ST-22-0005 03/15/2022 LEASING

Lessors of automobiles for initial lease periods in excess of one year are subject to Use Tax liability on the purchase price of those automobiles even if the lease agreements provide for renewal options of less than those initial lease periods. See 86 Ill. Adm. Code 130.2010. (This is a GIL.)

March 30, 2022

Dear NAME:

This letter is in response to your letter dated February 17, 2022, in which you requested 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:

> This letter is written on behalf of COMPANY1 ("COMPANY1"), a STATE limited liability company, which operates under the trade name "COMPANY2." COMPANY1's tax identification number is ##-#######. COMPANY1 is a finance company of heavy commercial trucks and trailers that offers TRAC Lease and traditional financing options to customers of a heavy truck dealership with locations in Illinois it partners with. All of COMPANY1's transactions take place electronically.
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> Typically, when a TRAC Lease is originated COMPANY1 will purchase the leased asset (which will be titled to COMPANY1) from the dealership. The TRAC Lease will provide the lessee the option to purchase the leased asset at a stated residual value or return the leased asset to COMPANY1 at the end of the lease term.
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> We are writing today due to receiving conflicting answers to our questions from speaking with multiple employees of the Illinois Department of Revenue over the phone the past few months. In an effort to assure its compliance COMPANY1 would like to confirm the proper sales tax treatment for TRAC Lease transactions as described above in the state of

Illinois we would like to request a written ruling from the Illinois Department of Revenue on the following questions. When the lessor purchases a heavy truck from the dealership to be leased under a TRAC Lease as described above, should the dealership collect and remit sales tax on the sale from the lessor or is the sale exempt from sales tax? If the purchase of the heavy truck by the lessor from the dealership is exempt from sales tax then would the lessor be responsible for collecting and remitting sales tax on the TRAC Lease upfront at the lease origination or over the term of the lease as lease payment are made? What kind of sales tax account is required for transactions as described?

We greatly appreciate your assistance and look forward to hearing back from you.

DEPARTMENT RESPONSE:

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than most 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 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 buy out provision does exist, it must be a fair market value buy out option 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 130.2010(b). 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.

Regarding terminal rent adjustment clause or TRAC leases, Section 3-201.1 of the Illinois Vehicle Code states: "Terminal rent adjustment clause leases. In the case of motor vehicles or trailers, a transaction does not create a sale or a security interest merely because it provides that the rental price is permitted or required to be adjusted under the agreement either upward or downward by reference to the amount realized upon sale or other disposition of the motor vehicle or trailer."

The guidelines set out in 86 Ill. Adm. Code 130.2010 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. 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 86 Ill. Adm. Code 150.310(a)(3). Lessors of automobiles for initial lease periods in excess of one year are subject to Use Tax liability on the purchase price of those automobiles even if the lease agreements provide for renewal options of less than those initial lease periods. These types of leases are not subject to taxation under the Automobile Renting Occupation and Use Tax Act. The renewal options for periods of less than one year are not treated as new leases but are merely extensions of the initial lease period.

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 lessees agree to reimburse lessors for the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

Illinois retailers who sell tangible personal property to purchasers who act as lessors under true leases incur Retailers' Occupation Tax liability on the sales of that property. See 86 Ill. Adm. Code 130.220. Retailers in Illinois report the retail sale of automobiles on Form ST-556. The retailers making those sales are responsible for the proper reporting of the tax. Those retailers may not contractually shift their responsibility for properly completing those forms and remitting the tax incurred on those sales. If the purchases of the property to be leased occur in Illinois, the purchasers must pay their Use Tax liability to the retailer at the time of purchase. The retailers are then allowed to retain the amount of Use Tax paid to reimburse themselves for their Retailers' Occupation Tax liability incurred on those sales. If the purchases of the property to be leased occur outside of Illinois and the retailers from whom those purchases are made are not registered to collect Illinois Use Tax, the purchasers must pay the appropriate amount of Use Tax incurred directly to the Department on Form RUT-25.

Please note that the analysis is different if the items being purchased for lease qualify for the alternative selling price established under P.A. 98-628, which is only allowed for leases with a defined period and for motor vehicles of the first division and certain motor vehicles of the second division. As a result, the alternative selling price would not apply to open-end leases (i.e. leases with a defined initial period with the option to continue the lease on a month-to-month or other basis). For further information, please see Informational Bulletin FY 2015-03.

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,

AKO

Alexis K. Overstreet
Associate Counsel