

STATE OF COLORADO

DEPARTMENT OF REVENUE
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John W. Hickenlooper
Governor

Barbara J. Brohl
Executive Director

GIL-08-023 (Amended)

April 29, 2013

XXXXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX

Re: Ruling Request — tax on leases

Dear XXXXXXXXXXXX

The Department previously provided you a general information letter (GIL-08-023) dated October 6, 2008. The Department has had an opportunity to revisit this issue and has concluded that late payment fees are not included in the purchase price, and therefore, are not subject to sales or use tax. This general information letter supersedes our October 6, 2008 general information letter.

Issue

You asked whether the following types of transactions are subject to sales and/or use tax.

1. Leases with a fair market value option.
2. Leases with a nominal value option
3. Insurance premiums
4. Documentation fees
5. Late payment fees
6. Personal property taxes assessed against your company, but subject to reimbursement under the lease

Discussion

1. Taxability of leases with either a market value purchase option or nominal value purchase options.

Colorado levies sales and use tax on leases of tangible personal property.¹ In general, a lessor must pay sales or use tax when it acquires the property if the lessor intends

¹ § 39-26-102(23) and 713(1), C.R.S.

to lease the property to a lessee for three years or less, unless the lessor obtains prior permission from the Department to collect the tax on lease payments. In contrast, the lessor must collect the tax on each lease payments, rather than pay tax at the time of lessor's acquisition of the property, if the lessor leases the property for more than three years.

In some instances, a lease is not a "true" lease, but a credit sale in which the lessor retains title to the property until the lessee completes the "lease" payments. These leases are sometimes referred to in tax literature as a "finance" lease or "capital" lease.² True leases and finance leases are similar in that both are subject to state and state-administered sales and use taxes. Moreover, the price paid on a purchase option, whether at fair market value or a nominal price, is taxable. This is because the option payment is consideration paid in acquisition of the property.³

However, there are a few important differences in how tax is administered for these two types of leases, particularly with respect to application of § 39-26-111, C.R.S. (Credit Sales). As noted above, a finance lease is not a true lease but, rather, a credit sale. The Colorado UCC sets forth criteria to distinguish between a true lease and a credit sale subject to a security interest. See, § 4-1-203, C.R.S. In general, a "lease" is a credit sale if the buyer/lessee cannot terminate the transaction before it expires. The buyer also often assumes all or many of the responsibilities typical of ownership, such as risk of loss, insurance, property taxes, maintenance, and claims a depreciation expense on its federal income tax return. The seller/lessor in a finance lease creates a security interest in the property during the term of the "lease," typically by retaining at least nominal title to the property. At the expiration of the finance lease, buyer typically "purchases" the property for nominal consideration or for less than fair market value. See, *In re Mesa Refining, Inc.*, 52 Bankr. 359 (Bankr. D. Colo. 1985). See, also, *Lease Equipment Company of Maryland, Inc. v. Ala. Dept. Rev., Admin. Law Div.*, Dkt. No. S. 06-558, 02/21/2007. The facts of each case should be carefully examined to determine the appropriate characterization of the transaction. See, § 4-1-203(1), C.R.S.

² It is helpful to note some potential confusion regarding terminology. The Colorado Uniform Commercial Code (CUCC) regulates, among other things, the rights and obligations of parties to what is referred to as a "finance lease." See, generally, § 4-2.5-103(1)(g), C.R.S. A CUCC finance lease is typically a three-party transaction involving a finance company, supplier, and buyer. The requirements of CUCC relating to "finance leases" apply only to true leases and do not apply to sales disguised as leases. See Official Comments, § 4-2.5-103(1)(g), C.R.S. See, Official Comment to § 4-2.5-103(1)(g) ("For a transaction to qualify as a finance lease it must first qualify as a lease. Section 2A-103(1)(j) [§ 4-2.5-103(1)(j), C.R.S.]... This definition [of a finance lease] focuses on the transaction, not the status of the parties; to avoid confusion it is important to note that in other contexts, e.g., tax and accounting, the term finance lease has been used to connote different types of lease transactions, including leases that are disguised secured transactions. M. Rice, *Equipment Financing*, 62-71 (1981)."). Conversely, a Finance Lease is a sale disguised as lease and, therefore, does not include a "finance lease" as that term is used in the CUCC.

³ § 39-26-102(5) and (7)(a) and 39-26-102(5) and (7)(a), C.R.S (tax computed based on consideration paid by purchaser).

Although passage of title often signals that a sale has occurred for purposes of the CUCC, title passage is not required in order to create a sale for tax purposes. In Colorado, title does not have to pass from seller to buyer in order to create a taxable sale. See, § 39-26-111(1), C.R.S. ("[Tax is due on installment payments on a] sale on credit, or a contract for sale wherein it is provided that the price shall be paid in installments and title does not pass until some future date ..."); § 39-26-102(10) (a "sale" includes installment and credit sales); see, also, § 4-1-203, C.R.S. (credit sales disguised as a "lease").

Other states have adopted substantially the same approach. See, e.g., Cal. Code Reg. 1641(b) (finance lease treated as credit sale); California Taxation Code Section 6006.3 and California State Board of Equalization Regulation 1660(a)(2)(A), Title 18, California Code of Regulations; California FTB Legal Ruling No. 419, 12/03/1981; Massachusetts Department of Revenue, LR 01-8, 9-11-2001; Nevada Admin. Code 372.086 (Finance Lease is a sale); West Virginia Code of State Rules 110-15-129 (Leases of Tangible Personal Property).

As noted above, it is not always necessary to determine whether a transaction is a lease or a credit sale because Colorado levies sales and use tax on both leases and sales. However, under certain circumstances, it will be important to determine the type of transaction at issue because there are important differences in how the tax, including the tax on the purchase option, is administered. The principal difference occurs when a seller/lessor assigns, factors, or otherwise transfers its interest in a finance lease. When a true lease is transferred to a third party, the lessee's obligation to pay tax continues (including the tax on the option purchase price) and the third-party transferee undertakes the obligation to collect, report, and remit the tax due on the remaining installment payments. In contrast, a transfer of a finance lease to a third party accelerates the seller's/lessor's tax obligation and the seller must remit to the Department the entire balance of tax due. This is because, pursuant to § 39-26-111(2), the seller is deemed to have received full consideration from the transferee. See, § 39-26-111(2). Therefore, if the purchase option is exercised after the finance lease is assigned, the additional consideration is not taxable because the seller will have already paid the tax in full at the time of transfer.

2. Insurance premiums.

Insurance premiums charged by the lessor are included in the calculation of the sales tax if the premiums are inseparable from the rental of the property. In *A.D. Stores v. Department of Revenue*, 19 P3d 680 (Colo.2001), the Colorado supreme court held that services that are separable from the sale of tangible personal property are not taxable. Inseparable services are generally those that the customer has no realistic option but to acquire from the retailer. Therefore, if the lessee has the option to purchase insurance from a party other than the lessor, then the insurance premium is considered separable from the sale of the property and is not taxable, even if the lessee elects to purchase insurance through the lessor, but only if the insurance premium is separately stated in the contract or invoice. Compare,

e.g., Tri-City Rentals, Inc. d/b/a Hertz Rent-A-Car vs. Joe B. Huddleston (Tennessee 07/01/1991).

3. Documentation Fee

It is not clear what is meant by documentation fee. I assume this is a service fee charged to the lessee by either the lessor or by a finance company to the lessor who passes the fee onto the lessee. Although services are generally not taxable in Colorado, Colorado does impose a sales tax on charges for services rendered in connection with the sale or lease of tangible personal property. Section 39-26-102(12), C.R.S., states in pertinent part,

“the full purchase price of article sold after manufacture or after having been made to order and includes the full purchase price for material used and the service performed in connection therewith, Except as otherwise provided ..., the sales price is the gross value of all materials, labor, and service, and the profit thereon, included in the price charged to the user or consumer.”

A documentation fee is part of the retailer's / lessor's overhead cost incurred in connection with the lease and is, therefore, included in the calculation of sales tax. See, e.g., California Sales Tax Counsel Ruling No. 330.1 874.200 (bank's documentation fee passed on to lessee by lessor included in sales tax calculation). This is in contrast to insurance that a purchaser may have the option to obtain from sources other than the lessor.

The documentation fee is inseparable from the lease and, therefore, included in the tax calculation. See, *A.D. Stores v. Department of Revenue*, 19 P3d 680 (Colo.2001); compare, also, *Velde Ford Sales, Inc. v. The Department of Revenue*, 136 Ill App 3d 589 91 Ill Dec 375 483 NE2d 721 (IL 1985).

4. Late Payment Fee

In Department Regulation 39-26-102.7(a)(4), we state that an amount charged on an unpaid balance of a purchase price is not part of the purchase price unless the amount is included in the principal amount of a promissory note. Late payment fees that reflect the vendor's carrying cost of money are substantially the same as a finance charge. Therefore, a late payment fee, if assessed to reflect the vendor's carrying cost of money, is not subject to sales tax if the charge is separately stated from the unpaid principal balance of the purchase price.⁴

⁴ Many states do not include late payment fees in the tax base. See, e.g., Iowa Admin. Code 701--16.50 (422, 423) ("The amount of any charge, commonly called a "late payment charge," imposed by a public utility on its customers, shall not be subject to tax if the charge is in addition to any charge for the utility's sale of its commodity or service and is imposed solely for the privilege of deferring payment of the purchase price of the commodity or service and furthermore is separately stated and reasonable in amount".); and Okla. Admin. Code 710:65-19-341 Natural or artificial gas and electric utility services, ("Charges which are separately stated and are unrelated to the amount of gas or electricity used such as charges for returned checks or for late payment are not subject to sales tax.").

5. Business personal property tax

Colorado counties have the option to levy a business personal property tax. The incident of taxation falls on the property owner, not the lessee. Parties to a private lessor sales contract can agree that the lessee / purchaser reimburses the lessor / seller an amount equal to the tax. The question then becomes whether the reimbursement is included in the sales tax calculation. Although Colorado law requires that a seller exclude direct federal taxes paid by the retailer / lessor from the sales tax calculation, there is no similar provision to exclude other types of taxes reimbursed by the purchaser / lessee. Personal property taxes are costs a seller / lessor incurs in connection with the sale or lease of taxable property. Unlike insurance premiums that the purchaser / lessee may acquire separately from the sale or lease of property, these property taxes are unavoidable costs incurred in the lessor's rental of taxable property. Therefore, these property taxes are inseparable from the lease and must be included in the sales tax calculation.

Please note that the Department of Revenue administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home-rule cities and counties. For a complete list of state-collected local jurisdictions and home-rule cities and counties, see Department publication 1002 (DRP 1002) which is on our website under "Taxation" > "Forms" > "Businesses" > "Sales and Use."

The Department's web site offers a wide range of resources regarding tax issues. These include tax publications, a tax index, FYIs, regulations and a variety of on-line services such as sales tax license verification, filing, local tax rates by address, and others. You can view these resources on our web site at: www.revenue.state.co.us and click on "Taxation." Pursuant to state law, the Department is required to make publish redacted responses to requests for general informational letters. Your letter requesting this informational letter is not made public. See, § 24-35-103.5(13), C.R.S. The regulation governing informational letters is available on our web site at: <http://www.revenue.state.co.us> > Tax Library > Rulings > Department of Revenue regulation 24-35-103.5.

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted letter.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Tele: (303)866-5627
Email: neil.tillquist@state.co.us

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DEPARTMENT OF REVENUE

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Bill Ritter, Jr.
Governor

Roxanne Huber
Executive Director

GIL-2008-23

October 6, 2008

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Re: Ruling Request – tax on leases

Dear XXXXXXXX,

The department has reviewed your letter dated April 3, 2008. I apologize for the delay in responding to your request. The department recently acquired the staff needed to respond to these types of requests. The department also recently enacted a regulation governing requests for tax advice. See, §24-35-103.5, C.R.S. and Department regulation (24)-35-103.5. Pursuant to this regulation, the department issues both private letter rulings and general information letters. Private letter rulings are issued in response to tax issues raised in specific factual settings, are binding on the department, and require payment of a fee. General information letters are issued in response to general tax questions and are not binding on the department. You can view this regulation on-line at:

<http://www.revenue.state.co.us/taxstatutesregs/3921reg24-35-103.5.html>

I will initially treat your request as one for a general information letter. If you would like a private letter ruling, please take a moment to review the regulation and resubmit the request with the required information.

Issue

You ask whether the following types of transactions are subject to sales and/or use tax.

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1. *Taxability of leases with either a market value purchase option or nominal value purchase options.*

Colorado levies sales and use tax on leases of tangible personal property. §39-26-102(23) and 713(1), C.R.S. In general, a lessor must pay sales or use tax when it acquires the property if the lessor intends to lease the property to a lessee for three years or less, unless the lessor obtains prior permission from the department to collect the tax on lease payments. In contrast, the lessor must collect the tax on each lease payments, rather than pay tax at the time of lessor's acquisition of the property, if the lessor leases the property for more than three years.

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However, there are a few important differences in how tax is administered for these two types of leases, particularly with respect to application of §39-26-111, C.R.S. (Credit Sales). As noted above, a finance lease is not a true lease but, rather, a credit sale. The Colorado UCC sets forth criteria to distinguish between a true lease and a credit sale subject to a security interest. See, §4-1-203, C.R.S. In general, a "lease" is a credit sale if the buyer/lessee cannot terminate the transaction before it expires. The buyer also often assumes all or many of the responsibilities typical of ownership, such as risk of loss, insurance, property taxes, maintenance, and claims a depreciation expense on its federal income tax return. The seller/lessor in a finance lease creates a security interest in the property during the term of the "lease," typically by retaining at least nominal title to

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the property. At the expiration of the finance lease, buyer typically "purchases" the property for nominal consideration or for less than fair market value. See, *In re Mesa Refining, Inc.*, 52 Bankr. 359 (Bankr. D. Colo. 1985). See, also, *Lease Equipment Company of Maryland, Inc. v. Ala. Dept. Rev., Admin. Law Div., Dkt. No. S. 06-558, 02/21/2007*. The facts of each case should be carefully examined to determine the appropriate characterization of the transaction. See, §4-1-203(1), C.R.S.

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2. *Insurance premiums.*

Insurance premiums charged by the lessor are included in the calculation of the sales tax if the premiums are inseparable from the rental of the property. In *A.D. Stores v. Department of Revenue*, 19 P3d 680 (Colo.2001), the Colorado supreme court held that services that are separable from the sale of tangible personal property are not taxable.

Inseparable services are generally those that the customer has no realistic option but to acquire from the retailer. Therefore, if the lessee has the option to purchase insurance from a party other than the lessor, then the insurance premium is considered separable from the sale of the property and is not taxable, even if the lessee elects to purchase insurance through the lessor, but only if the insurance premium is separately stated in the contract or invoice. Compare, e.g., *Tri-City Rentals, Inc. d/b/a Hertz Rent-A-Car vs. Joe B. Huddleston* (Tennessee 07/01/1991).

3. *Documentation Fee*

It is not clear what is meant by documentation fee. I assume this is a service fee charged to the lessee by either the lessor or by a finance company to the lessor who passes the fee onto the lessee. Although services are generally not taxable in Colorado, Colorado does impose a sales tax on charges for services rendered in connection with the sale or lease of tangible personal property. Section 39-26-102(12), C.R.S., states in pertinent part,

“the full purchase price of article sold after manufacture or after having been made to order and includes the full purchase price for material used and the service performed in connection therewith, Except as otherwise provided, the sales price is the gross value of all materials, labor, and service, and the profit thereon, included in the price charged to the user or consumer.”

A documentation fee is part of the retailer's / lessor's overhead cost incurred in connection with the lease and is, therefore, included in the calculation of sales tax. See, e.g., California Sales Tax Counsel Ruling No. 330.1874.200 (bank's documentation fee passed on to lessee by lessor included in sales tax calculation). This is in contrast to insurance that a purchaser may have the option to obtain from sources other than the lessor. The documentation fee is inseparable from the lease and, therefore, included in the tax calculation. See, *A.D. Stores v. Department of Revenue*, 19 P3d 680 (Colo.2001); compare, also, *Velde Ford Sales, Inc. v. The Department of Revenue.*, 136 Ill App 3d 589 91 Ill Dec 375 483 NE2d 721 (IL 1985).

4. *Late Payment Fee*

Late payment fees are included in the calculation of sales tax. Gross taxable sales “means the total amount received in money, credits, or property, ... or other consideration valued in money from sales and purchases at retail with this state ...” 39-26-102(5), C.R.S. There is no statutory basis that excludes this consideration from sales tax computation.

5. *Business personal property tax*

Colorado counties have the option to levy a business personal property tax. The incident of taxation falls on the property owner, not the lessee. Parties to a private lease or sales contract can agree that the lessee / purchaser reimburses the lessor / seller an amount equal to the tax. The question then becomes whether the reimbursement is included in the sales tax calculation. Although Colorado law requires that a seller exclude direct federal taxes paid by the retailer / lessor from the sales tax calculation,

there is no similar provision to exclude other types of taxes reimbursed by the purchaser / lessee. Personal property taxes are costs a seller / lessor incurs in connection with the sale or lease of taxable property. Unlike insurance premiums that the purchaser / lessee may acquire separately from the sale or lease of property, these property taxes are unavoidable costs incurred in the lessor's rental of taxable property. Therefore, these property taxes are inseparable from the lease and must be included in the sales tax calculation.

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The Department's web site offers a wide range of resources regarding tax issues. These include tax publications, a tax index, FYIs, regulations and a variety of on-line services such as sales tax license verification, filing, local tax rates by address, and others. You can view these resources on our web site at: www.revenue.state.co.us and click on "Taxation."

Pursuant to state law, the Department is required to make publish redacted responses to requests for general informational letters. Your letter requesting this informational letter is not made public. See, §24-35-103.5(13), C.R.S. The regulation governing informational letters is available on our web site at:

<http://www.revenue.state.co.us/taxstatutesregs/3921reg24-35-103.5.html>

I enclose a proposed redacted version of this letter. Please contact me within 60 days from the date of this letter if you have any questions, comments or concerns about the redacted letter.

I hope this is helpful. Please contact me if you have any questions or concerns.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Telephone: (303)866-5627
Email: ntillquist@spike.dor.state.co.us