

ST 24-0028-GIL 09/10/2024 MANUFACTURING MACHINERY AND EQUIPMENT
EXEMPTION

Machinery or equipment used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease that is made apart from or as an incident to the sellers engaging in the service occupation of producing machines, tools, dyes, jigs, patterns, gauges, or other similar items of no commercial value on special order for a particular purchaser is exempt from Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.330(a). (This is a GIL.)

September 10, 2024

NAME
EMAIL

Dear NAME:

This letter is in response to your email dated August 14, 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 <https://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 small start up company which designs and manufactures electric aircraft engine prototypes under federal contracts with the Air Force, NASA, and the Department of Energy. We are in the process of purchasing equipment which will be used in the manufacture of these prototype engines. We aren't a resale company. We have no sales at this point, as our revenue is all contract revenue for the design and manufacture of prototypes for the federal government. My question is whether or not our purchases of equipment and/or supplies would be exempt from Illinois Sales and Use taxes. Up to this point, we have paid our vendors sales taxes on our purchases. The particular purchase for which we're wondering if it would be tax exempt is one for equipment/supplies which will be consumed in the manufacturing process. I'm wondering if we should complete an ST-587 Exemption Certificate (for Manufacturing) and check the box for "the

item will be used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease", but in actuality, the item will not be sold, but tested for the federal government, and retained by the federal government thereafter.

DEPARTMENT'S RESPONSE:

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. 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. 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 reduce the amount of Use Tax they must remit by the amount of Retailers' Occupation Tax liability which they are required to and do pay to the Department with respect to the same sales. See 86 Ill. Adm. Code 150.130.

Retailers' Occupation Tax and Use Tax do not apply to sales of service. See 35 ILCS 120/2; 35 ILCS 105/3. The issue of whether a person incurs a Retailers' Occupation Tax or Service Occupation Tax liability depends upon the nature of the items being produced and the nature of the design work involved. If the item being produced is substantially similar to stock or standard items, even though custom-made, the sale of that item would result in Retailers' Occupation Tax liability. The test for special order items that result in Service Occupation Tax liability is set forth in subsection (b) of the Department's rule "Sellers of Machinery, Tools and Special Order Items" at 86 Ill. Adm. Code 130.2115.

The seller of a special machine, tool, die, jig, pattern, gauge or other similar item is engaged primarily in a service occupation, rather than in the business of selling tangible personal property, and so does not incur Retailers' Occupation Tax liability with respect to the sale, if the following tests for exemption are all met in the transaction:

- A) the purchaser employs the seller primarily for his engineering or other scientific skill to design and produce the property on special order for the purchaser and to meet the particular needs of the purchaser;
- B) the property has use or value only for the specific purpose for which it is produced; and
- C) the property has use or value only to the purchaser. 86 Ill. Adm. Code 130.2115(b).

Please note that if a manufacturer constructs and sells 50 or more identical sets of a particular product in a single repeat order or simultaneous orders from a user (so-called multiple orders), those sales will be deemed to be volume production and will be subject to Retailers' Occupation Tax (rather than Service Occupation Tax) liability based on the total amount received by the manufacturer from such volume production orders. Also, even items that qualify for exemption from the Retailers' Occupation Tax, if sold subsequently without material change to the purchaser for use (so-called repeat orders), will become subject to the Retailers' Occupation Tax because the skill that is involved after the first item is made is production skill and not specialized engineering and design skill. See 86 Ill. Adm. Code 130.2115(a)(4). If a manufacturer also makes retail sales of tangible personal property, such as other non-manufactured products, that manufacturer will incur Retailers' Occupation Tax liability on those sales.

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 transfer of tangible personal property to service customers may result in either Service Occupation Tax liability or Use Tax liability for servicemen, depending upon which tax base they choose to calculate their liability.

Servicemen may calculate their tax base in one of four ways: (1) Service Occupation Tax on the separately stated selling price of tangible personal property transferred incident to 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 Sections 140.106; 140.108; and 140.109.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of sales of service. They are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of

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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). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit 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.

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. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). 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 to be 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. Although liability rests with a serviceman, the Department has determined that a de minimis serviceman incurring a Use Tax liability may claim exemptions predicated upon either the exempt status of his or her customer or upon exemptions claimed by his or her customer based on nontaxable uses of the tangible personal property transferred by the serviceman.

A customer's status as an exempt entity may "flow through" to an unregistered de minimis serviceman. The Department has determined that such a serviceman is relieved of his or her Use Tax liability when making sales of service to customers who have obtained exemption identification numbers ("E" numbers) from the Department. The customer must provide its "E" number to the de minimis serviceman in order to relieve the de minimis serviceman of Use Tax liability on the purchase of tangible personal property being transferred to that customer. In the situation where there are both taxable and exempt purchases, the serviceman will notify the supplier the percentage of purchases that are exempt. The serviceman utilizing this flow through may either present the customer's "E" number to his or her supplier in advance when making the purchase of tangible personal property that will be transferred to the customer or, if tax was paid to the supplier, present it to his or her supplier along with a request that the supplier submit a claim for credit to the Department. If the de minimis serviceman, however, has previously self-assessed the Use Tax on that item to the Department, then the de minimis serviceman may file a claim for credit.

The Retailers' Occupation Tax does not apply to sales of tangible personal property made to a governmental body (federal, State, local or foreign) if the

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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. Sales of tangible personal property must be invoiced directly to and paid by governmental bodies that possess active E-numbers for the exemption to apply. 86 Ill. Adm. Code 130.2080. The Service Occupation Tax also does not apply to the transfers of tangible personal property as an incident to sales of service to any governmental body made in accordance with the provisions of 86 Ill. Adm. Code 130.2080. 86 Ill. Adm. Code 140.125(h)(3). Also see 86 Ill. Adm. Code 130.2076, Sales to Purchasers Performing Contracts with Governmental Bodies.

Machinery and equipment that is used primarily in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease is exempt from Retailers’ Occupation Tax. See 86 Ill. Adm. Code 130.330. The sale or lease may be made directly by the manufacturer or by some other person, and the sale or lease may be made apart from or as an incident to the seller’s engaging in the service occupation of producing machines, tools, dies, jigs, patterns, gauges, or other similar items of no commercial value on special order for a particular purchaser. See 86 Ill. Adm. Code 130.330(a). The exemption requires that the product produced as a result of the manufacturing or assembling process be tangible personal property for wholesale or retail sale or lease. 130.330(a)(7). Machinery and equipment used in the performance of a service, such as dry cleaning, is not used in the production of tangible personal property for wholesale or retail sale or lease and is thus taxable. 86 Ill. Adm. Code 130.330(a)(6).

Beginning on July 1, 2019, the manufacturing and assembling machinery and equipment exemption includes production related tangible personal property. 35 ILCS 105/3-5(18); 35 ILCS 105/3-50. Production related tangible personal property means all tangible personal property used or consumed in a production related process by a manufacturer in a manufacturing facility in which a manufacturing process takes place or by a graphic arts producer in graphic arts production. Production related tangible personal property also means all tangible personal property that is used or consumed in research and development regardless of use within or without a manufacturing or graphic arts production facility. See ST 20-0001-PLR (Jan. 28, 2020) for an example of tangible personal property purchased to produce preproduction vehicles used or consumed in activities such as research and development.

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,

Richard S. Wolters
Associate Counsel

RSW:sce