

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL).

December 30, 1999

Dear Xxxxx

This letter is in response to your letter dated October 11, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

COMPANY is in the aircraft engine repair and overhaul business. We are qualified to do business in Illinois. Our customers generally consist of commercial airlines, small privately owned repair shops, privately owned aircraft, and corporate owned aircraft. When an engine needs to be overhauled or requires major repair, it is removed from the aircraft at its regular maintenance location and shipped to our repair facilities here in CITY. When repairs are completed, the engine is then returned FOB shipping point to the customer in Illinois.

As part of our repair and overhaul services, turbine engines must be tested to determine if a repaired engine is functioning properly. To do this, COMPANY purchases fuel and oil to be used in the testing process and then charges the customer. All fuel is consumed in our repair facility in Texas. Any excess is removed from the engine prior to shipment. The customer is charged cost plus mark-up of 5-25%. In most cases, the cost of the fuel is separately stated in the invoice. However, in some cases, we perform overhauls on a lump-sum basis.

In many cases, COMPANY furnishes a replacement rental engine to the customer during the period required to repair or overhaul the engine. In addition, we use a variety of revenue classifications to account for each or the various services performed. Our normal invoices for engine repair include a number of these revenue classifications as separately stated charges. The next couple of pages contain descriptions of the various categories of revenue. Please send us your ruling as soon as possible to assist us in our invoicing process.

REQUEST FOR A LETTER RULING

In light of the above facts, we respectfully request a letter ruling on the sales and use tax treatment for the following categories of revenue, giving cites supporting your position:

1. **SPECIAL PROCESS:** A flat rate charge for labor, materials, and overhead used in the performance of special process functions such as x-rays for internal engine cracks or plasma spray. The billings for special process activities are lump-sum.
2. **TIME & MATERIALS LABOR:** A charge for labor billed on an hourly rate instead of a flat rate usually used in repair work. This classification constitutes labor only.
3. **SUB-CONTRACT:** A component of an engine is sent to a third party to be serviced or repaired. This charge is marked up and re-invoiced to the customer.
4. **FREIGHT:** Separately stated charge for shipping to/from customers. COMPANY does not mark-up the amount charged by the freight company.
5. **CUSTOMER FURNISHED PARTS & SUPPLIES FEE:** A handling fee charged to a customer when the customer provides the parts for COMPANY to use in a repair service. The handling fee is above and beyond the charge for labor.
6. **AIRFRAMES, INTERIORS & AVIONICS:** A charge for work done to the interior, exterior, electrical, or electronics parts of an aircraft that are not directly related to the engine.
7. **TRADE-IN SERVICE CHARGE (ROTABLE FEE):** A fee paid by customers who use parts from COMPANY's rotatable inventory, which is an inventory of reconditioned parts. The fee is calculated as a percentage of the parts list price and is done to expedite customer work.
8. **TRADE-IN ALLOWANCE (EXCHANGE):** A credit allowed by COMPANY for used parts taken in trade when a customer purchases new parts.
9. **LEASE RENTAL FEES:** A rental fee charged for the lease of an engine or engine module while the customer's engine module is being repaired. COMPANY may furnish a replacement rental engine to a customer while the customer's engine is being serviced.
10. **FOREIGN INSURANCE:** A charge passed through to the customer from an outside insurance company when an engine is transported to a foreign location. COMPANY does not mark-up the charge for foreign insurance.

11. **FUEL AND OIL USED IN TESTING ENGINES:** A charge passed through to the customer for fuel and oil used in testing customer engines. All fuel is consumed at the repair facility or removed from the engine prior to shipment to the customer. The charge is for cost plus a mark-up by product line of approximately 5 - 25%. Should COMPANY be the consumer of the fuel and oil only when it performs repair services on a lump-sum basis? In cases where COMPANY separately states the charge for fuel and oil to the consumer, should they be considered the retailer of the fuel and thereby obligated to collect Illinois sales tax on charges for such fuel and oil to its Illinois customers?
12. **PARTS:** A charge for aircraft parts sold to customers.
13. **TEST CELL FEES:** A fee for the use of our test cell. A test cell is a special facility used to test engines against the original manufacturers standards of power, vibration, and heat.
14. **ENVIRONMENTAL FEES:** Are environmental fees taxable in Illinois, if applicable?

If the above charges are included in a **LUMP-SUM** invoice, how will that affect the sales and use tax treatment of the above items?

Please feel free to contact me if you have questions concerning the above. I greatly appreciate your assistance in this matter.

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

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 servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their 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 they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under 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 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. Upon selling their product, 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) enclosed. 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 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 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. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis.

In the Service Occupation Tax context, the manner in which shipping and handling and postage charges are taxed depends upon how the serviceman calculates his or her Service Occupation Tax liability. If the selling price of the tangible personal property transferred incident to service is separately stated, the shipping charges are not taxable. However, if these charges are not separately stated, the Service Occupation Tax taxable base is 50% of the entire service bill, which includes the shipping charges. Under the de minimis serviceman situations, whether registered or not, the issue of shipping charges is moot because the tax liability is handled by paying Use Tax or Service

Occupation Tax on the cost price of the tangible personal property transferred to the service customer.

86 Ill. Adm. Code 130.410 provides that "[i]n computing Retailers' Occupation Tax liability, no deductions shall be made by a taxpayer from gross receipts or selling prices on account of the cost of property sold, the cost of materials used, labor or service costs, freight or transportation costs, overhead costs, clerk hire or salesmen's commissions, interest paid by the seller, or any other expenses whatsoever." We do not know specifically which fees you are referring to. However, environmental fees imposed upon importers or producers are not deductible in computing gross receipts from sales. They are merely part of a retailer's cost of doing business, which are not deductible. See Section 130.445, enclosed. Environmental fees are generally costs of doing business and are consequently always included in gross charges subject to tax. In a Service Occupation Tax context, costs of doing business apply only if the first two methods of tax computation are used. In these two methods, such fees should be included in the selling price of the tangible personal property. In regards to methods three and four, the fees would no be included because the serviceman is either paying Service Occupation Tax based upon the cost price of the tangible personal property transferred incident to a sale of service or is paying Use Tax to his suppliers.

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.

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. See the enclosed copy of 86 Ill. Adm. Code 130.220. 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.

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 would be the parties with Use Tax obligations. The

lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be 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) enclosed.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

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. The tax is measured by the seller's gross receipts from such sales made in the course of such business. See the enclosed copy of 86 Ill. Adm. Code 130.101. "Gross receipts" are considered to mean all the consideration actually received by the seller, except traded-in tangible personal property. See the enclosed copies of 86 Ill. Adm. Code 130.401 and 130.425. The tangible personal property must be taken by the seller in trade as all or part of the consideration for a sale. See Section 130.425(e).

No specific certification is required to document a trade-in. However, the retailer must maintain sufficient books and records to document such trade-ins. A purchaser may trade-in more than one item toward the purchase of another item or items from a retailer. Please note that the item or items to be traded-in must be of like kind and character as that which is being sold.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

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Associate Counsel

MAJ:msk
Enc.