

This letter concerns tax imposed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code Part 140. (This is a GIL.)

June 29, 2012

Dear:

This letter is in response to your letter dated August 29, 2011, 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:

XXX Company, respectfully requests a General Information Letter regarding the application of the Illinois Retailer's [sic] Occupation Tax related to the purchase of its packaging and shipping materials used in shipping of products to XXX Company's customers.

Statement of Facts:

XXX Company receives shipments of metal bars/pieces that have been purchased and remain owned by the XXX Company customers. XXX Company customers are manufactures [sic] that need their metal pieces electroplated before they sell it. The electroplating process involves depositing a finish (layer of material to surface). This layer adds a protective coating and beautifies the previously bare metal. A fee is paid by the XXX Company customers for the additional processing completed by XXX Company.

Upon completion of the electroplating process, XXX Company bundles the metal bars/pieces to ship back to their customer by wrapping them in kraft paper, with paper inserts between the layers of bars and other packaging materials. The packaging materials protect the metal from damage that could take place during the shipping process. The packaging materials remain with the product and are not returned to XXX Company for further use.

Request:

We hereby request a General Information Letter regarding the taxability of the packaging materials purchased by XXX Company used in the shipping process.

DEPARTMENT'S RESPONSE:

The work performed for customers as described in this letter would be a sale of service. 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 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) 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.

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. Servicemen may qualify as *de minimis* if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of sales of service is less than 35% of the servicemen's annual gross receipts from service transactions (75% in the case of pharmacists and

persons engaged in graphic arts production). 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.

We cannot tell from your letter how the company is required to satisfy its liability. If it would be under one of the first three methods, the company could provide its supplier with a resale certificate and remit Service Occupation Tax upon the transfer to its customer, assuming all ownership rights to the packaging and shipping materials are unequivocally transferred to the customer. If the company is de minimis and not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act, it would owe use Tax liability to its supplier. If the company's suppliers are not registered to collect and remit tax, the company must register, self-assess, and remit Use Tax to the Department. A resale exemption would not be appropriate in this situation because the company would be the "user" of the materials. In addition, please note that any tangible personal property that is used or consumed in the process of electroplating, but that is not transferred to the customer, is subject to Use Tax by the company.

Please note that a serviceman who incurs SOT on his or her selling price is authorized to claim any exemption provided for in the Service Occupation Tax Act. For example, he or she may claim the interstate commerce exemption or accept various exemption certificates from his or her customers (e.g., Certificates of Resale, exemption identification numbers). 86 Ill. Adm. Code 140.106(d). A de minimis serviceman incurring Service Occupation Tax liability on his or her cost price also is authorized to claim any of the various exemptions provided for in the Service Occupation Tax Act. For example, he may claim the interstate commerce exemption or accept various exemption certificates from his customers (e.g., he can accept Certificates of Resale). 86 Ill. Adm. Code 140.109 (a)(3). The Department has also determined that a de minimis serviceman incurring a Use Tax liability may claim any of the exemptions, except as provided in 86 Ill. Adm. Code 140.108(a)(2)(C), authorized under the Service Occupation Tax Act. De minimis servicemen incurring Use Tax liability may likewise claim the interstate commerce exemption, which is more fully explained at 86 Ill. Adm. Code 130.605 and 86 Ill. Adm. Code 140.108(a)(2)(B).

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.

Sincerely,

Samuel J. Moore
Associate Counsel