

## LEASE TAX FREQUENTLY ASKED QUESTIONS

Starting January 1, 2015, the Illinois Department of Revenue (IDOR) will change the way it will tax most motor vehicle leases. Public Act 98-628 provides that, for qualifying leases of qualifying vehicles, the “selling price” upon which sales tax will be imposed will be computed as the sum of all lease payments, including all amounts due at signing. All other leased vehicles will continue to be taxed on the entire selling price less any advance or third-party trade-in credits. Please make sure to contact your DMS provider to make sure that your computer software is ready for the changes that are coming on January 1st.

- **What is a qualifying lease?** A qualifying lease is a lease that is for a defined period and has a fixed termination date. Most retail leases are qualifying leases, and a provision that extends a lease for an additional month if the customer fails to turn in the vehicle on the lease termination date will not change the nature of the lease as a fixed-term lease.
- **What is a non-qualifying lease?** An open-ended lease is not a qualifying lease. For example, a 367-day lease with a customer option to extend the lease on a month-to-month basis after the initial 367-day period is not a qualifying lease. If the customer can unilaterally determine when to end the lease without incurring a penalty, the lease will most likely be a non-qualifying lease. Any vehicle that is the subject of a non-qualifying lease will not be subject to the new definition of “selling price”. Non-qualifying vehicles will continue to be taxed on the entire selling price, less and advance trade-in credits or third-party trade-in authorizations in the same manner as pre-2015 leases.
- **What is a qualifying vehicle?** A qualifying vehicle is any first division vehicle or any second division vehicle that is a (1) self-contained motor vehicle designed or permanently converted to provide living quarters for recreational, camping, or travel use, with direct walk-through access to the living quarters from the driver’s seat; (2) a motor vehicle of the van configuration designed to transport not less than 7 nor more than 16 passengers; or (3) has a gross vehicle weight rating (GVWR) of 8,000 pounds or less.
- **How will qualifying leases of qualifying vehicles be taxed?** A qualifying lease of a qualifying vehicle will be taxed based on a new definition of “selling price” that is equal to “the consideration received by the lessor 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”.
- **What types of items will be included in the tax base for qualifying leases of qualifying vehicles?** The tax treatment of certain ancillary items will change for leases that are subject to the new definition of “selling price”. Generally speaking, if an item appears

on the front side of the lease contract as being due from the customer at signing, it will be subject to tax. For example, the following items, which are not taxable in the case of a purchase or a pre-2015 lease, will be taxable under a new-school lease:

- Title and registration fees.
  - Reimbursement for a dealer's Retailers Occupation Tax liability when that liability is passed on to the customer. Information about how to calculate the tax due on reimbursement for the dealers ROT liability can be found on IADA's website, see Tax Reimbursement Calculation.
  - Rebates, when shown as money down. (Not a change from current law).
  - Service Contracts.
  - Warranties.
  - Negative Equity that gets rolled into a lease.
- **Are there any items that are subject to tax with regard to pre-2015 leases that will not be taxed under the new definition of "selling price"?** Yes. Items like dealer cash, which is a paid directly from a manufacturer to the dealer, does not appear on the lease contract and will not be subject to tax for transactions involving qualifying leases of qualifying vehicles.
  - **Can I apply a trade-in credit or third-party trade-in authorization to a lease that is taxed using this exciting new definition of selling price?** No. Part of the trade-off for reducing the taxable base for qualifying leases of qualifying vehicles is that such transactions will not be eligible for advance trade-in credits or third-party trade-in credits. You may still take a vehicle in trade in a lease transaction involving a qualifying lease of a qualifying vehicle, but you may not give the customer any tax benefit for the trade. Instead, you must treat the trade-in value similar to cash down if it is used as a capitalized cost reduction or to otherwise help pay for the lease.
  - **What about charges that are not imposed until the time the lease is terminated, such as for excess mileage, excess wear and tear, and penalties for late return of the leased vehicle?** Additional payments, penalties, or fees that result from failure to timely return a leased vehicle, charges for excess wear and tear or excess mileage, and similar charges that are not calculated until the termination of a lease are subject to tax and must be reported and paid by the lessor. Tax on such charges will be reported on the newly created form LSE-1 and will be due on the 20<sup>th</sup> day of the month following the termination of the lease.
  - **If the applicable tax rate for my leased vehicle changes between the date a lease is executed and the date that lease-end charges are imposed, what rate do I report on LSE-1?** If the sales tax rate changes during the course of the lease, the rate reported on form LSE-1 will be the rate that was in effect on the date that the lease was executed.

- **How do I treat locally imposed occupation and use taxes?** Locally imposed occupation and use taxes will be unaffected by the lease tax changes other than that those taxes will be calculated based on the new definition of “selling price”. The rates of locally imposed occupation and use taxes will not change as a result of this legislation.
- **How will leases of non-qualifying vehicles and non-qualifying leases of otherwise qualifying vehicles be taxed?** All leases of non-qualifying vehicles and all non-qualifying (open-ended) leases must be taxed on the entire selling price less. Non-qualifying leases and leases of non-qualifying vehicles will remain eligible for advance trade-in credits or third-party trade-in credits.
- **Can I pick which taxing methodology to apply to each lease transaction?** No. All qualifying leases of qualifying vehicles must be taxed on the sum of the amount due at signing plus all monthly payments and all leases of non-qualifying vehicles and all non-qualifying (open-ended) leases must be taxed on the entire selling price less any advance or third-party trade-in credits.
- **When is the tax due?** The entire tax bill must be paid to the Department of Revenue within 20 days after the lease is signed just as under current law. The due date of the tax is NOT related to the due date of the monthly payments.
- **How do I report and pay the tax to the Department of Revenue?** CVR will be properly programmed so that dealers will be able to report sales taxes on purchased and leased motor vehicles when the tax law changes take effect on January 1, 2015. Paper filers will be able to print the correct ST-556 and ST-556-LSE forms on and after January 1, 2015, just as they do now. Forms RUT-25 and RUT-25-LSE will still need to be ordered from the Department of Revenue.
- **Does an automatic holdover penalty turn a fixed-term lease into an open-ended lease?** Generally speaking, no. If a lease has a penalty for failure to turn in the vehicle on the lease termination date, the customer’s failure to return the vehicle is considered a violation of the lease agreement rather than the creation of an open-ended lease. Only leases where the termination of the leases is determined solely by the lessee
- **How do I treat a lease to an out-of-state customer?** All leases to out-of-state lease customers are tax exempt in Illinois. Even an out-of-state customer who would be taxed in a purchase transaction is not taxed in a lease transaction. Note: Your agreement with your manufacturer or your lender may require you to collect the tax for an out-of-state customer’s home state before funding the deal. That is a matter strictly between you and your manufacturer and/or your lender. This is exactly the same way leases to out of state customers are currently treated.
- **How can I get a copy of P.A. 98-628?** Right here:  
<http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=098-0628>.

- **What if I have more questions that are not covered here?** Please feel free to contact IADA at (217) 753-0220 or at [www.illinoisdealers.com](http://www.illinoisdealers.com).