

This letter concerns retailer discounts. See 86 Ill. Adm. Code 130.2125. (This is a GIL.)

December 14, 2010

Dear Xxxxx:

This letter is in response to your letter dated October 27, 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:

We are in need of your assistance with the following situation to confirm whether a vendor’s discount should be included or excluded in the tax based on which sales tax is calculated on the sale transaction.

Co X is the customer and purchases various promotional items from Co. Y, the seller/vendor. Co X is a separate legal entity from Co Y. Co Y, on a discretionary basis (big customer or special product type, type), allows its customers a program funding (incentive) discount. The program funding discount can range any % up to 50%. Co Y is not reimbursed for the discount by any third-party.

It is our understanding that your state’s sales tax is calculated pursuant to the price of the taxable retail sale. Price is generally defined as the total amount of consideration for which tangible personal property or services are sold, leased or rented. Price does not include discounts that are not reimbursed to the seller by a third-party.

Question(s):

- Please confirm, whether, based on this specific fact pattern, the customer discount should be included or excluded in the tax base?
- Are there any situations in which your State would include a discount in the tax base?

We appreciate your assistance.

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 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 86 Ill. Adm. Code 150.101. These taxes comprise what is commonly known as "sales" tax in Illinois.

Illinois Retailers' Occupation and Use Taxes do not apply to transactions that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon his or her activities. For general information regarding sales of service and Service Occupation Tax, see 86 Ill. Adm. Code 140.101 through 140.109.

Gross receipts subject to Retailers' Occupation Tax are defined as all the consideration actually received by the seller. If a seller provides a discount to a purchaser and does not receive a reimbursement or rebate from any source for that discount, only the (discounted) amount received by the seller is taxable. For example, if a retailer sells an item for \$10 and the purchaser provides the retailer with a \$1 in-store coupon for which the retailer receives no reimbursement from the manufacturer of the item or any other source, the retailer's gross receipts of \$9 are subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2125(b)(1).

When a retailer receives full or partial coupon reimbursement (from a manufacturer, distributor or any other source), the retailer incurs Retailers' Occupation Tax liability on the receipts received from the purchaser and the amount of any coupon reimbursement. For example, if a retailer lists an item for sale for \$15 and the purchaser provides the retailer with a \$5 manufacturer's coupon for which the retailer receives full reimbursement from the manufacturer of the item, the retailer's gross receipts are the \$10 received from the customer and the \$5 received from the manufacturer for a total of \$15 that is subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2125(b)(2).

When a retailer issues a coupon to a purchaser which entitles the purchaser to a free item conditioned on the purchase of a separate item (two-for-one, buy one get one free, etc.), the retailer's gross receipts are measured only by the amount actually received from the purchaser for both items. Thus, tax is only incurred on the amount actually received from the purchaser. The retailer does not incur tax based upon the value of the free item received because technically the item was not free and no gift was intended. The retailer was simply offering a special price for both items sold.

Likewise, if a retailer provides a customer with a card, coupon or other certificate later to be used to reduce ("discount") the purchase price of an item or items and the retailer is not to be reimbursed for that discount from a manufacturer or any other source, the amount representing that discount would not be subject to Retailers' Occupation Tax liability. See in general 86 Ill. Adm. Code 130.2125(b)(1).

Your letter mentions a definition of "price" that includes "the total amount of consideration for which tangible personal property or services are sold, leased or rented." Please note that this is not entirely correct. For sales of services, see 86 Ill. Adm. Code Part 140. The State of Illinois also 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.

Under Illinois law, lessors may not "pass through" their tax obligation 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 the lessees agree to reimburse the lessors for the amount of the tax paid, then the lessees are obligated to fulfill the terms of the private contractual agreements.

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

RSW:mzk