

This letter discusses sales of prescription drugs by servicemen. See 86 Ill. Adm. Code Part 140. (This is a GIL.)

March 16, 2012

Dear Xxxxx:

This letter is in response to your inquiry of recent date, 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:

I am the president and the majority owner of PHARMACY and in June of 2011 I received a call in regards to an audit of our business for the tax period July 1, 2008 to December 31, 2010. On the first day I was under the understanding that Medicaid and Medicare were exempt from sales tax which is 90% of my business. I was not aware that Medicare Part D is not considered Medicare since it is enforced by private insurances [sic] companies (PDP's). Only way I was able to change by [sic] belief was attempt [sic] to collect from a Part D plan. I had to call the software company (who questioned why I was doing this) and had them create a segment in the adjudication part of the claim and put in a 1% sales tax and then sent the claim electronically and in disbelief the insurance actually paid the sales tax. At that time I had to believe that indeed the Medicare part D plans pay sales tax at 1%. As I investigated further I pulled some old EOB's (explanation of benefits) from some commercial insurances. I found that they had already been paying a tax. So now at this time I know that not only the commercial insurances had been paying taxes but now I can bill the tax to the Medicare Part D plans and get reimbursed the tax. But, here is where the irritation starts. I had never sent a claim to a commercial insurance with a sales tax in the adjudication. I had to get the software company to put that in the claim segment. So the question is why were the commercial insurances paying a sales tax automatically and the Medicare Part D plans were not. I understand when the Medicare Part D plans negotiate their agreements with each state (that have a sales tax on prescriptions) they include the tax in the pricing. By the way, Illinois is 1 of 2 states out of 50 that even charge a sales tax

on prescriptions. Here is where the problem lies. That is my money that the plans kept prior to us fixing our system so we could charge taxes. I paid the taxes due and penalties and interest out of our bottom line since I had never collected from Part D plans. I want my money! The PDP's are keeping something that does not belong to them.

If a commercial insurance already paid taxes without us even charging it on the prescription then they obviously knew there is [sic] a tax in Illinois. Why are the Medicare Part D plans getting away with it! I even called a pharmacy in Missouri to make sure they do not get taxes on prescriptions. They looked at a commercial insurance EOB to make sure it was not some other fee and that they did not get tax paid. They indeed did not get a tax reimbursement because there is not a tax in Missouri. I can guarantee that #1 a majority of the pharmacies in Illinois are not aware of a sales tax and #2 they are not collecting it from the insurances and #3 they are not paying the proper taxes. I called 5 fellow pharmacists that own their own pharmacies and 3 pharmacies are not even paying a 1% sales tax the proper way. There were 3 different methods to the madness on how they calculated it. Two pharmacies which had been audited in the past knew about the tax, and all 5 of them had no idea that they could collect the tax from the Medicare Part D plans by having their software vendor put it in the adjudication.

The tax is collectable but my problem is that I need a letter from the Illinois Department of Revenue that states it is a sales tax so I can continue my journey on this to the Medicare Part D plans who owe the money to my business. They are knowingly getting money in the negotiated price to cover the State of Illinois tax and keeping it because a majority of pharmacies do not know that they can collect it. The reality in pharmacy is the margins of profit are ridiculously low. Everyone has an insurance plan there are very little cash paying customers it is a struggle to keep a business open that is independently owned and operated. I am trying my best to keep 23 employees employed but it will not continue to happen with the shrinking margins. I am trying to support the State of Illinois but we are being taxed to death. I am taxed on the income of this business 3 times. The business pays a 1.5% tax on the income, the business pays 1% on prescriptions and I pay personal income tax on my % of the company. I get very little monetary benefit from owning my own business just satisfaction that I run a good business and have very little turn over on staff and clients. That is something I am proud of. What I am not proud of is the fact that I never knew there was a tax on prescriptions but in my defense not too many other pharmacists know [sic] that either until they were audited. I blame my self [sic] and my accountant.

Several things need to happen.

#1 there needs to be a formula derived that everyone follows to pay the taxes properly or consistently so it is fair to all. The software does not make it easy to just run a report for sales tax collected. That would be the simple way and I am still working on that with the vendor.

#2 The Department needs to inform their staff about the taxes on prescriptions they have no clue about it or even how it should be calculated. I purposely have called on several different occasions and asked what the sales tax on prescriptions is and I have been told "there is not a tax on prescriptions". So not only does the department not know there is a tax on prescriptions do you really think they can tell me how to calculate it!

#3 the service occupation tax (SOT) needs to be null and void. This de minimus and not de minimus stuff for pharmacists is stupid and outdated. That worked well in the 80's but come on seriously let's update a little! According to the Department on how to calculate tax based on SOT. [sic] This is the third way that is recommended to pay a service tax:

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 140.10

Really can this be anymore [sic] ridiculous to understand! I can guarantee you that no one or very few know how to pay unless they were audited. BECAUSE WE DIDN'T KNOW! My accountants and other accountants don't even know!

#4 the ST-1 tax form which is for sales tax is going to have to be different for a pharmacy. If you are going to have a tax on prescriptions then have a form that pertains to pharmacy only. The one now is more complicated than it has to be. Every tax in the State of Illinois is more complicated then [sic] it has to be!

Finally, if you expect for small businesses to still do business in this fine State that we live in then you are going to have to quit taxing so much. Our margins are shrinking daily there is no more or very little cash paying customers, everyone has an insurance of some sort probably 99% of the population has something. This state loves to give out Medicaid like throwing candy off a float but cannot pay their vendors in a timely manner.

We do not determine the price that we are reimbursed by the insurances, PDP'S, Medicare or Medicaid. They do. Let us bring up the lovely State of Illinois prescription benefit for State employees (MEDCO) plan. We lose money on 90% of the prescriptions that we fill for a 90 days [sic] supply! Where is the justice in that? I am not in business to become filthy rich that would be the oil companies. Believe it or not independent pharmacies do not have much of a profit and it continues to shrink. I am in business to employ [sic] as many employees that I possibly can and help lower our State's unemployment. I am in business so I can give my staff a raise if they deserve it and free health insurance. How many businesses do that! I am in business to support the State of Illinois, but where is the support from my State when I am trying to recoup lost tax money. The Medicare part D plans should have been automatically paying the taxes like the commercial insurances have been doing.

I need a letter and assistance from the STATE to bring the Medicare Part D plans PDP's to justice. I need for the State to determine this tax as a "sales tax" because that is what it is! I am entitled to the taxes that the PDP's have been keeping since Medicare Part D started in January 1, 2006.

I am asking for the State to assist me in this task. I have been told that I need a letter from the State of Illinois stating this is a sales tax in order to continue my pursuit in retrieving lost taxes for my business.

Please let me know if this can be accomplished and what I need to do next in my mission towards justice.

Thank you in advance for you assistance.

DEPARTMENT'S RESPONSE:

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.

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.

The Department's regulation at 86 Ill. Adm. Code Section 130.311 governs Drugs, Medicines, Medical Appliances and Grooming and Hygiene Products and can be found on the Department's website. Those products that qualify as drugs, medicines and medical appliances are taxed at a lower State rate of 1% plus any applicable local taxes. Those items that do not qualify for the low rate of tax are taxed at the general merchandise rate of 6.25% plus applicable local taxes.

Pharmacists who sell prescription drugs to customers are considered to be servicemen under the Service Occupation Tax Act.

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 the cost price if they are registered de minimis servicemen; or, (4) Use Tax on the 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 do not have the option of determining whether they are de minimis using a transaction-by-transaction basis. See 86 Ill. Adm. Code 140.109.

It is my understanding that most pharmacists in this State use the third method to calculate their liability. As noted above, the third method is based upon the serviceman's cost price for the tangible personal property transferred. For example, if the serviceman paid \$20 for the drugs, he will owe Service Occupation Tax based upon his \$20 cost price even when he sells the drugs with a markup. It is important to stress that the third method is applicable only 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.

Customers purchasing prescriptions from these servicemen incur a corresponding Service Use Tax liability. The provisions of the Service Use Tax Act require the pharmacists to collect this tax from their customers. See 35 ILCS 110/3-40. Servicemen can collect this tax in one of two ways: (1) they can separately state the tax from the price of the service (and must do so if requested by the customer); or (2) they can include the tax in the total price of the service. How taxes are collected by such servicemen is generally a business decision of the servicemen and is not within the jurisdiction of the Department. Traditionally, many pharmacists in this State have included tax in the total price of the service.

In general, sales made to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active

exemption identification number “(E” number). See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare or Medicaid, tax is due upon any portion of the bill paid by individuals or private insurance companies not covered by Medicare and Medicaid. This means when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. In the case of an unregistered de minimis serviceman, (see the final method above), he or she may take a pass through of the exemption when selling to Medicare or Medicaid. Such servicemen will still owe Use Tax on the portion of the cost billed to the patient. See 86 Ill. Adm. Code 140.108(a)(2)(A) and 86 Ill. Adm. Code 140.108(a)(2)(B).

The Medicare Part D Prescription Plan is organized differently. The government provides funds on a per capita basis to the Prescription Drug Providers (“PDPs”). The PDPs operate as private insurance companies under contract with the government. They, not the government, are responsible for purchasing drugs for their beneficiaries. The beneficiaries usually pay a co-pay. Since sales are made to the PDPs and not directly to the government, the drug sales do not qualify for the government tax exemption. Therefore sales of drugs are not exempt from tax under the Medicare D Plan. Please note that according to the U.S. Department of Health and Human Services, sales tax cannot be added to a beneficiary’s co-payment under the Plan. As a result, sales tax is due on drugs sold under the Medicare Part D Plan, but it may not be charged to the beneficiary. The same applies to the State of Illinois Rx Program.

If tangible personal property is not sold for use or consumption, but rather, for resale, the seller may accept a Certificate of Resale from the purchaser. No tax is imposed on a sale of property purchased for resale. Illinois law requires a Certificate of Resale to contain the information set out in 86 Ill. Adm. Code 130.1405(b). An example of a sale for resale might be if you sell prescription drugs to a long term care facility, and the long term care facility sells them to their residents as part of the residents’ monthly fee. Again, unregistered de minimis servicemen may not give a certificate of resale. They must pay the Use Tax to their suppliers.

Please note that there is also an exemption for prescription and non-prescription medicines and drugs sold for use by a person receiving medical assistance under Article 5 of the Illinois Public Aid Code who reside in a licensed long-term care facility, as defined in the Nursing Home Care Act. See 35 ILCS 115/3-5(13).

The Department acknowledges the complexity of determining tax owed under the Service Occupation Tax Act. The Act has evolved over time to address different circumstances faced by servicemen in different occupations. For example, pharmacists have a different threshold for determining whether they de minimis servicemen. The rules are based on Service Occupation Tax Act and cannot be changed by the Department without the General Assembly first making changes to the Act.

We apologize if the persons you contacted at the Department provided you with inaccurate information regarding the taxability of prescription drugs. However, prescription drugs have been taxed at the rate of 1% for some time. The Department’s website provides resources to determine the taxability of different types of tangible personal property. The website contains links to the Department’s regulations, past letter rulings, forms and instructions, bulletins and taxpayer publications. Any accountant knowledgeable about State sales taxes should have known that prescription drugs are taxed at the rate of 1%.

The Form ST-1 and instructions are continually revised to address the latest tax changes. The form makes explicit provision for the taxation of food, drugs and medical appliance at the 1% rate.

The form is designed to address all retailers and servicemen. The Department cannot possibly design separate forms for every class or type of retailer or servicemen.

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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