

ST 15-0020 GIL 03/18/2015 SALE OF SERVICE

If no tangible personal property is transferred to the customer, then no Illinois Retailers' Occupation Tax or Service Occupation Tax would apply. See 86 Ill. Adm. Code Parts 130 and 140. (This is a GIL.)

March 18, 2015

Dear XXXX:

This letter is in response to your letter dated December 3, 2014, 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](http://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:

Several years ago, my client (hereafter "Client") submitted a ruling request to Illinois regarding the taxability of particular types of sales made to Client's Illinois customers. A copy of the Department's original response is enclosed for your reference. In an effort to maintain compliance with Illinois' current taxing procedures, we would like to request an updated ruling, based on any changes in Illinois' tax law and any changes in Client's facts.

On behalf of Client, I would respectfully request the Illinois Department of Revenue to respond to the questions we have identified below regarding the Illinois sales and use tax.

Client, a STATE corporation, is engaged in the business of collecting and furnishing health care information to requestors who wish to obtain copies of medical records. Currently, Client has operations at various medical facilities in Illinois and is registered and collecting sales tax on its charges for medical records. In order to clarify the taxability of specific services, we request a determination on the following issues:

1. Whether Client's charges for services and the provision of medical records are subject to sales or use tax when distributed in the following formats:
  - a. Printed copy of the medical record(s)
  - b. Copy sent by fax
  - c. Copy sent in a PDF document electronically via e-mail
2. Whether Client's charges for coding services are subject to sales tax.
3. Whether Client's charges for training and education services are subject to sales tax.
4. Whether Client's charges for abstraction services are subject to sales tax.
5. Whether Client's charges for access to records stored in an online database (Software as a Service) are subject to sales tax.
6. Whether a separately stated charge for "Postage" would be subject to either the sales or use tax. In addition, whether a separately stated charge for "Postage and Handling" would be subject to either the sales or use tax.
7. What the proper application of sales or use tax is when the requesting party, such as an insurance company, has locations both in-state (origination) and out-of-state (destination).

Client enters into agreements with various physicians, hospitals, and other health care facilities (collectively, "Health Care Providers"). These agreements require Client to respond on behalf of the Health Care Providers to all requests for medical records, data, and information relating to particular patients (collectively, "Medical Records") that are made by or for patients, insurance companies, physicians, other health care providers, payers, attorneys, federal and state organizations, and others (collectively, "Requesting Parties"; individually, the "Requesting Party"). In turn, when Health Care Providers receive requests for Medical Records, they are obligated to refer the Requesting Parties to Client.

Depending upon the scope of services being provided to a particular Health Care Provider, Client may:

- Receive and review all incoming requests for Medical Records and validate authorizations for release of medical records from Requesting Parties for HIPAA and state law compliance and/or request follow-up information as necessary to validate an invalid authorization. A request may be rejected if, for example, fulfillment would violate federal or state laws.
- Pull files and/or review electronic records and/or microfilm for Medical Records meeting the authorization request and either copy the Medical Records to paper, scan and upload records to Client's Central Processing Center (CPC) located at its corporate headquarters in STATE and then copy same to paper, or scan and upload to Client's CPC and make the Medical Records available through its e-delivery system online for the Requesting Party to download via a confidential pass code and print.

- Log in and record pertinent information regarding the requests in Client's web-based information request management application software system in order to provide tracking of the status of the processing of the requests.
- Mail records and/or make the records available through Client's e-delivery system online.
- Bill the customer, if an invoice is mailed to that customer, for postage charges with a separate line item on the invoice. The customer is only billed for separately stated postage charges. In certain situations, an invoice may be billed to a customer as "postage and handling charge."
- Invoice the Requestor for copies made in accordance with relevant state and federal regulations and collect payment of the invoices.

Typically, the pertinent Medical Records are identified and pulled by Client employee on-site at the Health Care Provider, where they are copied and/or scanned at the facility and then either mailed or made available at the Health Care Provider location or Client's headquarters. The billing and collections are done from Client's STATE office. The fees collected from the Requesting Parties by Client are retained by Client as its primary compensation for performing the services for the Health Care Provider, although there are instances where the Health Care Provider may also pay compensation to Client for its services.

The amount charged varies depending upon the Requesting Party, the quantity of medical records requested, and the type of information requested. Certain state and federal law may limit the amount that may be charged to certain requestors, but not others. In addition, when a proper request is submitted to the Health Care Provider by certain Requesting Parties, the Health Care Provider is required by law to provide a copy of the records requested within a reasonable period of time and upon payment of the mandated charge.

In addition to these services, Client performs the following services:

- **Coding.** Coding is the transformation of narrative descriptions of diseases, injuries, and health care procedures into numeric or alphanumeric designations (that is, code numbers). The code numbers are detailed in order to accurately describe the diagnoses (that is, what is wrong with the patient) and the procedures performed to test or correct these diagnoses. Because medicine is not always an exact science, codes were developed to identify all reasons for seeking health care. Coding health-related data permits access to health records according to diagnoses and procedures for use in clinical care, research, and education.
- **Training and education.** Training and education is provided for all levels of coders, physicians, and ancillary hospital personnel. The wide range of education services includes documentation improvement, inpatient and outpatient coding assessments and training, and revenue cycle management.

- **Abstraction.** Abstraction is the process of taking important medical information from handwritten and typed reports and physically entering that information in an electronic medical record. Client hires nurses and other credentialed health information management people to do this type of work.
- **Software as a Service.** Client provides customers secure, online storage space in which the customer can store and access, at any time, patient records and other sensitive documentation. The customer uses a username and password to access the stored files. The customer does not install any software and does not store any data on the customer's own server.

Some of the above services may be performed by Client's employees on-site at the local Health Care Provider facility, and some of the services may be provided from Client's corporate headquarters located in STATE, again depending on the scope of services chosen by the particular Health Care Provider. The services performed by Client are invoiced to health care providers, hospitals, clinics, etc.

Our anticipated responses are as follow:

1. The sale of a medical record when the information is transferred on a tangible medium (paper) is not subject to Illinois sales tax since the transaction is a service and the tangible personal property transferred is incidental to the sale of the service. In addition, the sale of a medical record when it is sent electronically via fax machine or in a PDF via e-mail is not taxable because there is no tangible medium involved. If it is determined by the Illinois Department of Revenue that the sale of the records would be subject to tax, only records that are transferred to a Illinois location are subject to the tax. Any records sent outside Illinois are not subject to Illinois tax even if the records were shipped from an Illinois location. To the extent records are shipped from outside Illinois (for example, STATE) to an Illinois location, they would be subject to the Illinois tax.
2. Charges for coding services are not subject to Illinois sales tax since they are considered to be exempt data processing services and no transfer of tangible personal property occurs.
3. Charges for training and education are not subject to Illinois sales tax since they are considered to be exempt professional services and no transfer of tangible personal property occurs.
4. Charges for abstraction services are not subject to Illinois sales tax since they are considered to be exempt data processing services and no transfer of tangible personal property occurs.
5. Charges for access to online document storage (Software as a Service) are not subject to Illinois sales tax since the information is

transferred by electronic means and no transfer of tangible personal property occurs.

6. To the extent the copied information mailed to the customer is deemed taxable by the Illinois Department of Revenue, separately stated charges for postage would be taxable if the customer is required to pay the charges incurred to ship the records. A separately stated charge as a "postage and handling charge" would not be subject to Illinois sales and use tax to the extent any taxable property is billed or invoiced to a customer and charges are actually reflective of the cost of shipping.
7. The shipping destination, not the billing address of the requestor, determines the imposition of tax. Therefore, a sale that either originates from Illinois and is shipped to a location in Illinois or is shipped from out of state (STATE) and directly to an Illinois customer (destination basis) is taxed in the same manner for sales and use tax purposes (for the state and local tax rates). It is immaterial whether the sale originates in Illinois or is destined for sale in Illinois; the sale is treated the same for imposing the state tax and any local tax rates.

We make the following representations for this request:

1. Client is not currently under audit by the Department.
2. Client has not been notified by the Department concerning a pending audit.
3. Client has not submitted a claim for refund containing transactions involving any issue contained in the request for declaratory ruling.
4. The same issue is not currently the subject of litigation with the Department.
5. Client has not previously submitted a ruling request on taxability of coding, training and education, abstraction services, and Software as a Service.

Therefore, we kindly request your assistance in guiding us to the appropriate response to our inquiries above. If you have any questions, please feel free to contact me at [XXX-XXX-XXXX], or by email at [NAME@EMAIL](mailto:NAME@EMAIL).

## **DEPARTMENT'S RESPONSE:**

### Tangible Personal Property

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 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. 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 purchases occur outside Illinois, purchasers must self assess their Use Tax liability and remit it directly to the Department.

### Service Transactions

Retailers' Occupation and Use Taxes do not apply to sales of service. The transactions you have described appear to be service transactions. 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 de minimis and is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Note, the Department does not consider the viewing, downloading or electronically transmitting of video, text and other data over the internet to be the transfer of tangible personal property. However, if a company provides services that are accompanied with the transfer of tangible personal property (e.g., medical records delivered to a customer in a hardcopy version, rather than sent electronically), such service transactions are generally subject to tax liability under one of the four methods set forth above.

If the transactions you are inquiring about do not involve the transfer of any tangible personal property to the customer, then they generally would not be subject to Retailers' Occupation Tax, Use Tax, Service Occupation Tax, or Service Use Tax.

### Nexus

An "Illinois Retailer" is one who makes sales of tangible personal property in Illinois. 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. Our regulations were recently amended in response to the Illinois Supreme Court's decision in Hartney Fuel Oil Co. v. Hamer, 2013 IL 115130. The regulations specify the selling activities that trigger Retailers' Occupation Tax liability in Illinois.

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 see 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. Illinois customers who do not pay tax to a retailer and who are not registered as a retailer under Section 9 of the Use Tax Act still incur Use Tax liability on the purchase of tangible personal property and must file use tax returns. If the Illinois customer's liability does not exceed \$600 per year, the returns and payments can be made annually, on or before April 15. Many retailers that do not have nexus with the State have chosen to voluntarily register as Use Tax collectors as a courtesy to their Illinois customers so that those customers are not required to file returns concerning the transactions with those retailers.

### Software as a Service

The Department is currently evaluating the taxability of Software as a Service (SaaS), cloud computing, computer software Application Service Providers (ASPs) and similar types of transactions. The Department has found that there is no universal agreement regarding the nature of these transaction. When the Department makes a determination regarding the taxability of these transactions, that determination will operate prospectively only.

### Shipping and Handling

The Retailers' Occupation Tax is imposed upon persons engaged in this State in the business of selling tangible personal property for use or consumption. Retailers' Occupation Tax is based upon the "selling price" of the tangible personal property sold. Section 1 of the Retailers' Occupation Tax Act defines the term, "selling price," as the "consideration for a sale valued in money ... and shall be determined without any deduction on account of the cost of the property sold, the cost of materials used, labor or service cost or any other expense whatsoever..." See 35 ILCS 120/1. As indicated by this definition, a retailer's cost of doing business is not deductible from his or her gross receipts. This principle is articulated in Section 130.410 of the Department's rules.

(86 Ill. Adm. Code 130.410) This rule states that in calculating Retailers' Occupation Tax liability, "labor or service costs" . . . "overhead costs" . . . "or any other expenses whatsoever" are not deductible from gross receipts. The rule provides that these costs of doing business are an element of a retailer's gross receipts subject to tax even if separately stated on the bill to the customer.

Handling charges represent a retailer's cost of doing business and consequently are always includable in gross charges subject to tax. See, 86 Ill. Adm. Code 130.410. However, such charges are often stated in combination with shipping charges. In this case, charges designated as "shipping and handling," as well as delivery or transportation charges in general, are not taxable if it can be shown that they are both separately contracted for and that such charges are actually reflective of the costs of shipping. To the extent that shipping and handling charges exceed the costs of shipping, the charges are subject to tax. As indicated above, charges termed "delivery" or "transportation" charges follow the same principle.

For example, if a seller delivers the tangible personal property to the buyer, and the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his or her tax liability. See the Department's regulation at 86 Ill. Adm. Code 130.415(d).

A separate listing on an invoice of such charges, however, is not sufficient to demonstrate a separate agreement. The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice. Note, as stated in Section 130.415 of the Department's regulations, if the charges for transportation or delivery exceed the cost of delivery or transportation, the excess amount is subject to tax. For further information, see Nancy Kean v. Wal-Mart Stores, Inc., 235 Ill. 2d 351, 919 N.E.2d 926 (2009).

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

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