

Compliance Alert - Procedures for Reporting Selling Price on Transaction Returns for Leases (Forms ST-556-LSE and RUT-25-LSE)



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Compliance Problem

The Illinois Department of Revenue (IDOR) is aware that some taxpayers are reporting an incorrect selling price on Form ST-556-LSE for motor vehicles that are simultaneously leased at the time they are sold, resulting in an incorrect calculation of tax due. This compliance alert is intended to assist motor vehicle dealers in determining which charges must be included when the alternate selling price (amount due at signing, plus the total amount of lease payments), is used on Form ST-556-LSE. This compliance alert is also intended to assist the vendors who program the dealer management systems (DMS) for these motor vehicle dealers.

If a motor vehicle sold for the purpose of leasing meets the criteria set forth in the law, then the alternate selling price reported on the tax return must include all consideration received by the lessor (i.e., "leasing company") pursuant to the lease contract.

If the following charges are included in the amount owed under the lease contract, they must be **included** in the taxable selling price:

- reimbursement by the lessee (i.e., "lease customer") of sales and use tax, and
- interest charges on the reimbursement of tax.

Even if the following charges are included in the amount owed under the lease contract, they are **excluded** from the taxable selling price:

- the "disposition fee" listed on the lease contract, and
- amounts collected under Chicago's Personal Property Lease Transaction Tax.

Background

Public Act 98-628 (effective January 1, 2015) amended the Retailers' Occupation Tax Act and the Use Tax Act to provide for an alternate method of determining the selling price ("alternate selling price") subject to sales and use taxes for certain motor vehicles that are simultaneously leased at the time of the sale. This alternate selling price must be used to calculate tax when a qualifying motor vehicle is sold for the purpose of being leased under a fixed-term lease contract for a period of more than one year. See **Informational Bulletin FY 2015-03, Leased Motor Vehicle Changes and New Reporting Requirements**, for more information on which motor vehicles and which leases are subject to the alternate selling price. The alternate selling price for these leased motor vehicles is the consideration received by the lessor (i.e., leasing company) pursuant to the lease contract, including amounts due at lease signing and all monthly or other regular payments charged over the term of the lease.

Tax reimbursement: In these transactions, the person selling the motor vehicle, (i.e., a motor vehicle dealership) owes Retailers' Occupation Tax. The person purchasing the motor vehicle (i.e., the leasing company) owes Use Tax. It is customary, however, for vehicle lease contracts to require lessees ("lease customers") to reimburse any sales taxes owed. If this reimbursement of tax is included in the lease contract, then, under the statute, it becomes part of the selling price subject to tax. In addition, if the lease contract includes finance charges on the tax reimbursement, these finance charges also become part of the selling price subject to tax. It is important to remember that, in these transactions, the tax is based on the amount due under the lease contract. So, whatever amounts are included in the lease contract become part of the "selling price" on which tax must be calculated.

The reporting problem IDOR has encountered involves situations where both a reimbursement of tax and finance charges on that reimbursement are included in the lease contract. In those cases, some retailers are reporting and paying tax on a selling price that is less than the consideration received by the leasing company pursuant to the lease contract.

Disposition fee and Chicago Personal Property Lease Transaction Tax: Although the “disposition fee” (also referred to as a “turn-in fee” or “termination fee”) often appears in motor vehicle lease contracts, it is not “consideration received by the lessor pursuant to the lease contract” because it is a conditional charge, not part of the lease itself, that is only imposed if the lessee does not purchase the vehicle at the end of the lease.

Similarly, Chicago’s Personal Property Lease Transaction Tax, while it may be included as a charge under the lease contract, is not “consideration received by the lessor pursuant to the lease contract” because it is a tax imposed directly on the lessee. For purposes of this tax, the motor vehicle dealer and lessor are acting as the collector of the tax.

Therefore, these two items (the “disposition fee” and Chicago Personal Property Lease Transaction Tax) are not included as part of the selling price when calculating tax.

Solution

Tax Reimbursement

Rule of Thumb: Regardless of the method you use to determine tax, the rule of thumb for determining whether you are paying the correct amount of tax on these transactions is that the lease contract amount multiplied by the rate of tax equals the amount of tax owed. Generally, you can use this simple calculation to check your work: multiply the amount in the “Total of Payments” box on the contract (minus any amount added as a “disposition fee” and any amount collected under Chicago’s Personal Property Lease Transaction Tax) by the rate of tax to confirm the amount of tax owed. See below for one method to use to calculate the proper tax when the lease contract includes both reimbursement of tax owed as well as finance charges on that reimbursement of tax.

Calculating Tax When Included in Lease Contract: If the lease contract includes a reimbursement of tax and also includes finance charges on that reimbursement, you must compute the total amount due under the lease in a way that ensures the proper amount of tax is paid. Regardless of how the lease payment amounts are calculated to recover tax, the retailer is required to remit tax based on the full amount due under the lease contract, including any increase resulting from a reimbursement of tax and finance charges on that reimbursement. One way to compute this mathematically is to use the example below. Whether the retailer uses this method or uses another method to compute tax owed, the retailer must always be sure to remit tax on the total consideration received by the lessor pursuant to the lease contract however the payments were computed.

EXAMPLE:

A lease contract for the sale of a qualifying motor vehicle reflects the following terms:

- An amount due at signing of \$5,000.
- Before calculating the reimbursement of tax, the dealer determines that the lease customer will owe a payment of \$500 each month for the next 36 months (*i.e.*, \$18,000).
- The lease contract requires the lease customer to reimburse the tax owed by the dealer and leasing company.
- The combined tax rate is 8.25% (state and local taxes).

Tax Reimbursement Formula

1. Enter 1.000.	1.000
2. Enter the combined state and local tax rate as a decimal.	0.0825
3. Subtract Line 2 from Line 1. (1.000 - 0.0825)	0.9175
4. Divide Line 1 by Line 3 and round the total to 4 decimal places. (1.000 / 0.9175)	1.0899
5. Enter the total taxable amount of the lease. (\$5,000 + \$18,000)	\$23,000
6. Multiply Line 5 by the percentage on Line 4. (\$23,000 X 1.0899)	\$25,068*
7. Multiply Line 6 by the tax rate decimal on Line 2. (\$25,068 X .0825)	\$2,068

In this case, the “Total of Payments” in your lease contract would be \$25,068 (not including any “disposition fee” or Chicago’s Personal Property Lease Transaction Tax amount, if applicable). This is because the increased monthly payment, which includes the reimbursement of tax by the lease customer, becomes part of the alternate selling price on which the tax is calculated. Using the “rule of thumb” to confirm that the tax reimbursement formula works, multiply the end result by the tax rate: \$25,068 (“Total of Payments” reported on lease contract) x 0.0825 (tax rate) = \$2,068 (tax due).

** This formula only works if you actually use this as the "Total of Payments" amount in the lease contract (not including any "disposition fee" or Chicago's Personal Property Lease Transaction Tax amount, if applicable). Remember, tax due equals the lease contract amount (minus allowable deductions) multiplied by the rate.*

The amount on Line 7 is the sales tax due if the lessor is not charging interest or a finance charge on the amount of the sales tax reimbursement it charges the lessee.

If the lessor chooses to charge interest or a finance charge on the sales tax reimbursement, continue with Line 8.

Interest on Tax Reimbursement Formula

8. Enter the total amount of the interest or finance charge the dealer will charge on the amount on Line 7**.	\$197
9. Enter the amount from Line 5.	\$23,000
10. Add Lines 8 and 9. (\$197 + \$23,000)	\$23,197
11. Enter the amount from Line 4.	1.0899
12. Multiply line 10 by Line 11. (\$23,197 X 1.0899)	\$25,282***
13. Multiply line 12 by the tax rate decimal on Line 2. (\$25,282 X 0.0825)	\$2,086

The amount on Line 13 of the above worksheet is the sales tax due when interest or a finance charge is imposed on the sales tax reimbursement the lessor charges to the lessee.

***For this example: the interest on a tax reimbursement of \$2,068 (the amount of tax owed per Line 7) at 6% interest for 36 months would equal \$197.*

**** This formula only works if you actually use this as the "Total of Payments" amount in the lease contract (not including any "disposition fee" or Chicago's Personal Property Lease Transaction Tax amount, if applicable). Remember, tax due equals the lease contract amount (minus allowable deductions) multiplied by the rate.*

In this case, the "Total of Payments" in your lease contract would be \$25,282 (not including any "disposition fee" or Chicago's Personal Property Lease Transaction Tax amount, if applicable). Therefore, this is the amount to be reported as the selling price on Form ST-556-LSE. This equals \$23,197 (basic lease payment plus interest on tax reimbursement) + \$2,086 (tax) = \$25,282 ("Total of Payments" reported on lease contract). The end result here is that tax due equals \$2,086. Using the rule of thumb to confirm that the tax formula works, multiply the end result by the tax rate: \$25,282 ("Total of Payments" reported on lease contract) x .0825 (tax rate) = \$2,086 (tax due).

Disposition fee and Chicago Personal Property Lease Transaction Tax: Do not include charges for disposition fees or the Chicago Personal Property Lease Transaction Tax that are included in the lease contract as part of the selling price reported on Form ST-556-LSE.

RUT-25-LSE

If you are titling or registering in Illinois a motor vehicle that was leased through an unregistered out-of-state dealer or retailer, you must complete Form RUT-25-LSE, Use Tax Return for Lease Transactions. If the transaction otherwise meets the criteria for the alternate selling price for motor vehicles that are simultaneously leased at the time of the sale as discussed in this Compliance Alert, the taxable selling price is the consideration received by the lessor pursuant to the lease contract. A good rule of thumb to follow for determining tax is that if you multiply the amount in the "Total of Payments" box on the contract (minus any amount added as a "disposition fee") by the rate of tax, you will arrive at the amount of tax owed. For leasing companies, see Page 2 for one method to use to calculate the proper tax when the lease contract includes both reimbursement of tax owed as well as finance charges on that reimbursement of tax.

NOTE: Out-of-state leasing companies **should not** use Form RUT-25-LSE to report sales to an Illinois resident at the end of the lease. For these transactions, you must use Form ST-556, Sales Tax Transaction Return.