

When a construction contractor permanently affixes tangible personal property to real property, the contractor is deemed the end user of that tangible personal property. As the end user, the contractor incurs Use Tax on the cost price of that tangible personal property. See 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075. (This is a GIL.)

April 19, 2010

Dear Xxxxx:

This letter is in response to your letter dated February 9, 2010, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at [www.tax.illinois.gov](http://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:

The purpose of this letter is to obtain, in writing, direction on how to properly charge and pay sales tax. In our attempts to comply with the State of Illinois, we have made numerous phone calls to your Des Plaines office asking how to handle sales taxes. When we thought we had our procedures in place, along comes a field auditor from the state, who contradicts information previously given to us. She cites that the rules are confusing. It begs the question that if the rules are confusing to a field auditor, how is the average taxpayer to comply confidently.

I am hopeful that you can provide a guideline that will support our procedures should an audit be conducted in the future, or direct us to someone who can.

Going forward—COMPANY is an interior design firm doing mainly residential design work. If the rules are different for working in an office building, please advise. Design services are provided and also there are sales to clients of furniture, furnishings, custom window treatments, and reupholstery.

#### CARPETING

Recently, a client decided to replace some carpeting in the home. We obtained a quote from a supplier and prepared a proposal for the client. The client objected to the amount of sales tax on the proposal as it was based on the total amount of this carpet

replacement, specifically, materials and labor. This client pointed out that the estimate they received from a carpet store included sales tax on carpet only. We called your Des Plaines office and were told that in fact, if we used separate line items for the carpet and installation, sales tax need only apply to carpet. Further, installation on any product was not subject to sales tax. We discussed a 'common sense' approach: if the labor/installation can only be completed after the product is brought into the residence- do not charge tax on the installation. This week an auditor from the state is here and I posed this same question to her. She said that I shouldn't charge tax to the client at all, rather, pay the tax to our supplier, and adjust our selling price to the client to cover this extra cost to us. The reasoning is that carpet becomes part of the structure. I called the Des Plaines office again this morning, and was told to charge the client, but only on the carpet. Further, installation or labor on any product was not subject to sales tax. So we are getting contradictory information. What we would like to have documented is as follows:

1. In providing wall to wall carpeting to a client, do we charge them sales tax, and if so, is it on carpet only-or on carpet and installation?
2. If we do not charge client sales tax, do we pay our vendor sales tax on product only?
3. If the vendor does not charge us sales tax, do we add it to line 12a on form ST-1?

### DRAPERIES AND WINDOW TREATMENTS

We provide custom window treatments which consist of fabric, trim, sometimes hardware such as rods, rings, and these items are shipped direct to a workroom where the fabric is cut, sewn and fabricated into a window covering. We have received conflicting information on whether or not the labor cost in this case is subject to sales tax to our client. I have heard 'No, it is labor and labor is not taxable'. And 'Yes, it is taxable as it is part of a new product.'

1. What components are taxable to the client?

### REUPHOLSTERY

We find replacement fabric for furniture pieces currently in the possession of the client. We provide the fabric to a reupholstery firm and they pick up the existing piece of furniture and replace the fabric on it. We have been told that sales tax applies to both fabric and any other material and also to labor because both are needed to produce a finished product. We have also been told that the labor portion, if broken out on the proposal, is not subject to sales tax, as this is reworking of an existing product. A client recently pointed out that she could purchase the fabric and take her chair and fabric to a reupholsterer and not pay sales tax for that labor.

1. What components are taxable to the client?

### SALES TAX RATE CHANGES

In the course of business, we provide a proposal to a client listing the item or items proposed for sale with the cost of those items and this proposal also lists the sales tax amount applicable to this sale. This proposal is signed by COMPANY and also the client, and a deposit normally accompanies the signed proposal from the client, thus

creating a contract. In a few circumstances, a sales tax rate adjustment went into place between the time that the contract was signed and the time when the product was actually delivered. In the case of customer furniture or area rugs, the lead time can be several months.

1. When we invoice for merchandise in a case like this, do we charge sales tax as outlined on the contract—or on the tax rate in place on the date of the delivery?
2. In the event that we are to charge the increased rate, how do we justify it to a client?

### HANDLING CHARGES

When we invoice a client for an order, we add a handling charge of \$7.50.

1. Is this taxable to client?
2. Do we need to 'self-assess' sales tax to the state if we do not charge sales tax on this fee?

Thank you for your assistance in this matter. It is very much appreciated.

### **DEPARTMENT'S RESPONSE:**

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. See 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales.

### Construction Contractors

If a customer purchases tangible personal property, for example carpeting, over the counter without installation, then the retailer owes Retailers' Occupation Tax and must collect the corresponding Use Tax from the customer. If a customer purchases carpeting over the counter and separately contracts for installation of the carpeting, then the retailer owes Retailers' Occupation Tax and must collect the corresponding Use Tax from the customer on the sale of the carpeting. The separately contracted for installation of the carpeting is a separate service and no tax is incurred by the customer on the installation charges. See 86 Ill. Adm. Code 130.450.

A contract that provides for both the sale and installation of tangible personal property that is permanently affixed or incorporated into a structure is considered a construction contract. The tax liabilities regarding construction contractors in Illinois may be found at 86 Ill. Adm. Code 130.1940 and 130.2075 on the Department's Internet website. The term construction contractor includes general contractors, subcontractors, and specialized contractors such as landscape contractors. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, these contractors incur Use Tax liability for such purchases based upon their cost price of the tangible personal property. See 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075.

Therefore, any tangible personal property that a construction contractor purchases that will be permanently affixed to or incorporated into real property in this State will be subject to Use Tax. If such contractors did not pay the Use Tax liability to their suppliers, those contractors must self assess their Use Tax liability and pay it directly to the Department. If the contractors have already paid a tax in another state regarding the purchase or use of such property, they will be entitled to a credit against their Illinois Use Tax liability to the extent that they have paid tax that was properly due to another state. See 86 Ill. Adm. Code 150.310.

It is important to note that since construction contractors are the end users of the materials that they permanently affix to real estate, their customers incur no Use Tax liability and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to "reimburse" the construction contractor for his or her tax liability. Please note that this reimbursement cannot be billed to a customer as "sales tax," but can be listed on a bill as a reimbursement of tax. The choice of whether a construction contractor requires a tax reimbursement from the customer or merely raises his or her price is a business decision on the construction contractor's part.

In the case of floor coverings, the construction contractor must permanently affix the floor coverings to the real estate under the terms of the contract. 86 Ill. Adm. Code 130.2101. The floor coverings must be cemented or otherwise permanently affixed to the structure by use of tacks, staples, or wood stripping filled with nails that protrude upward (sometimes referred to as "tacking strips" or "tack-down strips"). Floor coverings that are area rugs or that are attached to the structure using only two-sided tape are not permanently affixed to the real estate. 86 Ill. Adm. Code 130.1940(c)(1).

#### Vendors of Curtains, Slip Covers and Other Similar Items Made to Order

If vendors of curtains, slip covers and other similar items made to order sell merchandise in addition to furnishing services, they incur Retailers' Occupation Tax liability on the receipts from the sales of the merchandise involved. See 86 Ill. Adm. Code 130.101. In computing the tax base for custom-designed merchandise, such as draperies, labor is included in the gross receipts subject to tax. Please see 86 Ill. Adm. Code 130.2140(b), which states, in part:

"(1) In computing Retailers' Occupation Tax liability on the retail sale of custom-made items, no deduction may be taken for the cost of labor involved in producing the finished item for sale. This is true whether such production labor is included in a lump sum price with the tangible personal property or whether such production labor is priced separately from the tangible personal property. The thing that is being sold is the finished item (drapes, carpeting, etc.), and the cost of labor involved in making such item is no more deductible than is the cost of labor that is involved in producing a stock or standard item for sale.

2) However, receipts from installation charges are deductible from total receipts in computing Retailers' Occupation Tax liability if such charges are contracted for by the seller and the purchaser separately from the selling price of the finished tangible personal property, but even receipts from installation charges are taxable if the installation charge is included in a lump sum price with the tangible personal property (see Section 130.450 of this Part.)"

#### Service Occupation Tax

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. The purchase of 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.

For example, when a serviceman repairs or reupholsters a chair to its original state for a customer, he or she incurs a Service Occupation Tax or Use Tax liability based on one of the four methods described above. When a serviceman contracts out all or a portion of the service that he will provide, he is acting as a primary serviceman in a multi-service situation. As a primary serviceman, he engages the services of a secondary serviceman in order to obtain all or part of the product and

services desired by the service customer. See 86 Ill. Adm. Code 140.145 to determine the tax incurred in these situations.

### Rate Changes

The Retailer's Occupation Tax is incurred on the gross receipts from the sale of tangible personal property at the tax rate in effect on the date of delivery of the property. If delivery occurs after the tax rate changes, and if receipts were received before the date of the rate change, and tax was paid on the receipts when received by the seller, no additional tax will be due or credit allowed because of the delivery of the property after the change in rate. See 86 Ill. Adm. Code 130.101(a). For situation involving sales to construction contractors, please see Section 130.101a)(2).

### Handling Charges

Handling charges represent a retailer's cost of doing business, and are consequently always includable in gross charges subject to tax. See 86 Ill. Adm. Code 130.410. However, such charges are often stated in combination with shipping charges. If this is the case, please see Section 130.410(c) and Section 130.415.

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

Very truly yours,

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