

Under the Service Occupation Tax, servicemen are taxed on tangible personal property transferred incident to a sale of service. See 86 Ill. Adm. Code Part 140. (This is a GIL.)

October 26, 2010

Dear Xxxxx:

This letter is in response to your letter dated June 4, 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 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:

I have been in contact with the Central Registration Division of the Department of Revenue inquiring about the Sales Tax exemption on consumable items (Food, drugs, and various consumable paper products) for community-based providers of residential services for people with developmental disabilities. They were unable to answer my questions in detail but referred me to this office, which is why I am writing this letter to you.

Historically, businesses that provide long term residential services for persons with developmental disabilities have been exempt from paying Sales Tax on items consumed by clients of the facility. The basis for this exemption, as I understand it, was that the business purchased these items to be consumed one hundred percent by Medicaid recipients. My attempt to gain statutory or regulatory support for such exemptions, however, has proven difficult. Nobody seems to be able to give me concrete answers as to whether businesses such as ours are rightfully or legally exempt from paying Sales Tax on consumable items purchased solely for use by Medicaid recipients who reside in our facilities.

Before we pursue this further we will wait for your response.

If you have questions or need clarification, call me.

DEPARTMENT'S RESPONSE:

Although we cannot give you a specific answer in the form of a General Information Letter, we hope you find the following helpful.

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. 35 ILCS 120/2; 86 Ill. Adm. Code 130.101. In Illinois, Use Tax is imposed on the privilege of using, in this State, any kind of tangible personal property that is purchased anywhere at retail from a retailer. 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

In general, though, sales made to Medicare and Medicaid are exempt from tax as sales to a governmental body so long as the exemption is properly documented through the use of an active exemption identification number ("E" number). See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare or Medicaid, tax is due upon any portion of the sale that is paid by individuals or private insurance companies not covered by Medicare and Medicaid. For example, when Medicare directly pays 80% of the total sale and the remaining 20% of the sale is paid by the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a sale to a governmental body while the 20% is taxable.

However, most hospitals and long-term care facilities are not considered to be in the business of making retail sales subject to the Retailers' Occupation Tax Act. Rather, they are considered to be servicemen. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information, you may want to review the Department's regulation at 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax. The purchase of tangible personal property that is transferred incident to a sale of service may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen utilize to calculate their liability.

Servicemen may calculate their tax base in one of four ways:

- (1) Service Occupation Tax on the separately stated selling price of the tangible personal property transferred incident to service;
- (2) Service Occupation Tax on 50% of the serviceman's entire bill;
- (3) Service Occupation Tax on the serviceman's cost price if the serviceman is registered de minimis serviceman; or,
- (4) Use Tax on the serviceman's cost price if the serviceman is de minimis and is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

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 (the second method described above). 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.

Under the fourth method, the de minimis serviceman incurring Use Tax liability is considered to be the end user of the tangible personal property transferred to service customers. In this situation, the de minimis serviceman's customer incurs no tax liability, since the customer is not the "user" of the tangible personal property transferred to him by the serviceman. Although liability rests with a serviceman, the Department has determined that a de minimis serviceman incurring a Use Tax liability may claim exemptions predicated upon either the exempt status of his customer or upon exemptions claimed by his customer based on nontaxable uses of the tangible personal property transferred by the serviceman.

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

Note, a nursing home may follow the procedures set out in Section 140.108 regarding purchases of tangible personal property that are being transferred to "E" number holders, provided the requirements of Section 140.108 are met. For purchases involving the transfer of tangible personal property in non-exempt transactions, a nursing home must either (1) register as a serviceman under the Service Occupation Tax Act and provide a certificate of resale to its suppliers and pay Service Occupation Tax under methods 1 through 3 described above, or (2) pay the Use Tax to its suppliers who are registered to remit Illinois tax and self assess Use Tax on purchases from suppliers who are not registered to remit tax to the Department. A de minimis serviceman who has registered with the Department only for the limited purpose of self assessing Use Tax is prohibited from using that registration number with suppliers to avoid paying tax on taxable purchases or to document exempt purchases.

As stated above, sales made to Medicare and Medicaid are exempt from tax as sales to a governmental body so long as the exemption is properly documented through the use of an active E

number. Accordingly, under the first method, if a registered serviceman separately states the selling price of the tangible personal property transferred incident to a sale of service and Medicare or Medicaid does not pay the entire amount of the bill, then only that portion of the bill paid by Medicare or Medicaid would be tax exempt. For example, the entire bill is \$300, the separately stated tangible personal property is \$100, and Medicare or Medicaid pays 80% of the bill. Medicare or Medicaid is considered to have paid \$80 of the \$100 charge for the separately stated tangible personal property and the remaining \$20 is paid by another person or entity. Thus, the \$20 paid by the other person or entity would be taxable.

Similarly, using the second method where the serviceman calculates its tax liability based on 50% of the entire bill, only that portion paid directly by Medicare or Medicaid would be tax exempt. For example, the entire bill is \$200, and Medicare or Medicaid pays 80% of the bill. Medicare or Medicaid is considered to have paid \$80 of the \$100 tax base with \$20 paid by another person or entity. The \$80 paid by Medicare or Medicaid would not be taxable, but the \$20 paid by the other person or entity would be taxable.

Under the third method, a registered de minimis serviceman is authorized to pay Service Occupation Tax (which includes local taxes) based upon his cost price of the tangible personal property transferred incident to the sale of service. Thus, if Medicare or Medicaid paid 80% of the entire bill, then 80% of the serviceman's cost price of the tangible personal property transferred would not be taxable. However, the remaining 20% of the cost price of the tangible personal transferred incident to the sale of service would be taxable.

However, if an unregistered de minimis serviceman elects to pay Use Tax on the tangible personal property transferred incident to a sale of service, he may claim exemptions based upon either the exempt status of his customer or upon exemptions claimed by his customer based on nontaxable uses of the tangible personal property transferred. For example, a customer's status as an exempt entity shall "flow through" to the de minimis serviceman making the sale of service. The Department has determined that a de minimis serviceman is relieved of his Use Tax liability when making sales of service to customers who have obtained an exemption identification number ("E" number) from the Department (see 86 Ill. Adm. Code 130.2005). The customer must provide its "E" number to the de minimis serviceman in order to relieve the de minimis serviceman of Use Tax liability on the purchase of tangible personal property being transferred to that customer. The de minimis serviceman utilizing this flow through may either present the customer's "E" number to his supplier in advance when making the purchase of tangible personal property that will be transferred to the customer, or, if tax was paid to the supplier, present it to the supplier along with a request that the supplier submit a claim for credit to the Department. If, however, the de minimis serviceman has previously self-assessed the Use Tax on that item to the Department, then the de minimis serviceman, himself, may file a claim for credit.

Please note that there is also an exemption from tax liability through June 30, 2011, for food for human consumption that is to be consumed off the premises where it is sold (other than alcoholic beverages, soft drinks and food that has been prepared for immediate consumption) and prescription and non-prescription medicines, drugs, medical appliances, and insulin, urine testing materials, syringes, needles used by diabetics, for human use, when purchased for use by a person receiving medical assistance under Article 5 of the Illinois Public Aid Code who resides in a licensed long-term care facility, as defined in the Nursing Home Care Act. 35 ILCS 115/13.

Lastly, it is not clear what you mean when you say "various consumable paper products" that are consumed 100% by Medicaid recipients. We assume that you are referring to the purchase of toilet paper, paper towels, and tissue used in your facility. If those items are paid for by Medicare or

Medicaid, then the above information would apply. If those items are not paid for by Medicare or Medicaid, then the purchase of those items would be taxable.

I hope this information is helpful. I realize that determinations of tax liabilities can be difficult, especially when one is attempting to mesh the complexities of the Service Occupation Tax with issues involving Medicaid payments. 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.

Very truly yours,

Debra M. Boggess
Associate Counsel

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