

ST 16-0025-GIL-06/09/2016 SERVICE OCCUPATION TAX:

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

June 9, 2016

RE: Sales Tax on Eyeglasses

Dear XXXXX:

This letter is in response to your letter dated April 21, 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:

This letter requests information regarding the applicability of sales tax, or Use Tax, on the sale of eyeglasses to patients covered under a Medicare Advantage Plan, Medicaid Plan or Medicare Plan provided by a Health Maintenance Organization (“HMO”) or other managed care plans.

Previous General Information Letters (“GILS”) have noted that under the traditional Medicare and Medicaid plan, sales made directly to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification. See ST 13-0037-GIL; ST 11-0074-GIL. We also understand that while no sales tax, or Use Tax, may be due on payments made directly to vendors by Medicare, Medicaid or the Illinois Department of Healthcare and Family Services, sales or Use Tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare or Medicaid.

We are seeking a determination as to whether or not vision providers are required to charge sales tax, or Use Tax, to HMOs on eyeglasses that are sold to Medicare or Medicaid patients.

DEPARTMENT'S RESPONSE:

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 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. See 35 ILCS 105/3; 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois. If the purchases occur in Illinois, the purchasers must pay the Use Tax to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases occur outside Illinois, purchasers must self-assess their Use Tax liability and remit it directly to the Department.

Retailers' Occupation Tax and Use Tax do not apply to sales of service. 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 serviceman depending upon his activities. The serviceman's liability may be calculated in one of four ways:

- (1) separately-stated selling price of tangible personal property transferred incident to service;
- (2) 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 *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 incident to 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 serviceman's cost price of the tangible personal property transferred. See 86 Ill. Adm. Code 140.106. These methods result in the customer incurring a Service Use Tax liability. See 86 Ill. Adm. Code 160.101.

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 incident to 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 do not 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. This method also results in the customer incurring a Service Use Tax liability.

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. 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. Under this method the customer incurs no Service Use Tax liability. However, they generally either seek reimbursement of the tax from their customers or build the tax into their prices.

Prescription and non-prescription medicines, drugs and medical appliances, for human use, are not exempt from tax. A tax is imposed on these items at the rate of 1%. 35 ILCS 120/2-10; 86 Ill. Adm. Code 130.310(a). A medical appliance is an item that is used to directly substitute for a malfunctioning part of the human body. These items may be prescribed by licensed health care professionals for use by a patient, purchased by health care professionals for the use of patients, or purchased directly by individuals. Corrective medical appliances such as eyeglasses and contact lenses qualify for the low rate of tax. See 86 Ill. Adm. Code 130.310(c)(2). These rules apply to retailers as well as servicemen. See 35 ILCS 115/3-10; 86 Ill. Adm. Code 140.126.

When optometrists sell tangible personal property to purchasers for use or consumption apart from their rendering of service as optometrists, they incur Retailers' Occupation Tax liability. This is the case, for example, when optometrists sell eyeglasses, frames or mountings, without examination or treatment of the eyes, to purchasers for use or consumption, or where optometrists sell such items as sun glasses, cleaning solutions for lenses, or other tangible personal property to purchasers for use or consumption apart from their rendering of service. See 86 Ill. Adm. Code 130.1980(a).

When health care professionals such as optometrists render service, they are not subject to Retailers' Occupation Tax liability. They are, however, subject to liability under the Service Occupation Tax Act to the extent they transfer tangible personal property incident to their rendering of service. Servicemen incur tax liability in these transactions under one of the four methods described above.

What this all means for an optometrist at or above the 35% threshold is that the optometrist may purchase the eyeglass components with a resale certificate, and the optometrist would pay Service Occupation Tax at the 1% rate under the first or second methods described earlier (see Section 140.106). If the optometrist is below the 35% threshold, he or she may pay Service Occupation Tax at the 1% rate on either his or her cost price as described in Section 140.109 (assuming he or she is otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act), or pay on his or her selling price as described in Section 140.106. In either event, he or she should provide suppliers with Certificates of Resale. If the optometrist below the

threshold is not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act, he can pay Use Tax on his or her cost price as explained in Section 140.108.

The Department's existing GILs provide guidance for sales to Medicaid and Medicare patients. In ST 11-0074 (GIL), the Department stated:

"Under the traditional Medicare and Medicaid plan, sales made directly to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision of an active exemption identification number. See 86 Ill. Adm. Code 130.2080(a). While no tax may be due on payments made directly to vendors by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services, tax is due upon any portions of bills paid by individuals or private insurance companies not covered by Medicare, Medicaid, or the Illinois Department of Healthcare and Family Services. This means, for example, when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. 86 Ill. Adm. Code 130.2005 and 130.2007.

"It is important to note that payments will only be exempt from tax when they are paid directly to the provider/vendor by the government agency that has been issued an active exemption identification number by the Department. It is not enough that a payment to the provider/vendor is made by a patient or insurance company and then the patient or insurance company is reimbursed by the government agency."

ST 13-0037 (GIL) contains language similar to ST 11-0047 (GIL) but also addresses payments received by Medicare Part D plans:

"In general, sales made to Medicare and Medicaid are exempt from tax as sales to a government body so long as the exemption is properly documented through provision 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 bill paid by individuals or private insurance companies not covered by Medicare and Medicaid.

"This means when Medicare directly pays 80% of the medical bill and the remaining 20% is billed to the patient or his insurance company, assuming proper documentation of the exemption, the 80% is tax exempt as a governmental payment while the 20% is taxable. In the case of an unregistered de minimis serviceman, (see the final method above), he or she may take a pass through of the exemption when selling to Medicare or Medicaid. Such servicemen will still owe Use Tax on the portion of the cost billed to the patient. See 86 Ill. Adm. Code 140.108(a)(2)(A) and 86 Ill. Adm. Code 140.108(a)(2)(B)."

"The Medicare Part D Prescription Plan is organized differently. The government provides funds on a per capita basis to the Prescription Drug Providers ("PDPs"). The PDPs operate as private insurance companies under contract with the government. They, not the government, are responsible for purchasing drugs for their beneficiaries. The beneficiaries usually pay a co-pay. Since sales are made to the PDPs and not

directly to the government, the drug sales do not qualify for the government tax exemption. Therefore sales of drugs are not exempt from sales tax under the Medicare D Plan. Please note that according to the U.S. Department of Health and Human Services, sales tax cannot be added to a beneficiary's co-payment under the Plan. As a result, sales tax is due on drugs sold under the Medicare Part D Plan, but it may not be charged to the beneficiary. The same applies to the State of Illinois Rx Program.”

It is the Department's understanding that persons obtaining insurance under the Affordable Care Act (“ACA”) either obtain an insurance plan from a health insurance provider listed on the exchange or are placed into Medicaid, based on the income level of the applicant. Health care provided to Medicaid patients is paid for in a number of ways; the most common are on a fee-for-service basis or on a per-capita basis for managed care providers. It is also the Department's understanding that persons qualifying for Medicare can enroll in optional Medicare Advantage plans that are provided by private insurers.

A vendor making sales of service to a person enrolled in Medicaid or Medicare through an HMO paid by the government on a per-capita basis should calculate Service Occupation Tax or Use Tax using one of the four methods explained above. The HMO is not exempt from any corresponding Service Use Tax liability. Only sales made directly to Medicare and Medicaid are exempt from tax.

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,

Richard S. Wolters

RSW:bkl