

ST 20-0014-GIL 09/30/2020 CONSTRUCTION CONTRACTORS

When a construction contractor permanently affixes tangible personal property to real property, the contractor is deemed the end user of that tangible personal property. As the end user, the contractor incurs Use Tax on the cost price of that tangible personal property. See 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075. (This is a GIL.)

September 30, 2020

Dear Xxxx

This letter is in response to your letter dated February 5, 2019, in which you requested information. We apologize for our delay in responding. 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:

We are a STATE based manufacturer of demountable partition frames. We sell our products to general contractors in the ILLINOIS CITY region through an independent sales representative firm. We have a showroom at LOCATION in ILLINOIS CITY, and we have a single Illinois employee, a project manager, who works from his home. Here is a summary of how a transaction unfolds:

Company ABC decide [sic] to renovate their space and hire general contractor XYZ to perform the renovation. Our local sales representative firm, the GROUP, meet with the architect and contractor and try to sell our demountable wall system to them. As part of the sales process, they might bring the client to our showroom at the LOCATION to show our product. We have no employees at this location. If they are successful, the general contractor sends a notice to proceed and a subcontract to our STATE office. The general contractor views us as subcontractor, however this [sic] erroneous in that we are the manufacturer (will explain further later). I review and revise said contract until such time as it meets COMPANY’s terms and conditions, I then return it to the contractor in Illinois. If we reach an agreement, I sign and execute the contract in STATE. The contractor then sends their deposit check to our office in STATE, which is deposited in a STATE bank, as are all receipts from the contractor.

The independent sales representative receives a percentage of the sale in the form of a commission, they do not receive a draw or other forms of income from us.

Since we are the manufacturer of the product, not a subcontractor, we hire a local independent installation company to perform the installation of the partitions.

Recently, we hired an Illinois resident as project manager, who works from his home, to help facilitate projects. He goes onto jobsites occasionally to confirm the loading dock or freight elevators are sufficiently sized, or he may drop by to attend a construction meeting to put a face to [sic] transaction for the contractor. He is strictly while [sic] collar, he performs no physical labor. His main task is to ensure the installer performs as contracted and to schedule deliveries of materials to the jobsite.

All of the metal pieces of the demountable system come from our warehouse in STATE and go directly to the jobsite, we have no facilities in Illinois other than the showroom. The glass is ordered locally and delivered directly to the jobsite by an independent glass vendor. They send their invoices to our STATE office.

When we hired the project manager, we were told both by an Illinois Department of Revenue employee and our CPA, doing so created nexus and that we had to increase the sales tax amount we collect to 10.25%, which we did. The problem came when I tried to pay this additional tax, as the online ST-1 would not allow me to.

I called the Illinois Department of Revenue and spoke with three individuals, all of whom told me that I only need to be charging the 6.25% out-of-state sales tax amount, I was told we do not have nexus. I was directed to an online document that outlined the necessary items to create nexus. I believe it is accurate that we do not qualify for nexus and should return to charging the lower sales tax amount. However, before doing so and creating a potential shortfall that would be difficult to repay later, we would like to confirm returning to 6.25% is the correct action to take. To resolve temporarily, I have submitted the the [sic] additional collected tax in the excess tax column of the ST-1.

We request a private letter ruling on which sales tax rate we should be charging going forward, given the aforementioned facts. We have neve requested a ruling on this subject previously.

DEPARTMENT'S RESPONSE:

We are unable to provide a private letter ruling based on the information provided. However, below is a discussion of how Illinois taxes construction contractors. In addition, we refer you to other resources in the event that the facts of your situation are not fully governed by the construction contractor rules.

The Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property at retail to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. 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.

NEXUS

It is important to clarify that the question of whether one has nexus with Illinois is not the same as the question of whether one is engaged in the business of making retail sales in Illinois and subject to the Retailers' Occupation Tax. One can have nexus with Illinois and still not be subject to the Retailers' Occupation Tax Act, but rather, be subject to mandatory collection of one's customer's Use Tax.

An "Illinois Retailer" is one who makes sales of tangible personal property in Illinois. The Illinois Retailer is then liable for both state and local Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding state Use Tax incurred by the purchasers and may collect a reimbursement of local Retailers' Occupation Tax. The Department has adopted regulations that specify the selling activities that trigger Retailers' Occupation Tax liability in Illinois. See, e.g., 86 Ill. Adm. Code 270.115.

Physical presence nexus and Wayfair nexus:

An out-of-State retailer (a "remote retailer") making sales to Illinois purchasers from locations outside Illinois is required to register with the Department and collect and remit Use Tax on those sales at the rate of 6.25% if it falls within the definition of a "retailer maintaining a place of business in this State" in Section 2 of the Use Tax Act, 35 ILCS 105/2. The Department is authorized to require these retailers to act as tax collectors because they have established sufficient contacts, or nexus, with Illinois. There are two groups of remote retailers that must collect Use Tax on sales to Illinois purchasers:

- 1) Remote retailers with a physical presence in Illinois. Prior to October 1, 2018, remote retailers had to have a physical presence in Illinois before they could be required to collect Use Tax. The types of activities constituting a physical presence, as limited by the series of court cases described below, are found in Section 2 of the Use Tax Act's definition of a "retailer maintaining a place of business" in Illinois. See, 35 ILCS 105/2. The physical presence requirement was established in a series of United States Supreme Court decisions. See, for example, *Scripto v. Carson*, 362 U.S. 207 (1960); *National Bellas Hess v. Department of Revenue of the State of Illinois*, 386 U.S. 753 (1967); *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992). In 1996, the Illinois Supreme Court ruled that remote retailers need only "more than the slightest" physical presence to be required to collect Use Tax. See *Brown's Furniture v. Wagner*, 171 Ill.2d 410 (1996). Any remote retailer that currently has a physical presence in Illinois will continue to be required to act as a Use Tax collector. Regulations describing these types of retailers are found at 86 Ill. Adm. Code 150.801 and 150.802.

The physical presence required to establish physical presence nexus 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. Generally, the presence of a showroom, a sales representative, and a project manager in Illinois would establish nexus in Illinois sufficient to require Use Tax collection.

- 2) Remote retailers without a physical presence in Illinois. In *South Dakota v. Wayfair, Inc.*, 585 U.S. ____ (2018), 138 S. Ct. 2080, the U.S. Supreme Court upheld a South Dakota statute that imposed tax collection obligations on remote retailers that met specific selling thresholds but had no physical presence in the state. This decision abrogated the longstanding physical presence requirement of *Quill*, deeming it “unsound and incorrect.” Illinois Public Act 100-587 enacted nexus standards, effective October 1, 2018, that are virtually identical to those upheld in *Wayfair*. This nonphysical presence nexus we will call “Wayfair nexus.”

Following are the requirements for Wayfair nexus in Illinois. Public Act 100-587 (adding item (9) to the definition of “retailer maintaining a place of business in this State” at 35 ILCS 105/2) requires remote retailers with no physical presence in Illinois to register and collect and remit Use Tax, as provided below (see 86 Ill. Adm. Code 150.803):

- 1) Beginning October 1, 2018, a retailer making sales of tangible personal property to purchasers in Illinois from outside of Illinois must register with the Department and collect and remit Use Tax if:
 - a) The cumulative gross receipts from sales of tangible personal property to purchasers in Illinois are \$100,000 or more; or
 - b) The retailer enters into 200 or more separate transactions for the sale of tangible personal property to purchasers in Illinois.
- 2) A retailer shall determine on a quarterly basis, ending on the last day of March, June, September, and December, whether he or she meets either of the criteria of paragraph (1) for the preceding 12-month period. If the retailer meets either of the criteria of paragraph (1) for a 12-month period, he or she is considered a retailer maintaining a place of business in Illinois and is required to collect and remit the Use Tax and file returns for one year.
 - a) At the end of that one-year period, the retailer shall determine whether he or she met either of the criteria of paragraph (1) during the preceding 12-month period. If the retailer met either of the criteria in paragraph (1) for the preceding 12-month period, he or she is considered a retailer maintaining a place of business in Illinois and is required to collect and remit Use Tax and file returns for the subsequent year.
 - b) If at the end of a one-year period a retailer that was required to collect and remit the Use Tax determines that he or she did not meet either of the criteria in paragraph (1) during the preceding 12-month period, the retailer shall subsequently determine on a quarterly basis, ending on the last day of March, June, September, and December, whether he or she meets either of the criteria of paragraph (1) for the preceding 12-month period.

In determining whether a remote retailer meets the thresholds above, sales for resale are excluded. See 86 Ill. Adm. Code 150.803(c)(3)(E)(i). In addition, if a remote retailer makes exclusively nontaxable sales, he or she is not subject to the Wayfair nexus requirements. See 86 Ill. Adm. Code 150.803(c)(2). If, however, the remote retailer makes both taxable and nontaxable sales into Illinois, all sales are included, including the nontaxable sales (other than sales for resale and other sales specified at 86 Ill. Adm. Code 150.803(c)(3)(E)). See 86 Ill. Adm. Code 150.803(c)(3)(E)(v).

We note, however, that the law governing remote retailer obligations will change on January 1, 2021 under the Levelling the Playing Field for Illinois Retail Act (35 ILCS 185/5-1 et seq.). For more information, please see the Department's Levelling the Playing Field for Illinois Retail Act Resource Page at tax.illinois.gov.

CONSTRUCTION CONTRACTORS

While the detail supplied with your letter is not sufficient to make a determination, we assume, for the purpose of this letter, that you are not acting as a retailer or a mandatory use tax collector, but rather as a construction contractor. In that case, the following provisions apply.

A contract to incorporate tangible personal property into real property is considered a construction contract. The term construction contractor includes general contractors, subcontractors, and specialized contractors such as landscape contractors. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, these contractors incur Use Tax liability for such purchases based upon their cost price of the tangible personal property. See 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075. Therefore, any tangible personal property that a construction contractor purchases that will be permanently affixed to or incorporated into real property in this State will be subject to Use Tax. As a general rule, except in cases of construction contractors who also act as retailers as discussed below, construction contractors should not provide resale certificates to their suppliers and should instead pay Use Tax and any reimbursement for locally-imposed occupation taxes at the time of purchase of tangible personal property to be incorporated into real estate. If such contractors did not pay Illinois Use Tax liability to their suppliers, which may occur when purchasing from out-of-state suppliers, those contractors must self-assess their Illinois Use Tax liability and pay it directly to the Department. If the contractors have already paid a tax in another state regarding the purchase or use of such property, they will be entitled to a credit against their Illinois Use Tax liability to the extent that they have paid tax that was properly due to another state. See 86 Ill. Adm. Code 150.310.

When the purchasing construction contractor (whether he or she is the prime contractor or the subcontractor) buys the item that he or she will convert into real estate in finished form, the tax base is what such construction contractor pays for the item. When the construction contractor-installer (whether he or she is the prime contractor or a subcontractor) is also the manufacturer of the finished item that he or she will incorporate into real estate for his or her customer, the tax base is what such construction contractor pays for the materials that he or she incorporates into such finished item, plus whatever such construction contractor may pay for nails, screws or other items of tangible personal property that he or she buys and incorporates into real estate for his or her customer in the course of making the installation of the finished item. See 86 Ill. Adm. Code 130.2075(a)(2).

The Illinois Use Tax rate incurred by a construction contractor on purchases of materials from an unregistered supplier located outside of this State is generally 6.25% as described in subsection (c) of Section 130.2075. It is important to note that since construction contractors are the end users of the materials that they permanently affix to real estate, their customers incur no Use Tax liability and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to "reimburse" the construction contractor for his or her tax liability. Please note that construction contractors cannot bill this reimbursement to a customer as "sales tax," but can include a reimbursement of tax on the bill. The choice of whether a construction contractor requires a tax

reimbursement from the customer or merely raises his or her price is a business decision on the construction contractor's part.

CONSTRUCTION CONTRACTORS WHO ALSO ACT AS RETAILERS

If, in addition to acting as a construction contractor, a person makes separate "over the counter" sales of his or her product, then a different set of rules would apply. If that is the case, please see 86 Ill. Adm. Code 130.2075(b). If the sales are made in Illinois, please see as ST 15-0001-GIL and 86 Ill. Adm. 270.115 regarding how to source local retailers' occupation taxes for sales made in Illinois.

ILLINOIS RETAILERS AND OUT-OF-STATE RETAILERS WITH NEXUS

If a person is not acting as a construction contractor, but is, instead, strictly selling tangible personal property at retail, then, if the sale occurs in Illinois, that person is subject to Retailers' Occupation Tax and the sale is sourced to the appropriate Illinois location based on the sourcing rules cited above, which may be found, for example, at 86 Ill. Adm. Code 270.115. If, however the retail sale occurs outside Illinois, then, if the retailer has nexus with Illinois, the retailer is required to collect Use Tax on behalf of the purchaser and remit it to Illinois. For a discussion of nexus as it relates to whether an out-of-state retailer is required to collect Illinois Use Tax from his or her Illinois customer, please see ST 19-0005-GIL.

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,

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Associate Counsel

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