

This letter responds to an annual survey. See 86 Ill. Adm. Code, Parts 120, 130, 140, and 150. (This is a GIL.)

July 14, 2011

Dear Xxxxx:

This letter is in response to your email dated June 6, 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:

The ABC, in conjunction with XYZ, annually undertakes a major information collection effort with respect to the application of the tax laws of the states. ABC's goal in gathering this information is to assemble and publish the PUBLICATION. As the market has shown, such a publication is a useful reference source for departments of revenue, attorneys, corporate tax departments, and public accounting firms.

ABC is in the process of updating the *PUBLICATION* for its 2012 annual edition. Accordingly, we ask for your state's assistance in preparing this important publication. I have attached two Microsoft Word files—one for income tax and one for sales tax—to serve as this year's questionnaire. The questionnaire follows the same format as in past years. (If you do not have a copy of your 2010 response, and it would be helpful to you in completing the 2011 questionnaire, please let me know and I will email you a copy.)

This year, the numbering scheme and the sequence of the questions remains essentially the same. Also, please note that the new questions are highlighted in red font. Therefore, you should be able to easily follow the changes from last year to this year. Because of anticipated time constraints for respondents, again this year we are asking that you only respond to the questions for which your answers require a change and the new questions. All unanswered questions will be considered the same as last year's answer unless otherwise noted.

Please complete the 2011 questionnaire and return it by July 15, 2011. The enclosed questionnaire should be answered in accordance with laws in effect as of July 1, 2011. If there is legislation pending or recently enacted that would alter your answers, please explain any such changes that you are aware of at the time the questionnaire is completed.

Beginning in the fall 2000, ABC began a tuition assistance program for state department of revenue employees in appreciation for their assistance in publishing the PUBLICATION. A limited amount of tuition assistance is available for courses in ABC's Online Graduate Certificate in State and Local Taxation. This Certificate program is the first of its kind in the nation to be offered totally online. To receive the Certificate, students must complete the four-course curriculum. For further information about the program or available tuition assistance contact INDIVIDUAL.

If you have any questions about the questionnaire or individual questions, please contact me at. Thank you for your continued cooperation and support. Your contributions are extremely valuable in maintaining the quality of this outstanding reference work. A complimentary copy of the PUBLICATION will be sent to you when it is published next year.

Your new questions are as follows:

[54] REAL ESTATE TRANSFER TAXES

- Does your state impose real estate transfer taxes upon the sale or arm's length transfer of real property? Yes No
 - If YES, what is the measure of tax for the transfer tax?
 - Selling price of property Fair market value of property
 - Amount of mortgage or other indebtedness recorded in connection with the sale
 - Other, explain:
- If the measure of tax is the selling price of property, can the proceeds be adjusted for certain transactions that may be bundled into the selling price? Yes No
 - If YES, what adjustments are allowed (check all that apply)?
 - Value of tangible personal property included in the selling price
 - Value of any intangible property included in the selling price
 - Any services or maintenance agreements that may be included in selling price
 - Other, explain:

[55] DISCOUNTS, TIPS, AND GRATUITIES

- Does your state impose tax upon tip or gratuity charges?
 - Yes, all tips are taxable Yes, but only if tip is mandatory
 - No, tips and gratuities are not subject to tax

- How are third-party meal discount certificates and coupons, i.e., buy one get one free, treated? (Assume the restaurant is not reimbursed for the value of the meal given away.)
 - Sales tax is imposed upon only the amount paid by the customer, i.e., the cost of the meals minus the discount or coupon
 - Sales tax is imposed upon the amount paid by the customer and the value of the meal given away by the restaurant, i.e., the discount is ignored in making the determination of the taxable measure
- Does the restaurant owe use tax on the cost of the meal given away?
 - Yes No
- Are 'suggested tips,' shown on a receipt to assist the customer in determining how large their tip should be, subject to tax? Yes No

[56] RESEARCH AND DEVELOPMENT (R&D) EXEMPTION

- Does your state provide an exemption for R&D-related purchases?
 - Yes No
- If YES, which of the following purchases qualifies for the exemption (check all that apply)?
 - Equipment used in R&D
 - Direct materials used or consumed in R&D
 - Internal labor applied to R&D
 - Indirect materials (miscellaneous supplies and consumables) used in R&D
- If equipment is exempt for use in R&D, what criteria are used to determine what qualifies?
 - Must be 'directly and exclusively' used in R&D
 - Must be 'predominantly' used in R&D
 - Any use in R&D qualifies the item for the exemption

[57] FREE MAINTENANCE CHARGES INCLUDED IN SELLING PRICE. In recent years many vendors, particularly automobile dealers, have begun to offer free maintenance on the products they sell. The most commonly offered free maintenance is free oil changes for the life of the vehicle.

- Does your state allow a resale exemption for purchases of items provided to their customers free-of-charge? Yes No
 - If YES, must the contract, invoice, or other document supporting the sale indicate that the vendor is providing free maintenance for the life of the vehicle?
 - Yes No
- If the contract, invoice, or other documentation does not indicate that the vendor is providing the free maintenance for the life of the vehicle, does the vendor owe use tax on the cost of the items provided to their customers free-of-charge? Yes No

[58] REMOTE SELLER NOTIFICATION. Many states have recently enacted statutes that require unregistered remote sellers to notify the purchaser that they are not

registered to collect their state's tax and to periodically provide a list of their in-state customers to the state.

- Has your state enacted 'Remote Seller Notification' legislation: Yes No
 - If YES, is specific wording required on the invoice to the customer or just a general statement?
 Specific wording General statement
 - If specific wording is required on the invoice, what must it contain to be within the statute's notification requirements? _____
- Are remote unregistered sellers required to providing [sic] a list of purchasers on an annual or other periodic basis to your state? Yes No

DEPARTMENT'S RESPONSE:

The Department cannot approve publications other than those issued by the Department of Revenue. However, we hope the following information will provide sufficient guidance to answer your questions and update our answers to last year's survey questions.

Real Estate Transfer Tax Law

Transfers of title to real estate located in Illinois are subject to the provisions of the Real Estate Transfer Tax Law. 35 ILCS 200/31 *et seq.* The full actual consideration for a transfer or aggregated transfers shall be stated in the transfer declaration. The full actual consideration is the total sale price or amount actually paid (or required to be paid) for the real estate or beneficial interest in real property, whether paid in money or otherwise, including personal property, real property, services, or other item of value. See 86 Ill. Adm. Code 120.20. Although the full actual consideration is stated in the transfer declaration, the tax is based on the net consideration after allowed deductions. A deduction is allowed for the amount of personal property transferred to the transferee. See Section 120.20(c) for a list of deductions.

Discounts, Tips and Gratuities

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.

Gross receipts subject to Retailers' Occupation Tax are defined as all the consideration actually received by the seller. If a seller provides a discount to a purchaser and does not receive a reimbursement or rebate from any source for that discount, only the (discounted) amount received by the seller is taxable. For example, if a retailer sells an item for \$10 and the purchaser provides the retailer with a \$1 in-store coupon for which the retailer receives no reimbursement from the manufacturer of the item or any other source, the retailer's gross receipts of \$9 are subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2125(b)(1).

When a retailer receives full or partial coupon reimbursement (from a manufacturer, distributor or any other source), the retailer incurs Retailers' Occupation Tax liability on the receipts received

from the purchaser and the amount of any coupon reimbursement. For example, if a retailer lists an item for sale for \$15 and the purchaser provides the retailer with a \$5 manufacturer's coupon for which the retailer receives full reimbursement from the manufacturer of the item, the retailer's gross receipts are the \$10 received from the customer and the \$5 received from the manufacturer for a total of \$15 that is subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2125(b)(2).

When a retailer issues a coupon to a purchaser which entitles the purchaser to a free item conditioned on the purchase of a separate item (two-for-one, buy one get one free, etc.), the retailer's gross receipts are measured only by the amount actually received from the purchaser for both items. Thus, tax is only incurred on the amount actually received from the purchaser. The retailer does not incur tax based upon the value of the free item received because technically the item was not free and no gift was intended. The retailer was simply offering a special price for both items sold.

Likewise, if a retailer provides a customer with a card, coupon or other certificate later to be used to reduce ("discount") the purchase price of an item or items and the retailer is not to be reimbursed for that discount from a manufacturer or any other source, the amount representing that discount would not be subject to Retailers' Occupation Tax liability. See in general 86 Ill. Adm. Code 130.2125(b)(1).

When property is purchased and then given away in Illinois, the donor has made a taxable use of the property by making such gift. Therefore, it is the donor of the gift who is deemed the end user of the property and who is subject to the Use Tax, rather than the donee. See 86 Ill. Adm. Code 150.305(c) and see also 86 Ill. Adm. Code 130.2125(c) concerning "Gift Situations." The donor may satisfy this Use Tax obligation either by paying tax to his supplier or by self-assessing Use Tax and paying directly to the Department as discussed above.

The proceeds of mandatory service charges separately stated on customers' bills for the purchase and consumption of food and beverages purchased at retail from a retailer are exempt from tax to the extent that the proceeds of the service charge are in fact turned over as tips or as a substitute for tips to the employees who participate directly in preparing, serving, hosting or cleaning up the food or beverage function with respect to which the service charge is imposed. This procedure is required by 35 ILCS 120/2-5(15).

Specifically, Section 130.2145(d) states as follows:

"Mandatory gratuities are not included in the taxable receipts of persons operating restaurants, hotels and other places of business which come within the Act, if such mandatory gratuity is added to banquet or dinner checks in the form of a percentage of the total bill, or as a flat rate, to the extent that *the proceeds of the service charge are in fact turned over as tips or as a substitute for tips to the employees who participate directly in preparing, serving, hosting or cleaning up the food or beverage function with respect to which the service charge is imposed.* (Section 2-5(15) of the Act) If any part of the service charges are used to fund or pay wages, labor costs, employee benefits or employer costs of doing business, that part of the service charge is includable in gross receipts.

Therefore if the employer separately states the mandatory gratuity charge, and if the entire gratuity is distributed to the servers or other employees who participated directly in serving, preparing, hosting, or cleaning up the food or beverage function with respect to which the mandatory gratuity is charged, the gratuity is not subject to Retailers' Occupation Tax. However, if the employer retains and uses the entire mandatory service charge for any other use, including paying employee wages, the mandatory gratuity/service charge is subject to tax.

Research and Development

Illinois does not have an explicit research and development exemption in the Retailers' Occupation Tax Act and Use Tax Act. However, Manufacturer's Purchase Credit earned on the purchase of manufacturing machinery and equipment can be used to satisfy any State taxes incurred on the purchase of production related tangible personal property used or consumed by a manufacturer or graphic arts producer in research and development.

When a manufacturer purchases manufacturing machinery and equipment, the State of Illinois provides a Manufacturer's Purchase Credit (MPC) in addition to the exemption for manufacturing machinery and equipment. See 86 Ill. Adm. Code 130.331. A purchaser of manufacturing machinery and equipment that is exempt under the manufacturing machinery and equipment exemption also earns MPC in an amount equal to a fixed percentage of the tax which would have been incurred under the Use Tax or Service Use Tax. 35 ILCS 105/3-85; 35 ILCS 110/3-70.

In addition, MPC may also be used to satisfy Use Tax or Service Use Tax liability that is incurred on the purchase of production related tangible personal property that does not qualify for the manufacturing machinery and equipment exemption. The amount of MPC that can be applied to a purchase of production related tangible personal property is limited to the State rate of tax incurred on that property (6.25%). MPC cannot be used to satisfy any local taxes incurred on the purchase of production related tangible personal property.

"Production related tangible personal property" includes all tangible personal property used or consumed in a production related process by a manufacturer in a manufacturing facility in which a manufacturing process described in Section 2-45 of the Retailers' Occupation Tax Act takes place, and all tangible personal property used or consumed by a manufacturer or graphic arts producer in *research and development* regardless of use within or without a manufacturing or graphic arts production facility. See 35 ILCS 105/3-85.

Maintenance Agreements

The taxation of maintenance agreements is discussed in subsection (b)(3) of Section 140.301 of the Department's administrative rules under the Service Occupation Tax Act. See 86 Ill. Adm. Code Sec. 140.301(b)(3). The taxability of agreements for the repair or maintenance of tangible personal property depends upon whether charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. In those instances, no tax is incurred on the maintenance services or parts when the repair or servicing is performed. A manufacturer's warranty that is provided without additional cost to a purchaser of a new item is an example of an agreement that is included in the selling price of the tangible personal property.

When a retailer, after a sale of tangible personal property, subsequently transfers to a customer an item free of charge that the retailer is not contractually obligated to provide pursuant to the terms of the sale, the retailer has made a taxable use of the property by making such gift. Therefore, it is the donor of the gift who is deemed the end user of the property and who is subject to the Use Tax, rather than the donee. See 86 Ill. Adm. Code 150.305(c) and see also 86 Ill. Adm. Code 130.2125(c) concerning "Gift Situations." The donor may satisfy this Use Tax obligation either by paying tax to his supplier or by self-assessing Use Tax and paying directly to the Department as discussed above.

Remote Seller Notification

The State of Illinois does not have a remote seller notification law. However, the State recently enacted a law that requires remote sellers to collect Use Tax in certain situations. See P.A. 96-1544.

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