

A medical appliance is an item that directly substitutes for a malfunctioning part of the human body. Products that qualify as medical appliances are taxed at a lower State rate of 1% plus any applicable local taxes. See 86 Ill. Adm. Code 130.311. (This is a GIL).

February 4, 2021

Dear Xxxx:

This letter is in response to your letter dated January 25, 2021, in which you requested 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:

Below is a request for guidance as to the applicability of sales and/or use tax in your state, on certain transactions involving our client. Thank you in advance for your prompt attention, and please reach out to me at ADDRESS1 and/or to ADDRESS2 if additional information required, or any questions.

Introduction

Our Client makes sales of certain medical equipment and associated consumable supplies into your state to hospitals, surgeons and surgical facilities. We are respectfully requesting guidance regarding the taxability of the two types of items provided by our client to its customers. These two items are 1) the recurring sale of various types of single-use catheters; and, 2) the rental of electrical signal generating and laser light generating medical devices (equipment) used in conjunction with the catheters. **Both 1 and 2 are sold only on the order of a physician pursuant to Federal Law.**

Facts

Our Client develops, manufactures, markets and distributes medical devices used to diagnose and treat peripheral artery and coronary artery disease. The equipment and catheters using electrical signals are used in the diagnosis and analysis of various arterial conditions, while the laser light generating equipment and catheters are used in the procedure/treatment of arterial blockage, using photoablation. Photoablation is the use of laser light to break-down, vaporize, and remove matter. The types of devices used in these procedures are

1. Catheters

a. Single-use laser catheter devices are connected to the photoablation equipment and used to deliver the laser light during the procedure to remove arterial blockages. The catheter is inserted into the patient's vein or artery but is removed after completion of the procedure. The catheter is a single-use device and must be disposed of when the procedure is completed. The catheter must also be disposed of if the catheter package has been compromised causing it to be non-sterile.

b. Imaging catheters are used to aid in the diagnosis of various types of arterial blockages, including coronary and peripheral artery disease. These catheters are connected to the imaging equipment and help identify the placement, size, etc. of arterial blockages. These catheters are also single-use catheters, and must be disposed of after each diagnostic procedure.

2. PRODUCTS - The two different PRODUCTS are essentially the equipment which either generates the electrical signals which are carried through the catheters during diagnostic imaging procedures; or, the equipment which generates the laser light delivered into a narrow-gauge wire catheter, and through photoablation, is used to remove arterial blockages. In either case, the PRODUCT reads back the responses from the catheter unit. The PRODUCT, by itself, does not come into contact with the patient and cannot contribute anything to the diagnosis or treatment by the physician/surgeon without an appropriate catheter. The medical service provider must have the PRODUCT delivered and installed, and in some cases integrated with the existing X-Ray surgery suite equipment prior to ordering and using the catheters. As discussed below, the Client rents the PRODUCT to the medical service provider.

As stated above, both the catheters and the electrical signal generating equipment ("PRODUCT") are sold only on the order of a physician pursuant to Federal Law.

The above described PRODUCTS work in conjunction with our Client's specific catheter units. The catheters, such as the photoablation catheter, are either a metal wire or a fiber optic cable small enough to insert through the patient's leg vein, and moved up through the patient generally toward the heart. Each type of catheter has specific functionality while inserted into the patient including the photoablation procedure, or measuring blood flow, or imaging by providing a reference point for the surgical X-Ray system.

The catheters are only sold to medical service providers who rent the PRODUCT from our Client. The catheters are used on specific procedures being performed. Consequently, a medical facility may order dozens of these catheters, of various types, during a typical year. The single use catheters are useless by themselves, and must be used with the specific PRODUCT.

The catheters are plugged in to the PRODUCT through a proprietary interface plug drawing signal and/or laser light from the PRODUCT. The electric signals or laser light sent down the catheter activates the features in the patient end of the catheter to enable the surgeon to complete the procedure. Client's catheters are not compatible with other PRODUCTS that may try to perform the same function.

Our Client rents the signal generating PRODUCT to customers. Upon installation, the customer has ninety (90) days in which to evaluate the system. The initial rental term begins immediately following the expiration of the evaluation period and ends on December 31st of the current year. The term may be renewed for additional one-year periods by the customer issuing a purchase order for each one-year period.

The rental fee for each system is \$xxxxx per year and can be partially or completely offset by rental credits which are earned and dependent upon the volume of catheters purchased by the customer. This is commemorated in a "volume based" rental agreement executed between our Client and their customer.

Ruling Requests

1. Is the sale of the single-use catheters taxable in your state?
2. Are the rental charges for the PRODUCT (laser or electrical signal generating equipment) taxable in your state?
3. As stated above, the rental agreement (between our Client and their customers) contains "volume based" provisions by which the rental price of the PRODUCT (laser or electrical signal system) is offset based upon the volume of catheters purchased during the rental period ("rent credits"). Do these rent credits serve as a "discount" to reduce the taxable base of the laser equipment assuming the equipment is in fact taxable in your state?
4. If the earned rent credits are large enough such that there is no rental payment due by the customer for the laser equipment, and the catheters are subject to tax, does the tax collected on the catheters satisfy my client's sales tax collection obligation?
5. If the earned rent credits are large enough such that there is no rental payment due by the customer for the PRODUCT equipment, and if the catheters are not subject to sales tax, is there any sales tax collection obligation by my client?
6. Regarding the PRODUCT, does my client have any use tax obligation under #4 or #5 above?

7. Are sales to non-profit charitable hospitals (i.e., those customers who qualify as a 501(c)(3) under the Internal Revenue Code) exempt from sale/use tax in your state?
8. Does the taxability answer on #6 above change if the PRODUCT units are provided under an agreement structured as a loan - with no-charge - provided the customer exclusively purchases and uses the disposable items from my client.

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. 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. 35 ILCS 105/3; 86 Ill. Adm. Code 150.101.

Please see the Department's regulation at 86 Ill. Adm. Code Section 130.311, which is its regulation governing Drugs, Medicines, Medical Appliances, and Grooming and Hygiene Products. Those products that qualify as drugs, medicines and medical appliances are taxed at a lower State rate of 1% plus any applicable local taxes. Those items that do not qualify for the low rate of tax are taxed at the general merchandise rate of 6.25% plus applicable local taxes.

A medicine or drug is any pill, powder, potion, salve, or other preparation for human use that purports on the label to have medicinal qualities. A written claim on the label that a product is intended to cure or treat disease, illness, injury or pain, or to mitigate the symptoms of such disease, illness, injury or pain constitutes a medicinal claim. See Section 130.311 for examples of medicinal claims. Examples of qualifying products include prescription drugs or medicines and nonprescription drugs or medicines such as aspirin or other pain relievers that purport on the label to have medicinal qualities. The term "nonprescription medicines and drugs" does not include grooming and hygiene products. Grooming and hygiene products include, but are not limited to, soaps and cleaning solutions, shampoo, toothpaste, mouthwash, antiperspirants, and suntan lotions and screens, unless those products are available by prescription only. If an item is a nonprescription grooming and hygiene product, it will be taxed at the State 6.25% general merchandise rate regardless of any medicinal claims made on the product's label.

A medical appliance is an item that is used to directly substitute for a malfunctioning part of the human body. Included in the exemption as medical appliances are such items as artificial limbs, dental prostheses and orthodontic braces, crutches and orthopedic braces, wheelchairs, heart pacemakers, and dialysis machines (including the dialyzer). Corrective medical appliances such as hearing aids, eyeglasses and contact lenses qualify for exemption. Moreover, generally, home glucose monitors, test strips and related supplies

Based on the items listed in your letter, it does not appear that the items are drugs or directly substitute for a malfunctioning part of the human body or is a drug and, thus, would not qualify for the

1% rate. The items would be subject to general merchandise rate of 6.25% and any applicable local taxes.

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 buyout provision at the close of the lease. If a buyout provision does exist, it must be a fair market value buyout 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 lease receipts. Consequently, lessees incur no tax liability. See 86 Ill. Adm. Code 130.2010.

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.

While we cannot rule specifically in the context of a General Information Letter, a lease contract meeting the following conditions would generally be considered to be a true lease rather than a conditional sale: (1) a customer who has otherwise met the requirements of the agreement can cease making payments and return the property at the end of any lease term without further payment obligation, (2) the customer is never under any obligation to purchase the property, and (3) the agreement does not guarantee a sale of the tangible personal property at the inception of the contract. Because, under this type of lease agreement, the lessee is free to walk away from the lease at the end of each lease term and therefore a sale of the property is not guaranteed at the time the lease is entered into, it is the Department's opinion that such an agreement would be a true lease. A lessor engaging in this type of lease should pay Use Tax to his supplier for all items that he purchases to lease. Receipts from the rental of tangible personal property under a true lease are not subject to Retailers' Occupation Tax liability. See 86 Ill. Adm. Code 130.2013(g).

Without reviewing the actual lease agreement, the Department cannot determine the tax obligation of COMPANY or the lessee. The Department also cannot determine the taxability of the rent credits.

SALES TO HOSPITALS

Sales of computers and communications equipment utilized for any hospital purpose that are sold to persons who lease those items to exempt hospitals are not subject to Retailers' Occupation Tax. The exemption is otherwise available, provided that:

- 1) the computers and communications equipment described above must all be purchased for lease to a tax exempt hospital under a lease that has been executed or is in effect at the time of purchase;
- 2) the lease must be for a period of one year or longer; and
- 3) the lease must be to a hospital that has an active tax exemption identification number issued by the Department under Section 1g of the Retailers' Occupation Tax Act. 86 Ill. Adm. Code 130.2011(a).

Sales of equipment, other than that specified in subsection (a), used in the diagnosis, analysis, or treatment of hospital patients that is sold to persons who lease that equipment to exempt hospitals is not subject to Retailers' Occupation Tax. The exemption is otherwise available, provided that:

- 1) the equipment described above must all be purchased for lease to a tax exempt hospital under a lease that has been executed or is in effect at the time of purchase;
- 2) the lease must be for a period of one year or longer; and
- 3) the lease must be to a hospital that has an active tax exemption identification number issued by the Department under Section 1g of the Retailers' Occupation Tax Act. 86 Ill. Adm. Code 130.2011(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.

Very truly yours,

Richard S. Wolters
Associate Counsel

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