

This letter discusses the taxability of maintenance agreements. See 86 Ill. Adm. Code 140.301. (This is a GIL.)

September 29, 2008

Dear Xxxxx:

This letter is in response to your letter dated February 21, 2008, 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:

We have been retained by ABC and XYZ (collectively, 'Applicants') in order to request a written letter ruling from the State of Illinois whether, based on the acts in each of the three alternative scenarios described below, any sales or use tax would be required to be collected on the portion of a motor vehicle lease payment that is attributable to the purchase of an optional vehicle service contract ('VSC') for the leased vehicle.

ABC's name, address, telephone number, federal taxpayer identification number and Illinois sales/use tax registration number are as follows:

NAME/ADDRESS

XYZ's name, address, telephone number, federal taxpayer identification number and Illinois sales/use tax registration number are as follows:

NAME/ADDRESS

To the best of the knowledge of both the taxpayer and the taxpayer's representative, the Illinois Department of Revenue has not previously ruled on the same or a similar issue for the taxpayer or a predecessor. Neither the taxpayer nor any representative has

previously submitted the same or a similar issue to the Department and then withdrawn that request before a letter ruling was issued.

Furthermore, neither the taxpayer nor its representative is aware of any authorities contrary to the views expressed herein.

FACTS

ABC is engaged in the business of leasing motor vehicles in Illinois and many other states. The term of each lease is for 24 months or longer. ABC contracts with XYZ to administer each of the leases on behalf of ABC, including the collection of payments under the leases.

The motor vehicle lease agreements compute the monthly lease payment for a leased vehicle beginning with the 'gross capitalized cost' of the vehicle, which is generally equal to (i) the agreed-upon value of the vehicle, as equipped at the lease signing, plus (ii) the agreed-upon value of any accessories or optional equipment to be added after the lease signing, plus (iii) the cost of any VSC purchased by the customer for the leased vehicle, plus (iv) the acquisition fee. The gross capitalized cost is then reduced by the 'capitalized cost reduction', which is generally equal to any cash (or trade) down payment made by the customer. Finally, the monthly lease payments are computed based on the difference (amortized over the term of the lease) between the gross capitalized cost of the vehicle, as adjusted above, and the residual value of the vehicle at the end of the lease term (such difference being referred to hereinafter as the 'lease base amount').

Each VSC generally provides that XYZ, rather than the customer, will be responsible for any repairs that need to be made to the vehicle during the contract period. Each VSC is entirely optional in the discretion of the customer (*i.e.*, no VSC is required to be purchased as part of any lease agreement).

In the first alternative scenario ('Alternative A'), both the lease agreement and each of the monthly lease payment invoices sent to the customer separately state the portion of each lease payment that is attributable to any VSC purchased at the time of the lease, and the portion that is attributable to anything other than the VSC (*e.g.*, the value of the leased vehicle and any add-on accessories or equipment, and the acquisition fee).

In the second alternative scenario ('Alternative B'), the monthly lease payment invoices do not separately state the portion of each lease payment that is attributable to the purchase of the VSC, but the lease agreement does separately state this amount.

In the third alternative scenario ('Alternative C'), neither the lease agreement nor any of the monthly lease payment invoices separately states the portion of each lease payment that is attributable to the purchase of the VSC. However, the lease agreement does separately state the cost of the VSC and the cost of the vehicle (as well as the cost of any add-on accessories or equipment, acquisition fee, *etc.*) in computing the gross capitalized cost, which is in turn used to calculate the monthly lease payment.

In each of the three scenarios, a customer may also elect to purchase a VSC after the lease signing. In this event, the price paid for the VSC is not amortized as part of the monthly lease payment; instead, the customer pays the entire cost of the VSC at the time of purchase.

LEGAL ANALYSIS

In general, Illinois's [sic] sales tax applies to sales of tangible personal property at retail, and Illinois's [sic] use tax applies to the purchase of tangible personal property for storage, use, or other consumption in the state. 35 Ill. Comp. Stat. Ann. § 120/2; 35 Ill. Comp. Stat. Ann. § 105/3. However, as the Illinois Department of Revenue itself has noted, 'Illinois taxes leases differently ... than the majority of other states.'¹ In Illinois, 'Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased ... [and as] end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of the property.' *General Info. Letter*, ST-07-0065-GIL (June 14, 2007) (citing 86 Ill. Admin. Code 130.220). Accordingly, neither ABC nor XYZ would be required to collect or remit sales/use tax on the lease payments made by the customers. Rather, ABC would be required to pay sales/use tax on the cost price of the motor vehicles, if any, at the time that it acquires those vehicles for lease.

The sales and use taxes do not apply to services generally or, more specifically, to the service of repairing tangible personal property. See 86 Ill. Admin. Code 130.2015(c). In addition, the sale of a maintenance agreement is not subject to sales or use tax. 86 Ill. Admin. Code 140.141(c) ('[T]he maintenance agreement is not included in the retail selling price of the item covered by the maintenance agreement and, for that reason, the selling price of the maintenance agreement is not subject to Retailers' Occupation Tax and Use Tax liability'). Accordingly, since the VSCs are repair/maintenance contracts, the sale of a VSC, by itself, is not subject to sales or use tax.

Accordingly, since neither the lease of a motor vehicle nor the sale of a VSC is subject to sales or use tax by itself, the sale and lease of these items as part of the same transaction would also not trigger sales/use taxes under either Alternative A, B or C.

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If you need any additional information, please call me. I appreciate your consideration of this matter and look forward to your reply.

DEPARTMENT'S RESPONSE:

The Department's regulation "Public Information, Rulemaking and Organization" provides that "[w]hether to issue a private letter ruling in response to a letter ruling request is within the discretion of the Department. The Department will respond to all requests for private letter rulings either by issuance of a ruling or by a letter explaining that the request for ruling will not be honored." 2 Ill. Adm. Code 1200.110(a)(4). Your letter provides insufficient information regarding the motor vehicle leases and the optional vehicle service contracts to enable the Department to render a private letter ruling. In addition, the motor vehicle leases and vehicle service contracts referred to your letter were not provided to the Department. Therefore, it is the Department's position that we must decline to issue a Private Letter Ruling. However, we hope the following will be helpful in addressing your questions.

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101. If no tangible

personal property is being transferred to the customers, then no Illinois Retailers' Occupation Tax or Use Tax would apply.

Likewise, the Service Occupation Tax Act and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. See 86 Ill. Adm. Code 140.101 and 160.101. If no tangible personal property is being transferred to customers incident to the services provided then no Illinois Service Occupation Tax nor Service Use Tax would apply.

In Illinois, lessors of tangible personal property under a true lease, except for automobiles leased for terms of one year or less, are considered to be the end users of the property to be leased. See 86 Ill. Adm. Code 130.220 and 130.2010. As the end users of tangible personal property located in Illinois, lessors incur Use Tax on the lessors' cost price of the property. Since lessors are considered the end users of the property and have paid the Use Tax, no Retailers' Occupation Tax is imposed upon the rental receipts, and the lessees incur no Use Tax liability for the rental charges.

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

Even though lessees do not incur any tax liability in a true lease situation, it is typical of true leases to contain contractual provisions stating that the lessees will reimburse the lessors for their tax costs. This is not a matter of Illinois tax law but of private agreement between lessors and lessees. If the lessees agreed to such provisions, they are bound to satisfy that duty because of a contractual agreement, not because of Illinois tax law.

As stated above, the State of Illinois imposes no Retailers' Occupation Tax or Use Tax on rental receipts. Moreover, since a lessee under a true lease incurs no tax liability on the lease of tangible personal property, the lessee generally incurs no such tax liability on any related lease charges such as late payment fees, disposition fees, lease termination fees, service fees, or legal fees.

The taxability of maintenance agreements or extended warranties depends upon whether the charges for the agreements are included in the selling price of the tangible personal property. See Ill. Adm. Code 140.301(b)(3). If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance contracts are sold separately from tangible personal property, sales of the contracts are not taxable transactions. However, when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3). Purchasers of separate maintenance agreements are not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance contract.

In a situation where a lessor leases a motor vehicle to a lessee and sells the lessee a maintenance agreement, whether included as part of the lease or in a separate agreement, the maintenance contract is being sold separately from tangible personal property and the sale of the maintenance agreement is not generally a taxable transaction

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,

Richard S. Wolters
Associate Counsel

RSW:msk

¹ It should be noted that all leases at issue in this case are for terms of more than one year, so the Use Tax (discussed in 86 Ill. Admin. Code 130.2010(b)) and not the Automobile Renting Occupation and Use Tax (found at 35 Ill. Comp. Stat. Ann. § 155/1 *et seq.*) will apply. Nevertheless, we do not believe the outcome would be any different under the Automobile Renting Occupation and Use Tax.