

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 Part 140. (This is a GIL.)

February 27, 2008

Dear Xxxxx:

This letter is in response to your letter dated March 3, 2007, in which you request information. We apologize for the delay in responding to your inquiry. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.tax.illinois.gov to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

This request for information was original [sic] submitted to your sales tax department, but we were redirected to your office.

In an effort to be as accurate a [sic] possible in our contracting and tax reporting we need to update our files. ABC is a designer and supplier of materials for the construction of Earth Walls (Earth Walls) in the United States. We do not install or construct these walls. Please address the extent to which the following events are taxable in Illinois:

1. As a seller of Earth Walls for use on roadways and bridges, we also perform a number of engineering services related to the walls. The 'engineering' fee is for the design of the Earth retaining wall (i.e. Bridge Abutment, Sound Wall, etc.) and is usually paid upon approval of the design plans by the Department of Transportation or other Owner entity. On the contract it is either listed as a unit price per SF/SM of the total area or as a lump sum percentage (5%-18% depending upon the detail/complexity of the design) of the total contract price. Do we tax the standard engineering services that our clients are buying as part of the material contract?
2. When a contractor makes a change to the wall design, which requires us to perform additional Engineering and provide additional materials for their use, is the additional Engineering portion of the change taxable?

3. Occasionally, a client will come back to us after they've taken possession of the wall and ask for some other Engineering service related to the wall, but not as a part of the original contract. Is this extra engineering service taxable if we are no longer selling them the property (no materials), but are now advising on matters related to it?

4. Another scenario is where we produced the materials required for a wall and kept them in storage pending the contractor's needs. The contractor paid for those materials, but we kept possession of it for their convenience. The customer cancelled the wall which those materials were designated for and asked us to dispose of the materials. As a result of this change we charge them: 1) a disposal fee, 2) a storage fee, 3) an Inventory Fee, 4) an Administrative Fee, and 5) additional engineering. To what extent would these additional charges be taxable?

5. If a 'Mobilization' fee is broken out and charged up front at the start of the project as part of the contract terms, is this mobilization fee taxed?

6. If 'Freight' is broken out and charged as a separate line item as part of the contract terms separate from the material costs, are these freight expenses (actuals) taxed?

7. Assume that 'freight' is tax exempt. If our actual freight costs are \$1.00/SF from the material supplier, can we charge our customer \$1.78/SF for delivery? The \$1.78/SF is made up of \$1.00/SF from the actual freight invoice to our company PLUS an over head and profit markup. There is no handling or labor charge in this amount.

Thank you for your assistance.

DEPARTMENT'S RESPONSE:

Without review of the contractual agreements between your company and its customers we cannot provide you with a specific determination regarding the transactions you have described.

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. For your general information see of 86 Ill. Adm. Code 140.101 through 140.109 regarding sales of service and Service Occupation Tax.

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. Tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his activities. The serviceman's liability may be calculated in one of four ways:

- (1) separately stated selling price of tangible personal property transferred incident to service;
- (2) 50% of the servicemen's entire bill;
- (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or

- (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. 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. See 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction-by-transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen also collect a corresponding amount of Service Use Tax from their customers, absent an exemption.

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. 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.

Please see the Department's rules on treatment of transportation and delivery charges under the Retailers' Occupation Tax Act, 86 Ill. Adm. Code 130.415, which is available on the Department's website. As the regulation states, transportation and delivery charges, also designated as shipping and handling charges, are not taxable if it can be shown that the charges are agreed to separately from the selling price of the tangible personal property sold and the charges are actually reflective of the costs of shipping. To the extent the transportation and delivery charges exceed the costs of shipping, the charges will be subject to tax.

You may also want to review the Department's rules regarding sales to construction contractors, real estate developers and speculative builders at 86 Ill. Adm. Code 130.1940 and 130.2075.

I hope this information is helpful. If you require additional information, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Terry D. Charlton
Senior Counsel, Sales & Excise Taxes

TDC:msk