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AMENDATORY SECTION (Amending WSR 96-03-139, filed 1/24/96, effective 2/24/96)

WAC 458-20-211 Leases or rentals of tangible personal property, bailments. (1) **Introduction.** This section explains how persons are taxable who rent or lease tangible personal property or rent equipment with an operator. (~~RCW 82.04.050(4) was amended by chapter 25, Laws of 1993 sp. sess. to specifically include the rental of equipment with an operator as a retail sale. However, as will be explained in more detail below,~~) It explains that some activities performed by operated equipment may be taxable under classifications other than retail sales if the operator and equipment perform activities as a prime contractor or subcontractor and these activities are specifically classified under other tax classifications by the revenue act.

(2) **Definitions.**

(a) The terms "leasing" and "renting" are used interchangeably and refer generally to the act of granting to another the right of possession to and use of tangible personal property for a consideration. When "lease," "leasing," "lessee," or "lessor" are used in this section, these terms are intended to include rentals as well, even if not specifically stated.

Persons may not claim to be leasing or renting equipment to themselves since they are not granting to another the right of possession.

(b) The term "bailment" refers to the act of granting to another the temporary right of possession to and use of tangible personal property for a stated purpose without consideration to the grantor.

(c) The term "subcontractor" refers to a person who has entered into a contract for the performance of an act with the person who has already contracted for its performance. A subcontractor is generally responsible for performing the work to contract specification and determines how the work will be performed. In purchasing subcontract services, the customer is primarily purchasing the knowledge, skills, and expertise of the contractor to perform the task, as distinguished from the operation of the equipment.

(d) The term "rental of equipment with operator" means the

provision of equipment with an operator to a lessee to perform work under the specific direction of the lessee. In such cases the lessor is generally not responsible for performing work to contract specification and does not determine how the work will be performed. Though not controlling, persons who rent equipment with an operator typically bill on the basis of the amount of time the equipment was used.

(e) The term "true object test" as it relates to this section means the analysis of a transaction involving equipment and an operator to determine if the lessee is simply purchasing the use of the equipment or purchasing the knowledge, skills, and expertise of the operator beyond those needed to operate the equipment. Even if it is determined that the customer is purchasing the knowledge, skills, and expertise of the operator, the transaction may still be a retail sale if the activity is specifically included by statute within the definition of a retail sale. This test can also be applied to rentals of tangible personal property when the seller performs some service in connection with the rental.

(f) The term "true lease" (often referred to as an "operating lease") refers to the act of leasing property to another for consideration with the property under the dominion and control of the lessee for the term of the lease with the intent that the property will revert back to the lessor at the conclusion of the lease.

(g) The term "financing lease" (often referred to as a "capital lease") typically involves the lease of property for a stated period of time with ownership transferring to the "lessee" at the conclusion of the lease for a nominal or minimal payment. The transaction is structured as a lease, but retains some elements of an installment sale. Financing leases will generally be taxed as if they are installment sales. The presence of some or all of the following factors indicates a financing lease with the transaction treated as an installment sale:

(i) The lessee is given an option to purchase the equipment, and, if so, the option price is nominal (sometimes referred to as a "bargain purchase option");

(ii) The lessee acquires equity in the equipment;

(iii) The lessee is required to bear the entire risk of loss;

(iv) The lessee pays all the charges and taxes imposed on ownership;

(v) There is a provision for acceleration of rent payments; and

(vi) The property was purchased specifically for lease to this lessee.

(3) A true lease, rental, or bailment of personal property does not arise unless the lessee or bailee, or employees or

independent operators hired by the lessee or bailee actually takes possession of the property and exercises dominion and control over it. Where the owner/lessor of the equipment or the owner's/lessor's employees or agents maintain dominion and control over the personal property and actually operate it, the owner/lessor has not generally relinquished sufficient control over the property to give rise to a true lease, rental, or bailment of the property.

(4) RCW 82.04.050 excludes from the definition "retail sale" any purchases for the purpose of resale, "as tangible personal property." Persons who use equipment in performing services either as prime contractors or as subcontractors are not purchasing the equipment for purposes of reselling the equipment as tangible personal property. These contractors must pay retail sales tax or use tax at the time the equipment is acquired. Generally persons who rent equipment with an operator are not purchasing the equipment for resale as tangible personal property and must pay retail sales or use tax at the time the equipment is acquired. Persons renting operated equipment to others may purchase the equipment without payment of retail sales tax only when the equipment is rented as tangible personal property. This can be demonstrated only when:

(a) The agreement between the parties is designated as an outright lease or rental, without reservations; and

(b) The lessee acquires the right of possession, dominion, and control of the equipment, even to the exclusion of the lessor.

This last requirement is a factual question and the burden of proof is upon the owner/operator of the equipment to establish that the degree of control has been relinquished necessary to constitute a lessor-lessee relationship. Weight will be given to such factors as who has physical, operating control of the equipment; who is responsible for its maintenance, fueling, repair, storage, insurance (risk of loss or damage), safety and security of operation, and whether the operator is a loaned employee. If control of these factors is left with the owner/operator, then as a matter of fact, there has not been a relinquishing of control of the equipment to the degree necessary to create a lessor-lessee relationship for the rental of tangible personal property. This is true, even though the customer exercises some constructive control over such matters as when and where the equipment is used in connection with the construction work being performed, i.e., the contractor controls the job site.

(5) Business and occupation (B&O) tax.

(a) Outright rentals of bare (unoperated) equipment or other tangible personal property as well as leases of operated equipment are generally subject to the retailing classification of the business and occupation tax.

(i) When a lessor purchases equipment for bare rental or lease, the seller of the equipment is making a wholesale sale to the lessor and is required to obtain a resale certificate for sales made before January 1, 2010, or a reseller permit for sales made on or after January 1, 2010, from the lessor to document the wholesale nature of any sale as provided in WAC ((458-20-102)) 458-20-102A (Resale certificates) and WAC 458-20-102 (Reseller permits). Even though resale certificates are no longer used after December 31, 2009, they must be kept on file by the seller for five years from the date of last use or December 31, 2014.

(ii) Under unique circumstances when equipment is rented for rereant by the lessee, without intervening use, then the original rental is subject to the wholesaling classification of tax and the subsequent rental is subject to the retailing classification. The original seller is required to obtain a resale certificate (WAC 458-20-102A) for sales made before January 1, 2010, or a reseller permit (WAC 458-20-102) for sales made on or after January 1, 2010, for these wholesale sales.

(iii) Persons who purchase equipment for use as prime contractors or subcontractors are considered to be the consumers of these purchases. They are the consumers because they are not specifically reselling the tangible personal property. Persons selling equipment to these persons are retailers and subject to the retailing B&O tax.

(b) Persons who provide equipment or other tangible personal property and, in addition, operate the equipment or supply an employee to operate the same for a charge, without relinquishing substantial dominion and control to the customer, are providing a service that is classified as a retail sale unless the nature of the activity is specifically classified under another tax classification. Where a specific tax classification applies to the activity, the income is subject to the business and occupation tax (or public utility tax) according to the classification of the activities performed by the equipment and operator. In the case of building construction, it will be presumed that the rental of equipment with operator to a contractor is a retail sale unless the operator has responsibility for performing construction to contract specifications and assumes control over how the work will be performed.

(c) Under some circumstances, the leasing or renting of tangible personal property can be subject to the special "retailing of interstate transportation equipment" B&O tax classification. This classification applies if the sale is exempt from retail sales tax because of the specific tax exemptions of RCW 82.08.0261, 82.08.0262, or 82.08.0263. These exemptions apply primarily to sales to private or common carriers who are engaged in interstate or foreign commerce.

(d) The following examples show how the tax would be applied to certain situations.

(i) The charge made by a subcontractor to a prime construction contractor for use of equipment with an operator used in the paving of a parking lot as part of the construction of a building would be taxable under wholesaling--other when the subcontractor has the responsibility to perform the work to contract specification and determines how the work will be performed.

(ii) A contractor performing work to contract specification making a charge to a city for use of equipment and operator in the construction of a publicly owned road would be taxable under public road construction.

(iii) Income for loading of a vessel using equipment with an operator is taxable under the stevedoring classification.

(iv) Income from transporting persons or property for hire by motor vehicle, including leasing or renting motor carrier equipment with driver, is generally taxable under either motor transportation or urban transportation.

(v) A customer rents scaffolding and the seller is responsible for a technician to setup, move, and dismantle it. This is the rental of tangible personal property since the true object of the transaction is having the scaffolding available for use by the customer. The customer also assumes dominion or control over the scaffolding by determining who will use the scaffolding and by controlling the use of the scaffolding.

(vi) Income from transporting persons or property for hire by vessel is not a retail equipment rental with operator.

(6) **Retail sales tax.** Persons who rent or lease tangible personal property to users or consumers are required to collect from their lessees the retail sales tax measured by gross income from rentals as of the time the rental payments fall due.

(a) RCW 82.04.050 excludes from the definition of the term "retail sale," purchases for resale "as tangible personal property." Thus the retail sales tax does not apply upon sales of tangible personal property to persons who purchase the same solely for the purpose of renting or leasing such property without operators. However, the retail sales tax applies upon sales to persons who provide such property with operators for a charge, without relinquishing substantial dominion and control, or who intend to make some use of the property other than or in addition to renting or leasing.

(b) Financing leases are treated for state tax purposes as installment sales. The retail sales tax applies to the full selling price. Refer to WAC 458-20-198.

(c) The retail sales tax does not apply to lease payments made by a seller/lessee under a sale/leaseback agreement in respect to property, equipment, and components used by the seller/lessee primarily in the business of canning, preserving,

freezing, or dehydrating fresh fruits, vegetables, and fish. Nor does the sales tax apply to the purchase amount paid by the lessee pursuant to an option to purchase this specific kind of processing equipment at the end of the lease term. (See RCW 82.08.0295.) In both situations the availability of this special sales tax exemption is contingent upon the seller/lessee having paid retail sales tax or use tax at the time of acquisition of such special processing property, equipment, and components. The use tax will also not apply if the sales tax does not apply.

(7) **Use tax and/or deferred retail sales tax.** Consumers who rent or lease tangible personal property from others and who have not paid the retail sales tax to their lessors are liable for the retail sales tax or use tax on the amount of the rental payments as of the time the payments fall due unless an exemption from the tax applies. However, if the rental payments do not represent a reasonable rental value for the article, the taxable value shall be determined according to the rental charges made by other sellers of similar articles of like quality and character. This can include using the rate of return as a percentage of the capitalized value that lessors of the particular type of property are generally using in rate setting.

In some cases lessors may lease articles wherein the lease payments do not include property taxes or insurance. These leases are often referred to as "net leases" with the insurance and taxes paid directly by the lessee. If the lessor is the party insured and the party legally liable for payment of the taxes, the payments made directly by the lessee must be treated as additional consideration to the lessor and subject to the retailing and retail sales tax.

(a) Bailment. The value of tangible personal property held or used under bailment is subject to use tax if the property was purchased or acquired under conditions whereby the retail sales tax was not paid by the bailor. Tax liability is that of the bailor, or of the bailee if the bailor has not paid the tax. The measure of the tax to the bailor is the fair market value of the article at the time the article was first put to use in Washington. The measure of the use tax to the bailee for articles acquired by bailment is the reasonable rental with the value to be determined as nearly as possible according to the rental price at the place of use of similar products of like quality and character. In the absence of rental prices for similar products, the reasonable rental may be computed by prorating the retail selling price over the period of possession had by a bailee and payable in monthly installments. No further use tax is due upon property acquired by bailment after tax has been paid by the bailee or any previous bailee upon the full original value of the article.

(b) Use tax does not apply to use by a bailee of any

article of tangible personal property which is entirely consumed in the course of research, development, experimental, and testing activities conducted by the user, providing the acquisition or use of such articles by the bailor are exempt from sales or use tax. (RCW 82.12.0265.)

(8) **Examples.** The following examples identify a number of facts and then state a conclusion. These examples should be used only as a general guide. The tax results of other situations must be determined after a review of all of the facts and circumstances. In some situations it may be difficult to determine if the transaction is a retail equipment rental with operator. If in doubt as to whether a particular rental with an operator is a retail sale, taxpayers should contact the department for a specific ruling.

(a) ABC Crane is hired to supply a crane and operator to lift air conditioning equipment from the ground and hold it in place on the roof of a six-story building while the prime construction contractor bolts the unit down. ABC Crane's operator will retain control over the crane. ABC Crane has no responsibility to attach wiring, plumbing, or otherwise make the unit operational. ABC Crane is renting equipment with an operator since it has no responsibility to perform actual construction to contract specification. The activity of renting a crane with an operator is a service included within the definition of a retail sale and is not otherwise tax classified elsewhere within the revenue act. The purchase of the crane by ABC is also a retail transaction because ABC retained control over the crane and is not renting the crane as tangible personal property.

(b) ABC Crane is hired by a prime contractor to install a neon sign on the side of a new six-story building which is being constructed. ABC is responsible for making certain that the sign is correctly fastened to the side of the building and for installation of the electrical connections and meets the proper building codes. ABC is directly involved in construction and performs work to contract specification. Since the work is being done for the prime contractor for further resale, this is a wholesale sale, provided a resale certificate (WAC 458-20-102A) is obtained for sales made before January 1, 2010, or a reseller permit (WAC 458-20-102) for sales made on or after January 1, 2010. Had ABC only been hired to hold the sign in place while the prime contractor fastened it, this would have been a retail rental of equipment with operator.

(c) XYZ Concrete Pumping is hired by a prime contractor to supply a concrete pump and operator to pump concrete from a premix concrete delivery truck to the location of the forms. XYZ has no responsibility to build forms, do the concrete finishing, or otherwise see that the concrete meets or is placed according to contract specifications. In short, the pump

functions similarly to a wheelbarrow, but in a more efficient manner. XYZ is not a subcontractor and is making a retail rental of equipment with an operator.

(d) ABC Company purchases a crane which it rents to others as a bare rental. It periodically rents the crane to lessees on this basis for two years. Beginning in the third year of ownership of this crane, ABC decides to start providing these customers with an employee to operate the crane. The employee will operate under the direction of ABC with ABC retaining dominion and control over the crane. Does ABC owe use tax on the crane, and if so, what is the measure of the use tax?

ABC owes use tax upon the first use of the crane as a consumer. This occurred in the third year of ownership when ABC began supplying an operator. The measure of the tax is the retail market value of the crane at the time it is put to use by ABC.

(e) Farm Services, Inc. specializes in the cutting and baling of hay for farmers. The hay, after being cut and baled, is sold by the farmer. Farm Services is not making a retail rental of equipment with operator, but is engaged in a farming for hire activity which is taxable under the service and other business activities B&O tax classification. See WAC 458-20-209.

(f) Helicopter, Inc. contracts with Logs, Inc. to move logs from where they have been cut in the woods to a landing approximately one mile away where the logs will be sorted, loaded on trucks, and transported to a mill. Total control over the helicopter operation rests with Helicopter, Inc. This is not a rental of equipment with an operator, nor is it considered as an air transportation service. This activity is directly part of the timber extracting and harvesting activity and is taxable as extracting for hire.

(g) ABC Sound Productions provides lighting, amplifying equipment, and speakers as part of the services it sells to entertainment promoters. ABC also provides several operators of the equipment. This is a rental of equipment with operator. In applying the true object test, the promoter is primarily purchasing the use of the lighting and sound equipment. The performer or promoter could be expected to specify the color, location, and degree of lighting and may also request changes and modifications to the level of sound amplification during the performance.

(h) John Doe purchased a vessel which will be rented to others as a bare boat rental. The rentals will be arranged through an agent at a marina. The marina receives a commission based on any usage of the vessel, including usage by the owner. The rental of the boat is a retail sale when the boat is rented to others. The usage of the boat by John Doe is not a rental. Since John Doe will be using the boat at times for his own use, he may not purchase the boat for resale.

