

SALT Alert! 2015-31: Additional Guidance Issued on Application of City of Chicago Personal Property Lease Transaction Tax to Cloud Services

The City of Chicago Department of Finance (Department) recently issued an [Information Bulletin](#) discussing the application of the City's Personal Property Lease Transaction Tax (lease tax) to various non-possessory computer leases. The new bulletin discusses the City's controversial [Tax Ruling #12](#) (issued on June 9, 2015) and certain recent [amendments](#) made to the City lease tax ordinances that were passed by the City Council on October 28, 2015 in response to Ruling #12.

Background

The City of Chicago imposes a personal property lease transaction tax (the "Lease Tax") on personal property that is leased or rented in the City, as well as on personal property that is leased or rented outside the City that is used in the City. The lease tax, imposed at a 9 percent rate effective January 1, 2015 (the rate was 8.0 percent previously), applies to both possessory leases, where possession of the property is assumed by the lessee, and non-possessory leases, where the lessee does not take possession of the property, but uses it in the City. The tax on non-possessory leases is imposed in part on "leased time on or use of . . . computers, computer software . . . and data processing equipment."

There are numerous exemptions from the lease tax, including, an exemption (Exemption 11) for nonpossessory lease transactions in which (1) the customer's use or control of the provider's computer is de minimis and (2) the charge is primarily for information transferred to the

customer rather than for the customer's use or control of the computer. When it adopted Exemption 11 in 1995, the City Council provided certain examples of the types of products to which it would apply. Specifically, Exemption 11 applies to "certain so-called price quotation services and news services", but does not apply to "legal research and similar on-line data base searches."

On June 9, 2015, the City issued Tax Ruling #12. The Ruling is intended to provide guidance on how the tax applies to certain newer technologies, such as Platform as a Service (Paas), Software as a Service (SaaS), Infrastructure as a Service (IaaS), and other arrangements where customers access software remotely. Ruling #12 also addressed and made changes to how Exemption 11 applies in light of the new technologies discussed in the ruling. Ruling # 12 makes clear that, in addition to the already existing requirement that data be "fleeting and transitory", the receipt of the data must be "passive" in nature. An example of this is when a customer receives streaming stock quotations where there is no (or a very limited) search function. By contrast, charges for access to an interactive website that provides a customer the ability to search for information (e.g., a financial information website) will be considered taxable even if the information provided is of a "transitory and fleeting" nature. In other words, to be exempt under Exemption 11, as modified by Ruling #12, the transaction must involve a de minimis use of the provider's computer, the information provided must be of a transitory and fleeting nature, and receipt of the information must be passive, i.e., involving little or no interaction with the provider's computer.

The original effective date of Ruling #12 was September 1, 2015. It was later extended to January 1, 2016.

November 2015 Information Bulletin

The recently issued Information Bulletin provides background on Ruling #12 and Exemption 11, explains recent changes to the City's lease tax ordinances, and clarifies the effective date of Ruling #12. In addition, the bulletin sets forth a voluntary disclosure program for certain taxpayers that may not have been aware of how the City lease tax applied to certain transactions. These items are discussed in greater detail below.

Recent amendments to the City Ordinances: In October, the City of Chicago City Council approved a FY 2016 budget that included two

significant changes to the lease tax. The first change is the enactment of a small new business exemption as applied to the nonpossessory lease of a computer where the lessor or the lessee is a small new business. The term small new business means a business that: (i) holds a valid and current business license issued by the City or another jurisdiction, (ii) during the most recent full calendar year prior to the annual tax year for which the exemption is sought had under \$25 million in gross receipts or sales, as the term “gross receipts or sales” is defined for federal income tax purposes, and (iii) has been in operation for fewer than 60 months. In calculating the \$25 million limit, gross receipts or sales will be combined if they are received by members of a single unitary business group, as defined for Illinois income tax purposes. Specific rules apply for determining whether a business has been in operation for fewer than 60 months.

A qualifying small new business that is the lessor of a nonpossessory computer lease will not be required to collect tax on its charges for such nonpossessory computer leases. A lessee that qualifies as a small new business will not be required to pay tax on its charges for a nonpossessory computer lease. The lessor must document the exemption by collecting and retaining a copy of the lessee’s lease tax exemption certificate, which will be issued by the City Comptroller.

The second change noted in the Information Bulletin is the adoption of a reduced 5.25 percent lease tax rate that applies to certain cloud products, such as PaaS, IaaS, and SaaS. Specifically, where the nonpossessory lease is primarily for the purpose of allowing the customer to use the provider’s computer and software to input, modify or retrieve data or information that is supplied by the customer, the transaction will be taxed at the lower 5.25 percent rate.

Alternatively, a transaction where the nonpossessory lease is primarily for the purpose of allowing the customer to use the provider’s computer and software to input, modify or retrieve data or information that is supplied by the provider will be considered a “database product” product subject to the regular 9 percent lease tax rate. Providers or customers with questions on when the lower rate applies are directed to contact the Department.

Effective Date of Ruling #12: The Bulletin acknowledges that there were a number of questions raised regarding the effective date of Ruling #12. The effective date originally stated on the ruling was July 1, 2015,

but the ruling also specified that the Department would “limit the effect” of the ruling to “periods on and after September 1, 2015.” In response to numerous requests, the Department subsequently extended the effective date of to January 1, 2016.

The Information Bulletin further clarifies that any reference to Ruling #12’s effective date was intended to apply only to changes in the Department’s official interpretation of the lease tax Ordinance. As discussed above, the Department noted that its interpretation of Exemption 11 changed with the issuance of Ruling #12. However, according to the Bulletin, other portions of Ruling #12 were simply restatements of existing law and “the Department did not intend the effective date of the Ruling to mean the release of liability for periods before that date.”

Voluntary Disclosure Offer: The Bulletin acknowledges that a number of providers and customers were unaware of the lease tax as applied to nonpossessory computer leases, or were unaware of the scope of the tax. Thus, the Bulletin offers non-compliant taxpayers the opportunity to come forward under a voluntary disclosure program.

Any provider or customer that wishes to accept the voluntary disclosure offer must file an application by January 1, 2016. Applicants must come into compliance with the Lease Tax ordinance and Ruling #12 by January, 1 2016 (or such later date that the Department may agree to for good cause). Applicants must otherwise qualify for the City’s standard voluntary disclosure program (e.g., no written notice of tax audit or tax investigation). If accepted, an applicant will receive the following terms:

1. As to charges for nonpossessory computer leases that qualified for Exemption 11 under the Department’s interpretation of the exemption before the issuance of Ruling #12, no liability for tax, interest or penalties for periods prior to January 1, 2016.
2. As to charges for other nonpossessory computer leases (i.e., charges that do not meet the requirements of paragraph 1 above), payment of tax for the period of January 1, 2015 through December 31, 2015 (one year), and no liability for interest or penalties.
3. As to other lease taxes owed (i.e., based on leases other than nonpossessory computer leases), the terms of the City’s standard voluntary disclosure program will apply. Thus, penalties will be waived, and there will be no more than four years of liability for tax and interest.

Any provider or customer who wishes to accept the Department's offer should send an email indicating such to taxpolicy@cityofchicago.org with their business name, taxpayer contact name, and telephone number.

Next Steps

KPMG SALT professionals are available to assist clients determine whether they are required to collect or pay City lease tax for cloud-related services. In addition, KPMG can assist with drafting ruling requests related to the lease tax and assisting taxpayers that wish to take advantage of the City's voluntary disclosure offering. For more information on the recent Information Bulletin, please contact [Drew Olson](#) at 312-665-2897 or [Jill Nielsen](#) at 312-665-2794.

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