

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

October 12, 2010

Dear Xxxxx:

This letter is in response to your letter dated April 19, 2010, 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:

I am writing the Department to request guidance and clarification regarding Title 86, Section 150.331 which pertains to the leasing of medical equipment to tax exempt hospitals. My question involves the sales tax exemption for the leasing of said medical equipment particularly addressing Subsection (B)(1) which states that the exemption will be available if: 'the equipment described' is 'purchased for lease to a tax exempt hospital under a lease that has been executed or is in effect at the time of the purchase.'

To be more specific, my question is whether due to financing required to purchase the equipment to lease, such as a magnetic imaging machine, the exemption from sales tax will extend to the lessor creating the arrangement with the exempt hospital, who later 'technically' becomes the 'sublessee' when the lender of the money actually buys the machine from the manufacturer for collateral and then leases it to the original company creating the arrangement with the hospital. The following example will illustrate the arrangement.

Company A negotiates and arranges to 'lease' (this is a true lease arrangement and not a capital lease), an expensive diagnostic imaging machine to a sales tax exempt hospital. Under the above captioned statute this lease arrangement creates a transaction that is exempt from sales tax. Company A can go to the manufacturer and purchase the machine exempt from sales tax because the lease is in place; the

transaction is in accordance with the statute. However, here is the slight wrinkle. These machines can cost anywhere between \$200,000-\$1,400,000. Therefore, to facilitate the transaction, Company A goes to 'Bank' for financing. Bank wants a security interest to protect their loan and the machine is the collateral. Hence, Bank steps into the shoes as purchaser of the machine and buys it outright, on behalf of Company A, if you will, and then leases it to Company A. Company A now has the machine it needed to complete the transaction with 'exempt hospital'.

However, based on this fact scenario, when Company A then fulfills it's [sic] contract with exempt hospital, leasing the machine as agreed, it is technically, if not legally a 'sublessor' of the machine leasing to the hospital which is now the 'sublessee,' because the bank intervened to legally become the owner/lessor. The law states that leasing medical equipment to an exempt hospital qualifies for the exemption, and not technically 'subleasing.'

I believe the intent of the statute was to facilitate the ability of hospitals [sic] fulfill their medical equipment needs in order to provide the best care and treatment to our citizens. I believe the law would extend to the case scenario I have explained. Company A only becomes a 'sublessor' due to a financing requirement and the lender's need to purchase the exempt equipment first to collateralize it's [sic] loan. The lender really has no interest in 'leasing' the equipment to the hospital, only to complete the loan. Company A is still the true 'lessor' working with the hospital to provide the needed medical equipment it's [sic] patients. But legally, based on these facts, Company A becomes a lessee/sublessor.

Can you please give me an opinion as to whether: Company A, the true company contracting with the exempt hospital to provide medical equipment via a lease arrangement that has been executed, can provide an exemption certificate to the manufacturer and lender thereby purchasing/leasing or 'subleasing' the equipment exempt from sales tax even though the lender becomes the owner/lessor of the machine?

If you would like to discuss this matter or have any questions, please call me. Thank you very much for your assistance in this matter. I look forward to hearing from you.

DEPARTMENT'S RESPONSE:

Although we cannot give you a specific answer in the form of a General Information Letter, we hope you find the following helpful. 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 a lessor is 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. Persons who purchase items for resale under conditional sales contracts can avoid paying tax to suppliers by providing certificates of resale that contain all the information set forth in 86 Ill. Adm. Code 130.1405. All receipts received by a lessor/retailer under a conditional sales contract are 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. See 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. 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 subsection (a)(3) of 86 Ill. Adm. Code 150.310.

Generally, the tax exempt status of lessees does not affect the tax liability of lessors. However, please note that Illinois does have an exemption for certain purchases of tangible personal property by persons who are leasing that property to exempt hospitals that have been issued an E-number by the Department. See the Department's regulation at 86 Ill. Adm. Code 130.2011. This exemption applies to sales of two different types of tangible personal property. The first is computers and communications equipment utilized for any hospital purpose. The second is sales of equipment that are used in the diagnosis, analysis, or treatment of hospital patients.

To qualify for this exemption:

- (1) the qualifying equipment 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.

The rule does not preclude a lessor from claiming the exemption where the lessor leases the qualifying equipment to a lessee who subleases it to a hospital, as long as all the relevant leases have been executed or are in effect at the time of the purchase and all other criteria in Section 130.2011 have been met. 86 Ill. Adm. Code 130.2011.

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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