This notice has been corrected by Revenue Notice #02-20, please see that notice for the corrected language.

Minnesota revenue notice number 97-14

Sales and Use Tax - Leases of Tangible Personal Property

Introduction

A change enacted by the 1997 Legislature created a specific definition for “leasing” in Minnesota Statutes, section 297A.01, subdivision 22. This definition differentiates between an agreement that temporarily transfers possession of tangible personal property and an agreement that transfers title to tangible personal property.

Minnesota Statutes, section 297A.01, subd. 22, reads as follows: *"Leasing" includes all transfers of possession of tangible personal property or the use thereof by the lessee for a consideration when title remains with the lessor at the end of the lease. If a contract designated as a lease binds the lessee for a fixed term and the lessee is to obtain title at the end of the term of the agreement or has the option at that time to purchase the property for a nominal amount, the contract is regarded as a sale and not as a lease. For purposes of this chapter, a lease of tangible personal property is a series of transactions that impose upon the lessee multiple payment obligations. A taxable transaction is considered to have occurred when an obligation to make a lease payment becomes due under the terms of the agreement or trade practices of the lessor. For purposes of the subdivision, "nominal amount" means an amount so small, slight, or negligible that it is not economically significant and bears no relation to the real value of the item being purchased.*

Issues and Conclusions:

1. What clarification does the new language provide? Minnesota Statutes, section 297A.01, subd. 22 makes it clear that a contract where the lessor retains title to the property at the end of the contract is a lease, and sales or use tax is due on each lease payment. A contract is a sale if the lease provides that the lessee is to obtain title at the end of the contract, or if the lessee may obtain title for a nominal amount at the end of the contract. If the contract is a sale, sales or use tax is due on the entire contract amount at the time the contract is signed.

2. What is a "nominal amount"? For purposes of administering the provisions of Minnesota Statutes, section 297A.01, subd. 22, "nominal amount" is defined as one percent or less of the value of the tangible personal property at the time that the contract is signed.

3. How does this law change apply to existing leases? This law change is effective for leases entered into after June 30, 1997. Sales made or leases entered into prior to July 1, 1997 are subject to the laws and rules in effect at the time of the sale or lease. Tax treatment for extensions or renewals of leases will be determined by whether the lease, as originally signed, included an option to extend or renew the lease. The renewal or extension of an agreement originally entered into prior to July 1, 1997 that was considered a lease under prior law will continue to be treated as a lease under the renewal or extension. However, if the original agreement did not include an option to extend or renew the contract, the tax treatment will be determined based on whether the new contract is considered a sale or a lease under the new language above.

4, What tax rate will be refunded on leases of replacement capital equipment under this new language? Beginning July 1, 1997, the tax rate to be refunded on leases of replacement capital equipment is the rate in effect at the date the lease payment is made. This is true regardless of when the lease was originally signed. The statute now clearly indicates that a lease is a series of transactions taxable when the obligation to make a lease payment becomes due under the terms of the agreement. In other words, if tax rates increase or decrease over the term of a lease agreement, the tax rate on lease payments changes accordingly.

This is a change from past practice. Prior to this law change the department took the position that the rate of refund for replacement capital equipment was fixed at the time the lease was entered into. Thus, even though the rate of refund for replacement capital equipment increased each year, the purchaser was only eligible for a refund of the tax at the rate in effect at the time the lease was originally entered into.

5. How does this law change apply to motor vehicles? Vehicles are often financed using a lease agreement that includes a buyout option at the end of the agreement. The new law clarifies that a transaction designated as a lease will be considered a sale if the agreement provides that the lessee is to obtain title at the end of the term of the agreement or has the option at the time to purchase the property for a nominal amount. Under these agreements, the lessor collects and reports the general Minnesota sales or use tax to the Department of Revenue on all lease payments. If the customer exercises their option to purchase the vehicle, the sales tax on motor vehicles is reported to the Department of Public Safety on the buyout amount.

Effective date

This revenue notice is effective for leases or sales made on or after July 1, 1997.

Dated: 8 December 1997

Jennifer L. Engh
Assistant Commissioner for Tax Policy