

This letter discusses the taxability of various items which are the subject of a lease. *See* 86 Ill. Adm. Code 130.220 and 86 Ill. Adm. Code 130.2010. (This is a GIL.)

April 11, 2014

Dear Xxxx:

This letter is in response to your letter dated January 31, 2014, 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 seeking your assistance in securing a letter ruling regarding the treatment of certain items/transactions for sales tax purposes and sales tax compliance reporting. The facts and tax issues surrounding our client are detailed below.

Please let me know if you have any additional questions. Thank you for your help.

Facts

Company A is in the business of leasing equipment to various retail locations (“customers”) in the State. Company A has lease agreements with customers in the State which defines the monthly lease rate and repair and maintenance terms. Company A delivers, installs, and maintains the leased equipment either on its own or through the use of a third party.

Company A often purchases from Company B equipment that it intends to lease to its customers. Company A pays Company B a flat fee to ship equipment directly to Company A’s customers. This flat fee also covers the installation of the equipment of Company A’s customers’ sites. Company A also purchases from Company B services agreements, parts and/or labor related to keeping its equipment in working order as part of its lease agreement with its customers. Services are generally performed at the location of the retail customer in your state, but services may also be performed at staging facility outside of State. Company A is charged by Company B a flat monthly fee for the service contract. Additionally, Company A may be charged for parts and hourly labor for maintenance on the leased equipment that falls outside the scope of the service contract. Company A may also be charged a flat monthly fee for internet connectivity relating to the equipment that it leases to its customers.

Company C is an unrelated third party who works with taxpayers on matters related to billing and collections. It is our understanding that Company C is registered in each state for sales tax purposes, and collects and remits sales tax on behalf of its multiple clients, using its own tax identification number. Company C has not obtained approval use the filing method, nor has its clients.

Company A has contracted Company C to collect the lease payments from Company A's customers. Company C also collects the related sales tax that is imposed on the lease payments. Company C submits to Company A the lease payments that it has collected on Company A's behalf, but remits the sales tax that it has collected directly to the State under its own tax identification number. Company C files its sales & use tax returns to include Company A's taxable sales and related sales tax that was collected on Company A's behalf. Company A is not registered with the state and does not file a sales & use tax return. Neither Company A nor Company C has approval from the tax jurisdiction authorizing it to file and remit the sales tax collected under this reporting methodology. Company A pays Company C a fee for its collections services.

Issue 1

Can Company A issue a resale certificate to its supplier for the purchase of a third party service contract (labor and parts) and any separately charged labor and parts used exclusively to maintain its inventory of leased equipment?

Issue 2

Can Company A issue a resale certificate to Company B for the shipping & installation charges that it pays to Company B for the shipping/installation of equipment that it subsequently leases to its customers if

- 1) The shipping and installation charges are separately stated on each invoice, or
- 2) The shipping and installation charges are a lump sum charge on each invoice?

Issue 3

Is Company A's purchase of internet connectivity relating to its leased equipment subject to sales and use tax and/or telecommunications tax when it absorbs the cost as part of lease of the equipment?

Issue 4

Can a third party agent (Company C) get authorization to remit tax collected by lessor (Company A) on its lease stream under the agent's taxpayer identification number?

- If yes, what is the process to obtain approval?

- Does the lessor (Company A) still need to register for sales tax to issue a resale certificate for its purchases of equipment, maintenance, etc.?
- What is the tax filing obligation going forward for Company A, if any?

Thank you for opining on our Private Letter Ruling Request. Please let me know if you need any additional information.

DEPARTMENT'S RESPONSE:

LEASES

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. 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.

In contrast, a true lease generally has no buy out provision at the close of the lease. If a buyout 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.

We cannot determine the exact nature of Company A's leasing situation without examining the leases and contracts involved. However, if the lease is a true lease, the lessor incurs Use Tax on the cost price of the property located in Illinois. Since the lessee incurs no tax liability, a resale certificate is not appropriate nor necessary in this situation as a lessor does not purchase items for resale. Please note that resale certificates are for the purpose of documenting tangible personal property that will be resold. A contract for labor is not tangible personal property, and thus does not require a resale certificate.

SHIPPING & HANDLING

As stated earlier, resale certificates are used to purchase tangible personal property for resale. Please note that resale certificates cannot be used for items purchased for true leases. In the case of sales at retail, including conditional sales, if a seller delivers the tangible personal property to the buyer, and the seller and the buyer agree upon the transportation or delivery charges separately from the selling price of the tangible personal property which is sold, then the cost of the transportation or delivery service is not a part of the "selling price" of the tangible personal property which is sold, but instead is a service charge, separately contracted for, and need not be included in the figure upon which the seller computes his or her tax liability. See the Department's regulation at 86 Ill. Adm. Code 130.415(d). Note, as stated in Section 130.415 of the Department's regulations, if

the charges for transportation or delivery exceed the cost of delivery or transportation, the excess amount is subject to tax.

A separate listing on an invoice of such charges is not sufficient to demonstrate a separate agreement. The best evidence that transportation or delivery charges were agreed to separately and apart from the selling price is a separate and distinct contract for transportation or delivery. However, documentation which demonstrates that the purchaser had the option of taking delivery of the property, at the seller's location, for the agreed purchase price, or having delivery made by the seller for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice. For more information regarding taxability of shipping and handling charges, see *Nancy Kean v. Wal-Mart Stores, Inc.*, 235 Ill. 2d 351, 919 N.E.2d 926 (2009).

INTERNET

Regarding your question about internet connectivity charges, the Internet Tax Freedom Act imposes a federal moratorium on state or municipal taxes on Internet access until November 1, 2014. 47 USCA § 151 note; § 1101. "Internet access":

(A) means a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet;

(B) includes the purchase, use or sale of telecommunications by a provider of a service described in subparagraph (A) to the extent such telecommunications are purchased, used or sold-

(i) to provide such service; or

(ii) to otherwise enable users to access content, information or other services offered over the Internet;

(C) includes services that are incidental to the provision of the service described in subparagraph (A) when furnished to users as part of such service, such as a home page, electronic mail and instant messaging (including voice and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity;

(D) does not include voice, audio or video programming, or other products and services (except services described in subparagraph (A), (B), (C), or (E)) that utilize Internet protocol or any successor protocol and for which there is a charge, regardless of whether such charge is separately stated or aggregated with the charge for services described in subparagraph (A), (B), (C), or (E); and

(E) includes a homepage, electronic mail and instant messaging (including voice and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity, that are provided independently or not packaged with Internet access.

Telecommunications that are purchased, used or sold by an internet provider to enable users to connect to the Internet or to otherwise enable users to access content, information or other services offered over the Internet are subject to the federal moratorium.

NEXUS

You stated in your letter that Company A has contracted Company C to collect sales tax on the lease payments and remit them directly to the State. Please refer to the information above regarding leases to determine the proper tax owed on lease payments. You stated that Company C is registered to collect tax in the State of Illinois and A is not registered. You also stated that Company C uses its tax number to submit Company A's tax. Please be aware that this is an improper arrangement. A third party cannot use its tax identification number to collect and remit tax to the State on behalf of another party. We cannot determine from the limited information provided in your letter whether Company A has nexus in Illinois and would therefore be required to register for Retailers' Occupation Tax and/or Use Tax collection. However, please see the information that we have included below outlining the principles of nexus so that you may determine how Company A should proceed.

An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers.

Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i). This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910. The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause.

A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Any type of physical presence in the State of Illinois, including the vendor's delivery and installation of his product on a repetitive basis, will trigger Use Tax collection responsibilities. Please refer to *Brown's Furniture, Inc. v. Zehnder*, 171 Ill.2d 410, (1996).

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax liability on the purchase of the goods and have a duty to self-assess and remit their Use Tax liability directly to the State. Many retailers that do not have nexus with the State have chosen to voluntarily register as Use Tax

collectors as a courtesy to their Illinois customers so that those customers are not required to file returns concerning the transactions with those retailers.

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,

Cara Bishop
Associate Counsel

CB:ikm