

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 1, 2011

Dear Xxxxx:

This letter is in response to your letter dated July 7, 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:

My company currently has nexus in the state of IL. We have a transaction that needs an official ruling on for [sic] sales tax. I have contacted both the online support and phone bank and was directed to your office.

Below is the scenario:

Our IL location makes loyalty cards for a restaurant. We then ship them to an outsource vendor located in IL. As soon as the outsource vendor has completed the cards, we invoice the customer. The cards become customer owned finished goods. Ownership changes at this point. No Shipping occurs. Time goes by (a week in this example), the restaurant sends us a number of location [sic] to ship the cards to. The cards are shipped all over the country and we invoice the corporate office of the restaurant for a Drop Ship Fee and for Freight.

We are invoicing corporate office of the restaurant but shipping to the Franchisee. I believe corporate then recoups their money from each franchisee.

My questions are:

- 1.) Do we charge IL sales tax on all the cards since ownership changes hands in IL even though we will eventually drop ship them into other states?
- 2.) Do we charge sales tax on the drop ship fee and freight once we actually ship the cards?
- 3.) Is the restaurant reselling to the Franchisee? What is our legal obligation to investigate the Corporate/Franchisee relationship to determine if they are reselling? For example, we sell to another company who [sic] stores are not independent corporations. However, we also sell to a company where the Franchisees are independent corporations.
- 4.) Are there any exemptions in IL where a gift card is considered reselling an item?

DEPARTMENT'S RESPONSE:

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. 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.

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).

Service Occupation Tax Act

When a company contracts to print custom printed items, a special order printing situation may exist. 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.

Multi-service situations exist where a primary serviceman subcontracts work to a secondary serviceman. In multi-service situations, a primary serviceman's cost price is determined either by the separately stated selling price of the tangible personal property transferred from a secondary serviceman, or if the secondary serviceman does not separately state the cost of goods, it is

presumed that the primary serviceman's cost price is 50% of the secondary serviceman's total charge. See 86 Ill. Adm. Code 140.301(a).

When both primary servicemen and secondary servicemen are registered, primary servicemen provide secondary servicemen with a Certificate of Resale. A primary serviceman would then incur Service Occupation Tax based upon the separately stated selling price of the property, 50% of the bill to the service customers or as outlined in method three described above. Upon selling their product, servicemen are required to collect the corresponding Service Use Tax from their customers.

Please note that if an unregistered de minimis serviceman subcontracts service work to another unregistered de minimis secondary serviceman, the primary serviceman does not incur a Use Tax liability if the secondary serviceman (i) has paid or will pay Use Tax on his or her cost price of any tangible personal property transferred to the primary serviceman and (ii) certifies that fact in writing to the primary serviceman. This certification option is only available in multi-service situations when both the primary and secondary servicemen are unregistered and de minimis. If the primary serviceman is registered and the secondary serviceman is unregistered it will not work.

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 or she may claim the interstate commerce exemption or accept various exemption certificates from his or her customers (e.g., he or she 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
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RSW:mzk