ST 11-0103-GIL 12/28/2011 LEASING

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

December 28, 2011

Dear Xxxxx:

This letter is in response to your letter dated July 1, 2011, 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:

> On behalf of our client, I am writing to request a written Sales and Use taxability ruling related to the following questions and facts scenario. A properly executed Power of Attorney Form is enclosed for your reference.
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> ***Company Description***
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> CLIENT is in the business of acquiring equipment and other personal property for the purpose of leasing or financing to commercial users. In conjunction with this arrangement, CLIENT routinely sells the lease/finance contract to a 'funder' and signs a simultaneous service agreement with the funder to continue servicing the payments between the originating user and newly acquired funder.
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> ***Facts related to taxability question:***
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> - As part of CLIENT's 'Sale and Assignment Agreement' (standard copy of agreement enclosed for reference purposes), CLIENT transfers their entire right, title and interest in the equipment leased or otherwise financed to the funding company.

- CLIENT has a variety of funders to whom these agreements are entered into. There is no deviation in the contracts as to the transfer of entire rights, title and interest with the various funders.

- CLIENT's business practice is to collect sales tax (Retailer's [sic] Occupation Tax) on all financed purchases (or actual sales) of equipment at the time of the sale to the commercial user, and pay sales tax to the vendor (or self-remit use tax) on the upfront cost of all leased equipment in the state of Illinois.

- CLIENT's sale of the financed contract/equipment generally occurs at the beginning of the lease/finance contract but upon occasion could commence after a payment or two has been received from the commercial user.

- In conjunction with the above mentioned sale, CLIENT enters into a service agreement (standard copy enclosed for reference), with the funding company to continue servicing the lease/finance contract as an independent contractor of the funder; whereby, payments are collected and appropriate tax remittances are conducted through CLIENT's business entity.

- CLIENT may enter into a secondary agreement to the 'Sale and Assignment Agreement' with the funding company that addresses Residual Value Guaranty, Remarketing or Recourse actions. All of which speak to CLIENT's ability/option to repurchase the equipment or assist in the selling of the equipment after the originating lease/finance contract has been completed or broken by the commercial user.

Specific areas of inquiry:

1.) Sale of a financed purchase contract – When CLIENT sells equipment financed through a loan agreement, sales tax is charged on the purchase price of the equipment and incorporated into the total amount considered for financing. Sales tax is remitted to the Illinois Department of Revenue in the month of the sale and subsequently sales tax is not charged on the monthly payments received thereafter. CLIENT typically sells the equipment to a funder, but remains the servicing entity to the commercial customer in regards to the monthly payments.

QUESTIONS:

A. When CLIENT sales [sic] the rights, title and interest of the financed equipment to a 'funder' is there a sales tax burden created on the sale of the equipment to the funder in addition to the sales tax already collected from the commercial user at the time of the originating purchase?

B. Does the fact that the finance contract with the commercial user remains intact with CLIENT continuing to service the contract payments alter the tax implication created by the sale mentioned in 'A' above?

C. If a sales tax burden is created, would/should the funder be able to provide CLIENT an Illinois resell [sic] exemption certificate for the transaction since the equipment is being purchased with the intent to resell to the already contracted commercial user?

2.) Sale of lease contract – When CLIENT leases equipment through a lease agreement, sales tax will be paid by CLIENT on their purchase price of the equipment and no tax is charged on the monthly lease payments due from the commercial user. After CLIENT sells the equipment backed by the lease contract to a funder, they continue to service the lease payments as an independent contractor for the funder

QUESTIONS:

A. When CLIENT sales [sic] the rights, title and interest of the leased equipment to a 'funder' is there a sales tax burden created on the sale of the equipment in addition to the sales tax already paid on CLIENT's original cost when acquiring the equipment?

B. If a sales tax burden is created on the sale of the equipment, would CLIENT have a legal right to recoup the sales tax already paid on the equipment from the state of Illinois under a resale exemption authority?

C. Would CLIENT be able to purchase the equipment exempt for resell [sic] if the funder 'sales agreement' can be established prior to or simultaneously with the lease agreement with the commercial user?

D. Does the tax implication change on the equipment sale if a monthly payment is received from the commercial user prior to the sale of the lease contract (along with title and all rights) to the funder, versus if the funder can be established simultaneously with the leasing of the equipment?

E. Does the fact that CLIENT continues to service the lease payments as an independent contractor of the funder alter the tax implication associated with the sale of the equipment from CLIENT to the funder?

F. Does the fact that CLIENT may enter into a subsequent agreement with the funder in regards, recourse, remarketing or residual guarantee alter the tax burden if created in question 'A' above?

In summary, CLIENT would like to clarify if there is an additional sales tax application/responsibility created by the selling of the financed/leased contract along with the rights, title and interest in equipment located in the state of Illinois to a third-party funder. The questions posed are for clarification as to the proper handling of situations that CLIENT would like to enter into on a go-forward basis. To the best of our knowledge CLIENT is not currently under audit in the state of Illinois and does not have any formal or informal appeals in progress related to this issue.

FIRM on behalf of CLIENT is available to discuss the above issues with the Illinois Department of Revenue prior to finalization of the private letter ruling. The undersigned can be contacted to address additional questions or clarification as may be needed. We look forward to your response to this private letter-ruling request.

DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). Your letter describes a number of alternative contractual arrangements the Company may enter into with lessees and purchasers of equipment. You have also provided copies of blank contractual agreements between the Company as seller or lessor and purchasers or lessees and agreements between the Company and funding company that reflect these various possible contractual arrangements. Your letter and the documents represent possible, prospective contractual arrangements that at this time are little more than hypothetical examples. The Department's rule on Private Letter Ruling states that will not provide letter rulings based on hypothetical situations. It is the Department's position that we must decline to issue a Private Letter Ruling. However, we hope the following will be helpful in addressing your question.

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.

Under Illinois law, lessors may not "pass through" their tax obligation to 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.

The resale exemption is applicable when making sales to a purchaser who will in turn sell the tangible personal property. For general information regarding resale certificates, the Department's regulation for resale certificates, "Seller's Responsibility to Obtain Certificates of Resale and Requirements for Certificates of Resale," is found at 86 Ill. Adm. Code 130.1405.

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:msk