

Thursday, September 22, 2011

Mr. Scott Peterson
Executive Director
Streamlined Sales Tax Governing Board
4219 Hillsboro Pike, Suite 234
Nashville, TN 37215

RE: Kansas and West Virginia Recertification

Dear Mr. Peterson,

The Equipment Leasing and Finance Association (ELFA) submits herein comments for consideration during this year's recertification review of Kansas and West Virginia and active lease regulation in the respective states that is inconsistent with SSUTA's administrative definition of a Lease and rental.

ELFA concerns with the lease regulations in these two states are articulated as follows:

Kansas

Kansas Regulation 92-19-3a provides the following in defining a Lease:

92-19-3a(a)(6) "Financing lease" means a conditional-sale contract that is denominated a lease, but that is intended to finance a lessee's purchase of goods or its continued possession of goods under a sale-leaseback agreement. A lessor shall be presumed to have entered into a financing lease if the lessor accounts for the lease transaction as a financing agreement for federal income tax purposes. The term "capital lease" shall be considered synonymous with "financing lease."

92-19-3a(a)(1) "Conditional sale" means a sales transaction made pursuant to a written agreement that is treated as a sale of goods for federal income tax purposes in which the buyer gains immediate possession or control of the goods but the seller or a financial institution retains title to or a security interest in the goods to ensure its future receipt of full payment before clear title is transferred to the buyer in possession or control of the goods. Conditional sale contracts include "financing leases."

92-19-3a(a)(10) "Operating lease" has the meaning specified in K.A.R. 92-19-55b.

92-19-55b(a)(6) "Operating lease" shall mean a lease agreement that gives the lessee possession or control of goods for a fixed or indeterminate period, while the lessor retains all or substantially all of the risk and rewards of ownership of the goods. This term shall be synonymous with "true lease."

This Regulation for Leases in Kansas is inconsistent with the second to last paragraph of SSUTA's administrative definition of Lease or Rental and also inconsistent with Kansas statute (Sec. 79-3602(r)(3)) which provide as follows:

This definition shall be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the internal revenue code, the uniform commercial code, K.S.A. 84-1-101 et seq. and amendments thereto, or other provisions of federal, state or local law.

West Virginia

West Virginia Regulation Section 110-15-129 provides the following in defining a Lease:

110-15-129.2. Certain terms used in this section have the following meanings for purposes of application of this regulation:

110-15-129.2.1. Financing Lease.—The term "financing lease" means:

110-15-129.2.1.1. A lease contract which contains at the inception of the contract a provision or condition that (1) title to the leased property must be transferred to the lessee at the end of the lease, or (2) the lessee has an option to purchase the leased property at a nominal price.

110-15-129.2.1.2. A lease contract containing either of the following provisions or conditions at the inception of the contract is presumed to be a financing lease:

110-15-129.2.1.2.a. The primary lease term is equal to seventy-five percent (75%) or more of the estimated economic life of the property (determined at the time the primary term of the lease begins) and makes no provision for the return of the property to the lessor. For used property, this provision does not apply if the beginning of the lease term falls within the last twenty-five percent (25%) of the total estimated economic life of the leased property, or

110-15-129.2.1.2.b. The residual value of the leased property is less than ten percent (10%) of the property's fair market value at the inception of the lease and the contract makes no provision for the return of the property to the lessor.

110-15-129.2.1.3. The presumption that the contract is a financing lease may be rebutted by showing that the contract is not merely a security device, that the property will be usable for its intended purpose at the end of the primary lease term, that the lessor in good faith intends to reclaim possession of the property at the end of the lease term or to sell or re-lease it at that time for its fair rent or fair market value, and that the lease was not treated by the lessor as a sale of tangible personal property or by the lessee as the acquisition of a capital asset.

110-15-129.2.2. Lease.—The term "lease" means a transaction in which possession but not title to tangible personal property is transferred for a consideration. The term "lease" includes a rental, hire or license. Likewise, "lessor" includes a rentor, hirer or licensor; and "lessee" includes a rentee, hiree or licensee. For the purpose of these regulations, a lease must be made for bona fide consideration with lease payments approximating fair market lease payments at the time the lease contract is entered into.

110-15-129.2.3. Nominal Price.—The term "nominal price" means consideration for obtaining technical title to leased property which is significantly less than the fair market value of the tangible personal property at the time the consideration is paid or the option to purchase is exercised, whichever occurs first.

110-15-129.2.4. Operating Lease.—The term "operating lease" means a lease contract which gives the lessee use of the leased property for a certain period, while the lessor retains all or substantially all of the risk and rewards of ownership. For purposes of the consumers sales and use taxes, a contract in the legal form of a lease will be treated as an operating lease unless it meets the definition of a financing lease.

This Regulation for Leases in West Virginia is inconsistent with SSUTA's administrative definition of Lease or Rental and what is deemed a 'nominal option price'. The regulation also employs generally accepted accounting principles for the determination of a lease which is also inconsistent with the second to last paragraph of SSUTA's Lease or rental definition. The pertinent subsections of SSUTA's lease definition are recited below:

A transfer or possession or control of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price does not exceed the greater of one hundred dollars or one percent of the total required payments;

This definition shall be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the internal revenue code, the uniform commercial code, K.S.A. 84-1-101 et seq. and amendments thereto, or other provisions of federal, state or local law.

ELFA worked eighteen months with Streamline participating states to create a lease and rental definition with simplified characteristics to make it easy for member states, lessors and lessees to have certainty on transactions that are be treated as a lease or rental, and those that are not. Kansas and West Virginia have failed to implement this simplicity into their regulation.

We raise the follow questions for guidance from CRIC:

- When do active state regulations that are inconsistent with the conforming statute of Streamline member states put a state's compliance at risk?
- Is the two years SSUTA provides for a state to enact conforming legislation a reasonable timeline for member states to align their regulations with the SSUTA provisions?

ELFA acknowledges that in the hierarchy of law, statute always prevails over the regulation. Our concerns are the consistent application of SSUTA's provisions by both taxpayers and state auditors. Regulations are generally more explanatory and for this reason often referred to by taxpayers and auditors for interpretive guidance on how to apply the statute. In the spirit of consistent application of SSUTA provisions, ELFA urges CRIC to weigh in on this matter during this year's annual compliance recertification.

Thank you in advance for your time and consideration.

Dennis Brown
Vice President
State Government Relations