

A person who purchases tangible personal property for the purpose of giving it away makes a taxable use of the property and incurs Use Tax upon the purchase price of that tangible personal property. See 86 Ill. Adm. Code 150.305. (This is a PLR).

August 17, 2012

Dear:

This letter is in response to your Private Letter Ruling request dated February 14, 2012. 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.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY1 IBT # X, for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY1 nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

COMPANY1 ("the Company") respectfully requests a ruling concerning the sales and use tax requirements. The precise question is whether or not a service provided for breast cancer diagnosis using a test kit with a nominal value is subject to sales or use tax.

A. STATEMENT OF THE FACTS

1. Taxpayer Information:

a. **Names, addresses, and employer identification**

Interested Party: COMPANY1

Title: Wholly owned subsidiary of COMPANY2
(a COUNTRY corporation)

Address: X

EIN: XX

- b. Accounting periods, etc.** – The Company is a corporation formed under the laws of the State of STATE1 on June X, 20XX. COMPANY1 uses the accrual method of accounting and has a June 30th fiscal year end.

2. *Facts and Business Reasons Relating to the Transaction:*

The Company, a domestic subsidiary of foreign parent, COMPANY2 has introduced NAME genetic breast cancer risk test for assessing non-familial breast cancer risk in the United States (US).

The NAME breast cancer risk test is a genetic test panel that examines a patient's buccal (cheek) sample to detect the absence or presence of certain common genetic variations. The test is designed to help physicians assess breast cancer risk from these genetic markers, plus factors from a standard clinical assessment based on a patient's family and personal history. The cost of the test kit (defined below) is nominal and they are freely distributed to participating physician's [sic] within the state.

The Company's U.S. office is located in CITY, STATE2. The Company has a sales representative within the state of Illinois that will be providing the test kits to physicians. The sales representative operates from his home within the state. Otherwise, the Company maintains no physical presence within the state.

Participating physicians will use the "test kit" as part of their service provided to their Illinois patients. The test kit itself is a pre-printed box which contains a patient interview form, cotton swab and packaging to return the sample swab and interview form to its offices in CITY for processing. Each test kit costs approximately \$10 and are purchased directly from the Company's foreign parent. Once at the CITY office, the sample swab and patient information is received, documented and then sent to its parent company's labs in COUNTRY for test processing and results preparation. Once complete, the report is uploaded to a computer server and retrieved by the CITY office. The CITY office then forwards the report to the requesting physician.

Upon completion of test cycle, a third party claims processing service located in STATE3 processes an invoice and follows up with the physician, the patient and the patient's health care provider for payment.

B. ISSUE STATEMENT

The following rulings are respectfully requested:

The Company without an obvious physical presence in Illinois may be subject to sales or use tax. For Illinois to subject the Company to sales or use tax collection obligations, the Company must have nexus within the state. Accordingly, the following questions are posed:

1. Does the Company have nexus in Illinois?

2. Is the Company subject to sales tax on the processing and distribution of the test results?
3. Is the Company subject to use tax on the distribution of test kits to physicians?

C. STATEMENT OF LAW

In conjunction with our research, we contacted the Illinois Department of Revenue, Sales & Use Tax Division. Pursuant to our communications with various representatives, the following are citations provided by them in connection with the facts and circumstances noted above.

Nexus

According to Use Tax Nexus §150.201(i)(1) of the Illinois Administrative Code, a tax will be required if there is a 'retailer maintaining a place of business in this State', or any like term directly or by a subsidiary, an office, distribution house, sales house, warehouse or other place of business, or any agent or other representative operating within this state under the authority of the retailer or its subsidiary, irrespective of whether such place of business or agent or other representative is located here permanently or temporarily, or whether such retailer or subsidiary is licensed to do business in this State.

Sales Tax

Illinois Use Tax Nexus §150.201(i) of the Illinois Administrative Code, addresses nexus attributable to persons engaged in specific activities within the State that would constitute maintaining a place of business in the State. Subsection (2) states soliciting orders for tangible personal property, and Subsection (8) states sellers' acceptance of a purchase order.

In connection with the laboratory testing service, according to Retailers' Occupation Tax §130.120(d) of the Illinois Administrative Code, and Service Occupation Tax §140.125(c) of the Illinois Administrative Code, personal services rendered are not subject to sales tax.

Use Tax

In connection with the test kit, pursuant to Retailers' Occupation Tax §130.311(d)(5) of the Illinois Administrative Code, laboratory equipment, kits, and supplies such as medicated cotton swabs do not qualify for a reduced rate. On the other hand, pursuant to Use Tax §150.337 of the Illinois Administrative Code, the use tax shall not apply to the use of prescription and nonprescription medicines, drugs, medical appliances, insulin, urine testing materials, syringes, needles used by diabetic, [sic] for human use, when purchased by serviceman [sic] for use by a person receiving medical assistance.

D. ANALYSIS OF THE LAW

Nexus

According to Use Tax Nexus §150.201(d)(i) of the Illinois Administrative Code, it appears that having a representative present in the State of Illinois will create nexus. Based on the facts above, the Company will have a sales representative within the state to help gain expression of interest, to promote the tests, and to provide the test kit at no cost directly or via the STATE2 office to participating physicians.

Sales Tax

We then did a further analysis to determine if the tests [sic] kits were subject to the collection of sales tax. Under Retailers' Occupation Tax §130.120(d) of the Illinois Administrative Code, and Service Occupation Tax §140.125(c) of the Illinois Administrative Code, we believe the Company is exempt from the sales tax for the service of providing a breast cancer diagnosis by doing laboratory testing from the patients buccal (cheek) swab by using cotton swab provided in the test kit which is then sent to the laboratory in COUNTRY.

Use Tax

It is unclear as to whether the test kits are subject to a use tax for Illinois purposes as there is a gray area as to what category the test kits fall into.

The Retailers' Occupation Tax §130.311(d)(5) of the Illinois Administrative Code states that diagnostic equipment shall not be deemed to be a medical appliance, except as provided in Subsection (1). Other medical tools, devices and equipment such as x-ray machines, laboratory equipment and surgical instruments that may be used in the treatment of patients but, that do not directly substitute for a malfunctioning part of the human body do not qualify as medical appliances. The code states that sometimes a kit of items is sold where the purchaser will use the kit items to perform treatment upon himself or herself. Such "kit" will contain paraphernalia and sometimes medicines. An example as provided in Illinois's [sic] statute is a kit sold for the removal of ear wax. Because the paraphernalia hardware is for treatment, it generally does not qualify as a medical appliance. However, the Department will consider the selling price of the entire kit to be taxable at the reduced rate when the value of the medicines in the kit is more than half of the total selling price of the kit. It also indicates that supplies, such as cotton swabs do not qualify. Please note that no sales tax will be collected on the breast cancer diagnosis test kits by the Company as the kits will be provided at no cost to the participating physicians. Therefore, we believe the test kit maybe [sic] subject to a use tax as it involves tangible medical supplies (cotton swabs) used as part of the service provided.

Alternatively, under Use Tax §150.337 of the Illinois Administrative Code, the test kits could be exempt from use tax if they fall into the category of "testing materials for human use".

Additionally, we believe if the Company is required to pay a use tax, it will be based on the purchase cost of the test kit used for the service multiplied by the amount of kits utilized in the State of Illinois multiplied by the current state rate, assuming no sales tax paid to vendor. Should COMPANY1 pay sales tax to the vendor on the purchase, the

use tax paid to Illinois will be based on the difference between the sales tax paid, and the Illinois use tax rate in effect at the time of purchase.

Therefore, we conclude from our analysis of the law that the Company is exempt from sales tax but, that they may be subject to use tax in the State of Illinois. Please note that specific facts and circumstances, as outlined on page two above should be considered confidential information and should not be subject to public disclosure.

E. DOCUMENT LIST

- Process cycle documents
- Sample invoice
- Signed Power of Attorney

With respect to each of the issues that are involved in this ruling request, the facts are represented to the best of our knowledge. If there should be any questions, or if additional information is desired please feel free to contact me at X.

DEPARTMENT'S RULING:

Nexus

The Department declines to make nexus determinations in the context of Private Letter Rulings or General Information Letters because the amount of information required to make those determinations is often best gathered by an auditor. The following information outlines the principles of nexus, which we hope is helpful to you.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the

Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Zehnder*, 171 Ill.2d 410, (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State.

Notably, you stated in your letter that COMPANY1 has a sales representative within the state of Illinois.

Sales and Use Tax

Unless an exemption applies, 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.

Based on the representations you made in your letter, COMPANY1 will not be reselling the NAME genetic breast cancer risk tests. Rather, they will be provided to physicians at no cost so that the physicians may utilize the breast cancer diagnosis services offered by COMPANY1. Therefore, COMPANY1 would owe Use Tax on its cost price of the test kits that are purchased outside the state and brought into Illinois to be given to the physicians. See 86 Ill. Adm. Code 150.305(c). However, if tax was properly due and paid in another state on the test kits brought into Illinois, then your client may credit the amount of that tax paid on its return in determining its Illinois Use Tax liability. See 86 Ill. Adm. Code 150.310(a)(3).

For clarification, we wanted to note that the exemption you cited to in the Department's regulations at 86 Ill. Adm. Code 150.337 is inapplicable to the test kits described in your letter. That Section does not provide a blanket exemption from Use Tax on items that you described that "fall into the category of [']testing materials for human use[']." Rather, that Section provides a specific exemption from Use Tax on prescription and nonprescription medicines, drugs, medical appliances, and insulin, urine testing materials, syringe, and needles used by diabetics, for human use, when purchased by a serviceman for use by a person receiving medical assistance under Article 5 of the Public aid code who resides in a licensed long-term care facility, as defined in the Nursing Home Care Act. The NAME genetic breast cancer risk test described in your letter is used for testing or treatment purposes and does not fall within that exemption.

Service Occupation Tax and Use Tax

Illinois Service Occupation and Use Tax 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. See 86 Ill. Adm. Code 140.101.

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

As stated above, Illinois Service Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. In Illinois, information or data that is electronically downloaded is not considered the transfer of tangible personal property. See 86 Ill. Adm. Code 130.2105(a)(3). Via e-mail, we asked you to clarify how your client forwarded the reports to the requesting physicians. In your e-mail response, you stated that your client's STATE2 Office sends the reports either by U.S. mail or by Federal Express to the requesting physicians. Thus, when COMPANY1 charges for the processing of the test and distribution of the test results and forwards those results to the requesting physicians in a tangible format (written document), then those transactions would involve a transfer of tangible personal property. You have further notified us by e-mail that the annual aggregate cost of the materials (*i.e.* paper and ink) that are transferred by COMPANY1 to the requesting physicians are below the 35% threshold for *de minimis* servicemen. See 86 Ill. Adm. Code 140.109. Even though COMPANY1 is registered with the Department as a retailer and would not be able to take advantage of the fourth method listed above, it can remit Service Occupation Tax based on its cost price of the written test materials (*i.e.* paper and ink) transferred to service customers in this State under the third method listed above.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter ruling, you may contact me at 782-2844. If you have further questions related to Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Terry D. Charlton
Chairman, Private Letter Ruling Committee