

Tangible personal property that will be physically incorporated into public improvements, the ownership of which is required to be conveyed to a unit of local government pursuant to a pre-development transfer requirement, is exempt from Retailers' Occupation Tax and Use Tax. See 86 Ill. Adm. Code 130.2075(e). (This is a PLR.)

May 31, 2006

Dear Xxxxx:

This letter is in response to your letter dated November 1, 2005, 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 1200.1120. 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:

We represent ABC, a STATE limited liability company, which has executed that certain ABC/XYZ Development Agreement with XYZ, a political subdivision, a body politic and a municipal corporation of the State of Illinois ('XYZ') (the 'XYZ Development Agreement'). As is described in greater detail below, the XYZ Development Agreement provides, in part, that ABC will construct a new, below-grade, XYZ station and other XYZ facilities on the property commonly known as PROPERTY. Affiliates of ABC, DEVELOPER, which we also represent, intend to construct a private, mixed-use development in part below-grade and above-grade on the Property.

Some of the improvements that ABC is required to construct pursuant to the XYZ Development Agreement (the 'XYZ Improvements') will serve and therefore commonly and jointly benefit both the XYZ facilities and the Developer's mixed use development. These common improvements include but are not limited to, caissons and slurry wall, electrical and plumbing work and structural slabs. For example, ABC will not build one

slurry wall for the XYZ Improvements and a separate slurry wall for the mixed use development. Rather, there will be one slurry wall constructed for the XYZ facilities and the mixed use development. ABC, or its designee, will purchase all of the building materials for the slurry wall. ABC and XYZ will then share the cost of those materials based on the specific cost allocation provisions of the XYZ Development Agreement. We are writing to request a private letter ruling from the Illinois Department of Revenue (the 'Department') that confirms that the building materials for the XYZ Improvements are wholly exempt from the Retailer's [sic] Occupation Tax and/or Use Tax by virtue of the fact that they will be owned in part by and are being constructed for the benefit of a governmental body of the State of Illinois.

Background

The ABC Entities

ABC is a special purpose entity that is owned by ABC Services Corporation, which is in turn owned by The ABC Limited Partnership. DEVELOPERS are special purpose entities that are owned by The ABC Limited Partnership. The ABC Corporation, a publicly traded company, owns a majority interest in The ABC Limited Partnership. Attached hereto as Exhibit A is the ownership structure for ABC and Developer.

The Property

The Property is a # square foot parcel of land that is generally bounded by STREETS. The Property is currently owned by the CITY. The City intends to convey the Property, together with certain vacated rights of way, to Developer pursuant to the terms of that certain ABC Redevelopment Agreement (the 'City Redevelopment Agreement'). The City, ABC and Developer have executed the Redevelopment Agreement and intend to close on the conveyance of the Property on or about DATE. Attached hereto as Exhibit B is a survey of the Property, prepared by FIRM dated DATE.

The XYZ Improvements

As noted above, the XYZ Development Agreement requires ABC to construct or cause the construction of certain below-grade improvements for XYZ, referred to herein as the XYZ Improvements. The XYZ Improvements will include, but are not specifically limited to: (a) a new, three-level, below-grade subway station, including, train boarding platforms, rail track and related facilities to provide express rail service to AIRPORT; (b) a ticketing area for the public to purchase XYZ tickets or passes and to possibly purchase and/or confirm airline tickets or reservations; (c) an airport check-in facility and baggage facilities and other related improvements; (d) a below-grade pedestrian walkway or access system which connects the existing XYZ Station with the existing XYZ Station; and (e) certain other conveyancing systems such as elevators, escalators and stairs between the mixed use development and the new XYZ station and check in facility (collectively, the 'XYZ Improvements'). Schematic renderings of the XYZ Improvements are attached hereto as Exhibit C.

Pursuant to the terms of the XYZ Development Agreement, ABC must convey a portion of the XYZ Improvements and the land in which they are located to XYZ upon the completion of the XYZ Improvements. XYZ Improvements which are not conveyed by ABC to XYZ pursuant to the terms of the XYZ Development Agreement will be owned by ABC or its affiliates, but will nonetheless serve and support XYZ functions and

property owned by XYZ. A survey of the land to be conveyed to XYZ, prepared by FIRM and dated DATE, is attached hereto as Exhibit D.

The Mixed Use Development

The City Redevelopment Agreement requires Developer to construct or cause the construction of a mixed use development which will consist of certain above-grade and below-grade improvements. The below-grade improvements will include but are not limited to off-street parking, loading facilities, and service corridors that serve the mixed use development and the XYZ Improvements. The above-grade improvements will include but are not limited to a four-story retail and entertainment podium with approximately 400,000 square feet of rentable area as well as a multi-story office tower (the improvements referenced herein are collectively referred to as the 'ABC Improvements'). The above-grade improvements may also include, depending on market demand, a hotel and/or residential tower located on top of the retail and entertainment podium. A conceptual site plan and conceptual elevations for the mixed use development are attached hereto as Exhibit E. Please note that these documents have been updated since they were first produced but they nonetheless accurately depict the substance of the development program.

Integration between the XYZ Improvements and the Mixed Use Development

As noted above, certain XYZ Improvements jointly serve XYZ's operations at the Property and the ABC Improvements. The materials and the labor to construct those joint and common elements are inextricably linked. Because of this linkage, ABC and XYZ extensively negotiated a detailed budget which is part of the XYZ Development Agreement and which allocates the costs of certain jointly beneficial construction line items between XYZ and ABC. For example, ABC and XYZ have budgeted a total of \$million for structural slab #3. XYZ is responsible for 60% of the cost of that slab (\$) while ABC must pay for 40% (\$) of the cost. These negotiations were very involved and complex, and the cost ABC would incur to build only the ABC Improvements was merely one of many factors considered by the parties in determining how costs should be allocated. For example, ABC and/or XYZ may be responsible for a greater percentage of a construction line item because one party may (a) gain greater utility from a certain improvement (e.g., the pedway), (b) require a more labor intensive process for a certain improvement (e.g., the slurry wall) or (c) require higher quality finishes in certain common areas. There are multiple examples of such shared cost items in the budget. A copy of that budget is attached hereto as Exhibit F.

ABC's general contractor, (CONTRACTOR) and other subcontractors will purchase building materials to be incorporated into the XYZ Improvements and ABC Improvements. Because XYZ is responsible for a proportionate share of the development costs under the XYZ Development Agreement, XYZ will indirectly pay a portion of the Illinois sales tax (consisting of the Retailers [sic] Occupation Tax and/or the Use Tax) imposed on purchases made by CONTRACTOR and their subcontractors of building materials incorporated into the XYZ Improvements that jointly serve the XYZ Improvements and the ABC Improvements.

Tax Period at Issue

Construction of the XYZ Improvements under the XYZ Development Agreement is scheduled to begin DATE. The tax periods at issue are those periods beginning in

DATE and continuing until construction of the XYZ Improvements is completed. The Improvements are expected to be substantially complete by DATE.

Prior Rulings

To the best of my knowledge and the knowledge of ABC and the Developer, the Department has not previously ruled on the same or a similar issue for ABC or a predecessor of ABC. To the best of my knowledge and the knowledge of ABC and the Developer, neither ABC, the Developer, nor any representative thereof previously submitted the same or a similar issue to the Department but withdrew it before a letter ruling was issued.

Statement of Authorities

Illinois law exempts governmental bodies from both the Retailers' Occupation Tax and the Use Tax – neither tax is imposed on tangible personal property either purchased or used by governmental bodies. 35 ILCS 105/3-5(4); 35 ILCS 120/2-5(11). ABC and CONTRACTOR and their subcontractors are not ordinarily eligible for the governmental exemption to Illinois sales tax because they are not governmental bodies. However, recognizing that allowing government contractors to claim the governmental exemption furthers the purpose of the exemption, the Department grants an exemption to otherwise non-exempt entities performing work pursuant to government contracts. 86 Ill. Admin. Code 130.2975(d)(1) [sic] ('The intent of the Legislature was to relieve the above-designated kinds of purchasers from the burden of tax on their purchases whether the purchases are made directly or indirectly by these organizations. Therefore, the exemption applies to their indirect purchase of building materials.').

This governmental exemption applies to construction contracts in two situations: (1) the incorporation of building materials into real estate owned by a governmental body; and (2) the incorporation of building materials into public improvements that are required to be transferred to a local governmental unit upon completion. 86 Ill. Admin. Code 130.2075(d) and (e). The first exemption does not apply because, at the time of construction, the real estate will not be owned by XYZ. For that reason, only the second exemption is discussed.

With respect to the exemption for materials incorporated into public improvements, as a 'special district' created by the Illinois legislature, XYZ falls within the state constitutional definition of 'unit of local government.' Ill. Const. of 1970, Art. VII, Sec. 1 ('units of local government' includes 'special districts'); 5 ILCS 70/1.28 ('units of local government' has the meaning established in Article VII, Section 1); ILCS 3605/3 (establishing XYZ as a special district). The Illinois Administrative Code expressly provides that the term 'construction contractor' includes general contractors and subcontractors. 86 Ill. Admin. Code 130.1940(a)(1). 'Contractor' is defined in the regulations as 'any person who is engaged in the occupation of entering into and performing construction contracts for owners.' Id. Although there is little anecdotal guidance, presumably ABC, CONTRACTOR and the subcontractors qualify as 'construction contractors' because they are all engaged in the occupation of entering into and performing construction contracts.

With respect to a portion of the XYZ Improvements, the 'pre-development transfer requirement' is satisfied because a pre-development agreement between XYZ and ABC, a developer, explicitly requires that title to those public improvements be

transferred to XYZ upon completion. See 86 Ill. Admin. Code 130.2075(e)(2) (describing the 'pre-development transfer requirement'). However, it is highly impractical, if not impossible, to distinguish between materials used in constructing those XYZ Improvements that will be conveyed to XYZ pursuant to the Development Agreement and the remaining XYZ Improvements. The XYZ Improvements are highly integrated with a portion of the ABC Improvements. Because the parties are unable to precisely identify the materials to be incorporated into the portion of the XYZ Improvements to be ultimately conveyed to XYZ, ABC, CONTRACTOR and their subcontractors will be unable to claim the exemption under its current interpretation of the Department's regulations. Thus, under the cost-sharing structure established in the XYZ Development Agreement, XYZ will be indirectly taxed in the amount of its proportionate share of the line-item expense.

The cost-sharing budget also does not provide an accurate basis upon which to assign the exemption because the budget costs allocated to each party for each line item do not necessarily reflect the proportionate utility and benefit to each party or the cost to independently construct the XYZ Improvements and the ABC Improvements. Instead, all of the XYZ Improvements will, to varying degrees, jointly serve XYZ as well as the ABC Improvements.

Request for Relief

ABC, on behalf of itself, its Project affiliates including but not limited to the Developer, CONTRACTOR and their subcontractors (collectively, the 'Developer Parties'), respectfully requests that the Department issue a private letter ruling that confirms that those building materials for the XYZ Improvements are exempt from the Retailer's [sic] Occupation Tax and/or Use Tax by virtue of the fact that they will be owned in part by and/or will serve and support the property and functions of a governmental body of the State of Illinois. We further request, pursuant to Illinois Administrative Code 1200.110(a)(3)(A)(ii), that the private letter ruling may be relied upon by the Developer Parties because they all face a common tax issue with respect to the procurement of building materials for the construction of the XYZ Improvements and the ABC Improvements. Finally, it is our understanding that the Retailer's [sic] Occupation Tax and the Use Tax are not treated as separate taxes pursuant to Illinois Administrative Code 1200.110(a)(2) and therefore the Department's ruling may be relied upon with respect to both taxes.

Thank you for your consideration. Please contact me if you have any questions or need further information.

DEPARTMENT'S RESPONSE

You have asked whether ABC, its Project affiliates including but not limited to the Developer, CONTRACTOR and its subcontractors (collectively the "Developer Parties"), may purchase building materials for the XYZ Improvements exempt from Retailers' Occupation Tax and/or Use Tax by virtue of the fact that the improvements will be owned in part by and/or will serve and support the property and functions of a governmental body of the State of Illinois.

Generally contractors are the end users of the materials that they physically incorporate into real estate and as such owe Use Tax on those materials. 86 Ill. Adm. Code 130.2075. However, Section 130.2075(e) of the regulation states that sales to construction contractors of materials which

will be physically incorporated into public improvements, the ownership of which is required to be conveyed to a unit of local government pursuant to a pre-development transfer requirement are exempt from Retailers' Occupation Tax and Use Tax.

Section 130.2075(e)(2) provides that “[w]here language in a pre-development agreement between the local governmental unit and a developer explicitly requires that title to public improvements be transferred to the local governmental unit upon completion, the pre-development transfer requirement is satisfied as to all public improvements actually required to be transferred under the terms of that pre-development agreement.” When this exemption is properly claimed, the supplier shall have among his records the active registration number issued by the Department to the governmental unit to which the public improvements will be transferred upon completion. For this exemption to be properly claimed, however, title must be transferred to the local governmental unit, exclusively. The exemption may not be claimed if a local governmental unit together with another entity that does not qualify for the exemption will hold title. No provision is made for considering such factors as the proportionate utility or benefit to each party. Only the building materials that are incorporated into the public improvement transferred to the XYZ upon completion may be purchased free of tax. For example, the building materials purchased to build a wall that may benefit both the XYZ and another party will not qualify for the exemption unless the wall is part of the real estate that will be owned exclusively by the XYZ.

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.

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,

Martha P. Mote
Associate Counsel

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