ST 03-0027-PLR 11/19/2003 AUTOMOBILE RENTING TAX

Extensions or renewals of automobile leases that have initial terms of more than one year are not subject to Automobile Renting Occupation and Use Tax liability if the initial lease term is for a period greater than one year. 86 Ill. Adm. Code 180.101. (This is a PLR.)

November 19, 2003

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of January 2, 2003, which references the Department's Private Letter Ruling of December 17, 2002 (ST 02-0030-PLR). Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to AAA. and BBB for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither AAA and BBB 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:

Please view this letter as a private letter ruling request as to the application of the AROT/ARUT and Illinois Retailer's Occupation Tax and Use Tax ('ROT/UT') to automobiles purchased by AAA and the BBB for purposes of leasing such vehicles for a period of more than one year.

FACTS

We represent AAA, a company principally engaged in the business of leasing automobiles (the 'Company'). The vehicles are purchased by the Company, as the servicing agent for a trust called BBB (the 'Trust'). This Trust holds the titles to all of the Company's vehicles. The vehicles are purchased from dealerships which are located in Illinois (the 'Illinois Dealerships') and dealerships that are located outside of Illinois (the 'Out-of-State Dealerships'). The Dealerships withdraw funds from the Company's bank account for the factory invoice price of the respective vehicle. The Company then registers the vehicles in the name of the Trust. The Company holds the beneficial interest in the trust. This structure allows ease in borrowing from the Company's lenders. (For purposes of this letter, the 'Trust' and the 'Company' shall be together referred to as the 'Leasing Company.')

In a transaction in which a Leasing Company's vehicle is purchased from an Illinois Dealership, the purchase is reported on Illinois' Sales Tax Transaction Return (Form ST-556). If the vehicle purchased from an Illinois Dealership is not a replacement vehicle for a vehicle that is completely destroyed, the Leasing Company, pursuant to a contractual arrangement with each Illinois Dealership, completes Form ST-556. The

completed Form ST-556 references the Illinois Dealership as the seller, including its Illinois Business Tax Number, and the Trust as the purchaser. The Leasing Company then remits the ROT due on each vehicle under this scenario directly to the DOR. If the vehicle purchased from an Illinois Dealership is a replacement vehicle for a vehicle that is completely destroyed, each Illinois Dealership completes Form ST-556 and remits the ROT due on each such vehicle directly to the DOR. The Leasing Company, under this scenario, remits any UT due on the purchase price of the replacement vehicle to the Illinois Dealership.

In a transaction in which a Leasing Company's vehicle is purchased from an Out-of-State Dealership, the purchase is reported on an Illinois Use Tax Transaction Return (Form RUT-25). The Leasing Company completes RUT-25, referencing the Trust as the purchaser and naming the Out-of-State Dealership as the seller. The Leasing Company remits the UT due on each vehicle under this scenario directly to the DOR. In all of these transactions, the trust holds title to the vehicles.

Following their purchase, the vehicles are leased to customers by the Leasing Company pursuant to the 'BBB Leasing - Illinois' lease agreement (the 'Lease') (copy attached as Exhibit A).[1] The Lease is an open-ended true lease for a minimum term of 367 days and a maximum term ranging from approximately 50 to 75 months.[2] The language relating to the term of the Lease is addressed in the Lease as follows:

'12. TERM OF THE LEASE. Either Lessee or Lessor may terminate the obligation to lease additional or replacement vehicles at any time upon written notice to the other party. Such termination shall be limited to precluding delivery of additional or replacement vehicles not previously ordered, but this Lease shall continue in full force and effect on all vehicles under lease hereunder on the date of such termination and until the expiration of the Lease terms for such vehicles. Each motor vehicle shall be leased for an initial term of 12 months (except for vehicles located in the State of Illinois where the initial term will be 367 days) from the date of the delivery of such vehicle to Lessee, and thereafter for successive 12-month renewal terms; provided that Lessee shall have the right to cancel any vehicle at any time after the end of the first 12 months (367 days in Illinois) of the initial lease term for such vehicle by giving written notice of such cancellation to the Lessor, in which event the effective date of such cancellation shall be the sooner of the date of sale or 30 days after the vehicle shall have been surrendered to Lessor for sale, unless Lessee elects to arrange for the sale of the vehicle, in which case the date of cancellation shall be the day Lessor receives funds from the buyer designated by the Lessee. In the event that Lessee shall at any time terminate or cancel the lease of any vehicle as a part of, or in anticipation of, a financing plan under which Lessee or an affiliate of Lessee will retain the use of said vehicle, the Lessee will pay a charge equal to the excess, if any, of (a) the total rental payments which would have been required under the Lease for the terminated vehicle from the date of termination through the end of the 36th month of such Lease over (b) the total rental payments which would have been required for said period had such payments been determined on the basis of the interest rate in effect at the time of such termination rather than that at the inception of said Lease. Lessee agrees that upon termination of the lease of a motor vehicle for any reason whatsoever, the Lessee will cause the motor vehicle to be returned to the Lessor within the Continental United States, or if such vehicle is originally delivered in Hawaii, Alaska or Puerto Rico, Lessee will cause such vehicle to be returned to the point of original delivery.'

Pursuant to the terms of the Lease, the lessee shall pay all ‘use, sales, personal property, and other taxes, license fees’, etc. (§4 of Lease.) As a result, the Leasing Company is reimbursed by the lessees for any ROT or UT that the Leasing Company pays upon the purchase of any vehicles.

OPINION REQUESTED

The Leasing Company's purchases of vehicles for subsequent lease to customers pursuant to the Lease are subject to the ROT and/or the UT, and such Leases are not subject to the AROT or ARUT for the term of the Lease. In that regard, we also ask that the DOR acknowledge that our conclusions stated at the end of this letter are correct.

STATEMENT

This is a request for a private letter ruling (PLR) under 2 Ill. Admin. Code Sec. 1200.110. No audit or litigation is currently pending between the Leasing Company and the DOR. To the best of our knowledge, the DOR has not previously ruled on the same or similar issue for the Leasing Company or a predecessor, nor has the Leasing Company submitted the same or similar issue to the DOR prior to withdrawing it before a letter ruling was issued. However, the Department has issued a GIL dated May 3, 2002 and a PLR dated December 17, 2002 which have addressed issues substantially similar to those in this letter. Both AAA and BBB, are located at ADDRESS. A power of attorney for these entities is attached as Exhibit B.

LAW

Illinois imposes the ROT on persons selling tangible personal property at retail. 35 ILCS 120/2. A ‘sale at retail’ is defined as the transfer for consideration, and not for resale, of title to or ownership of tangible personal property to a purchaser. 35 ILCS 120/1. For purposes of the ROT, a purchaser is anyone who, through a sale at retail, acquires for consideration title to or ownership of tangible personal property. 35 ILCS 120/1. A retailer is required to remit the ROT to the DOR.

Illinois also imposes UT on the privilege of using in Illinois tangible personal property purchased anywhere at retail from a retailer. 35 ILCS 105/3. The UT is either collected from the purchaser of the tangible personal property by a retailer maintaining a place of business in Illinois or paid directly to the DOR by any person using the property within Illinois. 35 ILCS 105/3-45.

The ROT and UT are related in that the retailers remit the ROT, based on the gross receipts of their sales at retail of tangible personal property, to the DOR and collect the UT, based on the purchase of such tangible personal property, from the purchaser. The UT collected by the retailer is not remitted to the DOR; the UT is a reimbursement of the ROT paid by the retailer to the DOR. ST 00-0281-GIL (December 7, 2000).

In Illinois, lessors of tangible personal property under a true lease are considered to be the end users of the property to be leased. 86 Ill. Admin. Code Section 130.2010(b). As a result, lessors incur UT on the lessor's cost price of the property (except that the purchase of automobiles leased for terms of one year or less which are subject to the AROT/ARUT are exempt from the UT). The lessors either pay their suppliers, if their suppliers are registered to collect UT, or self-assess and remit the tax directly to the

DOR. 35 ILCS 105/3-45. Since the lessors are considered the end users of the property and therefore incur UT, no ROT is imposed upon the rental receipts and the lessees incur no UT liability for the rental charges. 86 Ill. Admin. Code Section 150.305(3).

Leases of automobiles for a duration of one year or less are subject to taxation under the AROT. 86 Ill. Admin. Code Section 180.101(a). Therefore, 'so long as the lease term for each automobile never binds the lessee for a period longer than one year,' the lease is subject to the AROT and not the ROT or UT. ST 92-0172-PLR (March 27, 1992); Accord, ST 02-0106-GIL (May 3, 2002).

ANALYSIS

Under the facts, the Illinois Dealerships are selling the vehicles to the Leasing Company at retail. Therefore, the Illinois Dealerships are subject to the ROT based on the gross receipts that they receive on the sale of such vehicles. The Leasing Company is purchasing the vehicles for the purpose of leasing the vehicles under a lease for a term greater than one year. Since the Lease is a true lease, the Leasing Company is considered the end user of the vehicles purchased by it from the Illinois Dealerships and the Out-of-State Dealerships.

Under this scenario, the Illinois Dealerships are required to remit the ROT directly to the DOR, based on the gross receipts that they receive on the sale of the vehicles to the Leasing Company. The Illinois Dealerships can be reimbursed for the ROT remitted to the DOR by collecting the corresponding UT from the Leasing Company. In this regard the Leasing Company and each Illinois Dealership have mutually agreed, pursuant to a contractual arrangement, that where a vehicle is purchased, other than as a replacement vehicle for a vehicle that is completely destroyed, that the Leasing Company will remit the ROT directly to the DOR on behalf of the respective Illinois Dealership. If a vehicle is purchased from an Illinois Dealership as a replacement vehicle for a vehicle that is completely destroyed, the Leasing Company will remit to the Illinois Dealership the UT due on the purchase of the vehicle from the respective Illinois Dealership. If a vehicle is purchased from an Out-of-State Dealership, the Leasing Company remits the UT, based on the purchase price of the vehicle, directly to the DOR.

In addition, since the Lease is a true lease, the lessees are not purchasing the vehicles from the Leasing Company at retail. Thus, the Leasing Company is not subject to the ROT on the rental receipts received from the lessees. Moreover, notwithstanding any contractual liability to reimburse the Leasing Company for any ROT or UT, the lessees under the Lease are not subject to the UT because, for purposes of these taxes, the lessees are not consumers or end users of tangible personal property in Illinois.

As to the AROT/ARUT, since the Leasing Company purchased the automobile for lease and the lease agreement 'binds' the parties to a lease term of greater than one year, no AR0T/ARUT would be due. The fact that the maximum lease period is open ended only means that the final lease term can vary anywhere from 367 days to 50 to 75 months. However, because the Lease Agreement entered into by the parties 'binds' the lessor to 50 to 75 months and 'binds' the lessee to at least 367 days up to 50 to 75 months, the Lease fulfills the requirement that it 'binds' the parties to a minimum period that exceeds one year. See ST 02-0106 GIL; PLR dated 12/17/02. As a result, such a lease does not transfer the possession or *right to possession* of an automobile 'for a period of one year

or less.' 35 ILCS 155/2. Rather, possession or the *right to possession* has been transferred from anywhere from 367 days to 50 to 75 months under the Lease and, thus, always exceeds one year.[3]

CONTRARY AUTHORITY AND DISCUSSION

No authority exists that is contrary to the positions expressed in this request for a private letter ruling.

CONCLUSIONS

We respectfully request that the DOR issue a private letter ruling (PLR) addressing the issues presented above and reaching the following conclusions:

1. That each Illinois Dealership is subject to ROT and satisfies its ROT obligations when either: (i) the Illinois Dealership prepares Form ST-556 and timely remits the correct amount of ROT directly to the DOR; (ii) the Leasing Company, pursuant to a contractual arrangement with each Illinois Dealership, prepares Form ST-556 on behalf of the Illinois Dealership and timely remits the correct amount of ROT owed by the Illinois Dealership directly to the DOR **(while we understand that the Dealership cannot contractually shift its tax obligation to another entity for DOR purposes, we are merely asking whether the Dealership's ROT obligation is satisfied if the Leasing Company <u>on behalf of the Dealership</u> timely files the returns and pays the ROT to the DOR).**

2. That the automobiles purchased by the Leasing Company are subject to UT and that UT obligation is satisfied when either: (i) the Leasing Company, pursuant to a contractual arrangement with each Illinois Dealership, prepares Form ST-556 on behalf of the Illinois Dealership and timely remits the ROT owed by the Illinois Dealership directly to the DOR (thus also effectively paying the UT due on the purchase of the vehicle); or (ii) the Leasing Company prepares Form UT-25 and timely remits the UT due directly to the DOR.

3. That the lessees under the Lease are <u>not</u> subject to ROT or UT.

4. That the Leasing Company and lessees are not subject to AROT/ARUT at the time that the Lease is executed and during the entire Lease period under the Lease since the Lease has a 'binding' term of greater than one year.

If you have any questions, or contemplate issuing a ruling different than that requested above, please call.

For purposes of this Private Letter Ruling, we are assuming that BBB is recognized as a valid legal entity under Illinois law. The Department considers a valid trust to be subject to the Retailers' Occupation Tax Act and the Use Tax Act if it is in the business of leasing tangible personal property in Illinois.

We believe that the copy of the agreement entitled the "BBB Leasing - Illinois" is a lease (not a conditional sale) for Illinois Retailers' Occupation Tax and Use Tax purposes. This determination is made in conformance with provisions of Section 3-201.1 of the Illinois Vehicle Code that 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."

Please be advised that we cannot provide you with a binding response with respect to the Retailers' Occupation Tax liability of any Illinois dealers or lessees referenced in your ruling request because those dealers and lessees are not parties to this letter ruling.

We believe that the leases are not subject to liability under the Automobile Renting Occupation and Use Tax Act because the minimum lease term is for a period greater than one year (greater than 365 days). See 86 Ill. Adm. Code 180.101. Our review of the documentation enclosed with your request indicates that any continued lease beyond the minimum lease term of 367 days does not constitute a new lease or rental, but is merely a continuation of the original lease. The lessee and lessor are bound by the terms of the lease for the minimum lease term and thereafter for successive 12-month renewal terms. The lessee has the right to cancel any vehicle at any time after the end of the first 367 days of the initial lease terms for such vehicle by giving written notice of such cancellation to the lessor. Because the minimum lease term exceeds 365 days and any continued lease beyond that minimum term is a continuation of that lease, the gross receipts from that lease for the minimum lease term and periods beyond that minimum term are not subject to Automobile Renting Occupation and Use Tax liability.

BBB, as lessor under a true lease, will incur a Use Tax liability on the vehicles that are being leased in Illinois. BBB is required to satisfy its Use Tax liability by paying the tax to an Illinois dealer at the time of purchase of a vehicle for lease in Illinois. BBB or AAA may contractually arrange with the Illinois dealers to file the dealers' transaction reporting returns (ST- 556s) and forward the dealers' Retailers' Occupation Tax payments to the Department relating to those returns as described in your letter ruling request. Please note that the Illinois dealers will remain liable for any tax not properly reported and paid to the Department regardless of their contractual arrangement with BBB or AAA

In standard retail transactions in Illinois, the retailers are required to collect the proper amount of Use Tax from their customers. The retailers then are allowed to retain those amounts as long as they properly pay Retailers' Occupation Tax on those sales. We understand that the contractual arrangement between the Illinois dealers and BBB, or AAA as agent for BBB, merely condenses these two transactions by having BBB make the Illinois dealers' Retailers' Occupation Tax payments directly to the Department of Revenue on behalf of those Illinois dealers. As long as the books and records of both the Illinois dealers and BBB establish that Retailers' Occupation Tax was properly paid on behalf of the Illinois dealers for each sale of a leased vehicle, the Department will consider BBB to have properly satisfied its Use Tax liability on the purchase of those leased vehicles.

If BBB purchases a vehicle from an out-of-State dealer that is not registered to collect Illinois Use Tax, BBB satisfies its Use Tax liability on those purchases by properly completing Form RUT-25 and remitting the proper amount of Use Tax directly to the Department.

The facts upon which this ruling are 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 material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk

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[1] There is no nominal buyout option or provision in the lease.
[2] This is the maximum range of lease terms that corresponds to the amortization schedule set forth in the respective vehicle orders.
[3] The maximum period under the open ended lease is not a new lease agreement, but merely the agreed-to term under the original lease agreement. ST 02-0106 GIL.