STATE OF COLORADO

DEPARTMENT OF REVENUE
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John W. Hickenlooper
Governor

Roxanne Huber
Executive Director

GIL-11-013

June 28, 2011

XXXXXXXXXXXXXXX
Attn: XXXXXXXXXXX
XXXXXXXXXXXXXXX
XXXXXXXXXXXXXXX

Re: Taxability of leased property

Dear XXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXX ("Company") a request for guidance on the collection of sales and use tax on leases of tangible personal property. The department issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues and is not binding on the department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the department but not the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department regulation 24-35-103.5 at www.taxcolorado.org > FYI/Publication > Rulings.

The department initially treats your request as one of a general information letter. If you would like the department to issue a private letter ruling on the issues you raise, you can resubmit a request and fee in compliance with regulation 24-35-103.5. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not a determination of the tax consequence of any particular action or inaction.

Issue

Should Company, as a lessor, collect from lessees both the sales tax lessor pays when it purchases the tangible personal property from its vendor and use tax on lease payments made by lessees for such property?

Background

Company does not have a physical presence in Colorado and does not hold a Colorado sales tax license. It does have a retailer's use tax account with the Department. Company enters into either a true lease or capital lease with lessees who use the leased property in

Colorado. The lease period is normally less than 36 months. Pursuant to the terms of the lease, Company requires lessees to reimburse it for Colorado sales tax the Company paid when it acquired the property to be leased. Company also collects Colorado use tax from lessees. Company would like confirmation that it must collect from lessees both the sales it pays for the initial purchase and use tax on lease payments made by lessees.

Discussion

Scenario No. 1

There are two alternative means of collecting tax when a lease is for 36 months or less. The default procedure requires lessor to pay sales tax on its purchase from its vendor if the sale takes place in Colorado or pay Colorado use tax if its purchase from its vendor occurs outside Colorado. Colorado law does not require that lessor also collect sales or use tax from lessees in this case. However, as a matter of contract, lessor and lessee may agree that lessee reimburse lessor for sales or use tax paid by the lessor when it first acquired the property to be leased. The department's only interest in such contract provisions is that the lessor cannot represent to lessees that the tax is an obligation lessee owes to the department nor can lessor represent the tax recovery as a true sales or use tax charge.

Under the alternative approach, which requires the department's permission, lessor purchases goods from its vendor as an exempt wholesale purchase [1] and then collects sales or use tax, as the case may be, from lessees on their lease payments. The net result under this alternative approach is that lessee pays tax only on its lease payments.

Note that under the default procedure, the incidence of taxation (i.e., who is legally obligated to pay the tax) for the Colorado tax falls on the lessor, not lessee. This means, among other things, that the tax is due regardless of whether the lessee makes lease payments.[2] However, when lessor obtains permission to exempt its purchase from the vendor and collect use tax on lessee's lease payments, then the incidence of taxation falls on the lessee and the use tax is due only to the extent that the lessee makes lease payments. In this circumstance, lessor must continuously treat the property as inventory and cannot use the property for the company's own business needs.

It may be the case that lessor pays sales tax to another state when it purchases goods from an out-of-state vendor.[3] This out-of-state tax will typically impact lessor's obligation to

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[1] A resale (wholesale) exemption is allowed when a buyer purchases goods for the purpose of reselling to a third party. A buyer wishing to make a wholesale purchase must present to the seller a sales tax license issued by the department or another state. Company does not have a Colorado sales tax license and, therefore, should present its license issued by the state in which it has its commercial domicile. See, FYI Sales 1 (How to Document Sales to Retailers, Charitable Organizations, and Direct Pay Permit Holders).

[2] Because the use tax is an obligation of the lessor, not lessee, under the default approach, this means that the lessor cannot claim a resale exemption when the lessor purchases the property from the Colorado vendor.

[3] Company states that it pays Colorado sales tax when it acquires the property from its vendor and we assume this means that the vendor is located in Colorado. For purposes of

Colorado by creating a credit against Colorado's state and local use taxes.[4] Because the credit can only be claimed by the person who pays the tax, this credit is available only when the lessor pays the tax upfront. Thus, the lessee, who did not pay the sales tax to the other state, cannot claim the credit on the sales or use tax it (lessee) pays on the lease payments.

Please note that the department collects certain local taxing jurisdictions that also levy use tax.[5] The tax paid to another state is first applied to the state tax and, if there is any credit remaining, then to any special district use tax (e.g., RTD use tax).

For more information on these issues, see FYI Sales 1 (How to Document Sales to Retailers, Charitable Organizations, and Direct Pay Permit Holders), FYI Sales 5 (Sales Tax Information For Out of State Businesses), FYI Sales 56 (Sales Tax on Leases of Motor Vehicles and Other Tangible Personal Property), and FYI Sales 62 (Guidelines for Determining When to Collect State-Collected Local Sales Taxes).

Scenario No. 2

In this scenario, the lease is not a "true" lease but, rather, a finance lease.[6] A finance lease is an installment sale of goods on credit and for which the seller / lessor retains title to the goods as a security interest in the event of the buyer's / lesse's default. A true lease is the sale of a possessory right to use property for a limited period of time. This distinction is important because the default procedure (lessor pays tax upfront) discussed in Scenario No. 1 only apply to leases. Because a finance lease is a sale and not a true lease, the "lessor" must collect tax on the "lease" payments.[7] The lessor should claim a resale exemption from its Colorado vendor. The net effect is that the Company's purchase from its Colorado vendor is an exempt sale for resale transaction and Company must collect use tax from lessees on "lease" payments.

If Company purchases the property from a vendor located outside Colorado, then, as in Scenario No. 1, any lawfully due sales tax paid by lessor to another state is applied as a credit against use taxes due from the lessee. Company, itself, has no use tax obligation because Colorado exempts from use tax property acquired by lessor for leasing to third parties.[8] Thus, Colorado requires lessees pay only the Colorado and local use taxes due on the lease payments.

Miscellaneous

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completeness, we discuss the tax treatment of transactions when the Company pays sales tax to another state for its purchases of property to be leased in Colorado.

[4] 39-26-713(2)(f), C.R.S

[5] For information about which local taxing jurisdictions levy use tax administered by the department, see Department publication DR 1002.

[6] See, GIL-2008-23 for a discussion of these two types of leases.

[7] Tax on credit sales is paid by the buyer and collected by the seller on each installment payment. See, §39-26-111, C.R.S.

[8] §39-26-713(2)((I), C.R.S. ("The storage, us, or consumption of any tangible personal property purchase for resale in this state ...")

Pursuant to state law and department regulation 24-35-103.5, noted above, the Department will make public a redacted version of this letter. Your letter requesting this general information letter is not made public. 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 objection concerning the redacted letter.

I hope this is helpful. Please feel free to contact me if you have any questions.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue