

Services Chapter Index**Purpose**

This chapter is meant to introduce the auditor to the Service Occupation Tax Act and the Service Use Tax Act and the rates charged by the Illinois Department of Revenue. The first part of this chapter provides a general overview of service-related sales taxes and the different types of servicemen. The second part provides general information on auditing service providers. For general audit practices, please refer to Audit Manual Chapter 6, Audit Procedures.

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Illinois taxes several types of services, including telecommunication services, the renting of hotel rooms, and the renting of automobiles under specific occupation or excise tax acts. This chapter, however, is primarily intended to address sales of services potentially taxable under the Service Occupation Tax Act (SOT) or Service Use Tax Act (SUT). In general, for taxpayers to be subject to tax under one of these acts, they must transfer at least some tangible personal property (TPP) to their customers as an incident to their service. Types of services include, but are not limited to, cosmetology, accounting, healthcare, repair, and computer.

Construction Contractor – Includes general contractors, subcontractors and specialized contractors such as landscape contractors. "Contractor" means any person who is engaged in the occupation of entering and performing construction contracts for owners. (86 Ill. Adm. Code 130.1940(a)(1))

Cost Price - The consideration paid by the serviceman for a purchase valued in money, whether paid in money or otherwise, including cash, credits and services. It is the portion of the supplier's invoice subject to Illinois tax in the absence of an exemption.

De Minimis Serviceman - A serviceman whose annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35%/75% of the aggregate annual total gross receipts from all sales of service. (86 Ill. Adm. Code 140.201(b))

Graphic Arts Production - The production of tangible personal property for wholesale or retail sale or lease by means of printing, including ink jet printing, by one or more of the processes described in Groups 323110 through 323122 of Subsector 323, Groups 511110 through 511199 of Subsector 511, and Group 512230 of Subsector 512 of the North American Industry Classification System (NAICS) published by the U.S. Office of Management and Budget, 1997 edition.

Includes persons engaged primarily in the business of printing or publishing newspapers or magazines that qualify as newsprint and ink, by one or more of the processes described in Groups 511110 through 511199 of subsector 511 of the North American Industry Classification System (NAICS) published by the U.S. Office of Management and Budget, 1997 edition.

It does not include the transfer of images onto paper or other tangible personal property by means of photocopying or final printed products in electronic or audio form, including the production of software or audio books.

Gross Service Receipts – The gross receipts from all sales of service during a fiscal year. It does not include retail or construction sales.

Incident to Service – The inseparable connection between tangible personal property and a performed service. Without the combination of labor and tangible personal property, the service has limited value to the customer.

In-State Serviceman – A serviceman subject to local service occupation taxes due to storing inventory or accepting orders at an Illinois location. The serviceman's taxable location is where the serviceman's place of business is located, not the place where the service was performed.

Intangible Property – stocks, bonds, evidence of interest in property, corporate or other franchises, evidence of debt, or similar financial instruments.

Interstate Commerce – The buying and selling of goods and services across state borders. Exempt from taxation unless a person has a nexus, or connection, with the state.

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Multi-Service Situation – A situation where a primary serviceman contracts with a secondary serviceman to perform some or all of the service sold to a customer. The secondary serviceman's charges are incorporated into the primary serviceman's bill.

Nexus – A connection between a person and a state which is significant enough to allow that state to impose a tax obligation on the person based on its activities within the state.

Out-of-State Serviceman – A serviceman who accepts purchase orders and stores inventory outside Illinois. They are not subject to local occupation taxes, but they may be required to register and collect use taxes.

Pass-through Exemption – An exemption based on a customer's exempt status which can be claimed by a retailer or serviceman on a purchase that would otherwise be subject to tax. It only applies to items transferred to the exempt customer.

Person – Any natural individual, firm, partnership, association, joint stock company, limited liability company, joint venture, public or private corporation, and any receiver, executor, trustee, conservator or other representative appointed by order of any court.

Primary Serviceman – The serviceman in a multi-service situation who bills the customer.

Real Property – Land, buildings, and other property intended to be permanently attached to the land. Includes property which by custom, usage, or law passes with a conveyance of land though not described or mentioned in a contract of sale or instrument of conveyance.

Retail Sale – The transfer of the ownership of tangible personal property for use or consumption for a valuable consideration.

Retailer - Includes every person engaged in the business of selling tangible personal property for use, and not for resale in any form. (86 Ill. Adm. Code 150.201(h)).

Sale for Resale – A sale of tangible personal property to a customer who will not use the item, but instead will resell it or incorporate it into a product for sale.

Secondary Serviceman – The serviceman hired by the primary serviceman in a multi-service situation to perform some or all of the services billed to a customer by the primary serviceman.

Selling Price – The portion of a service invoice which represents the tangible personal property transferred to the customer incident to the service.

Service – The portion of a transaction which does not represent the transfer of tangible personal property or real property. A "Sale of Service" is generally any transaction that is not a retail sale, sale for resale, sale of intangible property such as a bank CD, or sale of real property. (86 Ill. Adm. Code 140.201(f)1-10 provides more detail)

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Serviceman Maintaining a Place of Business in this State – A serviceman who has nexus with Illinois which requires them to collect service use tax. The serviceman does not have to have a physical location in Illinois.

Tangible Personal Property (TPP) – Physical property. Does not include intangible property such as stocks, bonds, and CDs or real property such as land and buildings.

Tax Basis – The amount of a purchase or sale subject to tax in the absence of an exemption.

Generally, sales of service are not taxable. Transfers of tangible personal property incident to a sale of service may be subject to service occupation tax liability, service use tax liability, or use tax liability.

5.3.1 Service Occupation Tax

The SOT [35 ILCS 115] imposes a tax upon persons engaged in the business of making sales of service in Illinois, based on tangible personal property transferred incident to sales of service. These persons are referred to as servicemen. A **“Serviceman”** is any person who is engaged in the occupation of making sales of service.

Under the SOT, businesses providing services (i.e., servicemen) are taxed on tangible personal property transferred incident to sales of service. 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. The serviceman's liability or tax base may be calculated in one of four ways:

- Service occupation tax on the separately stated selling price of tangible personal property transferred incident to service;
- Service occupation tax on 50% of the serviceman's entire bill (but never less than the cost price of tangible personal property transferred), if the selling price of the tangible personal property is not separately stated;
- Service occupation tax on the serviceman's cost price if the serviceman is a de minimis serviceman and is otherwise registered with the Department (e.g., a de minimus serviceman who also makes sales of tangible personal property at retail); or
- Use tax on the serviceman's cost price if the serviceman is de minimis and not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act (ROT).

The tax is closely related to the retailers' occupation tax described in Audit Manual Chapter 3, *Retailers' Occupation Tax & Related Acts*. They share the same record keeping and reporting requirements, statutes of limitations (with one exception see Section 5.3.4), and applicable exemptions.

Local governments who impose a local retailers' occupation tax also impose a local service occupation tax using the same rate.

5.3.2 Service Use Tax

The Service Use Tax Act [35 ILCS 110] imposes a tax on the privilege of using, in Illinois, tangible personal property that is received anywhere as an incident to a purchase of service from a serviceman. The Service Use Tax Act complements the Service Occupation Tax Act. 86 Ill. Adm. Code 160.101.

If a serviceman incurring service occupation tax liability is required or authorized to collect the service use tax (see 86 Ill. Adm. Code 160.115), the purchaser must pay the tax to the serviceman. However, if the serviceman would not be taxable under the Service Occupation Tax Act [35 ILCS 115] despite all elements of the sale of service occurring in Illinois, then the tax imposed by the Service Use Tax Act does not apply to the use of such property in Illinois.

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Transfers of tangible personal property by de minimis servicemen who incur use tax do not constitute "sales of service" under the Service Occupation Tax Act [35 ILCS 115/2(g)]. As a result, customers of such de minimis servicemen do not incur service use tax liability on such transfers. This is because they are considered the end users of the tangible personal property transferred to their service customers. 86 Ill. Adm. Code 160.125(e).

A serviceman, who is required to remit and does pay service occupation tax to the Department, need not remit that part of any service use tax collected by the serviceman on their sales of service involving the transfer by the serviceman of the same property as long as the amount paid to the Department is equal to or exceeds the amount collected from the service customer. 86 Ill. Adm. Code 160.101.

The following servicemen shall collect service use tax:

- 1) servicemen who incur and remit service occupation tax to the Department;
- 2) servicemen who come within the definition of a "Serviceman maintaining a place of business in this State" (as set out in 35 ILCS 110/2 and 86 Ill. Adm. Code 160.105(f)); and
- 3) those servicemen who are authorized to voluntarily collect the service use tax. 86. Ill. Adm. Code 160.115.

The service use tax is 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, the tax will be imposed on 50% of the entire billing from the serviceman. However, the service use tax which is collected by a de minimis serviceman who incurs service occupation tax on their cost price of tangible personal property transferred incident to service, as provided in 86 Ill. Adm. Code 140.109, shall be based upon their cost price of the tangible personal property transferred incident to their sales of service. (86 Ill. Adm. Code 160.115).

There are no local service use taxes, but the General Assembly has authorized servicemen subject to local service occupation tax to reimburse themselves for their local service occupation tax liability. This reimbursement may be stated separately or in conjunction with the service use tax. (86 Ill. Adm. Code 230.101(b)).

Purchasers incurring service use tax liability that is not paid to a serviceman must pay the service use tax directly to the Department. Such remittance to the Department shall be made on a form prescribed by the Department (either the ST-44 or ST-1) by the last day of the month following the month in which the user makes any payment to the serviceman. (86 Ill. Adm. Code 160.125(a)). Unlike the use tax, there is no provision which allows taxpayers with less than \$600 in service use tax liability to report the amount on an annual return. (See 86 Ill. Adm. Code 150.701).

5.3.3 Use Tax

The Use Tax Act [35 ILCS 105] imposes a tax on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer, as "retailer" is defined in the Use Tax Act. (86 Ill. Adm. Code 150.101(a)). For general information, review Chapter 4, Use Tax.

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“De minimis” servicemen who are not registered or required to be registered to collect tax from their customers incur use tax on the cost price of the tangible personal property transferred incident to their service. (86 Ill. Adm. Code 140.108(a)). They must either pay this use tax to their supplier, or if their supplier does not collect the tax, remit it directly to the Department.

5.3.4 Statute of Limitations

For filed original or amended service occupation tax or use tax returns, the statute of limitations is the same as that for retailers' occupation tax returns with the exception that for the SOT, the date is based on when the tax was due and not when the gross receipts were received. 86 Ill. Adm. Code 140.801. See Chapter 8, Claims, for additional information regarding Statute of Limitations.

5.3.5 Service Occupation Tax & Service Use Tax Penalties and Interest

Civil penalties and interest under the Service Use Tax Act and Service Occupation Tax Act are the same as those imposed under the Retailers' Occupation Tax Act, and Section 3-7 of the Uniform Penalty and Interest Act [35 ILCS 735]. (86 Ill. Adm. Code 160.140). (See Publication-103 Penalties and Interest for Illinois Taxes).

A serviceman is any person, whether an individual or company, who transfers tangible personal property as part of a sale of service. Servicemen may be subject to retailers' occupation tax, service occupation tax, use tax, service use tax, or any combination thereof. The type of tax applicable is determined by the type(s) of service performed, the Department's tax registration requirements for the serviceman, and the circumstances of the sales and purchases made during the year.

There are four types of servicemen, as discussed below.

1. Servicemen who exceed the cost ratio threshold and incur SOT.
2. "De minimis" servicemen who incur use tax on their cost price.
3. "De minimis" servicemen who incur service occupation tax on their cost price.
4. Out-of-State servicemen who must collect service use tax.

First, a serviceman must determine whether they must register with the Department. If the serviceman also makes retail sales in Illinois, the serviceman must register as a retailer under Section 2a of the ROT and will also incur service occupation tax liability on the tangible personal property transferred incident to sales of service. (86 Ill. Adm. Code 130.701).

If a serviceman is acting outside of Illinois and is shipping goods to Illinois residents for any reason, the serviceman may be required to register and collect tax on behalf of Illinois. 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, the serviceman will be considered maintaining a place of business in Illinois. As such, the serviceman will be required to register and collect and remit SUT from their Illinois customers for one year; they may reassess on a yearly basis looking at the last four quarters.

If the serviceman is not a retailer and has not voluntarily registered as a serviceman to report tax, they must calculate their "Cost Ratio" to determine whether they are a de minimis serviceman or they need to be registered with the Department to collect and remit SOT. See section 5.5.5 below.

5.5.1 Certificates of Registration

A taxpayer who is required to collect and remit Retailers' Occupation Tax, Use Tax, Service Occupation Tax, and/or Service Use Tax is only required to obtain one certificate of registration from the Department. (86 Ill. Adm. Code 140.601(a)). For simplification, the Department only issues Certificates of Registration for Retailers' Occupation Tax or Use Tax. There are no Certificates of Registration for Service Occupation Tax or Service Use Tax. A taxpayer who only remits Service Occupation Tax will still receive a Retailers' Occupation Tax registration certificate.

5.5.2 Servicemen as Retailers

Servicemen who make retail sales, even if those sales are a small part of their business, are required to register with the Department and remit retailers' occupation tax. (86 Ill. Adm. Code 130.701). They also must remit service occupation tax on the tangible personal property transferred incident to sales of service. (86 Ill. Adm. Code 140.109(a)).

If a serviceman meets or exceeds the cost ratio threshold as set out in Section 5.5.5, they must remit service occupation tax on the separately stated selling price or on 50% of the invoice if not separately stated. If the serviceman does not meet the cost ratio threshold, then they owe service occupation tax on their cost price of the tangible personal property transferred. However, they may opt to pay service occupation tax on their selling price.

Taxpayers who make occasional or isolated sales are not considered retailers and are not required to register or collect taxes on their occasional or isolated sales. For example, a company which rents power tools would not need to register when it sells its used equipment. If they purchase power tools for resale, or if they hold themselves out to be a retailer in some other way, they would be considered engaged in the business of selling tangible personal property at retail and must register and remit retailers' occupation tax. (86 Ill. Adm. Code 130.110).

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5.5.3 In-State Servicemen Who Exceed the Cost Ratio Threshold

Servicemen whose Cost Ratio equals or exceeds the 35% threshold (75% or greater in the case of servicemen transferring prescription drugs or engaged in graphic arts production) must register with the Department and remit service occupation tax. (86 Ill. Adm. Code 140.105).

5.5.4 Out-of-State Servicemen with Nexus Exceeding the Cost Ratio

Out-of-State Servicemen “maintaining a place of business in this State” as defined in 86 Ill. Adm. Code 160.105(f) must register to collect service use tax if their Cost Ratio equals or exceeds 35%(75%or greater in the case of servicemen transferring prescription drugs or engaged in graphic arts production).

5.5.5 Calculating Cost Ratio

The “Cost Ratio” is a measure of the amount of tangible personal property transferred with a service. It is calculated by comparing the serviceman’s product cost to their total income from services. The Cost ratio is calculated on the total annual activity rather than on any individual transaction. The annual aggregate cost of the tangible personal property transferred incident to sales of service, as well as the total annual receipts from sales of service, must be determined based on the taxpayer's fiscal year. The single most important factor is determining the cost ratio between the annual aggregate cost of tangible personal property transferred incident to sales of service and the annual gross receipts from all sales of service. 86 Ill. Adm. Code 140.105(a). The cost of materials that are not transferred to customers incident to sales of 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. 86 Ill. Adm. Code 140.105(c).

If the Cost Ratio is 35%or greater (75% or greater in the case of servicemen transferring prescription drugs or engaged in graphic arts production), the serviceman must register and remit service occupation tax on the **selling price** of the tangible personal property transferred incident to their service. The “selling price” is calculated based on the separately stated selling price or on 50% of the total bill (but never less than cost price of tangible personal property transferred) as explained in 86 Ill. Adm. Code 140.106(a). Servicemen who exceed the threshold are referred to as “non-de minimis” servicemen.

The following calculations are used to determine cost ratio:

- determine the total annual cost of the tangible personal property purchased that was transferred to customers incident to service, and compare that figure to
- the total annual gross receipts from all sales of service (including labor charges) for the fiscal year.
- the ratio will be the cost of property transferred divided by gross service receipts

$$\text{Cost ratio} = \frac{\text{Cost of tangible personal property transferred incident to service}}{\text{Gross service receipts}}$$

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If the cost ratio is equal to or greater than 35% (or 75%), the serviceman is required to be registered and owes service occupation tax on their sales of service.

For the remainder of the chapter, we refer to the Cost Ratio threshold as 35%/75%. In this context we mean a ratio of 35% generally and one of 75% for taxpayers transferring prescription drugs or servicemen engaged in graphic arts production.

EXAMPLE 1:**Retail****Services**

<u>Period</u>	<u>Retail Sales^{1,2}</u>	<u>Service Labor</u>	<u>Selling Price of Transferred tangible personal property</u>	<u>Total Service Sales</u>	<u>Cost of Transferred tangible personal property</u>
1 st Qtr.	\$15,000	\$35,000	\$32,000	\$67,000	\$16,000
2 nd Qtr.	\$10,000	\$33,000	\$30,500	\$63,500	\$15,250
3 rd Qtr.	\$20,000	\$36,000	\$34,500	\$70,500	\$17,250
4 th Qtr.	\$15,000	\$42,000	\$43,000	\$85,000	\$21,500
Annual	\$60,000	\$146,000	\$140,000	\$286,000	\$70,000

Notes

- 1) Includes both retail sales and sales for resale
- 2) Retail sales are not included in Cost Ratio calculation

Cost Ratio Determination

Cost Ratio = Cost of tangible personal property transferred incident to service / total service sales

Cost Ratio = \$70,000 / (\$146,000 + \$140,000)

Cost Ratio = \$70,000 / (\$286,000)

Cost Ratio = 24.5%

In Example 1, the serviceman is required to be registered because they are also making retail sales. The cost ratio must still be calculated to determine whether SOT is due on the cost price (de minimis) or the selling price.

EXAMPLE 2:**Retail****Services**

<u>Period</u>	<u>Retail Sales</u>	<u>Service Labor</u>	<u>Selling Price of Transferred tangible personal property</u>	<u>Total Service Sales</u>	<u>Cost of Transferred tangible personal property</u>
1 st Qtr.	\$0	\$35,000	\$32,000	\$67,000	\$16,000
2 nd Qtr.	\$0	\$33,000	\$30,500	\$63,500	\$15,250
3 rd Qtr.	\$0	\$36,000	\$34,500	\$70,500	\$17,250
4 th Qtr.	\$0	\$42,000	\$43,000	\$85,000	\$21,500
Annual	\$0	\$146,000	\$140,000	\$286,000	\$70,000

Cost Ratio Determination

Cost Ratio = Cost of tangible personal property transferred incident to service / total service sales

Cost Ratio = \$70,000 / (\$146,000 + \$140,000)

Cost Ratio = \$70,000 / (\$286,000)

Cost Ratio = 24.5%

In Example 2, the serviceman is de minimis and would not be required to register because they are under the 35% threshold, and they are not a retailer. They would incur use tax on the cost of tangible personal property transferred. However, they could register voluntarily with the Department to collect and remit service occupation tax.

EXAMPLE 3:**Retail****Services**

<u>Period</u>	<u>Retail Sales</u>	<u>Service Labor</u>	<u>Selling Price of Transferred tangible personal property</u>	<u>Total Service Sales</u>	<u>Cost of Transferred tangible personal property</u>
1 st Qtr.	\$0	\$35,000	\$32,000	\$67,000	\$25,000
2 nd Qtr.	\$0	\$33,000	\$30,500	\$63,500	\$20,000
3 rd Qtr.	\$0	\$36,000	\$34,500	\$70,500	\$22,000
4 th Qtr.	\$0	\$42,000	\$43,000	\$85,000	\$35,000
Annual	\$0	\$146,000	\$140,000	\$286,000	\$102,000

Cost Ratio Determination

Cost Ratio = Cost of tangible personal property transferred incident to service / total service sales

Cost Ratio = \$102,000 / (\$146,000 + \$140,000)

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Cost Ratio = \$102,000 / (\$286,000)

Cost Ratio = 35.7%

In Example 3, the serviceman would be required to register because their cost ratio is greater than the 35% threshold and they must collect and remit SOT on the selling price of tangible personal property transferred incident to sales of service. (This Example assumes the serviceman is not a pharmacist or involved in graphic arts production).

5.5.6 Cost Ratio Equal to or Greater than 35% or 75%

There are two options for servicemen to determine their tax liability.

1. Separately stated selling price. If the serviceman separately states the selling price of the tangible personal property transferred incident to service on billings to service customers, then their service occupation tax liability is based on that separately stated selling price. However, in no event can the service occupation tax liability be based on an amount less than the serviceman's cost price of the tangible personal property being transferred. 86 Ill. Adm. Code 140.106(a)(1).

Example:

Item	Price
Parts	\$50.00
Labor	\$100.00
Sales Tax (\$50.00 x 6.25%)	\$3.13
Total	\$153.13

If the taxpayer's cost for the parts was \$75.00, they are required to collect service occupation tax on this higher amount:

Item	Price
Parts	\$50.00
Labor	\$100.00
Sales Tax (\$75.00 x 6.25%)	\$4.69
Total	\$154.69

2. Fifty percent base. If the serviceman's bill to the service customer does not separately state the selling price of the tangible personal property transferred, the serviceman's service occupation tax liability is based on 50% of the entire customer bill, including labor. However, in no event can the service occupation tax be based on an amount less than the serviceman's cost price of the tangible personal property being transferred. (86 Ill. Adm. Code 140.106(a)(2)).

Example:

Item	Price
Parts + Labor	\$150.00
Sales Tax (\$150.00 x 50% x 6.25%)	\$4.69
Total	\$154.69

If the taxpayer's cost for the parts was \$100.00, they are required to collect service occupation tax on this higher amount:

Item	Price
Parts + Labor	\$150.00
Sales Tax (\$100.00 x 6.25%)	\$6.25
Total	\$156.25

The tax need not be separately stated on the service billing unless so requested by the service customer.

The taxpayer must use one method to determine their tax liability for any given service and once a method is selected it must be used for one year before being able to switch methods. This is also the case for subsequent switches between methods.

5.5.7 “De Minimis” Servicemen Who Incur Use Tax

De minimis servicemen who incur use tax on their cost price must register to remit use tax if their suppliers are not registered to collect it from them. (86 Ill. Adm. Code 140.108(a)(1)). De minimis servicemen are registered only for the purpose of self-assessing and remitting use tax.

Even though a serviceman is below the de minimis threshold and is otherwise eligible to pay use tax on the **cost price** of the tangible personal property transferred to service customers, they can, nevertheless, register with the Department and pay service occupation tax on their cost price. (86 Ill. Adm. Code 140.108(c)). Once a taxpayer voluntarily registers, they have all the rights and duties of a taxpayer who is required to be registered. (86 Ill. Adm. Code 140.601(d))

5.5.8 Certificates of Registration

A taxpayer who is required to collect and remit taxes under one or more of the tax acts (ROT, UT, SOT, or SUT) is only required to obtain one certificate of registration from the Department. (86 Ill. Adm. Code 140.601(a)). In fact, the Department only issues Certificates of Registration for retailers' occupation tax or use tax. There are no Certificates of Registration for service occupation tax or service use tax. A taxpayer who only remits service occupation tax will still receive a retailers' occupation tax registration certificate.

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5.5.9 Limitation on Switching from a Voluntary Service Occupation Tax Collector to Use Tax Payer

De minimis servicemen who voluntarily register to pay service occupation tax are required to collect service occupation tax on all applicable transactions while registered. They may not choose to pay service occupation tax on some transactions and use tax on others during their fiscal year. (86 Ill. Adm. Code 140.108(a)(4)).

If a voluntarily registered de minimis serviceman decides to cancel their registration at the end of their fiscal year, they must notify Central Registration and file a final sales tax return reporting use tax on the cost of any remaining inventory on which they did not pay tax to their supplier.

5.5.10 Reimbursements for Taxes Paid by De Minimis Servicemen

The de minimis serviceman incurring use tax liability is not authorized to collect "tax" from service customers, but they may collect "reimbursement" for their tax liability from the customer. If reimbursement is sought and appears as a separate item on the bill, it must clearly be identified as a "reimbursement" for the serviceman's use tax liability and not as a "tax." Any amount collected as a "tax" in this situation constitutes an overcollection that must be refunded to the customer or, if not refunded to the customer, paid to the Department. It cannot be used to offset the serviceman's use tax liability. (86 Ill. Adm. Code 140.108(a)(3)).

5.5.11 Registered De Minimis Servicemen - Cost Ratio Less than 35% (or 75%)

If a registered, de minimis serviceman is below the cost ratio threshold, they are only required to remit service occupation tax on their **cost price** of tangible personal property transferred incident to service. Service use tax must also be collected from customers.

The serviceman may determine their tax liability in the following ways:

1. **Cost price.** The serviceman will use the cost price as their basis of remitting service occupation tax and collecting service use tax.

Example:

Item	Price
Parts + Labor	\$150.00
(Unbilled Cost of Parts is \$10.00)	
Sales Tax (\$10.00 x 6.25%)	\$0.63
Total	\$150.63

2. **Selling Price.** Even though a serviceman meets the de minimis threshold and is otherwise eligible to pay service occupation tax on their cost price, they may opt to pay SOT on their **selling price**, using either the separately stated selling price or 50% of total bill methods of calculating service occupation tax Liability. (86 Ill. Adm. Code 140.109(b))

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The tax need not be separately stated on the service billing unless requested by the service customer.

5.5.12 De Minimis Serviceman Not Required to be Registered - Cost Ratio Less than 35% (or 75%)

If the serviceman is under the 35% or 75% threshold and is not a retailer required to register with the Department under Section 2a of the ROT and is not otherwise registered with the Department, they are considered a “de minimis” serviceman and will be liable for use tax. The serviceman may pay the use tax by using any of the following methods:

- directly pay the tax on the cost to an Illinois or out-of-State vendor or supplier who is registered to collect Illinois use tax; or
- if the suppliers or vendors are not registered to collect use tax, the serviceman must register with the Department as a use tax filer, then must self-assess use tax or service use tax on the cost of those purchases made from their unregistered vendors or suppliers. The de minimis serviceman should not provide Certificates of Resale to suppliers, even though they may possess a resale or registration number because the resale exemption is not available to de minimis servicemen incurring a use tax liability. (86 Ill. Adm. Code 140.108(a)(1)).

A serviceman who is not required to be registered may still voluntarily register with the Department as a serviceman and pay service occupation tax in accordance with 86 Ill. Adm. Code Sections 140.106 or 140.109.

5.5.13 Serviceman - Cost Ratio at or above 35% or 75%

If a serviceman exceeds the cost ratio threshold, they are required to register with the Department. They must remit service occupation tax on the selling price of the tangible personal property transferred incident to their service and collect service use tax from their customers.

5.5.14 Example Methods Used by Servicemen to Determine Liability

An auto mechanic contracts to repair a customer's automobile. In this example, the serviceman's entire bill to the customer is \$500. Labor costs account for \$300 of the total, and the serviceman's cost price of parts transferred totals \$100. The selling price of the parts, if separately stated, would be \$200. The following chart represents the way this serviceman might incur tax under the different methods discussed in 86 Ill. Adm. Code 140.106, 140.108 and 140.109.

Registered serviceman

	Cost Price of tangible personal property	Selling Price of tangible personal property	Gross Receipts	Service Occupation Tax Base
De Maximus Separately Stated	\$100	\$200	\$500	\$200 (selling price)
De Maximus Not Separately Stated	\$100	0	\$500	\$250 (1/2 of gross receipts)
De Minimis (paying SOT on cost price)	\$100	\$200	\$500	\$100 (cost price)

De minimis serviceman not required to be registered and not voluntarily registered as a retailer under Section 2a of the retailers' occupation tax Act.

	Cost Price of tangible personal property	Selling Price of tangible personal property	Gross Receipts	Service Occupation Tax Base
Separately Stated	\$100	\$200	\$500	**

** (Not subject to service occupation tax if not required to be registered as a retailer under Section 2a of the retailers' occupation tax Act. Subject instead to use tax on \$100, see 86 Ill. Adm. Code 140.108).

Interstate Service Transactions

When an out-of-state serviceman performs a job for an Illinois customer, the requirement to collect tax is based on the characteristics of the serviceman.

Unregistered de minimis out-of-state servicemen who perform their service outside the state for an Illinois customer are not subject to Illinois sales tax. If they perform their service within Illinois, they are subject to use tax or service use tax on their cost price of any tangible personal property transferred incident to service. No local taxes are applicable.

Registered out-of-state servicemen, whether de minimis or non-de minimis, are required to collect tax on the property they transfer into Illinois incident to their service regardless of where the service is performed.

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Mixed Reporting Methods by De Minimis Servicemen

Registered de minimis servicemen who are required to collect and pay tax based on their cost price may opt to collect tax on the separately stated selling price, or 50% of the bill. Selection of this option for some transactions does not prevent the serviceman from collecting and paying tax on their cost price for other transactions. When establishing audit exceptions and additional liability for these taxpayers, the auditor will use the cost price of the TPP transferred.

De Minimis Servicemen Who Exceed the Cost Threshold

The de minimis cost threshold determination is based on the taxpayer's current fiscal year. Prior years' ratios, while sometimes helpful, cannot be relied upon to establish the current year's threshold. Estimates can be made based on prior years, but if they are not accurate, the taxpayer must adjust the manner in which tax is calculated and remit all taxes, penalties and interest due. (86 Ill. Adm. Code 140.105(e)) It is possible that a serviceman will switch back and forth between de minimis and non-de minimis status during the fiscal years covered by an audit. In this situation, the auditor should carefully select their samples to ensure they accurately reflect these changes.

If the auditor determines that a taxpayer who reported taxes as a de minimis serviceman exceeded the cost threshold in a fiscal year, tax must be assessed based on the separately stated selling price or 50% of the bill if the taxpayer did not separately state the selling price. The serviceman should be given credit for any taxes paid to suppliers or remitted to the Department.

If a de minimis serviceman is close to the cost threshold, supervisors should generally not extend an audit to include periods from the taxpayer's current fiscal year. This could result in an understated audit liability if the taxpayer switches from de minimis to non-de minimis or an overstated audit liability if the taxpayer switches from non-de minimis to de minimis.

If the serviceman is de minimis and not registered or required to be registered, they are considered the user of the property transferred incident to their service. They must pay use tax (or service use tax if they are purchasing tangible personal property incident to a service) when they purchase this property. Generally, these transactions are included in the standard review of company purchases described in Audit Manual Chapter 6, *Audit Procedures*. Provisions that only apply to purchases by de minimis servicemen are listed below:

5.6.1 Flow Through Exemptions

With the exception of the resale exemption, an unregistered de minimis serviceman is allowed to pass on their customer's exemption to their supplier when purchasing tangible personal property that will be transferred to their customer. The serviceman must present their supplier with the customer's proof of exemption at the time of purchase along with a letter stating that the purchases will be transferred to the customer incident to their service. If the serviceman does not know whether the item is exempt at the time of purchase, the serviceman must pay the tax to their supplier. When the serviceman obtains proof of exemption, they can then request a refund from their vendor. (86 Ill. Adm. Code 140.108(a)(2))

Pass through exemptions are not allowed on items consumed while performing the service. The product must be transferred in order to be exempt.

5.6.2 Multi-Service Situations

Multi-service situations occur when one serviceman purchases a service from another serviceman. The primary serviceman is the serviceman purchasing or subcontracting out the work. The secondary serviceman is the serviceman who will be performing the service for the primary serviceman.

While labor, in a service function, is generally not taxable, sublet repair may involve a taxable occurrence. Sublet repair is often an area not properly understood by the taxpayer. The auditor must measure the taxpayer's operations in this area in relationship to 86 Ill. Adm. Code 140.145. If it is determined that the taxpayer is not in compliance with the law concerning sublet repair, it is generally easier to measure the extent of error by examination of sublet inventory purchases.

Many servicemen set up the sublet as a labor charge and do not tax any TPP transferred in the sublet. Invoices involving sublet repairs should be examined to determine if any TPP has been transferred.

When a primary serviceman purchases tangible personal property from a secondary serviceman, the primary serviceman shall determine their cost price either:

- by using the separately stated selling price of tangible personal property set forth on the invoice from the secondary serviceman, or
- if no selling price is separately stated, 50% of the total invoice including labor and service charges.

5.6.3 Transactions Between Unregistered De Minimis Servicemen

If a primary unregistered de minimis serviceman subcontracts service work to a secondary unregistered de minimis serviceman, the primary de minimis serviceman does not incur a use tax liability if the

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secondary de minimis serviceman has paid, or will remit, Illinois use tax on their cost price of any tangible personal property transferred to the primary serviceman. The secondary serviceman must certify that fact in writing to the primary de minimis serviceman. For example, a de minimis dentist paying use tax on their cost price who purchases dentures from a de minimis dental laboratory also paying use tax on its cost price will not incur use tax liability if the de minimis dental laboratory pays, or agrees to remit, Illinois use tax on its cost price of the items used to fabricate the dentures and certifies this fact in writing to the de minimis dentist. (86 Ill. Adm. Code 140.145(a))

The certification provided by the secondary de minimis serviceman shall contain the address of, and be signed and dated by, the secondary de minimis serviceman. It shall certify that the secondary de minimis serviceman has paid, or will remit, Illinois use tax on the cost price of the tangible personal property transferred to the primary de minimis serviceman. This certification may appear on the invoice to the primary de minimis serviceman. The primary de minimis serviceman shall retain this certification in their books and records. (86 Ill. Adm. Code 140.145(b))

If both the primary and secondary servicemen are unregistered and de minimis, any exemption, **except for resale**, can flow through from the primary to the secondary to the secondary's supplier. Unregistered servicemen are not allowed to issue resale certificates.

5.6.4 Multi-Service Transactions Between Registered Servicemen

Primary servicemen who are registered with the Department, regardless of whether they are de minimis servicemen paying service occupation tax on their cost price or servicemen paying SOT on their selling price, should provide Certificates of Resale to secondary servicemen who are also registered.

5.6.5 Multi-Service Transactions Between Registered and Unregistered Servicemen Each Located in Illinois

- **Registered primary serviceman - unregistered secondary serviceman**

If a registered primary serviceman located in Illinois subcontracts service work to a secondary serviceman located in Illinois who is not registered and has opted to incur use tax as described in Section 140.108 of this Part, tax will be incurred and remitted to the Department at two levels.

The secondary unregistered de minimis serviceman will already have paid use tax to their supplier on the tangible personal property transferred to the primary serviceman. Normally, the primary serviceman would have provided a Certificate of Resale to the secondary serviceman for the tangible personal property the primary serviceman will transfer to their service customers. However, an unregistered secondary serviceman is not authorized to accept Certificates of Resale from their customers (86 Ill. Adm. Code 140.108(a)) which means that the registered primary serviceman cannot provide a Certificate of Resale to the unregistered secondary serviceman. When the registered primary serviceman makes a sale of service to their service customer, they will incur service occupation tax on either their selling price or their cost price.

In this scenario, use tax will have been paid by the unregistered secondary serviceman to their supplier and SOT would be due from the registered primary serviceman.

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- **Unregistered primary serviceman - registered secondary serviceman**

If the primary serviceman is not registered or required to be registered and the secondary serviceman is registered, the primary serviceman can request that the secondary serviceman separately state the tax on the invoice. By having the tax separately stated on the invoice, the unregistered primary serviceman can easily prove that they paid the tax.

Maintenance agreements are contracts to provide repairs for a particular item within a stated time period and for a pre-determined fee. The party agreeing to provide service under a maintenance agreement may or may not be a seller of the item.

The taxability of maintenance agreements depends upon whether charges for the agreements are included in the selling price of the tangible personal property. (86 Ill. Adm. Code 140.141 and 86 Ill. Adm. Code 140.301(b)(3))

- **Maintenance contracts included in selling price (Manufacturer's Warranty)**

If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to ROT/UT. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

- **Maintenance contracts sold separately**

If maintenance contracts are sold separately from tangible personal property, sales of the contracts are not taxable ROT/UT transactions. The service providers will incur use tax based on their cost price of tangible personal property transferred to customers when the service is performed.

If a serviceman enters into an agreement to provide repair service for a particular piece of equipment for a stated period for a predetermined fee, the serviceman shall pay use tax to their supplier (or to the Department if the supplier is not registered to collect tax) on the cost price of tangible personal property purchased for transfer by the serviceman incident to completion of the maintenance agreement. However, a serviceman will incur no tax liability on repairs made under a maintenance agreement for a person that is able to claim an exemption, either because of that person's exempt status (e.g., the person possesses an exemption identification number issued by the Department, such as the Federal or State government) or because the tangible personal property being repaired is exempt from tax (e.g., due to the manufacturing machinery, graphic arts or pollution control equipment exemptions).

Purchasers of separate maintenance agreements are not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance contract. Where a business provides repair services outside of a maintenance agreement that are accompanied with the transfer of tangible personal property, such transactions are generally subject to tax liability under the Service Occupation Tax Act. (86 Ill. Adm. Code 140.140(l))

Auditing out-of-state based servicemen and service transactions adds some complexity to an audit. To help simplify the discussion, this Section will refer to “out-of-state based service transactions” and “out-of-state servicemen”.

An “out-of-state based service transaction” is a transaction where a serviceman with nexus is engaged in the occupation of making sales of service to Illinois customers from a location outside the State. (Some or all of the actual service work may be performed in Illinois, but the serviceman’s main service business operations take place in another state.)

Example: A motor repair company is located in Davenport, Iowa. The company has customers send motors needing repair to Davenport. Once repaired, the motors are sent back to the customers in Illinois. The motors repaired outside the state in Iowa are considered out-of-state based service transactions since the service business operations for that repair occurred outside Illinois.

“Out-of-state servicemen” are servicemen who have out-of-state based service transactions. It is possible for an “out-of-state serviceman” to also make sales of service in Illinois subject to SOT (for example, if the Davenport company had a repair shop in Moline, IL, the repairs performed in Moline would be Illinois services subject to the SOT Act).

Out-of-State Audit Approach

In general, auditing out-of-state based service transactions and out-of-state servicemen requires the same basic approach as auditing an in-state based serviceman. Auditors still need to determine nexus, classify sales, calculate a cost ratio, etc., but there are some additional factors that need to be taken into consideration.

Nexus

An out-of-state serviceman is only required to collect Illinois service use tax if they have nexus with Illinois. For more information on determining nexus, see Audit Manual Chapter 7.

Calculating the Cost Ratio

In general, the cost ratio for out-of-state servicemen is calculated in the same way as for in-state servicemen: the serviceman’s annual aggregate cost of TPP transferred incident to all their sales of service is divided by their annual gross receipts from all sales of service. Servicemen with service sales in multiple states, however, may calculate the ratio using only sales to Illinois service customers provided that their records can clearly identify those Illinois sales and costs.

Tax Jurisdiction

The service occupation tax applies when a serviceman is engaged in the business of making sales of service in Illinois. (86 Ill. Adm. Code 140.101(a)) Servicemen engaged in out-of-state based service transactions, however, are not considered engaged in the business of making sales of service in Illinois and so do not incur an SOT liability. Instead, they are required to collect service use tax from their customers unless they are eligible to pay use tax on their cost of materials transferred.

How to Determine if an Out-of-State Serviceman is Required to Register and collect SUT

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There are two types of out-of-state servicemen who must register and collect service use tax:

- 1) Out-of-state servicemen whose cost ratio is equal to or greater than 35% (or 75% in the case of servicemen transferring prescription drugs or engaged in graphic arts production)
- 2) Out-of-state servicemen whose cost ratio is less than 35% (or 75% in the case of servicemen transferring prescription drugs or engaged in graphic arts production) but who make retail sales in Illinois which require them to register as a retailer and remit ROT or who make sales in their own state which, had those sales occurred in Illinois would have required them to register as a retailer and remit ROT in Illinois.

Out-of-state servicemen whose cost ratio is less than 35% (or 75% in the case of servicemen transferring prescription drugs or engaged in graphic arts production) and who do not make retail sales are not required to register or collect SUT.

There are generally three situations when service use tax will apply in audits:

- When any out-of-state serviceman transfers tangible personal property incident to performing services on-site in Illinois for end users in Illinois (UT if de minimis and not a ROT retailer).
- When any out-of-state non-de minimis serviceman transfers tangible personal property incident to performing services outside this state on goods destined to end users in Illinois. Be aware that credit may have to be given for taxes properly due and paid to the other state.
- When Illinois consumers acquire tangible personal property transferred incident to the purchase of service from servicemen when there is evidence that the customer was aware that both the proper tax due was the service use tax and that this amount was not paid to the vendor because they gave an improper exemption certificate. (86 Ill. Adm. 160.101)

5.9.1 SUT Items that are First Used Outside Illinois By Purchasers

- **Depreciation on Property Used Outside the State by a Business With Illinois Operations**

In-state taxpayers who acquire and use tangible personal property outside the state which subsequently becomes subject to the Service Use Tax Act when brought into the state are allowed to reduce their tax base by an amount which represents a reasonable allowance for depreciation for the prior out-of-state use. A "reasonable allowance for depreciation" is deemed by the Department to be the amount of depreciation determined by use of the straight-line method of depreciation. (86 Ill. Adm. Code 160.101(d)) In the absence of evidence to the contrary, the service life will be determined using federal income tax guidelines.

- **Property Used Outside The State by a Business With No Illinois Operations**

When a business that does not operate in Illinois, but which operates in another state opens a location in Illinois, they are exempt from the service use tax on property that was used outside the state for at least three months prior to being brought into Illinois. (86 Ill. Adm. Code 160.110(d))

- **Property Used Outside the State by Nonresident Individuals**

Property which would normally be subject to service use tax is exempt from taxation if it is used outside the state for at least three months by a non-resident individual. An individual is defined as a human who would complete a US 1040 if required to file an income tax return. It includes sole proprietorships, but does not include corporations, partnerships, trusts, or similar entities. (86 Ill. Adm. Code 160.111(c))

- **Temporary Storage**

Service use tax does not apply to the use in Illinois of property, which is acquired outside this State and which, subsequent to being brought into this State and stored here temporarily, is used solely outside this State or is physically attached to or incorporated into other property that is used solely outside this

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State. (86 Ill. Adm. Code 160.110(a)(3)) The exemption is also available for de minimis servicemen subject to use tax. (86 Ill. Adm. Code 150.310(a)(4)) The exemption does not extend to property acquired in Illinois.

Example: XYZ Company is an unregistered de minimis serviceman with a repair facility in Illinois which refurbishes electric motors. They purchase bearings for the motors from an unregistered out-of-state supplier. They are not subject to tax on the bearings incorporated into the motors that are shipped outside Illinois. They are subject to use tax on the bearings incorporated into the motors shipped within Illinois.

As part of every ROT/SOT assignment, purchases must be examined to determine if the taxpayer owes use tax. Use tax on purchases must be paid by taxpayers to their suppliers or by self-assessment on their sales tax returns. Use tax liability will be established per audit when the taxpayer fails to do either. The examination for use tax on purchases is required only when the taxpayer has operations in Illinois. The following areas must be examined in accordance with procedures outlined in Chapter 6 of the Audit Manual:

- Consumable supply purchases
- Fixed assets
- Inventory withdrawals for personal use or consumption
- Out-of-state purchases and internet purchases
- Credit and procurement card purchases

5.11.1 Serviceman is Also a Retailer and Construction Contractor

There are situations in which a taxpayer may be a construction contractor, serviceman, and a retailer of the same or similar parts used on service or construction contractor jobs. This may introduce multiple tax liability issues. Each of these sections below will look at the ways tax may potentially be due. The following details will be assumed for the potential tax obligations discussed below:

- the taxpayer operates a new and used appliance retail store;
- the taxpayer orders and sells new appliances, repairs used appliances and offers them for sale, sells new and used repair parts for all kinds of appliances to other servicemen and the general public, makes service calls to repair appliances, makes service calls on electrical, heating and air conditioning problems, and installs water heaters, furnaces and central air conditioner systems;
- all of their purchases are bought for resale;
- the taxpayer also removes used working parts off used appliances that won't be refurbished;
- some of these parts will be used in the refurbishing of used appliances, sold over the counter or used in their service work;
- on all of their invoices the taxpayer charges the local ROT rate on the selling price of all parts and appliances sold at retail;
- the taxpayer qualifies as an SOT de minimis serviceman because they are below the 35% threshold but has opted to pay SOT on the separately stated selling price of the TPP transferred;
- the taxpayer does not self-assess any use tax on their ST-1.
- And all tax collected is remitted to the Department.

5.11.1.1 RETAIL SALES MADE OVER THE COUNTER

Retail sale of new appliances: ROT is due on the selling price. Provided this is purely retail sale of the appliance. If the appliance was permanently affixed to real property, then UT would be due by the taxpayer.

Retail sale of used appliances: ROT is due on the selling price. All of the new parts purchased with a resale certificate and any used parts that went into the refurbishing of that appliance are included in the selling price of the refurbished unit. Provided they are transferred along with the used appliance in a retail sale.

Retail sale of new parts: ROT is due on the selling price.

Retail sale of used parts: ROT is due on the selling price. Even if the taxpayer's material cost is zero, if they establish a selling price and sell the used parts at retail, ROT would be due.

5.11.1.2 SERVICE CALLS

The taxpayer is required to be registered as a serviceman because they are registered as a retailer. The taxpayer is a de minimis serviceman and could have reported their tax liability on their material costs for the TPP transferred. However, they opted to charge tax on the selling price of the parts transferred. These service calls involved repairs of washers, dryers, stoves, refrigerators, dishwashers and window air conditioners.

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Taxation of TPP transferred: Although they could have paid SOT on the cost of the TPP transferred, by electing to state and collect tax on the selling price on the bill for the TPP transferred, this amount must be remitted to the Department.

In some cases, a taxpayer that is considered primarily a retailer may not be allowed to follow these provisions for service calls. See *Best Buy Stores v. Dep't of Revenue* 2020 Ill. App. 191680 (Ill. App. Ct. 2020) for reference. This case will also apply to this next situation below.

5.11.1.3 SERVICE CALLS THAT BECOME CONSTRUCTION CONTRACTS

If the taxpayer does not differentiate between repair services on items which remain tangible personal property when installed and items which are incorporated into real estate which are considered part of a construction contract, then they may be collecting tax incorrectly from customers on certain jobs.

EXAMPLE

Replacement of central air conditioning condensing unit:
 Cost = \$560, Selling price = \$1000,
 Tax rate = 7%, Labor = \$500.

Customer Invoice

Labor	\$ 500.00
Parts	\$1000.00
Tax	\$ 70.00
Total	\$1570.00

Assuming that this central air conditioning condensing unit is permanently affixed, the taxpayer would be over-collecting \$70.00 in tax from their customer. Since this was a construction contract, the customer should not have been charged tax.

Since this over-collection of tax was reported and paid to the Department, the taxpayer can be granted relief from their use tax obligation.

It is commonly service use tax and service occupation tax that is wrongly collected in these situations. The Board of Appeals has authorized, through the Board of Appeals General Order 03-3001, the granting of relief against the unpaid Illinois use tax liability resulting from the taxpayer's improper collection and remittance of the Illinois retailers' occupation tax to the Department of Revenue. This relief is based on the fact that the use tax and the retailers' occupation tax collected and remitted are for the same transactions, and that the retailers' occupation tax is equal to or greater than the amount of use tax owed on the same transaction. See Audit Manual Chapter 13 for additional information.

5.11.2 Oil Change/Quick Lube Services

Lube/oil changes are considered sales of service. However, when a lube/oil business sells accessories (with or without installation), to purchasers for use or consumption, retailers' occupation tax is due on these sales transactions. The term "accessories" includes but is not limited to items of tangible personal property such as air fresheners, wiper blades, valve stem caps, and the like.

retailers' occupation tax is also due when a quick lube/oil business makes "over-the-counter" sales to purchasers for use or consumption, apart from the rendering of service, such items as lubricants, grease, paint, wax, polish, lacquer, solder, materials for patching or repairing tires, and other tangible personal property.

5.11.3 Installation, Alteration and Special Service Charges

86 Ill. Adm. Code 130.450 - Charges made for installing tangible personal property in conjunction with the sale of the property are taxable if the installation charge is included in the price charged for the property. Installation charges are not taxable when separately contracted for, between the buyer and the seller, apart from the selling price of the item being sold. In this instance, the installation charge would be considered a separately contracted sale of service.

Service situations such as the sales of and the installation of filters, parts and oil changes and other similar tangible personal property by automobile servicemen or other servicemen as an incident to the furnishing of services in Illinois are taxable under the Service Occupation Tax. 86 Ill. Adm. Code 140.140(j)

When a seller engages in the business of selling tangible personal property at retail, and such tangible personal property is installed by the retailer, the receipts from such installation charges must be included in the gross receipts upon which the Retailers' Occupation Tax liability is measured if such installation charges are included in the selling price of the property being sold. If, however, the seller and buyer agree upon the installation charges separately from the selling price of the tangible personal property which is sold, then the receipts from the installation charges are not a part of the "selling price" of the tangible personal property which is sold. Instead, such charges constitute a service charge, separately contracted for, which need not be included in the figure upon which the seller computes his Retailers' Occupation Tax liability. See 86 Ill. Adm. Code 130.450.

If the installation is to permanently affix the tangible personal property to real estate, however, the retailer is acting as a construction contractor, and he incurs a Use Tax liability only on his cost price of materials.

5.11.4 Catalogs

Catalogs which are distributed free of charge by retailers within Illinois, to prospective customers, are considered use items to the retailer. Normally, catalogs are specially printed for a particular retailer. Printers may be subject to Retailers' Occupation Tax, Service Occupation Tax, Use Tax, or Service Use Tax. The type of tax applicable is determined by the types of service performed and the IDOR tax registration requirements for the service person and the circumstances of the sales and purchases

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made during the year. The regulations 86 Ill. Adm. Code 130.2105, 86 Ill. Adm. Code 140.101, and 86 Ill. Adm. Code 140.501 can be reviewed for information on this topic.

This can best be addressed by providing some examples. The examples presented here are not intended to be all inclusive. The examples are based on court cases and various rulings by Legal.

Example #1. An Illinois taxpayer has catalogs printed by an out-of-state printer. The out-of-state printer shipped the material to the Illinois taxpayer for sorting. The Illinois taxpayer mailed the catalogs both inside and outside of Illinois. Only those catalogs mailed to Illinois addresses are subject to Service Use Tax. The catalogs mailed outside Illinois would be exempt under the temporary storage exemption.

Example #2. An Illinois taxpayer has catalogs printed by an Illinois printer who sends them to an Illinois mailer who is the taxpayer's agent for addressing, sorting, and mailing. The Illinois mailer distributes the catalogs both inside and outside Illinois. All the catalogs would be taxable because they were printed and delivered in Illinois.

Example #3. An Illinois taxpayer has catalogs printed by an Illinois printer and the Illinois printer ships them to an out-of-state mailing company, hired by the printer, who mails them into Illinois and outside Illinois, tax is due on the catalogs sent to the Illinois customers.

Example #4. A Missouri company has catalogs printed outside Illinois. The catalogs are mailed from outside Illinois to customers inside and outside Illinois. No Service Use Tax is due because the printing and mailing occurred outside Illinois.

5.11.5 Veterinarians

- Veterinarians (86 Ill. Adm. Code 130.2165) – Veterinarians are engaged primarily in rendering service to their clients and are considered servicemen. As medical professionals regulated under the Veterinary Medicine and Surgery Practice Act of 2004 (“the Act”), [225 ILCS 115/1 et seq.](#), they typically provide services to persons with whom they have established a “Veterinarian-client-patient relationship (“VCPR”)” as defined in Section 3 of the Act. Under the Act, in order to maintain a valid VCPR, a veterinarian must maintain sufficient knowledge of the animal to initiate treatment and be readily available for follow-up. In addition, they must maintain adequate medical records, as provided in regulations adopted under the Act at 68 Ill. Adm. Code 1500.50(k), and must comply with certification, licensure, professional conduct, and disciplinary requirements, including continuing education mandates, as provided for by the Act and 68 Ill. Adm. Code 1500. Services provided by veterinarians are predicated upon compliance with these requirements. 86 Ill. Adm. Code 130.2165 is a resource for this topic.

Tax Liabilities of Veterinarians - In conducting a veterinary practice, veterinarians may incur different types of tax depending upon the nature of their activities. When licensed veterinarians transfer tangible personal property to their clients because of the practice of veterinary medicine, a service transaction occurs resulting in liability under the Service Occupation Tax Act. Veterinarians also sometimes sell items of tangible personal property to clients or even to the public outside the scope of a service transaction. In such cases, they are retailers engaged in the business of selling tangible personal property at retail and incur Retailers' Occupation Tax

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liability. In addition, veterinarians incur Use Tax on items of tangible personal property that are not transferred to their clients and instead are consumed by them while performing veterinary services.

The following sections describe the requirements for a “service transaction” and define the tax liability that results from these transactions. Also, described are the circumstances under which Retailers’ Occupation Tax liability and Use Tax liability are incurred by veterinarians.

Service Transactions – Requirements – Taxation -

1. For a transaction to be considered a service transaction for purposes of taxation, several requirements must first be met. Specifically:
 - A licensed veterinarian must have first established a valid VCPR with the service client as defined in Section 3 of the Act;
 - A licensed veterinarian must have physically examined the animal;
 - A veterinary practice must maintain medical records demonstrating that the animal for whom tangible personal property was transferred was physically examined by a licensed veterinarian in that veterinary practice no more than 1 year prior to the date on which tangible personal property was transferred;
 - The above requirements are not intended in any way to affect the requirements of the Act concerning the establishment or maintenance of a valid VCPR but are intended only to establish the type of tax liability that will be incurred by a veterinary practice.
2. When veterinarians engage in service transactions, they incur liability under the Service Occupation Tax Act. See [86 Ill. Adm. Code Part 140](#) for a detailed explanation of these liabilities. Assuming a valid VCPR has first been established, a service transaction occurs under the following circumstances:
 - A service transaction occurs when medicines, drugs and other products are directly applied or administered by a licensed veterinarian during a veterinary examination. Tangible personal property transferred may include but is not limited to vaccines; flea and tick products; shampoos; bandages; ointments; splints and sutures.
 - A service transaction occurs when a licensed veterinarian sells medicines, drugs, and other products having a medicinal purpose as part of a continuing plan for the health and well-being of an animal under his or her care. These drugs, medicines and other medicinal products may be products that Federal law restricts to use only by prescription from a licensed veterinarian or may be products which are recommended by the veterinarian under a continuing plan for the health and well-being of the animal. These transactions include refills of such drugs, medicines and other medicinal products that are made “over-the-counter” without a physical examination of the animal on the date of the refill. To document that qualifying items are transferred as

part of a continuing plan for the health and well-being of the animal, the following requirements must be met:

- The licensed veterinarian transferring items to the service client (or the veterinarian's designee) must enter a notation in the animal's medical records that such medicine, drug or medicinal product was recommended or prescribed as a result of an examination or after consultation with the service client; and
- The licensed veterinarian transferring items to the service customer (or the veterinarian's designee) must sign and contemporaneously date the notation in the animal's medical records; and
- The animal's medical records must demonstrate that a licensed veterinarian in the veterinary practice that transferred the items to the animal examined the animal no more than 1 year prior to the date on which the items were transferred.
- A medicine, drug, or other product having a medicinal purpose means items that are ingested by or applied to an animal and which cure or treat disease, illness, injury, or pain or mitigate the symptoms of such disease, illness, injury or pain. Such items may include, but are not limited to, items that are required to be prescribed by a veterinarian; nonprescription medicines; vitamins, herbal remedies and dietary and nutritional supplements (e.g., glucosamine chondroitin); medicated shampoos; topical flea and tick products applied directly on an animal for the control of fleas and ticks; and flea and tick collars. Such items also include dental products such as toothpaste, toothbrushes, and chews that are specifically designed to promote dental health in animals, insecticides and insect growth regulators that are applied by broadcast treatment (e.g., hand pump sprayers or pressurized aerosols) or with total release aerosols or foggers, products used to treat urinary behavior issues, collars worn by an animal after surgery to prevent the removal of sutures, and splints and braces.

Animal food is considered to have a medicinal purpose only if its manufacturer restricts its sale to licensed veterinarians. In order to document the requirement that the manufacturer restricts the sale of animal food to licensed veterinarians, a veterinarian shall annually obtain a letter from the manufacturer representing that the animal food is sold only to licensed veterinarians. Provided that a veterinarian maintains this letter in his or her books and records, the Department shall consider the animal food to have a "medicinal purpose" for the period of one year following the date of issuance of the letter.

The following items are not considered to have medicinal purposes: combs, brushes, shears, nail clippers, name tags, non-medicated shampoo, leashes, collars, toys; clothing; odor eliminators; and waste handling products.

Prescriptions for animals are subject to the high rate of tax. See, [86 Ill. Adm. Code 130.311](#).

Registration Requirements - The veterinarian must first determine if they must be registered with IDOR as a serviceman:

- If the veterinarian is registered as a retailer, then they must be registered and will owe and must collect SOT.
- If the veterinarian is not a retailer and is not required to be registered as a retailer, then they first must determine a cost ratio to determine if they need to be registered. This requires the following calculations:
 - Determine the total annual cost of the tangible personal property purchased that was transferred to customers, and compare that figure to
 - The total annual gross receipts from all sales of service (including labor charges) for the calendar year.
 - The ratio will be the cost of tangible personal property (TPP) purchased divided by gross receipts

$$\text{Cost ratio} = \frac{\text{cost of TPP purchased}}{\text{Gross receipts}}$$

If the cost ratio is equal to or greater than 35%, the veterinarian is required to be registered and would owe SOT on sales of service.

Reporting Requirements -

Registered Retailer – If the veterinarian is already registered as a retailer the following rules apply:

1. If the cost ratio is equal to or greater than 35%, the veterinarian is:
 - Required to remit SOT on the selling price of TPP transferred.
 - The veterinarian may determine their tax liability in the following ways:
 - Separately stated selling price - If the veterinarian separately states the selling price of the tangible personal property transferred incident to service on billings to customers, then the Service Occupation Tax Liability is based on that separately stated selling price. However, in no event can the Service Occupation Tax liability be based on an amount less than the serviceman's cost price of the tangible personal property being transferred.
 - 50% base - If the veterinarian's bill to the customer does not separately state the selling price of the tangible personal property transferred, the Service Occupation Tax liability is based on 50% of the entire customer bill. However, in no event can the Service Occupation Tax be based on an amount less than the serviceman's cost price of the tangible personal property being transferred.

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- The tax need not be separately stated on the service billing unless so requested by the customer.
2. If the cost ratio is less than 35%, the veterinarian is:
 - Required to remit SOT on the cost price of TPP transferred.
 - The serviceman may determine their tax liability in the following ways:
 - Cost price. The serviceman will use the cost (purchase) price as the basis of remitting SOT. The tax need not be separately stated on the service billing unless requested by the customer, OR
 - The serviceman **may opt** to pay SOT on the selling price of the tangible personal property transferred as detailed above.
 - Whichever method the serviceman chooses to report SOT liability, they must use that method for the entire fiscal year. The veterinarian cannot utilize other methods during that year to determine tax liability.

Required To Be Registered And Not A Retailer -

1. If the cost ratio is equal to or greater than 35%, the veterinarian is:
 - Required to remit SOT on selling price of TPP transferred.
 - The veterinarian may determine their tax liability in the following ways:
 - Separately stated selling price. If the veterinarian separately states the selling price of the tangible personal property transferred incident to service on billings to customers, then the Service Occupation Tax Liability is based on that separately stated selling price. However, in no event can the Service Occupation Tax liability be based on an amount less than the veterinarian's cost price of the tangible personal property being transferred.
 - 50% base. If the veterinarian's bill to the customer does not separately state the selling price of the tangible personal property transferred, the Service Occupation Tax liability is based on 50% of the entire bill. However, in no event can the Service Occupation Tax be based on an amount less than the veterinarian's cost price of the tangible personal property being transferred.
 - The tax need not be separately stated on the service billing unless so requested by the customer.

Not Required To Be Registered And Not A Retailer -

2. If the cost ratio is less than 35% - If the veterinarian is under the 35% threshold and is not a retailer, then there is no requirement to register with IDOR. The veterinarian will be liable for Use Tax and in some circumstances, Service Use Tax on the cost price of the tangible personal property transferred to customers incident to the sales of service. The

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veterinarian may pay the Use Tax or Service Use Tax by using any of the following methods:

- Directly pay the tax on their cost to an Illinois or out-of-state vendor or supplier who is registered to collect Illinois Use Tax.
- If the suppliers or vendors are not registered to collect Use Tax, the veterinarian must register with IDOR as a Use Tax filer, then must self-assess UT or SUT on the cost of those purchases made from these unregistered vendors or suppliers. **OR**
- Voluntarily register with IDOR as a serviceman and pay SOT in accordance with Sections [140.106](#) or [140.109](#). See the section above on Registered Retailer.

EXAMPLE 1: During a veterinary examination of a dog, a veterinarian breaks open a 6-dose package of flea and tick product and applies one packet to the dog. He recommends that the pet owner continue use of the flea and tick product and offers the remaining 5 packets for sale. If the customer purchases all 5 packets of the flea and tick product at the time of the service transaction, the veterinarian will incur liability under the Service Occupation Tax on the 6 pack of flea and tick product (one applied to the animal incident to service, the other 5 transferred to the customer as part of the service transaction). If the customer returns 6 months later and purchases 2 additional flea and tick packets without examination of the dog, the veterinarian will incur liability under the Service Occupation Tax if the proper documentation is maintained in books and records.

EXAMPLE 2: A pet owner discovers that their dog has fleas, so they take it to the veterinarian for treatment. The veterinarian uses a lice comb to examine for fleas and then applies a nonprescription flea and tick bath to treat the infestation. The veterinarian recommends that the client purchase additional bottles of the product to ensure that treatment is complete. The client returns 2 weeks later to purchase an additional bottle of product. The veterinarian will incur liability under the Service Occupation Tax on the flea and tick product used and sold to the client, as well as on the subsequent sale of the same flea and tick product (provided that the required documentation is maintained).

The veterinarian will incur Use Tax on the flea and tick comb that is used in practice (as well as other items used or consumed in the grooming and bathing of animals, such as towels, dryers, or disposable pads).

Retail Transactions – Taxation - Retailers’ Occupation Tax Liability will be incurred by veterinarians in the following circumstances:

- Retailers’ Occupation Tax liability will be incurred on the sale of any tangible personal property to persons with whom the veterinarian has not established a valid VCPR. Such items may be medicinal (e.g., a flea and tick product for application on an animal) or non-medicinal (e.g., non-medicated shampoos, combs, leashes, collars).

- Retailers' Occupation Tax liability will be incurred on the sale of any tangible personal property to persons with whom a veterinarian has established a valid VCPR if those items are sold outside the scope of the service transactions described above. The following items are transferred outside of the scope of a service transaction, regardless of whether a VCPR has been established: combs, brushes, shears, nail clippers, name tags, non-medicated shampoos, leashes, collars, toys, clothing, odor eliminators, and waste handling products.

Use Tax Incurred by Veterinarians - A veterinarian will incur Use Tax on tangible personal property that is used or consumed in the veterinary practice and that is not transferred to a customer. In Example 2 (above), these items would include the disposable pads, dryers, combs and towels. Other items might include, but are not limited to, cleaning supplies, tables or chairs, thermometers, and hand soap. Certificates of Resale cannot be used for the purchase of these items. Instead, Use Tax must either be paid to suppliers or if suppliers are not registered to collect tax, then the veterinarian must self-assess and remit Use Tax to the Department.

There are a variety of transactions that have the characteristics of both service, retail, and/or construction contracts. In many cases, the Department has crafted regulations to provide guidance for taxpayers on how to treat these transactions. The regulations include:

- Manufacturing Machinery & Equipment and Servicemen - 86 Ill. Adm. Code 130.330 & 86 Ill. Adm. Code 140.125(o)
- Manufacturer's Purchase Credit and Service Use Tax - 86 Ill. Adm. Code 130.331 - See also, 35 ILCS 110/3-70, & 35 ILCS 115/9
- Barbers and Beauty Shop Operators - 86 Ill. Adm. Code 130.1920
- Blacksmiths - 86 Ill. Adm. Code 130.1925
- Chiropodists, Osteopaths and Chiropractors - 86 Ill. Adm. Code 130.1930
- Construction contractors - 86 Ill. Adm. Code 130.1940
- Dentists - 86 Ill. Adm. Code 130.1956
- Optometrists and Opticians - 86 Ill. Adm. Code 130.1980
- Personalizing Tangible Personal Property - 86 Ill. Adm. Code 130.1995
- Rentals - 86 Ill. Adm. Code 130.2010
- Persons Who Repair or Otherwise Service Tangible Personal Property - 86 Ill. Adm. Code 130.2015
- Physicians and Surgeons - 86 Ill. Adm. Code 130.2020
- Picture-Framers - 86 Ill. Adm. Code 130.2025
- Public Amusement Places - 86 Ill. Adm. Code 130.2030
- Registered Pharmacists and Druggists - 86 Ill. Adm. Code 130.2035
- Retailers of Clothing - 86 Ill. Adm. Code 130.2040
- Sellers of Floor Coverings - 86 Ill. Adm. Code 130.2101
- Sellers of Machinery, Tools and Special-Order Items - 86 Ill. Adm. Code 130.2115
- Undertakers and Funeral Directors - 86 Ill. Adm. Code 130.2130

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- Vendors of Curtains, Slip Covers and Other Similar Items Made to Order - 86 Ill. Adm. Code 130.2140
- Vendors of Meals - 86 Ill. Adm. Code 130.2145
- Vendors of Memorial Stones and Monuments - 86 Ill. Adm. Code 130.2150
- Tax Liability of Sign Vendors - 86 Ill. Adm. Code 130.2155
- Vendors of Steam - 86 Ill. Adm. Code 130.2156
- Taxation of Seminar Material - 86 Ill. Adm. Code 140.129
- Interim Use and Demonstration Exclusions - 86 Ill. Adm. Code 150.306
- Exemptions to Avoid Multi-State Taxation, Temporary Storage - 86 Ill. Adm. Code 150.310(a)(4)

(The following are tasks the auditor will complete during an audit of a Serviceman. The list is not all inclusive.)

- A. Review applicable portions of Sales and Use Tax law and rules to determine the following:
 - 1. Is the serviceman providing taxable or non-taxable services and transactions?
 - 2. Is the serviceman de minimis?
 - 3. Is the serviceman required to be registered?
 - 4. Is the serviceman properly paying taxes on their cost price or selling price of the tangible personal property transferred?
- B. Determine whether the taxpayer is providing repair service, fabricating, or selling tangible personal property.
- C. Discuss the taxpayer's business operations including:
 - 1. Determine if the taxpayer performs any taxable services.
 - 2. Determine whether the taxpayer performs any fabrication which is not a service.
 - 3. Determine where the service facilities are located.
 - 4. Determine what types of customers the taxpayer services - commercial, residential, contractors, exempt entities.
- D. Determine that the exemptions being claimed are legitimate with sufficient documentation to support the exemption.
- E. Determine if the serviceman is lump sum billing or separately stating the selling price.
- F. Determine how the serviceman accounts for warranty repairs and check for sales of extended warranty contracts.
- G. Determine how the serviceman accounts for maintenance agreements and repairs.
- H. Determine how the serviceman accounts for and bills for multi-service situations. Does the serviceman charge a lump sum without separately stating the price of the repair parts transferred?
- I. Verify that the materials charge is equal to or greater than the cost of all materials used in the repair, including any itemized charges from a third party.
- J. Determine how the serviceman accounts for consumable supplies which are not transferred to the customer.
- K. Determine if the taxpayer has paid tax on all assets purchased during the audit period.
- L. Perform a compliance check to determine if the serviceman has filed and paid all other types of taxes that they may be responsible for.