

Rentals

Rentals: Retail Sale or Lease

The imposition of the sales tax or use tax to the purchase of tangible personal property for lease to another is complicated. However, the taxpayer has some options and with creative planning can minimize the tax.

In a **retail sale** there is a transfer of title to property as it passes from the seller to the purchaser.

In a **lease** there is a transfer of possession of property but title does not pass from the lessor to the lessee.

Taxpaying Option

A person engaged in business of renting or leasing tangible personal property to others shall pay the sales or use tax at time of purchase, or may purchase the property exempt from sales tax for resale - lease purposes and report and pay use tax on rental receipts.

The taxpayer does not have to treat the entire rental inventory in a consistent manner if adequate records are kept.

Statutory Provisions

The Sales Tax Act in Section 4d provides an exemption from the sales tax for tangible personal property sold to a licensed purchaser for lease to another person when the rental receipts are taxed unless specifically exempt. (MCL 205.54d(a))

Section 1a of the Sales Tax Act defines "lease or rental".

"Lease or rental" means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration and may include future options to purchase or extend. This definition applies only to leases and rentals entered into after the effective date of the amendatory act that added this section and has no retroactive impact on leases and rentals that existed on that date.
(MCL 205.51a(k))

Lease or rental does not include the following:

- a. A transfer of possession or control of tangible personal property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments. (MCL 205.51a(k)(i))
- b. A transfer of possession or control of tangible personal property under an agreement requiring transfer of title upon completion of the required payments and payment of an option price that does not exceed \$100.00 or 1% of the total required payments, whichever is greater. (MCL 205.51a(k)(ii))
- c. The provision of tangible personal property along with an operator for a fixed or indeterminate period of time, where that operator is necessary for the equipment to perform as designed. To be necessary, an operator must do more than maintain, inspect, or set up the tangible personal property. (MCL 205.51a(k)(iii))
- d. An agreement covering motor vehicles or trailers if the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined in section 7701(h)(1) of the internal revenue code, 26 USC 7701.
(MCL 205.51a(k)(iv))

Use Tax on Sales Tax Prohibited

"No tax is to be computed or collected on rental receipts when the tangible personal property rented or leased has previously been subjected to a Michigan sales or use tax when purchased by the lessor." (MCL 205.92f)

Manufacturer Lessor

A manufacturer of property to lease to others must collect and remit Use tax on rental receipts of leased inventory. The manufacturer is not allowed the election of paying sales tax on the manufactured price.

Exemptions

There are exemptions from the use tax as provided for in the use tax act (agricultural producing, industrial processing, etc.) If an item leased normally would be exempt under a specific provision (used in agricultural producing or industrial processing) then the rental receipts are exempt from use tax also.

Third Party Lease

In a third party lease where the lessor leases an item to a lessee who in turn leases out to final lessee, the original lessor would be considered the same as a wholesaler under the sales tax and not subject to use tax on the rental receipts.

Example: IBM leases to John Smith who leases to Jane Doe. IBM would not remit use tax on rental receipts collected from John Smith. John Smith would register with the state as a lessor and collect Use Tax on the rental receipts from Jane Doe.

Out of State Lessors

If tangible personal property is physically located in Michigan and leased to someone in Michigan, the Michigan Use Tax would be applicable even though lessor may not be located in Michigan. The non-Michigan lessor would need to be registered and collect and remit use tax on the rental receipts.

Section 205.95 MCLA, Section 5(1) Use Tax Act

"Every seller (lessor) shall collect the tax imposed by this act from the consumer."

Maintenance Contracts

Section 205.92, Section 2f, Act 94, 1937

"Price means aggregate value in money or any thing or things paid or delivered...by a consumer to a seller in the consummation and complete performance of the transaction by which tangible personal property or services shall have been purchased or rented for storage, use or other consumption in this state, without any deduction therefore on account of the cost of the property sold, cost of materials used, labor or service cost, interest or discount paid, or any other expense whatsoever."

Any and all charges billed by the lessor to the lessee are considered to be connected to and a part of the price of the lease and as such are subject to use tax.

Personal property taxes billed to the lessee by lessor are subject to use tax.

When the lessee goes to third party and purchases a maintenance contract, the lessee pays use tax on rental receipts to the lessor but does not pay sales or use tax on maintenance contract to the third party. When separate and distinct from lease, it is not considered part of lease contract.

Safe Harbor Lease

When a company purchases and owns tangible personal property and then sells it and transfers title to a third party and then leases it back the state does not consider it a true lease sale. The state looks at original transaction as a sale. Tax would be due on the original purchase unless a specific exemption applies.

Automobiles and Airplanes

In a wet lease where the lease agreement includes gas and lubrication, the lessor purchases gas, lubrication, etc is exempt from tax for the purpose of resale. Use tax is due on the total gross proceeds including any and all charges for gas, lubrication, and any other provided items.

When insurance is provided as part of the lease for collision damage waiver to protect the driver from charges when in an accident and damage to the vehicle, use tax is due on the total rental proceeds including any charges for collision insurance.

Life insurance charges are not subject to the use tax when shown as a separate charge and not a part of the lease.

Out Of State Purchases For Lease

When an item is purchased from an out-state vendor and brought into Michigan for lease, the lessor would owe use tax on the value at the time the property is brought into Michigan if the purchaser is a lessor/consumer or remit use tax on rental receipts if lessor/retailer. In order to avoid tax on the purchaser by a lessor/retailer, the purchaser must have a sales tax license.

Sale of Lease Property

The sale of leased property is subject to sales tax on the retail-selling price. It does not matter if the property is sold to the previous lessee or to a third party.

When a sale of tangible personal property is made to the lessee, the lessor would bill the lessee for tax on the total selling price as of that moment.

\$4,000.00	Value	Or	\$8,000.00	Original value
<u>160.00</u>	6% tax		<u>- 4,000.00</u>	Lease payments
\$4,160.00			\$4,000.00	Net selling price
			<u>+ 160.00</u>	Sales tax
			\$4,160.00	

Sale of Leased Vehicles

If the lessor is not a dealer and does not have dealer's license, it is considered an isolated transaction. Tax would be paid by the purchaser at time of application for title at the Secretary of State office.

If a dealer leases a vehicle for three years and the terms include a clause that after three years the lessee could purchase the vehicle for \$1.00, then the \$1.00 would be selling price, even though vehicle might have book value of \$1,000.00. The lessee has paid the tax due over the three years through payment of use tax on rental payments.

The parent company will establish a new wholly owned subsidiary to house its capital asset procurement operations. The parent company will contribute cash to the new *Procurement Company* entity in exchange for stock. The *Procurement Company* entity will acquire assets used in the company's operations from the unrelated suppliers. The *Procurement Company* will then lease the equipment to the affiliates for a specified lease amount. It is important for the lease agreement between the parent company and the *Procurement Company* subsidiary to have standard contractual and legal language. The lease terms must maintain the true lease test which include:

1. Evidence of the parties intention to create a bona fide lease at the time of the lease execution
2. The lease term is less than 75% of the economic useful life of the asset
3. Conveyance of possession and the use of the property to the lessee for the lease term in exchange for the consideration paid

Our firm provides the information in this whitepaper for general guidance only, and does not constitute the provision of legal advice, tax advice, accounting services, investment advice, or professional consulting of any kind. The information provided herein should not be used as a substitute for consultation with professional tax, accounting, legal, or other competent advisers. Before making any decision or taking any action, you should consult a professional adviser who has been provided with all pertinent facts relevant to your particular situation. Tax articles in this whitepaper are not intended to be used, and cannot be used by any taxpayer, for the purpose of avoiding accuracy-related penalties that may be imposed on the taxpayer. The information is provided "as is," with no assurance or guarantee of completeness, accuracy, or timeliness of the information, and without warranty of any kind, express or implied, including but not limited to warranties of performance, merchantability, and fitness for a particular purpose.