



MAINE REVENUE SERVICES SALES, FUEL & SPECIAL TAX DIVISION INSTRUCTIONAL BULLETIN NO. 20

LEASE AND RENTAL TRANSACTIONS

This bulletin is intended solely as advice to assist persons in determining and complying with their obligations under Maine tax law. It is written in a relatively informal style and is intended to address issues commonly faced by those involved in lease and rental transactions in Maine.

Taxpayers are responsible for complying with all applicable tax statutes and rules. Although bulletins issued by Maine Revenue Services ("MRS") do not have the same legal force and effect as rules, justifiable reliance upon this bulletin will be considered in mitigation of any penalties for any underpayment of tax due. This bulletin is current as of the last revision date shown at the end of the document.

The application of sales, use or service provider tax to any specific lease transaction depends upon the terms of the lease. The following information applies to most property and is intended as a guideline for determining the correct application of tax.

The Sales and Use Tax Law provides that every lessor engaged in the leasing of tangible personal property located in this State must register with MRS and collect and remit sales or use tax in connection with the leasing of that property. The Sales and Use Tax Law is found in Part 3 of Title 36 of the Maine Revised Statutes ("M.R.S."). For most items, the applicable sales tax rate is the general rate established by 36 M.R.S. § 1811. Section 1811 establishes a separate higher rate for the short-term rental of automobiles and certain other rentals. Any person engaged in leasing automobiles, either on a short-term or long-term basis, should also see Instructional Bulletin No. 24 ("Vehicle Dealers").

The Service Provider Tax Law provides that service providers must also register with MRS and remit service provider tax in connection with the lease or rental of certain types of property. The Service Provider Tax Law is found in Part 4 of Title 36. The applicable service provider tax rate is established by 36 M.R.S. § 2552. For more information see Instructional Bulletin No. 55 ("Service Provider Tax").

Title 36, MRS rules, forms and instructional bulletins that are referenced in this bulletin may be viewed on the MRS website, www.maine.gov/revenue.

1. GENERAL TYPES OF LEASING TRANSACTIONS

A. STRAIGHT (TRUE) LEASE. In a "straight" or "true" lease, the lessor enters into a lease agreement with a lessee for a stated period of time (including day-to-day, week-to-week, and similar leases) and the property is to be returned to the lessor at the conclusion of the lease term. The lessor is making a taxable use of the property through the derivation of rental income

in the State. The lessor is liable for a sales or use tax when the property enters the State (generally at the beginning of the lease), based on the purchase price paid by the lessor for the property. If sales tax was not paid directly to the vendor when the property was purchased, the lessor must report the use tax directly to MRS. **No sales tax is charged to the lessee, and the lease payments are not subject to sales or use tax.** If the property is returned to the lessor and leased to another Maine customer, no additional use tax is due.

B. TRUE LEASE WITH OPTION TO PURCHASE. In a true lease with option to purchase, the lessor enters into a lease agreement with the lessee for a stated period of time and offers the lessee a bona fide option to purchase the property at the conclusion of the term of the lease or at any time during the lease.

The lessor is making a taxable use of the property through the derivation of rental income in the State, just as in the "straight lease" situation described above. **The lessor is liable for sales or use tax** when the property enters the State (generally at the beginning of the lease) based on the purchase price paid by the lessor for the property.

If the lessee elects to exercise the option, the lessor is making a sale of the property. Unless the sale is otherwise exempt by statute, **the lessor must collect and remit sales tax on the option price**, including any amounts previously paid as rentals if those amounts are applied to that price.

For leases that have been deemed by the State Tax Assessor ("Assessor") to be in lieu of purchase, see paragraph C below.

C. LEASE IN LIEU OF PURCHASE. Any lease, including a lease of an automobile, that is deemed by the Assessor to be a lease "in lieu of purchase" is treated as a sale for tax purposes. The sale occurs at the commencement of the lease. The sale price on which tax is based is the total of all of the projected lease payments. Separately stated finance charges and personal property taxes may be excluded from the taxable base.

The Assessor may review the specific terms of a particular lease in order to determine whether it is a lease "in lieu of purchase." A lease will generally be a lease "in lieu of purchase" under the following circumstances:

- If the terms of the lease create a security interest as defined by 11 M.R.S. § 1-1201(35).
- If the lease contains an option to purchase the leased property for \$1.00 or other nominal consideration.
- If the lessee must assume responsibility for the disposition of the property at the end of the lease term; or if the lease is a so-called T.R.A.C. (Terminal Rental Adjustment Clause) lease.

If a lease is determined to be a lease in lieu of purchase and the term of the lease is indeterminable at the commencement of the lease, sales tax must be collected and remitted on each lease payment. If a lease in lieu of purchase is for a determinable period, but has an option to continue for a further indeterminable term, sales tax must be collected and remitted up front

on the determinable amount. When this period is complete, sales tax must then be collected and remitted on each subsequent lease payment.

Lessors are encouraged to contact MRS when uncertain whether a particular lease constitutes a lease in lieu of purchase.

D. INTERIM RENTALS. A retailer that purchases tangible personal property for resale then removes the property from inventory to rent out is generally required to pay use tax based on its cost of the property. However, 36 M.R.S. § 1758 allows the retailer, in lieu of paying this use tax, to collect a sales tax on all the rental payments received if the rental qualifies as an "interim rental." In order to qualify as an interim rental:

- The property must be purchased for resale; and
- The property cannot be rented to any one person for more than 12 months.

Any retailer that engages in interim rental transactions must maintain adequate records for audit purposes, detailing when each item is withdrawn from inventory, to whom the property is rented, the duration of the rental, and the amount of rental income and tax collected. If, after electing to execute an interim rental, a retailer makes any other taxable use of the property, including the rental to one customer for more than a year, the retailer becomes liable for the use tax based on the purchase price of the property, less the amount of tax collected on the rentals.

2. RENTALS AND LEASES SUBJECT TO SALES TAX

A. AUTOMOBILES. The Sales and Use Tax Law treats the rental and leasing of automobiles differently from the rental and leasing of other vehicles. The term "automobile" is defined as a self-propelled 4-wheel motor vehicle designed primarily to carry passengers, including a pickup truck or van with a registered gross vehicle weight of 10,000 pounds or less. See 36 M.R.S. § 1752(1-B). Under this definition, the term "automobile" would also include a 4-wheel all-terrain vehicle ("ATV"); see 36 M.R.S. §§ 1752 (1-B) and (7).

(1) Short-term rentals. Short-term rentals of automobiles are subject to sales tax at the separate, higher rate established by 36 M.R.S. § 1811. "Short-term" means a period of less than one year. A person that makes short-term rentals of automobiles may purchase the automobile free of tax, but must collect tax on each rental payment. The short-term rental rate also applies to the rental of pickup trucks and vans with a gross vehicle weight of up to 26,000 pounds, but only when the rental is by a person engaged primarily in the business of renting automobiles. The short-term rental rate does not apply to vehicles with more than four wheels, motorcycles, motor homes, or pickup trucks and vans weighing 26,000 pounds or more.

All rental payments made pursuant to a rental agreement executed in Maine are subject to tax regardless of where the rented automobile is used. The tax is based on the value of the rental, which means the total rental charged to the lessee for time and mileage including any other fees or services associated with the rental, without any deduction for separately

itemized charges. Separately stated fees associated with the rental of the vehicle that are taxable include, but are not limited to, the following:

- Maintenance and service contracts;
- Drop-off or pick-up fees;
- Airport surcharges;
- Intercity fees;
- One-way charges;
- Collision damage or loss damage waiver ("CDW" or "LDW") charges;
- Young driver charges;
- Additional driver charges;
- Additional keys;
- Mileage fees;
- Cost recovery fees, such as license recovery fees, concession recovery fees, title or registration fees, and other governmental fees;
- Rentals of additional equipment such as infant seats, ski racks, GPS systems, or toll transponders (e.g. E-Z pass); and
- Cleaning fees.

Separately stated fees that are not part of the taxable rental charge of the vehicle include, but are not limited to:

- Reimbursement of tolls;
- Charges for goods and services sold after the rental has terminated (such as fuel sales) and
- Sales of optional insurance coverage for the protection of the lessee or of the lessee's personal property (such as additional liability insurance, personal accident insurance, or personal effects protection).

(2) Long-term rentals. Long-term rentals of automobiles are subject to the general sales tax rate established by 36 M.R.S. § 1811. "Long-term" means 12 months or more. The tax is due in the month in which the lease begins. The tax base consists of the total monthly lease payments plus the equity of any trade-in plus any cash down payment. Total monthly lease payments are arrived at by multiplying the dollar amount of each lease payment by the number of payments in the lease term. Trade-in equity is the value of any trade-in that reduces the cost of the lease. (**Note:** unlike sales of automobiles, no deduction is allowed for trade-in allowances.) Cash down payment means any initial cash payment that reduces the cost of the lease, including rebates applied to the lease. Cash down payment does not include pre-payment of lease payments or required "up front" costs disbursed by the lessor such as sales tax, excise tax, and registration fees.

Taxes, such as excise taxes and sales taxes, are allowable exclusions from the tax base. Ancillary services such as registration fees, life/disability insurance, warranties, and management services, are excluded from the tax base only if separately stated from the lease payment. A fee charged when the lessee opts to return a vehicle to the lessor rather

than exercising the option to purchase it (sometimes called a "disposition fee") is not subject to sales tax.

Non-residents of Maine that enter into a long-term lease of an automobile with a Maine dealer may sign an "Immediate Removal Affidavit" (Form ST-A-106) if they are going to immediately remove the automobile from the State. If a properly completed affidavit is accepted by the dealer in good faith, the dealer is not required to collect sales tax on the lease transaction. Automobile dealers and lessors should see Instructional Bulletin No. 24 ("Vehicle Dealers") for more information.

B. MOTOR HOMES AND CAMPER TRAILERS. The rental or lease of a camper trailer or a motor home is a taxable service subject to the general sales tax rate established by 36 M.R.S. § 1811. The statutory definition of "retail sale" excludes the sale of a camper trailer or a motor home to a person engaged in the business of renting these items. This exclusion applies only if the motor homes or camper trailers are subsequently rented or leased as tangible personal property. If, instead, the motor homes or camper trailers are used to provide the rental of living quarters, the purchase of the motor homes or camper trailers do not qualify for the exclusion and are subject to sales tax. If a camper trailer or motor home is sold after having been rented for a period of time, the sale is subject to sales tax.

For purposes of this paragraph, "camper trailer" means a camper trailer as defined in 36 M.R.S. § 1481(1-A); and "motor home" means a motor home as defined in 29-A M.R.S. § 101(40). "Motor home" does not include a mobile home.

Note: A campground rental that may include the use of a motor home or camper trailer owned by the campground is a rental of living quarters and is subject to the higher rate as established in 36 M.R.S. § 1811.

3. RENTALS AND LEASES SUBJECT TO SERVICE PROVIDER TAX

The service provider tax is imposed upon the provider of the services rather than upon the customer. The statute allows, but does not require, the provider to pass the tax on to the customer. If the provider includes the tax on the customer's bill, it must be separately stated and identified clearly as service provider tax. For more information on the service provider tax, see Instructional Bulletin No. 55 ("Service Provider Tax").

A. RENTAL OF VIDEO MEDIA & EQUIPMENT. Rentals by any person of video media, (including video games, DVDs, Blu-ray discs, etc.) and video equipment used to record or play back video media are subject to the service provider tax. The taxable sale price includes any services that are part of the rental transaction. Taxable services include, but are not limited to, a late charge in the form of an additional day's rental, movie passes redeemable for a certain number of DVDs, and insurance or damage waiver fees.

The statutory definitions of "video media" and "video equipment" exclude commercial video tape and equipment rentals. Movies rented to theaters are not subject to tax.

A person engaged in the business of renting video media and video equipment is not required to pay sales tax on equipment purchased for subsequent rental. A resale certificate must be provided to the vendor. For more information, see Instructional Bulletin No. 54 ("Resale Certificates").

Note: If video media or video equipment are sold after having been rented for a period of time, the sale is subject to sales tax.

B. RENT-TO-OWN BUSINESSES. Many of the types of leases and rentals engaged in by "rent-to-own" businesses have both sales tax and service provider tax components. Businesses should be careful to account for their sales on the correct return and at the correct rate.

(1) Taxable rentals. Rentals of audio media, audio equipment, and furniture as defined by 36 M.R.S. §§ 2551(1) and (4) by "rent-to-own" businesses regulated under Title 9-A, Article 11, are subject to the service provider tax. Tax must be applied to each rental payment. If a customer elects to purchase the product being rented, sales tax must be collected on the buyout price at the time of the sale. See paragraph (3) below.

A person engaged in the business of renting audio media, audio equipment, or furniture is not required to pay sales tax on the purchase of these items to be rented. A resale certificate must be provided to the vendor. For more information on resale certificates, see Instructional Bulletin No. 54 ("Resale Certificates").

(2) Non-taxable rentals. "Rent-to-own" businesses should not collect sales tax or report service provider tax on the rental of products not included in the definition of audio media, audio equipment or furniture. This includes, without limitation:

- Electronic devices rented to businesses;
- Computers rented to businesses;
- Office equipment, such as photocopiers or fax machines;
- Fixtures affixed to realty;
- Tools & equipment; and
- Decorative furnishings.

When a rent-to-own business purchases any of these products, sales tax must be paid on the purchase price at the time of purchase. If these products are purchased without paying sales tax for any reason, use tax must be reported directly to MRS based on the purchase price.

(3) Option to purchase. If a customer elects to purchase a product being rented, sales tax is due on the transaction based on the buyout price. No credit is allowed for the sales or use tax previously paid by the lessor on the original purchase of the product or for the service provider tax paid by the lessor on the lease payments. If a customer elects to continue renting a product to the end of the term of the contract and the contract provides that at the end of the rental term the customer will own the item after the last payment is made, the last rental payment represents the "sale price". Sales tax, rather than service provider tax, must be computed on the final rental payment.

4. EXEMPT ORGANIZATIONS AND EXEMPT ACTIVITIES

The purchase of tangible personal property that is then leased to a governmental entity or exempt organization, or used by a lessee in an exempt activity under the terms of a straight lease or a lease with an option to purchase, is taxable to the lessor based on the purchase price. The fact that the property is rented by an exempt organization or used by a lessee in an exempt activity does not relieve the lessor from liability for use tax. The following are exceptions to this rule:

- Leases in lieu of purchase to agencies of the State or federal government, leases in lieu of purchase to organizations exempt under 36 M.R.S. § 1760, and leases in lieu of purchase of property used in an exempt activity, such as manufacturing, are exempt from sales tax. See Section 1(C) above for an explanation of leases in lieu of purchase.
- Certain purchases of depreciable machinery and equipment for lease to customers who are engaged in commercial agricultural production, commercial aquacultural production, commercial fishing, or commercial wood harvesting are eligible for a refund of sales or use tax. See Instructional Bulletin No. 59 ("Farming, Fishing and Wood Harvesting").
- Purchases of a portable classroom or tangible personal property to be physically incorporated into a portable classroom for lease to a school are exempt under 36 M.R.S. § 1760(58).

Purchase of repair or replacement parts for leased property by a lessee who is an exempt organization or is engaged in exempt activity are exempt from tax.

For more information on exempt sales to governmental agencies and exempt organizations, see Rule 302 ("Sales to Governmental Agencies and Exempt Organizations") and Instructional Bulletin No. 36 ("Exempt Organizations and Governmental Agencies").

5. OTHER SITUATIONS

A. ASSIGNMENTS (LESSOR). The transfer of title to leased property from one lessor to another lessor constitutes a taxable sale between the two lessors. However, if one lessor is assigning only the financing arrangements, no sale has occurred. Since leases in lieu of purchase are sales to the lessee (title being held by the lessee), a lessor's assignment of such a lease to another lessor does not constitute a taxable event and no sales tax liability is incurred by the assignment.

B. PRIOR USE OUTSIDE OF MAINE. Property that is used outside of Maine for more than 12 months by the present owner prior to being used in Maine is not subject to use tax. This includes leases executed outside of Maine since lessors are the "users" of the leased property. If a lessee subsequently makes use of the leased property in Maine, no use tax is due from the lessor. The exemption applies only if the use of the property outside of Maine during the 12 months after it was purchased was sufficiently substantial. Whether the use of any particular property outside of Maine during the 12-month period was sufficiently substantial is a case-specific determination depending upon all of the facts and circumstances.

C. "SALE/LEASEBACK" TRANSACTIONS. A "sale/leaseback" transaction occurs when a person purchases property, sells the property to a leasing entity, then leases the property back from the lessor. This type of financing arrangement is generally a combination of three separate transactions. The application of sales tax depends on a number of factors. Due to the complexity of these factors, each arrangement must be analyzed based on its own set of facts. Generally, the transactions will transpire as follows:

- The first transaction is the original purchase of the property by the end user (lessee), and is generally a taxable transaction unless a statutory exemption applies.
- The subsequent sale of the property from the purchaser to the leasing entity is the second transaction. This is generally a casual sale, not typically subject to tax unless it is an item listed in 36 M.R.S. § 1764.
- The taxability of the final transaction, the lease of the property back to the purchaser by the leasing entity (lessor), is determined primarily by the type of lease executed between the leasing entity and the purchaser. See Section 1 above.

For a discussion of sale/leaseback transactions involving machinery and equipment used in production (manufacturing), see Instructional Bulletin No. 22 ("Manufacturers").

D. SOFTWARE LICENSES. Software licenses are generally treated as leases and are taxable to the lessor based upon the purchase price. If the software lessor is also the developer of the software, the taxable cost of the product is based upon the lessor's material costs.

Software licenses that must be renewed on an annual basis are regarded as one-year licenses. The software is taxable to the lessor based on the lessor's purchase price at the time of the original licensing transaction. The lease amount and the cost of subsequent renewals have no sales or use tax consequences.

If the software license is perpetual or for 10 years or more (with no annual renewals), it is a lease in lieu of purchase. The lessor may purchase the software without paying sales tax, but must then collect sales tax from the lessee at the start of the lease based upon the total amount of the lease payments. Separately-stated finance charges may be excluded from the taxable base.

6. ADDITIONAL INFORMATION

The information in this bulletin addresses some of the more common questions regarding the Sales, Use and Service Provider Tax Laws faced by lessors. It is not intended to be all-inclusive. Requests for information on specific situations should be in writing, should contain full information as to the transaction in question, and should be directed to:

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