

Out-of-State servicemen making sales of service to Illinois purchasers from locations outside Illinois may be required to register with the Department and collect and remit Service Use Tax on those sales. See 86 Ill. Adm. Code 160.115; 35 ILCS 110/2. (This is a GIL.)

March 22, 2024

COMPANY
NAME
ADDRESS

Dear XXXX:

This letter is in response to your email dated February 26, 2024, 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 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:

Hope you both are doing well! We wanted to circle back to the discussion we had last MONTH regarding the Illinois tax implications for mail order pharmacies. One of our clients (referred to as Client A in our original email dated DATE) is now in the process of registering its new mail order pharmacy to collect Illinois tax and is preparing to file its initial periods of returns; however, they have some concerns around how to appropriately register the entity and how to appropriately report the pharmacy’s sales to Illinois customers. Unfortunately, when our client contacted the Department directly for clarification (Central Registration and REV.TA-Sales@illinois.gov), they received some guidance that conflicts with the guidance you had provided us over the phone in MONTH so we are hoping you can quickly help clear up any confusion and ensure our client is prepared to comply with its Illinois tax obligations.

Below is a summary of our client’s facts and the key topics and questions at issue. We are also attaching again our understanding of the relevant authority on these topics. Please let us know if you have any clarifying questions or if it would be helpful to schedule a call to talk through these questions. Otherwise, a quick confirmation in writing of each item would be greatly appreciated.

Thank you,
NAME

Facts

- Client A is a health insurance provider and pharmacy benefit manager (PBM) who is standing up a mail order pharmacy of its own (referred to here as Pharmacy A). Client A has engaged us to help them understand the multistate indirect tax obligations of the mail order pharmacy and to prepare their systems to collect the proper amount of tax, where applicable.
- Pharmacy A only makes sales of prescription drugs. It does not make any retail sales of tangible personal property (e.g., over-the-counter medicines).
- Although Pharmacy A is the dispensing pharmacy of record on the prescription drug transactions, Pharmacy A engages a third-party fulfillment partner who is responsible for maintaining the drug inventory and shipping the prescription drugs to Pharmacy A's customer at Pharmacy A's direction. The third-party fulfillment partner retains ownership of the drug inventory at all times. At no point does Pharmacy A own the drug inventory located at the third-party fulfillment partner's locations.
- Pharmacy A is headquartered outside of Illinois and does not have any business locations or employees located in Illinois. However, Pharmacy A's third-party fulfillment partner operates a fulfillment location inside the state of Illinois from which the third-party fulfillment partner will fulfill prescription drug orders on behalf of Pharmacy A. It is assumed that most of Pharmacy A's prescription drug sales to Illinois customers will be fulfilled from of [sic] the third-party fulfillment partner's Illinois fulfillment location; however, it is possible that an Illinois customer's order could be fulfilled from one of the third-party fulfillment partner's locations outside of Illinois.

Registration Questions

- Given that pharmacists who sell drugs on the prescription of a licensed physician are viewed as serviceman and their sale of prescription drugs is governed by the Service Occupation Tax (SOT) Act, and given that Pharmacy A only makes sales of prescription drugs and does not make any retail sales of tangible personal property, it's our understanding that Pharmacy A should not be registered as an "out-of-state remote retailer." Please confirm.
- Does the third-party fulfillment partner's location in Illinois create a physical presence for Pharmacy A? If so, how should REG-1 be completed to properly reflect that relationship and the third-party fulfillment partner's physical location?

Tax Rate Questions

- Below are the tax rate questions we had previously posed. Based on our discussion on DATE, you confirmed our understanding on all five (5) of these items. Please confirm that each of these statements remain accurate.
 - It is our understanding that when a mail order pharmacy ships prescription drugs from a location outside of Illinois to a customer's Illinois address, the prescription drugs would only be subject to the 1.0% state rate. Please confirm.
 - It is our understanding that this is true regardless of whether the out-of-state mail order pharmacy has established physical presence nexus or

economic nexus (i.e., the “destination” sourcing rules of the Leveling the Playing Field Act do not apply to serviceman subject to SOT). Please confirm.

- It is our understanding that when a mail order pharmacy ships prescription drugs from a location inside Illinois to a customer’s Illinois address, the RTA SOT or MED SOT (0.25%-1.25%) may apply in addition to the 1.0% state rate based if [sic] the location from which the prescription drugs are shipped to the customer is located in the RTA region or MED district. Please confirm.
 - It is our understanding that this is true regardless of whether the prescription drug inventory located in Illinois is owned directly by the mail order pharmacy or owned by a third-party fulfillment partner shipping the prescription drugs to the Illinois customer on behalf of the dispensing mail order pharmacy. Please confirm.
- It is our understanding that if the location from which the sale is fulfilled is within Illinois but is not located in the RTA region or MED district, the prescription drugs would only be subject to the 1.0% state rate, even if the ship-to address of the customer is located in the RTA region or MED district (i.e., it is the location of the serviceman’s inventory that determines whether the RTA SOT or MED SOT apply to the transaction, not the location at which the customer receives the prescription drugs). Please confirm.

Reporting Questions

- Assuming you confirm that the above understanding of the applicable tax rates remains accurate, please confirm logistically how Pharmacy A would report the sales fulfilled from the third-party fulfillment partner’s location inside Illinois. Based on our experience filing returns within MyTax, it seems Pharmacy A would need to list the third-party fulfillment partner’s Illinois location as a “permanent site.” Please confirm.

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 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.

Retailers’ Occupation Tax and Use Tax do not apply to sales of service. The Service Occupation Tax Act (SOT) imposes a tax upon persons engaged in this State in the business of making sales of service, based on tangible personal property transferred incident to sales of service. Under the SOT, businesses providing services (i.e., servicemen) are taxed on tangible

personal property transferred as an incident to sales of a service. See 86 Ill. Adm. Code 140.101. For Illinois servicemen, the transfer of tangible personal property to service customers may result in either Service Occupation Tax liability (which includes local service occupation taxes) or Use Tax liability for servicemen, depending upon which tax base they use to calculate their liability. Servicemen who make retail sales that are sourced in Illinois, even if those sales are a small part of their business, are required to register with the Department and remit Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.701.

The Service Use Tax is a privilege tax imposed on the privilege of using, in this State, tangible personal property that is received anywhere as an incident to a purchase of service from a serviceman. However, if the serviceman would not be taxable under the SOT despite all elements of the sale of service occurring in Illinois, then the tax imposed by the Service Use Tax Act (SUT) does not apply to the use of such property in this State. Any evidence that property was sold by any person for delivery to a person residing in or engaged in business in this State shall be prima facie evidence that such property was sold for use in this State.

The SOT and the SUT impose tax at the rate of 1% on food for human consumption that is to be consumed off the premises where it is sold (other than alcoholic beverages, food consisting of or infused with adult use cannabis, soft drinks, candy, and food that has been prepared for immediate consumption) and prescription and nonprescription medicines, drugs, medical appliances and insulin, urine testing materials, syringes and needles used by diabetics, for human use transferred incident to a sale of service. See 86 Ill. Adm. Code 140.101 and 160.101. For general merchandise, the rate of the Service Occupation Tax and Service Use Tax is 6.25% of the serviceman's selling price of the tangible personal property transferred by the serviceman as an incident to a sale of service. 86 Ill. Adm. Code 140.101 and 160.101.

Calculation of Tax Incurred by Servicemen and Cost Ratio

Service Occupation Tax

Servicemen may calculate their tax liability in one of four ways: (1) Service Occupation Tax on the separately-stated selling price of tangible personal property transferred as part of the service; (2) Service Occupation Tax on 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. See 86 Ill. Adm. Code 140.105; 86 Ill. Adm. Code 140.106. For purposes of this letter, servicemen who meet either criteria (1) or (2) are referred to as "de maximis" servicemen.

Using the first method, de maximis 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. See 86 Ill. Adm. Code 140.106(a). Servicemen who incur Service Occupation Tax on their selling price should provide Certificates of Resale to their suppliers when purchasing tangible personal property that will be transferred to service customers and are required

to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106(b) and (e).

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 must calculate their cost ratio to determine whether they are de minimis. The cost ratio is a measure of the amount of tangible personal property transferred incident to a sale of service. It is calculated by comparing the serviceman's materials cost to his total income from services. The cost of materials that are not transferred to customers incident to a service, such as those sold at retail, removed from inventory for use, or incorporated into repairs of real estate, must be excluded when determining the cost ratio. See 86 Ill. Adm. Code 140.105(c). 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 140.109. If the serviceman's cost ratio is equal to or exceeds 35% (75% in the case of pharmacists and persons engaged in graphic arts production), the serviceman is considered a "de maximis" serviceman.

Registered de minimis servicemen are authorized to pay Service Occupation Tax based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax based upon their cost price collect the Service Use Tax from their customers. They remit tax to the Department by filing returns and do not pay tax to their suppliers. They provide suppliers with Certificates of Resale for the tangible personal property transferred to service customers. See 86 Ill. Adm. Code 140.109(a)(1) and (a)(4).

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act (referred to as "unregistered de minimis servicemen"). Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess, and remit Use Tax to the Department. The servicemen are considered the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See 86 Ill. Adm. Code 140.108.

Service Use Tax Act

Servicemen who incur and remit Service Occupation Tax to the Department as well as servicemen who come within the definition of a "Serviceman maintaining a place of business in this State" (as set out in 86 Ill. Adm. Code 160.105 and in Section 2 of the Service Use Tax Act) and who, therefore, have a Service Use Tax collection obligation, shall collect Service Use Tax from users at the time of purchase. The Service Use Tax shall be based on the selling price of the tangible personal property transferred incident to the sale of service if stated separately on the invoice from the serviceman. If not stated separately, then the tax will be imposed on 50% of the entire billing from the serviceman. However, the Service Use Tax which is collected by a registered de minimis serviceman shall be based upon the serviceman's cost price of tangible personal property transferred incident to the serviceman's sales of service. 86 Ill. Adm. Code 160.115.

Out-of-State Sales of Service

Out-of-State servicemen making sales of service to Illinois purchasers from locations outside Illinois may be required to register with the Department and collect and remit Service Use Tax on those sales. If the serviceman meets the definition of a “serviceman maintaining a place of business in this State” in Section 2 of the SUT, 35 ILCS 110/2, and either (1) his or her cost ratio is equal to or greater than 35% (75% in the case of servicemen transferring prescription drugs or engaged in graphic arts production), or (2) he or she is required or elects to register under Section 2a of the Retailers’ Occupation Tax Act, the serviceman must register with the Department to collect and remit Service Use Tax on sales of service to Illinois purchasers from locations outside of Illinois. The Department is authorized to require these servicemen to act as tax collectors because they have established sufficient contacts, or nexus, with Illinois. For de maximis servicemen, this Service Use Tax would be based on the selling price of the tangible personal property transferred incident to the sale of service if stated separately on the invoice from the serviceman. If not stated separately, then the tax will be imposed on 50% of the entire billing from the serviceman. For registered de minimis servicemen, the Service Use Tax will be imposed on the serviceman’s cost price of the tangible personal property transferred.

Out-of-State servicemen who also make retail sales to Illinois customers that are sourced outside of Illinois, even if those sales are a small part of their business, are required to register with the Department and remit, with respect to those transactions, either Use Tax, if they meet the definition of “retailer maintaining a place of business in this State”, or Retailers’ Occupation Tax, if they do not have a physical presence in Illinois and meet a tax remittance threshold in 35 ILCS 120/2(b). Out-of-State servicemen who also make retail sales to Illinois customers that are sourced inside of Illinois must register under Section 2a of the Retailers’ Occupation Tax Act. Any out-of-State serviceman maintaining a place of business in this State who is required or has elected to register under Section 2a of the Retailers’ Occupation Tax Act must register with the Department to collect and remit Service Use Tax on all of their sales of service to Illinois customers. If such serviceman is a de minimis serviceman, the Service Use Tax for such serviceman is based upon the serviceman’s cost price of tangible personal property transferred incident to the serviceman’s sales of service. 86 Ill. Adm. Code 160.115.

Finally, out-of-State servicemen who do not meet the definition of “serviceman maintaining a place of business in this State” and whose cost ratio is less than 35% (less than 75% in the case of servicemen transferring prescription drugs or engaged in graphic arts production) are not required to register with the Department to collect and remit Service Use Tax on their sales of service to Illinois consumers. Such serviceman would owe use tax on their cost price of the tangible personal property that they transfer in Illinois incident to sales of service (note, however, such a serviceman who places prescription pharmaceuticals in the U.S. mail outside of Illinois and loses the right of recall of such pharmaceuticals outside Illinois is not using the pharmaceuticals in Illinois and would not owe Illinois Use Tax on the pharmaceuticals).

Where tangible personal property is located in this State at the time of its transfer (or is subsequently produced in Illinois) as an incident to a sale of service, and is then delivered in Illinois, the de maximis out-of-State serviceman incurs Service Occupation Tax liability on the selling price of the property. 86 Ill. Adm. Code 140.501(a). A registered de minimis out-of-State serviceman would incur SOT on the cost price of the property.

Economic Nexus

In *South Dakota v. Wayfair, Inc.*, 583 U.S. 1089 (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.” See *Quill Corporation v. North Dakota*, 504 U.S. 298 (1992). Illinois Public Act 100-587 enacted nexus standards, effective October 1, 2018, that are virtually identical to those upheld in *Wayfair*. For the purposes of this letter, this non-physical presence nexus is referred to as “economic nexus”.

Effective October 1, 2018, an out-of-State serviceman making sales of service to Illinois purchasers with gross receipts totaling \$100,000 or more or making 200 or more separate sales of service transactions meets the definition of “serviceman maintaining a place of business in this State”. Out-of-State servicemen must determine on a quarterly basis whether they meet either of the tax remittance thresholds for the preceding 12-month period. If a threshold is met, the serviceman will be required to register and collect and remit Service Use Tax from their Illinois customers for one year. At the end of that one-year period, the serviceman may reassess on a yearly basis looking at the last four quarters. See 35 ILCS 110/2.

The principles provided in 86 Ill. Adm. Code 150.803 are applicable to out-of-State servicemen with no physical presence in Illinois who have met a tax remittance threshold. However, note that Section 150.803 also applies to periods after December 31, 2020, for the purposes of such servicemen. In determining whether an out-of-State serviceman meets the thresholds above, see 86 Ill. Adm. Code 150.803(e)(3). In addition, if an out-of-State serviceman makes exclusively nontaxable sales of service, that serviceman is not subject to the economic nexus requirements. See 86 Ill. Adm. Code 150.803(e)(2). If, however, the out-of-State serviceman makes both taxable and nontaxable sales of service into Illinois, all sales of service are included, including the nontaxable sales of service (other than sales for resale and other sales specified at 86 Ill. Adm. Code 150.803(e)(3)(E)). See 86 Ill. Adm. Code 150.803(e)(3).

Applicability of Leveling the Playing Field for Illinois Retail Act

Public Acts 101-0031 and 101-0604 enacted the Leveling the Playing Field for Illinois Retail Act. The Act implemented a series of structural changes to the Illinois sales tax law that are intended to “level the playing field” between Illinois-based retailers and remote retailers by imposing State and local retailers’ occupation taxes on Illinois retailers, remote retailers and marketplace facilitators alike. Public Acts 101-0031 and 101-0604 require “remote retailers” to collect and remit State and local retailers’ occupation taxes. Beginning January 1, 2021, a retailer must remit Retailers’ Occupation Tax if the retailer is a remote retailer and the retailer met a tax remittance threshold during the preceding four quarterly periods ending on the last day of March, June, September, and December. 35 ILCS 120/2(c).

A retailer is a “remote retailer” if the retailer does not maintain within this State, directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this State under the retailer’s authority or a subsidiary of the retailer, irrespective of whether such place of business or agent is located here permanently or temporarily or whether the retailer or the retailer’s subsidiary is licensed to do business in this State. 35 ILCS 120/1.

Public Acts 101-0031 and 101-0604 did not amend the Service Occupation Tax Act or the Service Use Tax Act. Local service occupation taxes are not imposed on servicemen maintaining a place of business in this State, including servicemen whose only nexus is triggered by meeting one of the tax remittance thresholds. Servicemen who come within the definition of "Serviceman maintaining a place of business in this State" as set out in 86 Ill. Adm. Code 160.105 and in Section 2 of the SUT remain obligated to collect and remit Service Use Tax for sales of service to Illinois customers sourced outside of the State. 86 Ill. Adm. Code 160.115(a).

Jurisdictional Issues – Service Occupation Taxes

If the Illinois Service Occupation Tax on a transaction is being remitted to the Department by the serviceman, the serviceman shall also pay any local service occupation tax to the Department on the same transaction if such serviceman engages in the business of making sales of service within a jurisdiction that has adopted a local service occupation tax. If a purchase order is accepted outside this State but the tangible personal property which is sold incident to the sale of service is in the inventory of a serviceman located in a jurisdiction that has imposed a local service occupation tax at the time of its sale (or is subsequently produced in that jurisdiction) then delivered in Illinois to the service customer, the place where the property is located at the time of the sale (or where the property is subsequently produced) will determine where the seller is engaged in business for local service occupation tax purposes with respect to such sale. See, for example, 86 Ill. Adm. Code 280.115.

For sales of service made by an out-of-State serviceman maintaining a place of business in this State but fulfilled by third-party fulfillment centers located in Illinois and then delivered in Illinois to the purchaser, the out-of-State serviceman must remit Service Occupation Tax and any applicable local service occupation taxes based on the Illinois location at which the tangible personal property was subsequently produced by the out-of-State serviceman through its agreement with the third-party fulfillment center. See generally ST 20-0009-PLR. As previously discussed, the Service Occupation Tax will be incurred either on the separately stated selling price of the tangible personal property transferred incident to the service; or, if the serviceman does not wish to separately state the selling price of the tangible personal property transferred, the serviceman incurs tax on 50% of the entire bill to its customers as the tax base; or, if the serviceman is a registered de minimis serviceman, on the serviceman's cost price of the tangible personal property transferred.

Registration and Returns

Servicemen maintaining a place of business in this State who make transfers of general merchandise; qualifying foods, drugs, and medical appliances; and/or prepaid wireless telecommunications service in Illinois must file Form ST-1, Sales and Use Tax and E911 Surcharge Return. If a serviceman has one business but sells items at more than one location (site), the serviceman must collect and remit service occupation taxes according to the rates of each particular location. Such serviceman must complete and attach Form ST-2, Multiple Site Form, to its Form ST-1 to show the breakdown of taxes collected and paid from each site. MyTax Illinois allows users to calculate their tax due for each location on Form ST-2, Multiple Site Form, and combine their liability on a single Form ST-1. Sales from locations within Illinois are reported on lines 4 and 5 while sales from locations outside of Illinois are reported on lines 6 and 7. See ST-1 Instructions, for reporting periods January 2024 and after.

COMPANY/NAME

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

Very truly yours,

Alexis K. Overstreet
Deputy General Counsel
Sales and Excise Tax Policy

AKO:slc