UNIFORMITY RECOMMENDATION FOR DETERMINING SALES AND USE TAX PRIORITY FOR LEASING TRANSACTIONS

A. STATEMENT OF BASIS AND PURPOSE

When leased property is moved from one state to another during the lease term, an unfair burden can be placed on taxpayers because duplicative state taxes may be imposed on the same lease. Some states accelerate the tax due requiring payment on the entire stream of lease payments at inception. Others tax the lease payments as they become due. Some states impose a tax on cost or value of leased property when purchased by the lessor, and then may, or may not, impose additional tax when such property is subsequently leased.

The purpose of this statute/regulation is to establish standard rules (1) for claiming tax credits to avoid double or multiple taxation of portions of a single leasing transaction, and (2) to provide a basis for comparing the impact of different forms of state transaction taxes on a leasing transaction.

B. SCOPE AND APPLICATION.

1. This statute/regulation applies to all leases of tangible personal property, including, but not limited to, property used for transportation.

2. This statute/regulation applies to:

    (a) all transaction-type taxes levied on leasing transactions by state and local jurisdictions authorized to impose such taxes, and

    (b) nominal purchase option leases, finance leases, and conditional sales where such transactions are not distinguished from true leases pursuant to state law.

3. This statute/regulation is to be applied on a transaction-by-transaction, item-by-item basis, including any unapplied credits accumulated, through lease extensions and/or renewals or where relevant, apply to payments imposed by the "subsequent state" during or for a period subsequent to the period covered by the tax imposed by the "first state", as such terms are defined below. No excess credit resulting from a single leasing transaction may be applied to the tax due on a different leasing transaction. In no event may the credit exceed the total amount of tax due to a state re-

specting the portion of the lease for which the credit is granted to eliminate double taxation.

4. This statute/regulation shall not be construed to authorize a state or local jurisdiction to impose transactional taxes on leases of tangible personal property if such transactions are exempt from tax under current state or local law.

5. Credits and refunds permitted by this statute/regulation may be claimed by the taxpayer or by an assignee of the taxpayer where the cost of the tax has been passed on to the ultimate consumer.

6. The examples provided below are illustrative only and are limited to the facts they contain.

C. PRIORITY RULES

Under this statute/regulation, the "first state" means the state 1) where the lease originated, 2) where the leased property was delivered, and/or 3) where the property was previously used. The "subsequent state" means the state to which the leased property is subsequently relocated.

1. Where the first state at inception of the lease accelerates the tax due based on all or a portion of the total lease payments and the subsequent state imposes tax either up-front on the value or cost of the leased property or on the lease payments due after relocation on a per payment or accelerated basis, the subsequent state will grant a credit against the tax it levies equal to the portion of the accelerated payment covered by the period of the tenancy in the subsequent state until that period or the credit is exhausted, whichever first occurs. This credit is determined by multiplying the total accelerated payment in the first state by a fraction, the denominator of which is the total number of months in the period covered by the accelerated payment in the first state, and the numerator of which is the number of months after relocation of the property remaining in the period covered by the accelerated payment in the first state.

Example A

State A imposes a 6% sales tax on leasing transactions and at lease inception accelerates the total tax due on payments due during the first 12 months of the lease term. Lessor leases an item of tangible personal property to Taxpayer for a two-year term at a rate of $500.00 per month. The tax paid to State A at lease inception totals $360.00 (12 x $500 x .06 = $360)

State B imposes a 7% sales tax on each monthly lease payment as it becomes due. Taxpayer relocates the property to State B in the end of the 6th month after lease inception.

The amount of tax paid to State A available for purposes of calculating the allowable credit in State B is $180.00. (Total amount paid State A ($360) multiplied by the ratio of the number of months left in the period covered by the accelerated payment (6) over the total period (12) (360 x ½ = 180)). State B will grant credits against each monthly tax payment due until the $180 credit is exhausted.

If State B imposes its 7% tax on an accelerated basis, it will give credit of $180 against that accelerated payment due.

Example B

Same facts as in Example A except that State B's tax rate is 4% instead of 7%.

The credit against the accelerated tax payment to State A for the six months period that the property is in State B would be a maximum of $180 as in Example A. Because of the lower rate of tax in State B, however, by the time that six-month period has expired, only $120 of the credit will be used. (State B's tax on the $500 a month lease payments is only $20 per month, or $120 for the six month period.) That is the maximum credit allowed

2. Where the first state imposes tax measured by the cost or value of the property subsequently leased but does not tax the lease payments and the subsequent state imposes tax either up-front on the cost or value of the leased property or on the lease payments due after relocation on a per pay-

ment or accelerated basis, the subsequent state will allow a credit against tax payments due, until the credit is exhausted, equal to the portion of tax paid in the first state that is covered by the useful asset life of the property spent under the lease in the subsequent state. This is calculated by multiplying the amount of tax paid to the first state at the time of purchase by a fraction, the denominator of which is the asset life of the property (deemed to be MACRS class life under 26 U.S.C. §168), and the numerator of which is the remaining term of the lease after movement of the property to the subsequent state. The credit shall be allowed only where the lessor documents the first state's tax on the initial purchase and the subsequent state would not tax both the original sale and the subsequent lease payments.

Example C

State A imposes a 5% sales tax on all purchases of tangible personal property but does not impose sales tax on leasing transactions.

Lessor purchases a piece of construction equipment for $20,000 in State A and pays $1,000 in sales tax at the time of purchase. The equipment is promptly leased to Customer for a term of 60 months, which is equal to the property's useful life. The tax paid by Lessor on the purchase is capitalized and amortized as part of the total lease price charged to Customer.

At the end of the 6th month of the lease Customer moves the property to State B for the remainder of the lease term. State B imposes a 6% sales tax on leasing transactions, payable upon each lease payment. State B will allow a credit against its sales tax due on each lease payment, until exhausted, in the amount of the portion of the sales tax paid by the Lessor on the purchase of the equipment calculated as follows:

Lessor's State A sales tax *$1,000*

Amount of tax paid in State A attributed to the remaining lease term at time property is moved to State B ($1,000 x 54/60 = $900, where 54 equals the number of months remaining under the lease and 60 equals the entire lease term) *$ 900*

Example D

Example D illustrates the tax credit procedures for multiple movements of leased property on a five-year lease or having a five year IRC MACRS class life. The property starts out in State A, which imposes a 5% tax on the purchase price of $20,000, but not on the lease payments. The property is leased immediately after purchase to Customer for $200 per month. At the end of the 6th month of the lease, the property is moved to State B, which imposes a 6% tax on the lease on an accelerated basis. At the end of the 18th month, the property moved to State C, which imposes a tax of 7% on each lease payment. Neither State B nor C taxes the sale of property that is subsequently leased.

State A taxes the purchase price of $20,000 @ 5 % for a tax of $1,000.

State B taxes lease payments @ 6 %, accelerating the tax on the first 12 months of payments for a tax payment due of $144 (6% x $200 x 12 = $144). State B will grant a credit against that tax due in the amount of $900 determined by multiplying the amount of tax paid to State A ($1000) by a fraction the numerator of which is the remaining months of the lease term (54) and the denominator of which is the property's class life (60) ($1000 x 54/60 = $900). Were the property to remain in State B, the taxpayer would be entitled to apply the balance of the $900 credit less the accelerated tax payment in the amount of $756 against the subsequent monthly payments until the credit was exhausted. Since the property is moved out of State B at the end of the 12 months, however, there remains a balance of credit available on the tax paid to State A in the amount of $756.

State C imposes tax on each lease payment @ 7 %. The $756 available credit will be applied to the tax on each lease payment until the credit is exhausted.

3. Where the first state continues to impose tax on each lease payment after the leased property has left the state and the subsequent state imposes tax either up-front on the cost or value of the leased property or on the lease payments due after relocation on a per payment or accelerated basis, the first state will allow a credit against tax due on post-relocation lease payments equal to the amount of tax paid in the subsequent state on the cost or value of the lease property or on the accelerated lease payment until that credit is exhausted, or on each lease payment on a per payment basis.

Example E

State A imposes tax on each lease payment of $100 on a two year lease at the rate of 6% and continues to impose that tax after the property is moved to State B at the end of the 6th month of the lease.

If State B imposes tax on each lease payment at the rate of 5%, State A will grant a credit of $5 on the $6 of tax due on each lease payment.

If State B accelerates the 5% tax due for the remaining 18 months of the lease for a $90 payment, State A will grant a total credit of $90 applicable against each subsequent month tax payment of $6 until the $90 credit is exhausted.

4. Where the first state imposes a tax on rental of tangible personal property and the property is relocated to a state that imposes an up-front tax on the cost of the property, the subsequent state shall grant a credit equal to the lesser of: a) the amount of tax paid to the prior state on lease payments made during the term of the property's use in that state, or b) for an amount equal to the subsequent states tax rate times the difference between the cost of the property and the fair market value of the property at the time of movement. In the event fair market value of the property cannot be determined, the tax basis will be computed by subtracting straight-line depreciation from the original cost of the property. The asset life of the property will be deemed to be its IRC MACRS class life for the purpose of calculating straight-line depreciation.