

LEASE OR RENTAL OF TANGIBLE PERSONAL PROPERTY

Notice #07-15

Sales and Use Tax

December 2007



Highlights

- *Amended definition does not include agreements that require transfer of title upon payment of an option price of \$100 or 1% of total payments*
- *Amended definition applies to new lease agreements*
- *The complete definition for lease or rental can be found in T.C.A. § 67-6-102*

INTRODUCTION

This notice is intended to provide taxpayers and the general public with information concerning Public Chapter 602, Acts of 2007, which makes substantial changes to Tennessee sales and use tax statutes in order to comply with the Streamlined Sales and Use Tax Agreement.

Effective January 1, 2008, Tennessee has amended the definition of a lease or rental for sales and use tax purposes.

The amended definition of lease or rental does not include transfers of property under an agreement that requires the transfer of title upon completion of all payments and the payment of an option price that does not exceed the greater of \$100 or 1% of the total payments.

The new definition applies to leases entered into on or after January 1, 2008, and will have no impact on existing leases or rentals. The prior definition applies to options to purchase or extend included in agreements entered into prior to January 1, 2008.

DISCUSSION

The new lease and rental definition will be used for sales and use tax purposes regardless of whether a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, or Title 47 Chapter 2A, or any other provision of federal, state, or local law.

"Lease or rental" means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. A lease or rental may include future options to purchase or extend.

The definition of lease or rental does not include the following types of transactions:

1. Transfer of property under a security agreement or deferred payment plan that requires the transfer of title at the end of the required payments. Such transactions continue to be subject to tax as a sale, and not as a lease or rental.
2. Transfer of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of \$100 or 1% of total required payments. This represents a change in Tennessee law and applies to agreements entered into on or after January 1, 2008. The total sales price of the

property is subject to tax at the time of the sale. The periodic payments, including interest and financing charges, made under the agreement are not subject to tax.

3. Providing an operator along with the property. An operator must do more than maintain, inspect, or set up the tangible personal property. Such transactions continue to be treated as the sale of a service rather than the lease or rental of property.

Terminal rental adjustment clause

Lease or rental includes agreements that contain a terminal rental adjustment clause covering motor vehicles and trailers where the amount of consideration may increase or decrease by reference to the amount realized upon sale or disposition of the property as defined in 26 U.S.C. Section 7701(h)(1).

The amended definition clarifies that additional payments or refunds required under agreements pursuant to a terminal rental adjustment clause are part of the proceeds of the lease. At the end of a lease term:

1. If a motor vehicle or trailer sells for less than was estimated by a lessor and lessee at the beginning of the lease and the lessee is required to make an additional payment under the lease, the additional payment is subject to tax if the lease was subject to tax, or
2. If a motor vehicle or trailer sells for more than was estimated by the lessor and lessee at the beginning of the lease and the lessor is required to make a refund to the lessee, the refund amount is a reduction in the amount of consideration for the lease and the lessor should refund tax on the amount refunded to the lessee, if tax was collected on the original lease payments.

Sourcing

Pursuant to Public Chapter 602, statutory changes to comply with the Streamlined Sales and Use Tax Agreement sourcing requirements for leases of property are scheduled to take effect July 1, 2009. Until then lease or rental agreements that are entered into or take place in Tennessee continue to be subject to sales tax in Tennessee for the duration of the lease, regardless of whether the leased or rented property is moved outside Tennessee.

Lease or rental agreements entered into or originally taking place outside Tennessee are subject to use tax in Tennessee if the leased or rented property is subsequently moved into Tennessee. Credit, however, will be provided for any sales tax properly paid to another state on the lease or rental payment subject to Tennessee use tax.

➤ *New sourcing requirements do not take effect until July 1, 2009*



References:

PC 602 (2007)
T.C.A. § 67-6-102
T.C.A. § 67-6-204

The information provided here is current as of the date of publication but may change as a result of new statutes, regulations, or court decisions. While this notice is intended to be comprehensive, events and situations unanticipated by this notice may occur. In such cases you should contact the department or your tax professional for further guidance.