily in the transaction in furnishing graphic arts' services is not engaged in such transaction in the business of selling tangible personal property within the meaning of the Act, if the item so produced does not serve substantially the same function as stock or standard items of tangible personal property

that are sold at retail, but is engaged in such transaction primarily in a service occupation.

The code further defines stock or standard items as those items standard enough to be stocked for sale or offered for sale from catalogues or other sales literature. Examples in subsection (b)(1) given include legal forms, stock or standard greeting cards, pictures or other items which are stocked for sale or offered for sale to the public generally, or products of photo-processing. Subsection (b)(2) of the code further states that a printed item that is personalized is always considered to be printed on special order.

All of TAXPAYER's work consists of personalized printed items with customer logos or other identifying marks. Therefore, we conclude that its work would be considered special order and they would be classified as a serviceman. As such, they would not be liable for the Retail [sic] Occupation Tax (ROT) pursuant to 86 Illinois Administration [sic] Code 130.2000(c)(2), which states,

To the extent to which any such person engages in a service occupation, he is not liable for Retailers' Occupation Tax on his receipts there from, [sic] including receipts from both labor and tangible personal property.

This exemption from the ROT is not lost because TAXPAYER is a print broker. Chapter 86 of the Illinois Admin Code section 130.2000(c)(3) goes on to state:

If the tax exemption described in this Section would otherwise apply, the person supplying the printed item or other item that is produced through the graphic arts' processes to the user will not lose that exemption because of the fact that he farms the work of producing the item out to someone else.

Traditional Method of Reporting

TAXPAYER is registered as a 'de minimis serviceman in order to address its SOT/SUT reporting and filing requirements. They have chosen a methodology that can generally be termed as the 'traditional' method. As long as the aggregate annual cost price of the tangible personal property transferred to the service customer incident to service is less than 35% (75% percent [sic] in the case of servicemen transferring prescription drugs or servicemen engaged in graphic arts production) of the aggregate annual total gross receipts from service, a registered serviceman can handle his SOT liability under this 'Traditional Method' [*Illinois Private Letter Ruling ST-91-0928, November 25, 1991*].

The aforementioned traditional method states that when the serviceman transfers this property in the context of a sale of service, he will incur an SOT liability based either upon the separately stated selling price of the property transferred, or if this price is not separately stated, then upon 50% of his entire service bill. In no event, however, can the base be less than the cost price of the tangible personal property which is transferred. TAXPAYER does not separately state the selling price of tangible personal property transferred, therefore, state tax rate plus local taxes, if applicable, should be applied to 50% of the total invoice [*Illinois Private Letter Ruling ST-93-0103, March 22, 1993*; Illinois Administration [sic] Code 140.101(e)]

Interstate Commerce

To determine the applicability of Illinois' inter-state [sic] commerce exemption, the relationship between TAXPAYER, its third party subcontractors and its customer in [sic] should be examined.

Pursuant to an Illinois Private Letter Ruling [*ST-91-0928, November 25, 1991,*] when an out-of-state purchaser contracts with an Illinois serviceman to manufacture and mail mailers to out-of-state locations, a transaction subject to the Service Occupation Tax exists. The letter ruling references Illinois Administration [sic] Code 130.605(b) – (f), stating that if a registered serviceman performs this service, it can claim the interstate commerce exemption because it mails the items out-of-state.

We note that the fact pattern described in Illinois Private Letter Ruling ST-91-0928 is analogous to the facts at hand in that TAXPAYER, rather than its customer, contracts with the fulfillment house to mail the items. The fulfillment house then mails the mailers through the U.S. mail or through common carrier. Therefore, there is no Illinois delivery of the items made except for those mailed to Illinois addresses.

An Illinois case involving Deere & Company ('Deere') [*Deere & Company v. State of Illinois, 49 Ill App 3d 164 7 Ill Dec 130 364 NE2d 117, 06/14/1977*] specifically addressed the taxability of advertising brochures. The brochures were purchased from a commercial printer in Illinois and then at Deere's request sent to a fulfillment company in Illinois to ready the materials for mailing and subsequently mail. The brochures were mailed to Deere's customers residing both within and without the State of Illinois. The main focus of the case was to determine if Deere exercised right of ownership of the property while it is in Illinois thereby generating a use tax liability. The Illinois court referenced a Supreme Court ruling where that court determined that goods do not enter interstate commerce until they have been shipped or otherwise begun to move from one state to another. Deere exercised a right to the goods prior to the goods entering into the stream of interstate commerce because they directed the printer to send the brochures to the fulfillment company. Based on these facts a use tax obligation for Deere was established. Deere would be analogous to TAXPAYER's customer, however, in contrast to the fact pattern in the case TAXPAYER's customers do not have control over the property, the selection of the subcontractors or the work the subcontractors will perform. TAXPAYER retains control of the property throughout the transactions.

Because TAXPAYER is registered and subcontracts with a fulfillment house to mail the items, it can still claim the interstate commerce exemption because its subcontractor mails the items out-of-state. In addition, the fulfillment house is a registered serviceman and not only mails the mailers, but also transfers tangible personal property incident to service. The transfer of property is subject to the Service Occupation Tax but is also exempt because it, too, can claim the interstate commerce exemption (the items it transfers are also shipped out-of-state). Illinois Private Letter Ruling ST 06-141-GIL, discusses the change in Illinois Administrative Code 140.108(a)(2)(B) allowing a de minimis serviceman to claim the interstate commerce exemption if his customer is eligible for the exemption.

Due to the fact that TAXPAYER is a registered serviceman it is eligible for all exemptions that are afforded to other registered servicemen and has the option of reporting its SOT liability under the 'traditional method' described above. Pursuant to Illinois Private Letter Ruling ST 93-0103-PLR, March 22, 1993 TAXPAYER has elected

to issue resale certificates to its servicemen and takes advantage of the interstate commerce exemption. As noted in Illinois Private Letter Ruling ST 93-0103, 'Such servicemen, since they are registered, can claim all the exemptions any other registered serviceman can claim.'

Because there is no guidance in the form of published rulings, regulations or court cases on this issue the Taxpayer respectfully requests a ruling on the above issues and desires that the State looks favorably upon its contentions. If additional information is required or you have additional questions please do not hesitate to contact me.

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 declines to issue a Private Letter Ruling in this instance. Although we are not providing you with a Private Letter Ruling, we hope the following general information will be of assistance.

Retailers' Occupation Tax Act

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. The tax is measured by the seller's gross receipts from retail sales made in the course of such business. "Gross receipts" means the total selling price or the amount of such sales. The retailer must pay Retailers' Occupation Tax to the Department based upon its gross receipts, or actual amount received, from the sale of the tangible personal property.

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 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 retailer does not collect the Use Tax from the purchaser for remittance to the Department, the purchaser is responsible for remitting the Use Tax directly to the Department. See 86 Ill. Adm. Code 150.130

Service Occupation Tax Act

Illinois Service 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 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax. Services that involve the transfer of tangible personal property (such as, for example, written reports, other tangible media and training manuals) incident to a sale of service may be subject to either Service Occupation Tax liability or Use Tax liability.

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. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). 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.

When a serviceman contracts out all or a portion of the service that he will provide, he or she is acting as a primary serviceman in a multi-service situation. As a primary serviceman, he or she 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 to determine the tax incurred in these situations.

A de minimis serviceman required to be registered because he or she incurs Retailers' Occupation Tax liability with respect to a portion of his or her business that does not separately state the selling price of the tangible personal property transferred may chose to use 50% of the entire bill

to service customers as the tax base; however, in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. 86 Ill. Adm. Code 140.105(b)(2); 86 Ill. Adm. Code 140.109(b); 86 Ill. Adm. Code 140.106(a)(2).

Graphic Arts

For your information, please refer to 86 Ill. Adm. Code 130.2000, which is the regulation for "Persons Engaged in the Printing, Graphic Arts or Related Occupations, and Their Suppliers." Items that would not be considered stock or standard items and would not be sold to someone other than the purchaser for substantially the same price would not be subject to the Retailers' Occupation Tax when sold, but would be subject to the Service Occupation Tax. Special order or custom print items are generally not considered stock or standard items and are generally not sold to someone other than the purchaser for substantially the same price. Therefore special order or custom print items are generally subject to the Service Occupation Tax. 86 Ill. Adm. Code 130.1995(b).

As a general rule, when products are items of general utility and serve substantially the same function as stock or standard items, the products will be subject to the Retailers' Occupation Tax when sold. Items which serve substantially the same function are those which, when produced on special order, could be sold as produced to someone other than the original purchaser at substantially the same price. Items which "serve substantially the same function" are those which, when produced on special order, could be sold substantially as produced to someone other than the original purchaser at substantially the same price. A printed item that is personalized is always considered to be printed on special order. 86 Ill. Adm. Code 130.2000(b)(2).

See also subsection (a)(1) of 86 Ill. Adm. Code 1995 Personalizing Tangible Personal Property for items in which Retailers' Occupation Tax liability applies:

"Thermometers, pencils, pens, mirrors, silverware, notebooks, diaries, baby books, guest registers and other similar books of general utility for the recording of information, brief cases, wallets, toys, paper weights, pins and other jewelry, watches, rulers, match books, playing cards, blotters, calendars, bags and other fairly standard salable containers, napkins, dishes (whether made from paper or some other material), handkerchiefs and other articles of merchandise which bear the name, monogram or trade-mark of the purchaser or of some other person, or which bear advertising inscriptions of the purchaser or of some other person, have intrinsic usefulness and general utility and so have commercial value (i.e., value to persons other than the purchaser), notwithstanding the fact that such items are personalized for the purchaser by the seller by printing, engraving or some other process by means of which the purchaser's name, monogram, trade-mark or special advertising matter is placed upon the article for the purchaser by the seller."

This rule applies to the sales of personalized shirts and golf balls, as well.

Interstate Commerce Exemption

A serviceman who incurs SOT on his or her selling price is authorized to claim any exemption provided for in the Service Occupation Tax Act. For example, he or she may claim the interstate commerce exemption or accept various exemption certificates from his or her customers (e.g., Certificates of Resale, exemption identification numbers). 86 Ill. Adm. Code 140.106(d). A de minimis serviceman incurring Service Occupation Tax liability on his or her cost price also is authorized to claim any of the various exemptions provided for in the Service Occupation Tax Act. For example, he may claim the interstate commerce exemption or accept various exemption

certificates from his customers (e.g., he can accept Certificates of Resale). 86 Ill. Adm. Code 140.109 (a)(3). The Department has also determined that a de minimis serviceman incurring a Use Tax liability may claim any of the exemptions, except as provided in subsection (a)(2)(C), authorized under the Service Occupation Tax Act. De minimis servicemen incurring Use Tax liability may likewise claim the interstate commerce exemption, which is more fully explained at 86 Ill. Adm. Code 130.605. 86 Ill. Adm. Code 140.108(a)(2)(B).

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,

Richard S. Wolters
Associate Counsel

RSW:msk