

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

April 27, 2009

Dear Xxxxx:

This letter is in response to your letter dated July 1, 2008, 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](http://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:

I would like to request a letter of ruling regarding a sales tax issue with a lessor. COMPANY was billed sales tax on twelve monthly lease payments before purchasing the equipment. Enclosed is a copy of the Addendum to Lease-Purchase Agreement showing the purchase price and that lease payments would be applied at 70% toward purchase. The lessor then charged sales tax on the \$265,497.00 purchase price per addendum less 70% of the lease payments in the amount of \$13,181.06. I believe that we have been erroneously charged sales tax on finance charges which is what the 30% of lease payments not applied to purchase essentially are.

Sales taxes paid on monthly lease payments of \$6,500 (12 @ \$406.25)	\$ 4,875.00
Sales taxes billed on purchase:	
Purchase price	\$ 265,497.00
Less: 70% of lease payments (12 @ 6,500 x 70%)	\$ 54,600.00
Net purchase price	\$ 210,897.00
Sales tax on net purchase price @ 6.25%	\$ 13,181.07
 Total sales tax billed	 \$ 18,056.07
 Sales tax if billed only on purchase price (\$265,497.00 x 6.25%)	 \$ 16,593.57

Overcharge of sales tax

\$ 1,462.50

Thank you for your assistance in this matter, I look forward to your letter.

#### **DEPARTMENT'S RESPONSE:**

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. See 86 Ill. Adm. Code 150.101. If no tangible personal property is being transferred to the customers, then no Illinois Retailers' Occupation Tax or Use Tax would apply.

Likewise, the Service Occupation Tax Act 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 being transferred to customers incident to the services provided then no Illinois Service Occupation Tax nor Service Use Tax would apply.

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states do. For Illinois sales tax purposes, there are two types of leases: 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 the 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, thus making all receipts subject to Retailers' Occupation Tax.

In Illinois, lessors of tangible personal property under a true lease, except for automobiles leased for terms of one year or less, are considered to be the end users of the property to be leased. See 86 Ill. Adm. Code 130.220 and 130.2010. As the end users of tangible personal property located in Illinois, lessors incur Use Tax on the lessors' cost price of the property. Since lessors are considered the end users of the property and have paid the Use Tax, no Retailers' Occupation Tax is imposed upon the rental receipts, and the lessees incur no Use Tax liability for the rental charges.

In Illinois, 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. As mentioned, 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).

Even though lessees do not incur any tax liability in a true lease situation, it is typical of true leases to contain contractual provisions stating that the lessees will reimburse the lessors for their tax costs. This is not a matter of Illinois tax law but of private agreement between lessors and lessees. If the lessees agreed to such provisions, they are bound to satisfy that duty because of a contractual agreement, not because of Illinois tax law.

As stated above, the State of Illinois imposes no Retailers' Occupation Tax or Use Tax on rental receipts. Moreover, since a lessee under a true lease incurs no tax liability on the lease of tangible personal property, the lessee generally incurs no such tax liability on any related lease

charges such as late payment fees, disposition fees, lease termination fees, service fees, or legal fees.

If the Agreement you have referred to is considered a true lease as described above, then lease payments are not taxable, and the "selling price" for tax purposes would only be computed on the purchase price of the equipment at the time of sale. If the Agreement is a conditional sale, all of the lease payments are subject to tax, in addition to the purchase option amount of the equipment at the time of the sale.

I hope this information is helpful. If you require additional information, please visit our website at [www.tax.illinois.gov](http://www.tax.illinois.gov) or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters  
Associate Counsel

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