

This letter addresses a lessor's tax liability when the lessor is engaged in the business of renting and selling tangible personal property. See 86 Ill. Adm. Code 130.2013(e)(2). (This is a PLR).

October 15, 2015

Dear Xxxxx:

This letter is in response to your letter dated March 19, 2015, 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.

Review of your request disclosed that all the information described in paragraphs 1 through 8 of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to ABC for the issue or issues presented in this ruling, and is subject to the provisions of subsection (e) of Section 1200.110 governing expiration of Private Letter Rulings. Issuance of this ruling is conditioned upon the understanding that neither ABC 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:

ABC is a lease-to-own specialty retailer, who operates lease-to-own stores throughout the United States, including company owned stores and franchised locations in Illinois. The company focuses on both lease-to-own and retail sale of furniture, electronics, appliances and computers.

The company purchases items for both sale and lease into a mixed inventory and consequently pays use tax on all items. Sales tax is collected on all retail sales whether the item was new or previously rented. Less than X percent of our store revenues come from retail sales of new and used items. The used items are from merchandise that was previously out on agreement, but returned by the customer. Approximately Y per cent of the items that go out on lease go to term the first time out, in other words the customer makes all the scheduled payments and becomes the

owner of the merchandise. An item may go out on lease more than once. In which case it is [sic] either becomes the property of the lessee after making all payments, is leased again, sold, or discarded as worthless.

I. FACTS

With respect to its lease-to-own contracts, ABC enters into either a cancelable 12 or 24-month agreement commonly referred to as a "Lease " (the "Agreement") with the customer. The Agreement designates a term with applicable monthly renewal payments being due monthly (the "renewal period"). At the end of the monthly renewal period, the customer must either surrender the lease property to ABC or renew the agreement by making another renewal payment. At the end of the 12 or 24-month term, and after the last payment is made, title is transferred to the customer who then owns the product free and clear of any encumbrances. No buyout or nominal fees are required. In addition, the customer also has the option to purchase the merchandise at any time before the end of the term by making all applicable payments. Conversely, as noted above, the customer can stop making payments at any time and return the product with no obligation to make additional payments. **(See copy of Agreement attached)**

The transaction between the parties may thus be summarized as follows:

- The agreement requires 12 or 24 renewal period payments to ABC commencing on the effective date of the lease agreement for ownership to transfer to the customer upon the last payment.
- The customer may terminate the agreement at the end of any renewal period, without penalty, by surrendering or returning the property and paying all applicable charges through the date of the surrender or return.
- No buyout or nominal fees are required.
- There are no guarantees on the part of the customer that the goods will be sold to them. The only guarantee is that title will pass from ABC to the customer after all payments are made.
- At the end of the 12 or 24-month term and after the last payment is made, the customer owns the product free and clear of any encumbrances.
- ABC removes the product from its depreciation and inventory schedule after the title is transferred to the customer. This occurs at the end of the month even if the sale occurs prior to month-end close of the books.

II. ILLINOIS TAXATION OF LEASING TRANSACTIONS

For Illinois sales and use tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is typically characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if a lessor is guaranteed at the time of the lease that the leased property will be sold to the lessee, that transaction is considered to be a conditional sale at the outset of the transaction. Persons who purchase items for resale under conditional sales contracts can avoid paying tax to suppliers by providing certificates of resale that contain all the information set forth in 86 Ill. Admin. Code 130.1405. All receipts received by a lessor/retailer under a conditional sales contract are subject to Retailers' Occupation Tax. See 86 Ill. Adm. Code 130.2010.

A true lease in contrast, 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. Admin. Code 130.220. As end users of tangible personal property located in Illinois, lessors of a true lease owe Use Tax on their cost of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

III. ISSUES

- What is the proper treatment of the final payment on the Agreements? Although ABC and its franchisees use the same agreement, two of our franchisees in Illinois have received conflicting official advice from the state.
- It appears that we are now in a position where the state is requiring some of our franchisees to subject the final payment to Retailer's Occupation tax and some of our franchisees not to tax the final payment. Since we are the Point of Sale administrator for all ABC's franchise and company owned stores in Illinois we need to know how to treat the same transaction between two different methods within the same state.

IV. STATE OF ILLINOIS POSITIONS & RELATED ANALYSIS

On July 24th, 1998, an Illinois franchisee, FRANCHISEE, received a private letter ruling, ST XX-XXXX PLR, from the state of Illinois on the treatment of the Agreements. A copy of the Letter Ruling is attached. In that ruling, the state held that the Agreements were "true leases and not conditional sales" for purposes of Illinois sales and use tax. It explained, "when a rent-to-own agreement allowed lessees to 'walk away' at the end of the lease term without

further obligation or penalty, those agreements will be considered as true leases." Accordingly, the franchisee was instructed to: (i) pay Use Tax on its purchase of merchandise for lease-to-own transactions, and (ii) not collect [sic] Retailers' Occupation tax on any payments from the customer.

Since then, ABC and its franchisees have implemented this ruling for all scheduled lease-to-own payments. While we recognize that private letter rulings are only binding on the taxpayer who requested the ruling, the underlying substantive tax analysis is nonetheless the same since the business model and the Agreements are the same for both ABC, Inc. and all franchisees. Moreover, consistency should result in the same ruling being applicable to all substantially similar Agreements. In the instant case, the relevant portions of our Agreements have not changed substantially since ST XX-XXXXX-PLR was issued.

In MONTH YEAR, the State of Illinois audited another franchisee, COMPANY, and took the position that the final lease payment constitutes a sale subject to ROT. This means that sales tax should be collected from the customer on the final payment, but in such situations, a credit is allowed for Use Tax paid up to the amount of the state portion of the ROT collected, per Ill. Admin. Code § 130.2013.

The IDOR Auditor, citing Ill. Admin. Code § 130.2013 concluded that, "The final payment is not a rental payment as when the customer makes the payment they take possession of the merchandise like a sale. Whenever a customer takes possession of the merchandise that is a taxable event."

Ill. Admin. Code § 130.2013(e)(2) (Sales of Items Coming Off Lease That are No Longer Needed in a Rental Inventory) states,

[A] lessor of tangible personal property who sells like-kind property apart from his sale of items no longer needed for his rental inventory incurs Retailers' Occupation Tax liability on all retail sales of that property including sales of items no longer needed for his rental inventory. This is true because a person who is engaged in the business of selling tangible personal property cannot make an isolated or occasional sale of like-kind tangible personal property.

See also, 130.2013(f)(2) for credit allowed.

Ill. Admin. Code § 130.2013(h)(1)(B) (Persons Who Sell Tangible Personal Property After Using It for Rental Purposes) states:

Lessors who are otherwise engaged in the business of selling like-kind property incur Retailers' occupation Tax liability on all

their sales, including sales of items coming off lease that are no longer needed for their rental inventories.

III. Admin. Code § 130.2013(h)(2) states:

A lessor who incurs a Retailer's Occupation Tax Liability on the sale of an item can take a credit against that liability for any Use Tax and any local Retailer's Occupation Tax reimbursements that he paid to a supplier registered to collect Illinois Tax when he purchased that particular item. However, this credit cannot exceed the amount of ROT incurred by the lessor/retailer when he sells the item.

Due to the credit mechanism provided for in the Regulations, we believe we should be indifferent as to the sales and use tax treatment of the final payment, but we need to know how to properly charge the customers and correspondingly, how to report and pay these amounts to the State of Illinois. This is because, even if the auditor's conclusion is correct that the final payment constitutes a retail sale as opposed to being the final lease payment, the State will never collect any additional revenue. Per the regulations, the lessor is entitled to a credit for the Use Tax paid when the merchandise was acquired. The sales tax due on the final payment will always be less than the use tax paid because the final payment is a fraction of the cost. Taxing the last payment does not seem to make sense because the customer must pay extra and the State receives no additional revenue.

V. RULING REQUESTED

Since it has come to our attention that our franchisees in the state are potentially subject to fundamentally different taxing positions regarding how the final payment of a lease-to-own payment should be treated for our Point of Sale we are respectfully requesting a private ruling on the two related issues listed below.

- 1. Whether the final payment should be considered part of the lease or whether it constitutes a separate sale transaction?**
- 2. Consequently how should ABC's Point of Sales (POS) handle customer tax on the last payment?**

Enclosed Documents

- Master lease Agreement XXXXX
- Copy of FRANCHISEE private letter ruling dated July 24, 1998.

We respectfully request an opportunity to discuss this ruling with you before it becomes finale [sic]. In addition, we respectfully request to [sic] the ability to withdraw this ruling request at any time prior to its promulgation.

If you have any questions or need any additional information, please feel free to contact me at (XXX) XXX-XXXX.

DEPARTMENT'S RESPONSE:

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. 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 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. 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. See 86 Ill. Adm. Code 130.2010.

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.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois are the parties with Use Tax obligations. The lessors should either pay their suppliers, if their suppliers are registered to collect Use Tax, or self-assess and remit the tax to the Department. If the lessors have already paid tax in another state with respect to the acquisition of the tangible personal property, they are 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).

Persons who are lessors and whose only selling activity consists of selling items that come off lease and are no longer needed for rental purposes cannot purchase for resale. If an item is placed in a rental inventory, it has been purchased for rental purposes and Use Tax is due. "Rental inventory" means that the owner, in order to state his intended use of the property as rental property, has recorded the property in his books and records as rental property in accordance with generally accepted accounting principles. Depreciation of property used for rental purposes demonstrates an intent to include that property in rental inventory. See 86 Ill. Adm. Code 130.2013.

The question of whether a lessor's sale of tangible personal property coming off lease that is no longer needed for the lessor's rental inventory is subject to Retailers' Occupation Tax liability depends on whether the seller is strictly a lessor, or whether the seller is otherwise engaged in the business of selling like-kind property. Except in the case of motor vehicles, as defined and explained at 86 Ill. Adm. Code 130.111, a person who is strictly a lessor and whose only sales are of items no longer needed for his rental inventory does not incur Retailers' Occupation Tax liability on those sales.

Lessors who are otherwise engaged in the business of selling like-kind property incur Retailers' Occupation Tax liability on all their sales, including sales of items coming off lease that are no longer needed for their rental inventories. A lessor who incurs a Retailers' Occupation Tax liability on the sale of an item can take a credit against that liability for any Use Tax and any local Retailers' Occupation Tax reimbursements that he paid to a supplier registered to collect Illinois tax when he purchased that particular item. However, this credit cannot exceed the amount of Retailers' Occupation Tax incurred by the lessor/retailer when he sells the item. Further, only the entity that originally paid the tax on the item can take the credit on the subsequent sale. See 86 Ill. Adm. Code 130.2013. If a lessor filed a return and paid the tax directly to the Department, the lessor must file a claim to recover it.

Based on the assertions in your letter and the attached lease agreement, it is our understanding that your company engages in lease-to-own transactions as well as retail sales of items that are no longer needed from rental inventory and new items. It is our understanding that you place items for lease into a rental inventory and that you depreciate the property. Your letter states that customers enter 12 or 24 month agreements with each month being a renewal period. If all payments are made, the customer owns the tangible personal property, but no dollar or other nominal options to purchase are included in the lease. It is our understanding that the customer can cease making payments and return the property at any time without further payment obligation. Furthermore, the customer is never under any obligation to purchase the property. The agreement you attached to your document does not guarantee a sale of the tangible personal property at the inception of the contract as is common with conditional sales agreements. Because the lessee is free to walk away from the lease at any time and therefore a sale of the property is not guaranteed at the time the lease is entered into, and because there is no dollar or other nominal option to purchase at the close of the lease term, it is the Department's opinion that the agreement is a true lease.

Your tax liability is determined by the overall nature of your business as explained in 86 Ill. Adm. Code 130.2013. For tangible personal property that you sell at retail which is not first leased, you should provide your suppliers with resale certificates for the percentage of such items that you purchase which will be resold. See 86 Ill. Adm. Code 130.1405(c)(2). You should then pay Use Tax for all items which you place in your rental inventory. If those items are later sold at retail (not transferred as part of a true lease), you should collect Retailers' Occupation Tax on the sale. See 86 Ill. Adm. Code 130.2013(h)(1)(B). You may take a credit for the amount of Use Tax and any local Retailers' Occupation Tax reimbursements that you paid to your supplier when you purchased the item for rental purposes. See 86 Ill. Adm. Code 130.2013(h)(2). You should also collect Retailers' Occupation Tax on any new items of tangible personal property that you sell without first leasing the items. See 86 Ill. Adm. Code 130.2013(e)(2). Receipts

from the rental of tangible personal property under a true lease are not subject to Retailers' Occupation Tax liability. See 86 Ill. Adm. Code 130.2013(g). Therefore, none of the monthly payments, including the last payment, are subject to Retailers' Occupation Tax.

The factual representations upon which this ruling is 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 factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.tax.illinois.gov or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Richard S. Wolters
Chairman, Private Letter Ruling Committee

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