In January, the Ohio Department of Taxation issued a draft letter to vendors on changes resulting from the up-front sales and use tax treatment of leases in Ohio. While it anticipated revisions by the end of January, the Department of Taxation believed the advisory is the generally the information it would make available to vendors and sellers. Consult the news section of ELA Online for the final guidelines released after publication of this edition of ELT.

Enacted with the passage of Ohio House Bill 405, the up-front tax is applicable to consumer and commercial leases of motor vehicles, watercraft, aircraft, and leases of all other tangible personal property with a business use. The legislation is available online. Go to www.legislature.state.oh.us. On the left it says Current Legislation 2001-2002. Type in “405” next to “Find Bill Number” and click on “House” below it. Then click on “Go” On the next screen click on “View Bill Text.” See Section 40 of the legislation for text related to the accelerated sales tax on leasing.

Implementation was scheduled for February 1, 2002. Questions can be directed to Tim Sachs, Ohio Department of Taxation at timothy_sachs@tax.state.oh.us. Please copy ELA and/or send additional issues or inquiries to dbrown@elamail.com. Your questions can be presented to the Department by ELA if you don’t wish to disclose your company name.

ELT thanks ELA Vice President, State Government Relations Dennis Brown for this month’s column.
Advisory Letter Issued January 2002
Subject to Revision on February 1, 2002

To All Ohio Vendors:

The Ohio 124th General Assembly recently passed Amended Substitute House Bill 405, which made significant changes in the way Ohio sales and use tax is applied to the lease of motor vehicles, watercraft, outboard motors, and aircraft. The change in the law also applies to tangible personal property used for business purposes. Effective February 1, 2002, the sales tax on leases of these types of property will be computed and paid at the beginning of the lease rather than on the monthly payments. The following information will explain the changes of the law and how they may apply your business.

Statutory Law

Section 5739.01 (H) (4) has been added to the definition of “Price.” It states: “In the case of the lease of any motor vehicle designed by the manufacturer to carry a load of not more than one ton, watercraft, outboard motor, or aircraft, or the lease of any tangible personal property, other than motor vehicles designed by the manufacturer to carry a load of more than one ton, to be used by the lessee primarily for business purposes, the sales tax shall be collected by the vendor at the time the lease is consummated and shall be calculated by the vendor on the basis of the total amount to be paid by the lessee under the lease agreement. If the total amount of the consideration for the lease includes amounts that are not calculated at the time the lease is executed, the tax shall be calculated and collected by the vendor at the time such amounts are billed to the lessee. In the case of an open-end lease, the sales tax shall be calculated by the vendor on the basis of the total amount to be paid during the initial fixed term of the lease, and then for each subsequent renewal period as it comes due.

Additions similar to the above were made to the Use Tax code in Section 5741.01 (G) (6).

Section 5739.01 (VV) has been added. It defines the term “lease”. “Lease” means any transfer for a consideration of the possession of and right to use, but not title to, tangible personal property for a fixed period of time greater than twenty-eight days or for an open-ended period of time with a fixed period of more than twenty-eight days.

Explanation

This change in the sales and use tax law applies to qualifying lease contracts entered into on or after February 1, 2002. The price on which sales tax is collected “up front” is the total amount to be paid from the beginning of the lease and throughout the term of the lease contract. Tax on additional charges that are not calculated at the time the lease is consummated must be collected at the time those charges are billed to the lessee. Examples of this type of charge would be an excess mileage charge or a reimbursement of personal property tax.

There are many questions that arise as a result of the law change. Below you will find basic questions and answers to assist you in implementing the new law. At a later date, there will be more detailed information available on the Department of Taxation website, www.state.oh.us/tax.

Q1) To what items does the new law apply?

A1) The law specifically lists motor vehicles, watercraft, outboard motors and aircraft. (Note the exclusion of motor vehicles designed by the manufacturer to carry a load of more than one ton. A lease of this type of vehicle will still be subject to the tax on each monthly lease payment as treated under prior law). Also included under the law is “tangible personal property used primarily for business purposes.” This includes, but is not limited to, leases of computers, computer peripherals, canned software, furniture, machinery, plants, wall hangings, communication equipment, and any other personal property used by a business.

Q2) How is the “price” determined for computing the up-front sales tax?

A2) The price on which to compute the sales tax is the total amount to be paid by the lessee under the lease agreement. The change in the law requires that price includes the value of the lease payments over the term of the lease. For example, if the lease calls for 48 payments of $300.00, total payments would be $14,400.00. This amount would be taxable at the time the lease is consummated. As under prior law, tax would also apply to other charges that are related to the lease of motor vehicles, watercraft, aircraft and other personal property including but not limited to: down payments, manufacturer rebates, interest, and documentary fees.

Refundable deposits are not taxed up front. Should part of the deposit be held at the end of the lease to cover taxable charges and fees, the tax on that portion will be collected as lease end.
In the case of the lease of a NEW motor vehicle, or a new or used watercraft or outboard motor, price may be reduced by the value of a trade-in of the same type item. The amount for the trade-in allowance should be deducted from price before the value of the lease payments is computed.

Q 3) Who collects the tax and where is it paid?
A 3) The vendor collects and remits the tax. This is the person with whom the lessee negotiates the transaction, to whom the down payment or initial lease payment is made, and from whom delivery of the leased item is taken. The vendor will pay the tax on the appropriate Ohio sales or use tax return. The vendor is entitled to the .75% discount of the tax for returns that are paid and received in a timely manner.

Q 4) When is the tax to be collected and remitted?
A 4) The tax is to be collected at the time the lease is “consummated.” For purposes of sales and use tax, the lease will be considered to be consummated when the property which is the subject of the lease is delivered or the initial payment under the lease is required to be made, whichever is earlier. Charges such as interim interest payable during the period the lease property is being produced are not considered to be the initial payment on the lease. Such charges are part of the taxable price of the leased property and tax should be collected and remitted separately on these charges. Tax is to be remitted on the sales or use tax return for the period in which the lease is consummated.

Q 5) What is the rate of tax to collect?
A 5) In the case of a lease of a motor vehicle, watercraft or outboard motor, the dealer must collect the tax at the rate of the customer’s county of residence as reflected on the certificate of title. In the case of the lease of an aircraft, the vendor should collect the tax at the rate where the aircraft is based. For other tangible personal property used for business purposes, the vendor should collect tax at the rate where the property is to be primarily located and used. Non-Ohio vendors must collect the tax at the point of use of the property.

Q 6) What is the appropriate sales or use tax account under which to report and pay the tax?
A 6) In-state businesses that facilitate lease transactions will need two accounts on which to report their sales/lease transactions: a regular county vendor’s license and an Ohio transient vendor’s license, license number 89-X5XXXX. Out-of-state sellers will need an Ohio seller’s use tax account, account number 99-XXXXXXX.

Q 7) What is to be reported on each of the sales and/or use tax returns?
A 7) A vendor that facilitates the lease transaction is effecting two sales, the sale of the property to the leasing company and the lease of the property to the lessee. The sale to the leasing company should be reported on the return for the retailer’s regular vendor’s license (Form ST-10) as an exempt sale. The amount of the sale would be reported on line 1, Gross Sales, and subtracted on line 2, Exempt Sales.

The tax collected up front on the lease transaction will be reported and remitted on the return for the transient vendors license (Form UST-1). The amount of the sale, and the tax will be listed on the supplemental portion of the return on the line for the county rate that was collected. The lease transaction amount is reported on line 1, Gross Sales. The amount of the sale is everything included in the “price” as described in A2, above. If the lease is not subject to the tax, it should be subtracted on line 2 and not reported on a line in the supplemental portion of the return. Any taxable lease would be included in lines 3 and 5. The actual tax is stated on line 6. If the vendor files the return so as to be timely received and paid by the due date, the vendor may deduct a discount of .75% of the tax on line 7. If the return is not received and paid timely, an additional charge of $50.00, or 10% of the tax on line 6, whichever is greater, should be added on line 8. The net amount due on line 9 should be paid to the Ohio Department of Taxation.

An Ohio leasing company that only leases property directly to lessees will report and pay the tax on a transient vendor’s license. An out-of-state leasing company that only leases property directly to lessees will report and pay the tax on a seller’s use tax account.

Q 8) If the lease is terminated prior to the lease term, is there a refund for any of the sales tax previously paid?
A 8) No. There is no provision in the Ohio Revised Code for a refund of the tax, unless the entire purchase price is refunded to the customer.

Q 9) Is sales tax due on charges that are not calculated at the time the lease is consummated?
A 9) If the lessor assesses fees for items such as property tax reimbursement, excessive wear or mileage, either during the lease period or at the end of the lease, sales tax must be collected on these fees at the time they are billed. This tax collected should be reported.
and paid on the lessor’s regular sales or use tax return.

No tax would be due on any early termination fee if that fee represents a recovery for the unpaid amounts on the lease that have already been subject to up-front taxation. If the customer decides to purchase the property, tax should be collected on the purchase price and any other fees associated with the transfer of ownership. For motor vehicles, watercraft and outboard motors, tax should be paid to the Ohio Clerk of Courts at the rate in effect in the customer’s county of residence. For other property, the tax should be paid on the leasing company’s Ohio Transient Vendors License.

Q 10) What about existing leases entered into prior to February 1, 2002?

A 10) The method of tax collection on these leases will remain the same as under prior law. Tax should be collected on each monthly payment through the end of the lease. Tax should be charged on any fee for the early termination of such a lease. Similarly, additional fees such as property tax reimbursement, or excessive wear or mileage charges would be taxable as they are billed.

Lease contracts entered into prior to February 1, 2002 may provide for extensions of the original lease. If the extension contains the same provisions of the original lease, the tax shall continue to be collected and reported on the monthly lease payments. However, if the provisions of the original lease are changed by the extension change, this constitutes a new lease and tax would be collected up front according to the terms of the new lease contract.

Q 11) When is a lease “entered into” as it pertains to the February 1, 2002 date?

A 11) For purposes of applying the “grandfather” provision of Sub. H.B. 405, the Department of Taxation will consider a lease “entered into” when the parties are obligated to the terms of the lease and the specific motor vehicle, watercraft, outboard motor, aircraft, or tangible personal property that is the subject of the lease is identified, and steps toward performing the lease have been undertaken. For example, assume a lessor and a lessee have agreed to the lease of an airplane, an order has been placed and the airplane is being manufactured for delivery to the lessor, prior to February 1, 2002. In this case, the parties have obligated themselves to the lease, the specific property has been identified and performance has been undertaken by having production of the airplane initiated. This lease would qualify under the grandfather clause as one to be treated under the terms of the law that existed prior to that date.

Often lessors and lessees will enter into contracts whereby a lessor will agree to lease property to a lessee where the specific items that are subject to the lease is not identified in the lease or the property leased may change over time. Some examples of this type of agreement may by styled master lease, lease line or fleet lease. Many of these contracts have been in existence for many years. In determining the application of the “grandfather” provision to these agreements, the Department of Taxation will look to the date when each specific motor vehicle, watercraft, outboard motor or other tangible personal property was identified and included in the lease. In other words, we will consider each item to be separately leased under the terms of the pre-existing contract. For example, a lessee with an agreement to lease a fleet of motor vehicles from a lessor orders new vehicles to be covered by the lease on March 1, 2002. The lease of these newly identified vehicles would be taxable at the time the lease is consummated on the total amount to be paid on under the lease agreement for those vehicles. The existing fleet on January 31, 2002 would continue to be taxed on the monthly installments.

Q 12) A lessor may advance the tax money to the lessee and finance the tax over the term of the lease. If this is done, is the repayment of the tax and any interest on that repayment subject to tax?

A 12) The repayment of the financed tax and any interest on that financed tax are not part of the tax base of the lease for sales and use tax purposes where the records of the lease document the total price on which the tax is calculated and the tax due on the lease. It would be preferable, though not required, that the financed tax portion of the lessee’s payment be separately stated on lease billings.

If you should have any other questions, please contact our Taxpayer Service Center at 1-888-405-4039.

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