

Examples of Credit for Taxes Paid to Other States Lease and Rental Issues

Example 1 – Both States Tax Stream of Payments – Lessor Notified by Lessee of Location of the Leased Equipment When Moved to State B (Agreed)

- Company X leases equipment (not motor vehicles or other items identified in Section 310.C. or D. of the SSUTA) from Lessor Y.
- The lease agreement requires Company X to pay Lessor Y \$1,000 per month for 24 months plus the applicable sales tax.
- Company X and Lessor Y are both located in State A.
- State A imposes a 5% sales tax on each lease payment sourced to State A.
- Six months into the lease, Company X moves the equipment to State B.
- State B imposes a 6% sales tax on each lease payment sourced to State B.
- Company X notifies Lessor Y that the equipment is being moved to State B.
- The equipment remains in State B for the remaining term of the lease.

Tax Treatment: In this scenario, State A should receive its 5% tax on the first 6 lease payments. State B should receive its 6% tax on the remaining 18 lease payments.

Example 2 – Both States Tax Stream of Payments – Lessor NOT Notified by Lessee of Location of the Leased Equipment When Moved to State B (Not Agreed – Some believe Alternative 1 should apply but others believe Alternative 2 should apply)

- Same as Example 1, except that Company X does not inform Lessor Y that the equipment is being moved to State B. Therefore, under Section 310.B.1 of the SSUTA, Lessor Y sources these payments to State A.

Alternative 1: In this scenario, State A should receive its 5% tax on all of the lease payments. State B may impose its 6% use tax on Company X, but must give credit for the 5% tax Company X paid on each of the payments. The end result is that State B will only receive 1% tax on the 18 lease payments while the equipment was in State B.

Alternative 2: State A should receive its 5% tax only on the first 6 lease payments since the equipment was not located in State A after those 6 lease payments were made. State B should receive its 6% tax on the remaining 18 lease payments since the equipment was in State B during that time period.

Issues to Resolve:

- Was tax "legally due and paid" to Lessor on all the payments?
 - Do Section 310 sourcing requirements of Seller/Lessor make the tax "legally due and paid" by Lessee?
 - If Lessee does not inform Lessor property was moved, is this "bad faith"?
- Mark N – Does a state's imposition statute really impose the tax such that the Lessor would have to collect the tax even if the leased property was not actually in their state?
- Should State B be prevented from receiving its entire 6% sales tax just because the lessee failed to tell the Lessor the property was moved?
- Can refund claims be filed so tax only due on where property actually was located?

Example 3 – First State Imposes Tax on Sum of Lease Payments At Inception of Lease (i.e., when first payment is due) and Second State Taxes Stream of Payments – Lessee Notifies Lessor When Equipment is Moved to Second State (Not Agreed)

- Company J leases equipment (**not** motor vehicles or other items identified in Section 310.C. or D. of the SSUTA) from Lessor K.
- The lease agreement requires Company J to pay Lessor K \$1,000 per month for 24 months plus the applicable sales tax.
- Company J and Lessor K are both located in State C.
- State C imposes a 5% sales tax on the sum of the lease payments sourced to State C upfront (i.e., at the time the lease begins, State C expects Lessor K to remit State C's sales tax on the entire \$24,000 in payments) which is permitted under the SSUTA Section 310.B.3.
- Lessor K remits the \$1,200 in sales tax due on the lease payments at the time the lease begins.
- Six months into the lease, Company J moves the equipment to State D.
- State D imposes a 6% sales tax on each lease payment sourced to State D.
- Company J notifies Lessor K that the equipment is being moved to State D.
- The equipment remains in State D for the remaining term of the lease.

Tax Treatment: State C is entitled to its 5% upfront tax on the sum of the lease payments. When Company J moves the equipment to State D and notifies Lessor K that the equipment was moved to State D, Lessor K is required to collect State D's 6% sales tax on these lease payments. However, since Lessor K already collected and remitted the 5% sales tax on all of the lease payments, State D must provide a credit against its 6% sales tax due on these payments for the 5% sales tax already paid on those same payments to State C. Therefore, State D will only receive 1% sales tax (the difference between State D's 6% sales tax rate and the 5% sales tax rate paid to State C) on the payments that are sourced to State D.

Issues to Resolve:

- WA would not allow credit currently because there is no provision in their sales tax law to give credit for tax paid to another state.
- NJ would give credit if other state would allow a similar credit. If other state would not give credit, NJ would refund the tax on the payments after the property was moved out of NJ.
- Why should states that tax stream of payments have to give credit for tax paid to another state that taxes all the payments upfront when the property isn't even located in the "upfront" state when many of the payments are made?

Example 4 – First State Imposes Tax on All Lease Payments Upfront and Second State Taxes Stream of Payments – Lessee Does NOT Notify Lessor When Equipment is Moved to Second State (Not Agreed)

- Same as Example 3, except that Company J does not inform Lessor K that the equipment is being moved to State D.

Tax Treatment – Since Lessor K does not know that the equipment was moved to State D, Lessor K does not have to collect any additional tax on this lease. However, Company J would owe State D's 6% use tax on the lease payments while the equipment is located in State D, but State D would have to allow a credit for the 5% use tax Company J already paid to Lessor K on

those same lease payments. The result is that Company J would owe an additional 1% tax to State D on the payments while the equipment is located in State D.

Issues to Resolve:

- Same issues as in Example 2

Example 5 – First State Requires Lessor to Pay Tax on its Purchase of Leased Equipment and Second State Taxes Stream of Payments – Lessee Notifies Lessor When Equipment is Moved to Second State (Not Agreed – Two different transactions)

- Company T leases equipment (not motor vehicles or other items identified in Section 310.C. or D. of the SSUTA) from Lessor U.
- The lease agreement requires Company T to pay Lessor U \$1,000 per month for 24 months plus the applicable sales tax.
- Company T and Lessor U are both located in State E.
- State E requires Lessor U to pay its 5% sales/use tax on Lessor U's purchase price of the equipment being leased, but does not impose tax on the lease transaction between Company T and Lessor U.
- Lessor U purchases the equipment being leased for \$21,600.
- Lessor U pays the \$1,080 in sales/use tax due on its purchases of the equipment to State E.
- Six months into the lease, Company T moves the equipment to State F.
- State F imposes a 6% sales tax on each lease payment sourced to State F.
- Company T notifies Lessor U that the equipment is being moved to State F.
- The equipment remains in State F for the remaining term of the lease.

Tax Treatment: State E is entitled to its 5% tax on Lessor U's purchase of the equipment it leases to Company T. When Company T moves the equipment to State F and notifies Lessor U that the equipment was moved to State F, Lessor U is required to collect State F's 6% sales tax on these lease payments. However, since Lessor U already paid State E's 5% sales tax on its purchase price of the equipment, State F must provide a credit against its 6% sales tax due on these payments for the prorata portion of the 5% sales tax already paid to State E. (i.e., \$1,080 sales tax paid to State E divided by 24 months = \$45 credit per month for tax paid to State E). Therefore, State F will receive \$15 in sales tax for each \$1,000 monthly lease payment (the difference between State F's 6% sales tax rate and the prorata amount of tax (\$45/month) already paid to State E) on the payments that are sourced to State F.

Issues to Resolve:

- These are two different transactions. Lessee would not get credit for tax paid by Lessor.
- Some states would allow credit. Should it be required of all the states or is this an area where states can give credits that are more generous than the minimum required?
- Val – Additional examples. Should get same treatment as a "sale" would get