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State and Local Tax Challenges With Leases of Equipment and Other Assets

Navigating Differing State Approaches With Sales, Business Personal Property and Income Taxes

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Sales Tax Issues with Leases of Equipment and Other Assets – Examples

- **Leasing - intangible or tangible property?**
 - Theatrical royalties paid by a nonprofit theater company for the rights to produce plays were subject to Virginia sales tax.
 - The royalties paid by the taxpayer procured not only the intangible right to use the theatrical scripts and musical scores, **but also tangible hard copies of these items**. Therefore, the transactions were analogous to taxable leases of tangible personal property.
 - No tax was due, however, in instances where the taxpayer merely obtained a license to produce a play and did not receive any copies of these items.
 - VA Ruling of Commissioner, P.D. 90-163, September 11, 1990

- **Lease vs. Loan**
 - An agreement under which a lessee made payments over three to five years, at the end of which it could purchase the equipment for \$1, **constituted a lease subject to sales and use tax, rather than a financing arrangement**.
 - Provisions and phrases of the agreement made it clear that the agreement was a lease. **The lessee could not purchase the equipment for a \$1 until it had paid all rents in full; consequently, title did not pass to the lessee during the rental period.**
 - Because the lessor was the purchaser of the property to be leased and total charges for rent were in excess of the cost and associated expenses of the property, the lessor was **engaged in the business of leasing tangible personal property for sales and use tax purposes**.
 - **The lessor purchased equipment solely to lease it to customers**. The lessor also was required to register as a dealer and collect and pay the sales and use tax on gross proceeds.

- **The lessor's failure to collect and remit retail sales taxes during the period of audit justified a six-year examination of the lessor's sales records.** The lessor would be allowed a credit for sales tax it regularly paid when charged by vendors on the cost price of the equipment at issue throughout the audit period.
- VA Ruling of Commissioner, P.D. 96-270, October 7, 1996
- **Lease AND Loan**
 - A company that leased and financed office equipment pursuant to a single agreement **was only liable for Virginia retail sales and use tax on the lease portion of the transaction.**
 - The financing transaction included in the agreement with a lease transaction constituted a loan between the taxpayer and its customer and was not subject to tax, even though they were contained in the same document.
 - **The lease transaction and the finance transaction were two separate transactions that were not related to one another.** The proceeds received as a result of the financing transaction were not considered gross proceeds because they were not related to or associated with the leasing of tangible personal property.
 - In addition, the taxpayer's request for a credit for sales tax paid on purchases of tangible personal property that were purchased for lease was rejected. The Department of Taxation generally does not credit taxes that had been incorrectly paid to vendors. The taxpayer must contact its vendor to secure a refund of the erroneously paid tax.
 - VA Ruling of Commissioner, P.D. 08-163, August 29, 2008
- **Computerized information services – lease of tangible property?**
 - A corporation that provided information services and computer hardware necessary to receive the information **was not subject to use tax on its monthly charge to its subscribers.**
 - The corporation's **dominant purpose** was furnishing services, not leasing equipment.
 - The subscribers were given access to the computer equipment but the taxpayer retained ownership and installed, maintained, repaired, and insured the equipment.

- **The contract and the monthly bills characterized the transaction between the taxpayer and its subscribers as a service rather than a rental of computer hardware.** In addition, the equipment was essential to receive the information provided but had no other use to the subscriber.
- Quotron Systems, Inc. v. Comptroller, (1980, Md Ct App), 411 A2d 439
- **Computer hardware and financial services – lease of tangible property?**
 - The taxpayer's provision of stock market or financial data by computer terminals located in his customers' offices **was a nontaxable service.**
 - **The leasing of computer hardware was an inconsequential element of the service transaction.** However, as the provider of the service, the taxpayer was required to remit the use tax on terminals or other tangible personal property used in Virginia to provide the service.
 - Further, repairs made in connection with the services were nontaxable, while repairs to customer-owned equipment were taxable.
 - VA Ruling of Commissioner, P.D. 86-204, October 17, 1986
- **Equipment and services – lease of tangible personal property?**
 - An out-of-state manufacturer of automatic blood pressure machines was required to collect sales tax on rentals of the machines to retail chains in Virginia.
 - The taxpayer contracted to provide coin-operated blood pressure machines to a retail outlet in the state; the store personnel were responsible for installing and operating the machines and for collecting the proceeds, of which the taxpayer received a 50% share.
 - **This arrangement constituted a lease of the machines and was therefore subject to the sales tax.**
 - In some cases, however, the taxpayer transferred its rights to the leasing agreements, as well as title to the equipment, to a national leasing company and then provided billing and collection services and forwarded the monthly rental payments. In these instances, the taxpayer was merely an agent of the leasing company, and its billing and collection services were not taxable.
 - VA Ruling of Commissioner, P.D. 92-132, August 4, 1992

- **Equipment and services – lease of tangible personal property?**
 - Where the alarm equipment installed by the taxpayer was custom designed to meet the needs of the particular buildings, and the contracts characterized the customers as "subscribers" and the fees as "operating and service charges," **the primary intent of the agreement was as a contract for protection services and not the leasing of equipment**; the equipment involved was incidental to the services provided.
 - Thus, the purchase of the alarm equipment was subject to sales tax but the charges to its customers for protection services were exempt.
 - Alarm Services Corp. v. Comptroller, Md Tax Ct, March 21, 1985
- **Equipment leased with an Operator**
 - The leasing of vehicles with drivers has been held to be the conduct of a transportation business subject to tax under Secs. 183 and 184. (People ex rel Peter J. Curran Funeral Serv. Co. v. Graves, 257 App Div 888, 12 NYS2d 153 [1939], lv denied 281 NY 888) ¶80-010.68).
 - However, in several cases, taxpayers have attempted to avoid taxation by claiming that, by relinquishing control and supervision over their vehicles and personnel, they are not involved in a "transportation" company
 - McAllister Bros., Inc., supra; Peter J. Curran Funeral Service v. Graves, supra.
- **Trailers – motor vehicle sales tax, not retail sales tax**
 - Trailers leased to a construction company were **subject to the motor vehicle sales tax rather than the retail sales tax**
 - The trailers were owned by a transportation company, and leased out for use as storage facilities at construction sites
 - The statutory definition of "motor vehicle" encompassed these rental transactions
 - VA Ruling of Commissioner, P.D. 87-160, June 2, 1987
- **Tax Base – inclusion of separately stated charges:**
 - Separately stated finance, assembly, and disassembly charges, made in connection with the leasing of property, **were subject to Virginia sales and use tax.**

- The taxpayer rented scaffolding and ladders to contractors. In addition to rent for these items, the taxpayer charged separate fees for assembly, disassembly and financing.
- The gross proceeds received for the lease or rental of tangible personal property included any service charges, **even if separately stated.**
- VA Ruling of Commissioner, P.D. 95-189 , July 28, 1995
- **Resale exemption - sublease**
 - The leasing of computer equipment by a purchaser was exempt from sales tax since the lessee subleased the equipment and collected the tax on the sublease.
 - VA Ruling of Commissioner, Dept. of Taxation, April 30, 1985
- **Casual, Isolated and Occasional Sale Exemption**
 - A professional corporation engaged in the practice of law was subject to sales and use tax on items leased from a principal of the firm.
 - While neither of the parties to the lease were involved in the routine leasing of tangible personal property, the corporation's lessor was involved in an activity, i.e., the leasing business, requiring the holding of a certificate of registration. Therefore, the occasional sale exemption did not apply.
 - VA Ruling of Commissioner, P.D. 86-179 , August 26, 1986

Corporate Income Tax Issues with Leases of Equipment and Other Assets – Examples

- **Mobile property used by lessee doesn't always create nexus for lessor**
 - Illinois Department of Revenue ruled that a Wisconsin truck leasing company whose customers used its trucks in Illinois did not have income tax nexus in Illinois
 - Airoidi Bros., Inc. v. Illinois Department of Revenue [Admin. Hearing Decision No. 98-IT-0330 (Ill. Dep't of Revenue Sept. 29, 2000)]
- **Regular and systematic presence by lessee creates nexus for lessor**
 - Massachusetts Supreme Judicial Court ruled that the imposition of the Massachusetts corporate income tax on an out-of-state corporation whose leased trucks operated in Massachusetts violated neither the Due Process Clause nor the

Commerce Clause of the U.S. Constitution, even though the lessor had no physical presence in Massachusetts beyond the presence of the leased trucks.

- By providing registration and licensing services that allowed the lessees to operate the trucks in Massachusetts, the out-of-state lessor was purposefully availing itself of the privilege of doing business in the state, as required by the Due Process Clause.
 - In addition, the physical presence of the taxpayer's trucks within the state on a regular and systematic basis created a substantial nexus, as required by the Commerce Clause.
 - Truck Renting & Leasing Association, Inc. v. Commissioner of Revenue [No. SJC-08308 (Mass. Apr. 17, 2001)]
- **Lack of control over lessee allows lessor to escape taxation**
 - Indiana Tax Court ruled that two out-of-state leasing companies were not subject to Indiana tax on income from equipment and autos leased to Indiana customers, because their **ownership of the leased property was the companies' only contact with the state.**
 - The out-of-state leasing companies did not exercise control over the leased equipment, and were not active participants in the leasing activities within the state.
 - Comdisco, Inc. v. Indiana Department of Revenue [No. 49T10-9903-TA-19, Ind. Tax Ct. Dec. 8, 2002)] and Enterprise Leasing Company of Chicago v. Indiana Department of Revenue [No. 49T10-9807-TA-74, Ind. Tax Ct. Dec. 8, 2002)]
 - **Leasing to parent company can create nexus for subsidiary**
 - A leasing company that was in the business of renting movable tangible personal property to its parent could be included on a combined Virginia return for corporate income tax purposes
 - Although the subsidiary's only contact with Virginia was the presence of the property in Virginia as needed by the parent company, the **leasing on a regular and continuous basis created sufficient nexus for imposition of income tax**
 - VA Ruling of Commissioner, P.D. 94-175, June 8, 1994, ¶202-471

- **Equipment rentals were “leases” NOT “installment sales”**
 - A taxpayer's heavy equipment rental activities were sufficient to create nexus with Virginia and, therefore, subject the taxpayer to Virginia corporate income tax
 - Taxpayer unsuccessfully argued that the transactions were “installment sales” not rentals (documentation did not support this)
 - Owning tangible personal property in Virginia exceeded the protections of P.L. 86-272 and gave the taxpayer nexus
 - Ruling of Commissioner, P.D. 06-38, Virginia Department of Taxation, April 5, 2006

- **Apportionment method for leasing aircraft to corporate lessees**
 - Lease payments apportioned on the basis of revenue miles
 - Sales factor calculated by comparing the miles traveled by the aircraft over Vermont to total miles traveled
 - Commissioner of Taxes has discretion to require use of a different apportionment which more accurately reflects the value of a taxpayer's mobile property
 - Ruling 93-03, Vermont Department of Taxes, February 4, 1993

- **End-of-lease sales allocated to the location of the leased property**
 - In a New York bank franchise tax case, receipts from the end-of-lease sales of certain equipment were properly allocated by the taxpayer to the location of the leased property
 - The taxpayer successfully maintained that the sales proceeds from the property that was leased and ultimately sold under the operating leases should be treated as receipts from lease transactions, which for allocation purposes are located where the property subject to the lease is located
 - **Division of Taxation argued that the proceeds from the sales should be allocated based upon where the work earning the receipts was performed.** However, there was no requirement in the statute that receipts from a lease transaction be limited to the periodic lease payments.
 - BTMU Leasing & Finance, Inc., New York Division of Tax Appeals, Administrative Law Judge Unit, DTA No. 821525, November 26, 2008

- **Leases of fiber optic cable based on location (fiber or route miles)**
 - Receipts from contracts for the lease of "dark" strands of fiber optic cable are allocated to New York for New York corporate franchise (income) tax purposes to the extent that the strands are situated in New York because the receipts are from the rental of tangible personal property
 - Location of the strands determined by computing fiber miles, which is done by multiplying the number of strands leased pursuant to a contract by the route miles located in New York
 - Metromedia Fiber Network, Inc. (Advisory Opinion), New York Commissioner of Taxation and Finance, TSB-A-00(10)C, April 21, 2000, ¶403-675
- **Leasing capacity on a transponder is “intangible property”**
 - Lease agreements where an entertainment company is only leasing capacity on a transponder for the right to use FCC designated frequencies **constitutes intangible property** that is not includable in the numerator or denominator of the property factor of the business allocation percentage for New York corporate franchise (income) tax purposes
 - Transponders owned by the entertainment company and transponders leased by it from either satellite owners or the owner of a transponder previously purchased from the satellite owner, are tangible personal property and are included in the denominator of the property factor of the business allocation percentage
 - Since the satellite transponders are not physically situated or located in New York, the transponders would not be included in the numerator of the property factor
 - TSB-A-04(8)C, New York Commissioner of Taxation and Finance, May 12, 2004