

This letter addresses whether a finance lease is a conditional sale or a true lease. See 86 Ill. Adm. Code 130.2010. (This is a PLR.)

September 15, 2016

RE: Request for Illinois Letter Ruling
Conditional Sale Lease Addendum

Dear Xxxxx:

This letter is in response to your letter dated November 4, 2015 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.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110, governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request. In your letter you have stated and made inquiry as follows:

COMPANY 1, an equipment financing division of COMPANY, which is a bank organized under the National Bank Act, respectfully requests a Private Letter Ruling regarding our draft addendum being added to a Fair Market Value Lease at lease inception. Our intention is for the addendum (Exhibit A) to delete and supersede the end of lease term of the contract and that the new end of lease term is that of a Conditional Sale. Since the lessor is guaranteed at the time of the lease that the leased property will be sold, this transaction would then be considered a conditional sale at the outset of the transaction, thus making all receipts subjects to Retailers’ Occupational Tax.

Attached is a copy of our standard lease agreement (Exhibit B). Some of our customers prefer to keep the monthly payment lower throughout the lease and then have a balloon

payment at the end. To accommodate this option, we are proposing the attached addendum to the contract.

Our proposed addendum was informally reviewed by PERSON, Revenue Auditor 3, and his supervisor. The response was they agreed it would be treated as a Conditional Sale since the addendum is modifying the buyout terms to the original lease document.

Based on your review of the standard lease agreement and the proposed addendum, COMPANY 1 respectfully requests that the Department rule that the use of the addendum at the commencement of the lease would in fact prove the contract to be a Conditional Sale and not a True Lease.

DEPARTMENT'S RESPONSE:

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 buy out 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.

Based on the assertions in your letter, the attached lease agreement, and the Illinois Addendum To Lease Agreement, it is our opinion that under these agreements your company engages in conditional sales. Specifically, the Illinois Addendum supersedes the end-of-term options contained in the lease agreement and instead provides that the customer will not have the option to return the equipment. The Addendum then goes on to provide that the customer's two options are to purchase the equipment at the end of the lease for a fixed 10% of the original cost of the equipment ("balloon payment"), or add the remaining unpaid payments into a new lease covering new equipment ("trade-up to keep"). In both circumstances it is our opinion that the customer is guaranteed at the outset of the agreement to purchase the equipment – using this lease agreement (with the Illinois Addendum) to finance the purchase of the equipment. Please be advised that this letter should in no way be construed as an endorsement of the Illinois Addendum as the most suitable manner in which to structure a conditional sale. Despite the novelty of this approach, we find that the agreement meets the minimum requirements to be considered a conditional sale – *i.e.*, that the lessor is guaranteed at the time of the lease that the leased property will be sold.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, 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
Chairman, Private Letter Ruling Committee

RSW:SM:bkl