

ST 16-0051-GIL 09/30/2016 LEASING

Information regarding the tax liabilities in lease situations may be found at 86 Ill. Adm. Code 130.220 and 86 Ill. Adm. Code 130.2010. (This is a GIL.)

September 30, 2016

Dear Xxxxx:

This letter is in response to your letter dated June 20, 2016 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:

Here is the scenario:

Company A: owns equipment and leases to Company B and Company C
purchases all lab supplies and raw materials, delivers to
Company B and Company C owns and rents the building that
houses Company B and Company C

Company B: Laboratory - manufactures dentures, custom per patient

Company C: Dental practice

Sales and Use tax issues:

*Company A: pays sales tax to state for gross amount of rents received for both
the real estate and the equipment?

*Company B: Charges sales tax on the sale of the completed dentures to
Company C?

- * Pays use tax on supplies purchased for which no sales tax was charged?
- * Pays use tax on raw materials used in the manufacturing process of the dentures?

- *Company C: Charges sales tax on the sale of the dentures to the patient?
- * Pays use tax on supplies purchased on which no sales tax was charged?

DEPARTMENT'S RESPONSE:

Sales Tax

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property at retail to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. In Illinois, a Use Tax is also 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.

Service Occupation Tax

Custom work performed for patients (e.g., the manufacturing of dentures, custom per patient) would be considered a sale of service. As such, under Illinois law, a dentist engaged primarily in a service occupation is deemed a serviceman. The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the serviceman, depending upon which tax base the serviceman chooses to calculate his or her liability. A serviceman may calculate his or her tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if he or she is a registered de minimis serviceman; or (4) Use Tax on 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 sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. They are required to collect the corresponding Service Use Tax from their customers.

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. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See, 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen is authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of

tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the tangible personal property transferred to service customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2(a) of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self-assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. These servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. These servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen do not have the option of determining whether they are de minimis using a transaction-by-transaction basis.

Assuming that a dentist qualifies as a serviceman under the fourth method above, (the dentist's annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of his or her annual gross receipts from service transactions and he or she is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act) the dentist could pay his or her supplier Use Tax on the cost price of the tangible personal property transferred to his or her customers in conducting his or her service.

You appear to be describing a multi-service situation. 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 (dentist), he engages the services of a secondary serviceman (laboratory) in order to obtain all or part of the product and services desired by the service customer. Whether the primary and secondary servicemen are registered or not or de minimis or not will determine what type of tax will be incurred as well as who will incur the tax. The provisions of 86 Ill. Adm. Code 140.145 explain the different ways in which servicemen may handle their tax liability in multi-service scenarios.

Please note that a medical appliance is an item that is intended by the manufacturer to directly substitute for a malfunctioning part of the body. Dentures generally qualify as such and are taxed at the lower State rate of 1%. See, 86 Ill. Adm. Code 130.310. Also, dentists incur Use Tax when they buy consumable supplies and fixed assets for use in their practice (see 86 Ill. Adm. Code 130.310) that are not transferred to patients. Examples of items that would be subject to the full rate of tax at 6.25% when sold to dentists are dental hand instruments, materials used for dental impressions, as well as other items used by dentists which do not become a physical part of teeth or dentures.

Leases

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases. A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2010.

A true lease generally has no buy out provision at the close of the lease. If a buy-out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability. See 86 Ill. Adm. Code 130.2010. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois are the parties with Use Tax obligations. The lessors should either pay their suppliers, if their suppliers are registered to collect Use Tax, or self-assess and remit the tax to the Department. If the lessors have already paid tax in another state with respect to the acquisition of the tangible personal property, they are exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3).

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.

Very truly yours,

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