

Except as provided in 86 Ill. Adm. Code 130.2011 and 130.2012, lessors incur Use Tax even if the tangible personal property is leased to an exempt entity that has been issued an exemption identification number. See 86 Ill. Adm. Code 130.2011 and 130.2012. (This is a GIL.)

August 24, 2009

Dear Xxxxx:

This letter is in response to your letter dated July 24, 2009, 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:

Taxpayer leases tangible personal property to businesses located in Illinois. The Taxpayer recently underwent a sales/use tax audit by the Illinois Department of Revenue ('Department'). Part of the findings of the audit were that the Taxpayer was not properly paying Illinois use tax on its purchases of tangible personal property that was subsequently leased to religious, educational or charitable organizations. The taxpayer agreed with the findings and paid the deficiency to the Department.

Lease documents utilized by the Taxpayer in its business state that the lessee must pay the Taxpayer all taxes, fines and penalties relating the lease. As a result, the Taxpayer sought reimbursement from its lessees for the use tax that was paid to the Illinois Department of Revenue in connection with the above referenced audit. A representative for one of the lessees, a church, contacted a representative in the Department to seek advice on whether the church was liable for the use tax that it was billed by the Taxpayer. REPRESENTATIVE indicated that the lessee was not liable for the use tax because of its tax exempt status. I subsequently had a discussion with REPRESENTATIVE and referred him to guidance published in General Information Letters ST 05-0068 GIL and ST 08-0124 GIL as follows:

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 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 amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

REPRESENTATIVE indicated that he was aware of the guidance provided in the foregoing General Information Letters, but was still of the opinion that the church was not liable for the tax due to its tax exempt status. He also indicated that since we disagreed on the matter it was our right to seek a ruling from your office. Hence, that is the purpose of this letter.

Therefore, I would like to receive a ruling with respect to the following issues:

- 1) Has there been a change in position by the Department concerning the above paragraph quoted from General Information Letters ST 05-0068 GIL and ST 08-0124 GIL?
- 2) If not, does it make a difference if the lessee is a religious, educational or charitable organization? In other words, is there anything in Illinois law that precludes a lessor from pursuing reimbursement of use tax from a lessee pursuant to a lease contract if the lessee is a tax exempt?

If you indicate there has been no change in position concerning the paragraphs in General Information Letters ST 05-0068 GIL and ST 08-0124 GIL and that Illinois law does not preclude the Taxpayer from pursuing reimbursements of use tax from its tax exempt lessees, will you provide assurance that your taxpayer assistance representatives will receive a copy of the ruling and be trained on its implications for future taxpayer inquiries? We want this assurance because several of our lessees are not reimbursing us based on advice from REPRESENTATIVE and other taxpayer assistance representatives.

If you have any questions or require additional information in order to respond to our request, please direct inquiries and responses to:

DEPARTMENT'S RESPONSE:

For general information purposes please refer to 86 Ill. Adm. Code 130.2010, the Department's regulation that covers the taxation of leases. Under Illinois law, "true leases" and "leases" that are actually conditional sales contracts are treated differently for Retailers' Occupation Tax and Use Tax purposes. 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 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.

Organizations that make application to the Department and are determined to be exclusively religious, educational, or charitable, receive an exemption identification "E" number. See 86 Ill. Adm. Code 130.2007. This number evidences that this State recognizes that the organization qualifies as exempt from incurring Use Tax when purchasing tangible personal property in furtherance of its organizational purpose. An organization must provide a retailer with its "E" number to document the exemption. If an organization or governmental body does not have an "E" number, then its purchases from a company are subject to tax. Only sales to the organization or governmental body holding the "E" number are exempt, not sales to individual members of the organization. The Retailers' Occupation Tax does not apply to receipts from sales to organizations holding a valid "E" number.

Except as provided in the limited exceptions set out in Section 130.2011 and 130.2012, lessors who execute true leases with lessees that have E-numbers owe Use Tax on their cost price of the rental property. The Use Tax liability remains on the lessor notwithstanding the status of the lessee. See Continental Illinois Leasing Corp. v. Department of Revenue, 108 Ill. App. 3d 583 (1st Dist., 1982).

Even though under Illinois law, lessors may not "pass through" their tax obligation to the lessees as taxes, 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 amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements. The Department, however, is not a party to those agreements, as those are agreements between the lessor and lessee. If the lessee fails to fulfill its obligation under this separate agreement, then the breach of that agreement would be between the lessor and the lessee.

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,

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Associate Counsel

DMB:msk

Bcc: Debbie Stout