ST 07-0020-GIL 05/04/2007 OCCASIONAL SALE

Tangible personal property transferred pursuant to a business reorganization may qualify for the occasional sales exemption if the transferor of such tangible personal property has not ordinarily sold like-kind property at retail. See 86 Ill. Adm. Code 130.110. (This is a GIL.)

May 4, 2007

Dear Xxxxx:

This letter is in response to your letter dated October 10, 2006, 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.ILTAX.com 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:

> Our client (CLIENT) would like clarification regarding the application of the Illinois sales and use tax statutes to its activities in Illinois.
>
> CLIENT assembles compressors (in STATE) that are used in connection with natural gas exploration, production, processing and transportation. Historically, the assembled compressors are either sold to third party customers or CLIENT retains ownership and the compressors are used by CLIENT at customer locations to provide compression for a fee. Most of CLIENT's current contractual agreements with their customers are structured such that they would be considered a 'rental' or 'lease' for Illinois sales and use tax purposes.
>
> CLIENT is in the process of reorganizing its business. As a result of the reorganization, CLIENT will have four primary entities involved in the compression business in your jurisdiction. Three of these entities will be new entities. One entity will lease compressors, ABC Leasing ('Lease Company'), to a related entity through agreements that should be considered bare rentals. One of the purposes of Lease Company will be to streamline sales tax compliance procedures by eliminating inefficiencies in the sales/use tax self-assessment process. This is accomplished as a result of the bare rentals changing the nature of the tax from a use tax to a sales tax in most jurisdictions.

The lessee of the compressors from Lease Company, CLIENT Operating Partnership ('Service Company'), will provide compression services to third parties. CLIENT will contribute a portion of its current fleet of compressors, subject to certain liabilities, to Lease Company in a transaction that will be tax-free for federal income tax purposes. The remaining compressors will be contributed to a new entity owned by CLIENT, CLIENT Holding ('CLIENT Lease Company'), that will lease the compressors to CLIENT for use in its compression business. This contribution will also be tax-free for federal income tax purposes. Lease Company and CLIENT Lease Company will be disregarded entities for federal tax purposes.

As part of the reorganization, CLIENT is changing its contracts with certain customers. The revised contracts will be used by both Service Company and CLIENT.

After these changes, the following contractual provisions indicate that the new service contract is properly treated as a services agreement for federal income tax purposes, rather than a lease:

- risk of loss, control, and certain other characteristics will be the responsibility of Service Company / CLIENT rather than the customer,
- the new contract does not specify a particular compressor or model of compressor that will be used to perform the service, rather the contract stipulates only that the compression services will be provided based on certain agreed upon parameters. Thus, as the contract acknowledges, the compressors are tools used by the Service Company / CLIENT to perform services,
- ad valorem taxes will be the responsibility of Service Company / CLIENT,
- Service Company / CLIENT will be responsible for insurance for the compressors,
- the fee charged for compression services is substantially higher than the cost of bare rental of a compressor,
- the contracts are typically for approximately three years, or less than 15 percent of a compressor's economic life,
- Service Company / CLIENT bears the risk of performance of its contractual obligation to provide compression services. Thus, to the extent that Service Company / CLIENT is unable to provide compression services to its customers, the Service Company / CLIENT will suffer a reduction in the fee for compression services that it charges the customer and
- Service Company / CLIENT does not own the gas at any point in the process, but Service Company / CLIENT compresses the natural gas for its customers that typically sell the natural gas to third parties.

CLIENT would specifically like guidance on how the changes described above affect the Illinois sales and use tax treatment of Service Company's / CLIENT's business transactions in the state.

1. Will the Illinois Department of Revenue treat the attached agreement ('Master Services Agreement') as a service agreement rather than a rental for Illinois sales and use tax purposes?

2. Will there be any Illinois sales or use taxes due as the result of transferring the existing compressors from CLIENT to CLIENT Lease Company and Lease Company? Will the resale exemption apply to the transfer?

3. If the Master Services Agreement is treated as a service for Illinois sales tax purposes, will the compression services provided be subject to Illinois sales tax?

If you have any questions or need additional information related to this ruling request, please call me.

DEPARTMENT'S RESPONSE

This response is limited to sales and use taxes.

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. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. This Use Tax liability includes tangible personal property brought into Illinois from out-of-State. See 86 Ill. Adm. Code 150.101. If no tangible personal property is transferred to the customers, then no Illinois Retailers' Occupation Tax or Use Tax would apply.

Likewise, the Service Occupation Tax and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. See 86 Ill. Adm. Code 140.101 and 160.101. If no tangible personal property is transferred to the customers incident to the services provided, then no Illinois Service Occupation Tax or Service Use Tax would apply.

The agreement you provided appears to be a service agreement, but we cannot provide a binding answer in the context of a General Information Letter. Since no tangible personal property is transferred incident to the service, no Service Occupation Tax is due. However, Use Tax is due on the cost price of the equipment being used.

Regarding sales tax on the transfer of equipment, please note that generally, the transfer of tangible personal property pursuant to a business reorganization will not be subject to sales/use tax liability in Illinois if the transferor of such tangible personal property has not ordinarily sold like-kind property at retail. Please see 86 Ill. Adm. Code 130.110 regarding occasional sales.

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.

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.

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.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

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