

Equipment and materials purchased by a contractor in order to fulfill its contract with a unit of government are subject to Illinois Use Tax even if ownership of the equipment is ultimately transferred to the government. (This is a GIL.)

December 9, 2020

NAME
ADDRESS

Dear Xxxx:

This letter is in response to your letter dated April 23, 2019, in which you requested 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 pertinent 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:

This letter represents a request for a revenue ruling by the Illinois Department of Revenue (“Department”) under 2 Ill. Admin. Code § 1200.110 concerning the application of the Illinois Retailers’ Occupation Tax to the purchases of materials, supplies and equipment by a federal contractor for use in fulfillment of contracts with the United States government and its agencies for tax years 2018 and 2019.

Thus, on behalf of our client, who wishes to remain anonymous, a ruling of the Department is hereby requested. The facts and representations concerning Sales and Use Taxes imposed on our client by the State of Illinois are provided herein. A ruling that our client is exempt from Use Tax imposed by 35 ILCS § 105/3, Service Use Tax imposed by 35 ILCS § 110/3, Service Occupation Tax imposed by 35 ILCS § 115/3 and Retailers’ Occupation Tax imposed by 35 ILS § 120/2 (hereinafter collectively referred to as “Sales and Use Tax”) on the sale, storage, use, or other consumption of property used to fulfill contracts exclusively with the federal government is hereby requested. To the best of our client’s and our knowledge the Department has not previously ruled on the same or a similar issue for the client or a predecessor.

QUESTION

Is the Company, which serves exclusively as a federal construction contractor, subject to Illinois Sales and Use Tax on its purchases of materials, supplies, and equipment for use in fulfillment of its federal construction contracts?

FACTS

Our client, referred to herein as the Company, is a STATE limited liability company. The Company offers design-build and design-bid-build general contracting and construction management services to various agencies of the federal government.

Because of the Company's eligibility to participate in special federal programs, the Company provides construction services *exclusively* to the United States federal government. Program contracts include Multiple Award Task Order Contracts and Indefinite Delivery Indefinite Quantity contracts. Many of its projects are awarded following submission of Request for Proposal responses. Many of the Company's projects involve the FEDERAL AGENCY and are fixed-firm price contracts. While the Company provides services in states other than Illinois, the Company estimates approximately twenty-six percent (26%) of the Company's federal contracts during 2019, by revenue, will involve government properties located within Illinois. The remainder of the Company's federal contracts are in states surrounding STATE.

The federal government maintains extensive control over the Company during the execution and fulfillment of the contracts. With respect to contracts with the FEDERAL AGENCY, all work is performed under the direction of the Contracting Officer. Regular conferences are often required between the parties. At any time, however, the government's Contracting Officer can make changes in the work within the general scope of the contract. Furthermore, in some cases these adjustments can be made without any equitable adjustments benefiting the Company. The government must also order and approve contract changes, and may be involved in conflict resolution involving the Company. While the Company is encouraged to develop cost savings plans, any such plans must ultimately be approved by the government.

The Company is also subject to many reporting requirements. For example, payroll must be reported to the federal government on a weekly basis. The Company must also submit executive compensation information to the government. When the Company's contract is with the FEDERAL AGENCY, daily reporting on the Company's activities is often required.

The federal government also dictates employee relations and wages within the Company. All Company employees and employees of any subcontractors classified as tradesmen or craftsmen must be paid predetermined amounts based upon tasks performed, rather than merely complying with federal minimum wage and overtime requirements. Special hotline flyers must also be displayed and made available for employees. Many wage requirements and other employee related provisions must be incorporated into the contracts of any subcontractors hired by the Company as well.

Certain activities of the Company are also limited or subject to government control. For example, the government places limits on what the Company may do with respect to

existing vegetation, structures, equipment, utilities and improvements at a job site. The contract dictates when work must begin under the contract and when it must cease, both in terms of a commencement and completion date and a daily work schedule, which must be coordinated with federal facility management. The government must approve the work schedule and can require the Company to increase the number of shifts, overtime operations, days of work, and/or the amount of construction plant.

Under the standard agreement with the federal government, the government maintains the right to take possession of or use any completed or partially completed part of the work, including materials and supplies. The Company receives incremental payments throughout its work on the project based on the work completed on a monthly basis. The Company does not purchase and improve property only to sell it in an arms' length transaction with the United States. Rather, work is undertaken at an existing government facility, often actively operating. For this reason, the Company and its workers must obtain security clearances and participate in related training.

For purposes of these federal contracts, "work" specifically includes the ordering of job specific materials and supplies, which are often shipped directly to the federal facility. In addition, when supplies are provided under the contract, it is the government who inspects and accepts the supplies. In the case of FEDERAL AGENCY contracts, the materials and supplies are inspected by FEDERAL AGENCY resident engineers.

It is also contemplated that pursuant to FAR 52.299-3, the federal government is responsible for all federal, state, and local taxes, which is incorporated by reference into the contracts. Further, the contracts provide that the government will provide evidence to establish exemption from any federal, state or local tax imposed on the transactions or property covered by the contract.

Specific to Illinois, the FEDERAL AGENCY awarded the Company with Illinois construction projects on three of its project bids. The Company received an award from the FEDERAL AGENCY for a construction project for the FEDERAL AGENCY HOSPITAL, attached as **Attachment A.** This Contract provides that purchases of materials to be incorporated into the FEDERAL AGENCY property may be exempt from Illinois Sales and Use Tax and that, "the FEDERAL AGENCY will furnish a Certificate to the successful awardee under this solicitation that contains appropriate information that will allow the awardee to take advantage of this tax exemption within the State of Illinois for the project identified in this solicitation."¹

The Company also received an award from the FEDERAL AGENCY for work at the CITY FEDERAL AGENCY Medical Center, attached as **Attachment B.** This Contract provides that, "[c]ontractors working on this project are exempt from state sales tax, and a project exemption certificate will be issued upon award of this contract."²

Lastly, the Company also received another award from the FEDERAL AGENCY for additional work at the CITY FEDERAL AGENCY Medical Center, attached as **Attachment C.** This Contract also provides that, "[c]ontractors working on this project

¹ Danville Contract at pg.5

² Marion Contract at pg. 1

are exempt from state sales tax, and a project exemption certificate will be issued upon award of this contract.”³

As an example, the Company has received a project exemption, See attached as **Attachment D.** The FEDERAL AGENCY also provided the Company with a letter providing the renewal of the FEDERAL AGENCY’s tax exemption identification number, E9985-8754-07, attached as **Attachment E.**

AUTHORITIES

1. United States Constitution

Article VI, Clause 2 of the United States Constitution, known as the Supremacy Clause, provides: “[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof, and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.” This clause has been interpreted as granting the federal government immunity from state and local taxes.

2. Federal Regulations

A federal regulation incorporated by reference into many of the Company’s contracts directs the government to provide evidence to support an exemption from state and local taxes to the contractor. 48 C.F.R. § 52.229-3(h) (“The Government shall, without liability, furnish evidence appropriate to establish exemption from any Federal, State, or local tax when the Contractor requests such evidence and a reasonable basis exists to sustain the exemption.”)

Federal regulations specific to contracts with the FEDERAL AGENCY dictate state and local taxes on purchases to the government. In particular, a regulation provides that “[i]f a vendor refuses to sell at a price exclusive of the State and local tax, the contracting officer must use Standard Form (SF) 1094, US. Tax Exemption Certificate, as a basis for billing taxing authorities for a refund of taxes paid.” 48 C.F.R. § 829.302.

3. Illinois Statutes

Illinois imposes Sales and Use Taxes, as applicable, on tangible personal property sold or used in the state. However, Illinois statutes also provide a exemption from Sales and Use Tax for sales or use by federal government. Specifically, statutes provide an exemption for the sale or use of “[t]angible personal property transferred to a purchaser who is exempt from the tax imposed by this Act by operation of federal law.” 35 ILCS § 105/3-5(3). Based on the federal authorities discussed above, this exempts the federal government from Illinois Sales and Use Tax. Further, 35 ILCS § 120/2-5(11) specifically provides an exemption from Illinois Retailers’ Occupation Tax for the sale of “[p]ersonal property sold to a governmental body ... [i]f it has an active identification number issued by the Department.”

³ Ward 2A Contract at pg. 1

4. Regulations of the Department of Revenue

Illinois regulations provide an exemption from Sales and Use Tax for sales or use by the federal government. Specifically, regulations provide an exemption for sales “that are made to any governmental body ...” 86 Ill. Admin. Code § 130.120(i). Additionally, to be exempt, “sales of tangible personal property made to a governmental body (federal, State, local or foreign) are exempt from the Retailers’ Occupation Tax only if the governmental body has an active exemption identification number (“E-number”) issued by the Department and it provides this active E-number to the retailer, who records that number instead of collecting the tax.” 86 Ill. Admin. Code § 130.2080(a).

Illinois regulations also provide an exemption from Retailers’ Occupation Tax for a government contractor who purchases items for sale to a governmental unit. Specifically, the regulations provide that “if the contract with governmental unit explicitly requires the contractor to sell those items to the governmental unit, the purchase of those items by the contractor can be structured as purchases for the purpose of resale to the governmental unit.” 86 Ill. Admin. Code § 130.2076(a). To qualify for this exemption, the contract between the purchaser and the governmental body must require the purchaser to provide tangible personal property to the governmental body and specify that the tangible personal property is transferred to the governmental body. For example, a statement that title to all of the tangible personal property that is purchased shall pass to the governmental body is sufficient to meet this requirement. 86 Ill. Admin. Code § 130.2076(a)(1)-(2). The exemption also applies to tangible personal property that is used or consumed in the performance of a contract with a governmental body and to which title passes to the governmental body under the terms of the contract. 86 Ill. Admin. Code § 130.2076(b)

For real estate developers and builders, such as the Company, 86 Ill. Admin. Code § 130.2075(d)(1) provides that “[s]ales of materials to construction contractors ... for incorporation into real estate owned by governmental bodies, are exempt from Retailers’ Occupation Tax and Use Tax.” 86 Ill. Admin. Code 130.2075(d)(4) requires suppliers of the materials to retain a “certification from the purchasing contractor stating that his purchases are for conversion into real estate under a contract with a ... governmental body, identifying the ... governmental body that is involved by name and address and stating on what date his contract was entered into.” The regulation also requires suppliers to retain “the active exemption number issued by the Department to the organization for which the purchasing contractor is acting.” As such, if the contractor provides the proper documentation, the purchase of materials for incorporation into real estate owned by governmental bodies will be exempt.

5. United States Supreme Court Cases

It is a well-settled principle under United States Supreme Court jurisprudence that “a State may not, consistent with the Supremacy Clause, U.S. Const., Art. VI, cl. 2, lay a tax ‘directly upon the United States.’”(sic) U.S. v. New Mexico, 455 U.S. 720, 733 (1982). See *also*, U.S. v. Metro. Gov’t of Nashville & Davidson County, 808 F.2d 1205, 1208 (6th Cir. 1987) (“Taxation of United States property by states or their political

subdivisions violates the Supremacy Clause of the United States Constitution. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 4 L.Ed. 579 (1819)").

6. Illinois Court Cases

Illinois courts have upheld the exemption from Illinois Retailers' Occupation Tax provided in 86 Ill. Admin. Code § 130.2075 in circumstances where proper documentation was provided. Hess, Inc. v. Department of Revenue, 278 Ill. App. 3d 483, 484 (1996), discussed whether a retailer can rely upon the tax exemption certificate provided by a purchaser. In Hess, the court ultimately held that the receipt from a buyer of exemption certificates for materials purchased for incorporation into church, charity, school, or governmental body project entitles seller to exemption from Illinois Retailers' Occupation Tax on those materials. The court further held that while the regulation that requires sellers seeking an exemption to collect exemption certificate from the buyer does not explicitly provide that possession of certificate constitutes prima facie proof of exemption, this does not require seller to determine whether each item purchased goes to a project that warrants a Retailers' Occupation Tax exemption.

Based on Hess, if proper exemption documentation for materials purchased for incorporation into a governmental body project is provided to a supplier, the sale qualifies for an exemption from Illinois Retailers' Occupation Tax.

In addition to the sale of materials incorporated into the real estate of governmental bodies, agents of governmental bodies are also entitled to the exemption from Illinois Retailers' Occupation Tax for the sale of "[p]ersonal property sold to a governmental body ... [if] it has an active identification number issued by the Department" provided by 35 ILCS § 120/2-5(11). In Southern Illinois University Foundation v. Baker, 98 Ill.App.3d 1062 (1981), a not-for-profit corporation held title to certain real property that was used to provide family housing for married students attending Southern Illinois University-Carbondale. The contract between the corporation and the University provided that the corporation was to "act as the business agent of the said Board."⁴ While property belonging to the state of Illinois is exempt from property tax, the corporation was assessed property tax because it was not a state entity. The court ultimately determined the corporation was plainly controlled by the University and therefore should be exempt from property tax. As such, a governmental agent should receive the same tax-exempt status of its principal.

Sales and Use Tax cases provide a similar principle. In Weber-Stephen Prod., Inc. v. Department of Revenue, 324 Ill. App. 3d 893 (2001), the court determined whether a party was properly treated as the seller/purchaser or merely an agent of the ultimate seller/purchaser. The court looked at what party claimed title to the property, what party was liable for any title issues, what party possessed the property, the control over the purchase price, whether any profit could be earned from a subsequent sale, and the responsible party for any closing costs. Id. The agency relationship for Sales and Use Tax was also analyzed in Jl Aviation, Inc. v. Department of Revenue, 335 Ill.App.3d 905 (2002), which used the same analysis to determine that an intermediary airplane dealer was not the purchaser or seller of a plane but acting as the seller's agent. Based on the

⁴ Southern Illinois University Foundation v. Booker, 98 Ill. App. 3d 1062, 1064 (1981)

decision the ultimate purchase was exempt from Sales and Use Tax under the occasional sale exemption. Id.

As provided in Illinois case law, if an agency relationship exists between the intermediary buyer/seller and ultimate purchaser, Illinois will disregard the intermediary agent in the determination of whether the transaction qualifies for an exemption. Under Illinois law, “[a] hallmark of the principal/agent relationship is the principal’s right to control the conduct of the agent.”⁵ Therefore the amount of control the principal has over the actions of the agent and the control over the property subject to Sales and Use Tax will determine if any agency relationship exists. If an agency relationship is created, the acts of the agent on behalf of and under the authority of the principal will bind the principal to those actions.⁶ Therefore, the obligation to pay Sales and Use Tax would be imposed on a principal if the agent incurs such liability.

ANALYSIS OF FACTS AND LAW

It is the Company’s position that Illinois Sales and Use Tax would not apply to tangible personal property sold, stored, used or otherwise consumed by the Company in fulfillment of its contracts with the federal government. The Company seeks confirmation of its position.

86 Ill. Admin. Code 130.2075(d)(1) provides an exemption from Illinois Retailers’ Occupation Tax for purchases of materials for conversion into real estate under a contract with a governmental body. Thus, if a contractor under contract with a governmental body purchases building material to incorporate into real estate of the governmental body, the sale is exempt provided an active exemption number and project information is presented to the supplier.

The Company is under contract with a federal governmental body, the FEDERAL AGENCY, and the contracts require the Company to incorporate building materials into the FEDERAL AGENCY property to construct new buildings or rehabilitate current structures owned by the FEDERAL AGENCY. As such the purchases of materials and supplies needed in order to fulfill construction obligations under the FEDERAL AGENCY contracts qualify as materials that may be exempt under 86 Ill. Admin. Code § 130.2075(d)(1). Further, as the Company has received the FEDERAL AGENCY’s exemption certificate and will provide the exemption certificate along with the project details to any supplier. Therefore, the Company has met the requirements to be exempt under 86 Ill. Admin. Code § 130.2075(d)(1).

Further, since McCulloch v. Maryland was decided in 1819, the law has been clear that state and local taxes may not be imposed against the federal government. See 35 ILCS § 120/2-5(11). The law is equally clear that the acts of an agent are binding upon the principal within the scope of the agent’s actual or implied authority. See Schoenberger v. Chicago Transit Authority, 84 Ill.App.3d 1132 (1980). Thus, if an agent of the federal government engages in a transaction on behalf of the federal government, within the

⁵ Wisconsin Cent. Ltd. V. TiEnergy, LLC, 894 F.3d 851, 858 (7th Cir. 2018), cert. denied, 139 S. Ct. 918, 202 L. Ed. 2d 645 (2019) citing

⁶ See Schoenberger v. Chicago Transit Authority, 84 Ill.App.3d 1132 (1980)

scope of the agent's authority the imposition of any Sales and Use Taxes on the transaction are treated as being imposed upon the federal government itself. The Company is the agent of the federal government with respect to purchases of materials and supplies needed in order to fulfill construction obligations under the federal contracts. Thus, any Sales and Use Taxes imposed on the Company in this manner are treated as having been imposed on the federal government, in violation of the United States Constitution.

As Illinois case law has noted, the extent of the control exercised by the principal over the agent is an important factor in the establishment of an agency relationship. As documented herein, the federal government exercises extensive control over the Company. Without the federal government, the Company would not be in business.

Work by the Company is performed under the direction of the Contracting Officer, a federal official. Regular conferences are mandated between the parties, and the government may and often does make changes to the work requested and property used. When the Company's contract is with the FEDERAL AGENCY, daily reporting on the Company's activities is required. While efficiency and innovation are encouraged, all cost savings plans developed by the Company must be approved by the government. The government dictates not only the reporting of payroll, but also the amount of pay a Company employee is entitled to receive, as well as subcontractors used by the Company. The government further controls the Company's activities with respect to interactions with existing government property, and dictates when work must begin under the contract and when it must cease, both in terms of a commencement and completion date and a daily work schedule, which must be coordinated with federal facility management. The government must approve the work schedule and can require the Company to increase the Contracts also require the work to be performed in accordance with federal laws. As the Company only does business with the federal government, the federal government is the only entity exercising control over the Company's work.

Other factors also point to an agency relationship. While the Company performs work for various federal agencies, it is exclusively a federal contractor. This suggests the Company's position is more that of an agent or servant than an independent contractor. Likewise, while construction is a specialized business, the government has chosen to retain supervision of the Company in the performance of the work, and requires supervisors to hold a thirty-hour OSHA card. It is the government who approves material submittals, monthly pay applications, and the supervisors by reviewing resumes/qualifications. When the contract is with the FEDERAL AGENCY, FEDERAL AGENCY engineers are involved in the project. While the Company does furnish certain equipment used on government property and is paid by the job, the work itself is performed exclusively on the property of the federal government.

The Company's contracts with the federal government range in length depending on the project, although many last a year or longer. Furthermore, the Company is typically performing work for the federal government on any given work day throughout the year. While the federal government is not itself in the business of running a construction company, it is in the business of providing adequate and updated facilities for its own use and dictating terms in all material manners.

All of these factors point to the creation of an agency relationship between the parties. Furthermore, the federal government appears to believe the agency relationship is sufficiently strong that federal regulations direct the provision of federal exemption certificates to avoid state and local taxation.

The Company is a unique organization that performs services for the federal government only. Utilizing common law agency principles, the Company is the agent of the federal government, and thus Sales and Use Taxes imposed on materials and supplies purchased on behalf of the federal government are in fact imposed on the federal government itself. These purchases would thus be exempt from taxation under 35 ILCS § 120/2-5(11) and 35 ILCS § 105/3-5(3). We were unable to locate any authorities contrary to this position.

RULING SOUGHT

Whether the Company is subject to Sales and Use Tax on the purchase, storage, use or consumption of tangible personal property to fulfill contracts exclusively with the federal government. If the Company is exempt, we accordingly request a ruling confirming same and if applicable, an Illinois Retailers' Occupation Tax Exemption Certificate issued to the Company.

DEPARTMENT'S RESPONSE:

Generally, a government contractor who purchases items to fulfill his obligations under a contract with a governmental unit purchases those items for use and is subject to Illinois Use Tax. See, United States v. New Mexico, 102 S.Ct. 1373 (1982). However, if the contract with the governmental unit is specific to the items the contractor will sell to the governmental unit, the purchase of those items by the contractor can be structured as purchases for the purpose of resale to the governmental unit. 86 Ill. Adm. Code 2076, Sales to Purchasers Performing Contracts with Governmental Bodies. The active tax exemption number referenced in your letter is the applicable exemption number to be used in documenting exempt sales to the federal government.

Please note that if a government contractor qualifies as a construction contractor (see 86 Ill. Adm. Code 130.1940), the construction contractor may purchase certain materials without incurring tax if the materials are for incorporation into real estate owned by a governmental body. To document the exemption from tax, the construction contractor must provide its suppliers with a certification stating that its purchases are for conversion into real estate under a contract with a governmental body and include the active exemption number issued by the Department to the governmental body. See subsection (d)(4) of Section 130.2075. Please also note that purchases by a construction contractor of tools, fuels, lumber for forms and other end use or consumption items are taxable sales no matter who the contractor's customer may be. See subsection (d)(3) of Section 130.2075.

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,

Debra M. Boggess

Associate Counsel

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