

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition)	<u>D E T E R M I N A T I O N</u>
For Prior Determination of)	
Tax Liability of)	No. 88-458
)	
. . .)	Registration No. . . .
)	
)	

- [1] **RULE 198 AND RULE 211:** RETAIL SALES TAX -- LEASES--
CONDITIONAL SALES DISTINGUISHED. A contract
designated as a lease will be regarded as a sale and
controlled by WAC 458-20-198 where the lessee has
the option at the end of the term to purchase the
property for a nominal amount. Courtright Cattle
Co. v. Dolson Co. followed.
- [2] **RULE 198 AND RULE 109:** RETAIL SALES TAX -- SERVICE
B&O TAX -- LEASES REGARDED AS FINANCING ARRANGEMENTS
-- ALLOCATION OF INTEREST AND PRINCIPAL --
REQUIREMENTS FOR. When a contract designated as a
lease is regarded as a financing arrangement, the
retail sales tax is due on the selling price in the
tax period in which the sale is made. The payments
may be apportioned between interest and principal if
the seller complies with Rule 109 and the principal
amount represents the fair market value of the
property purchased.
- [3] **RULE 211:** RETAIL SALES TAX -- LEASES -- OPTIONS
GRANTED THIRD PARTY. A lease granting one other
than the lessee an option to purchase for a nominal
amount will be treated as a lease and controlled by
WAC 458-20-211. Retail sales tax will be due on the
lease payments. If the third party exercises the
option to purchase, sales tax will be due on the
total consideration paid.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

NATURE OF ACTION:

Taxpayer requests an advisory determination under WAC 458.20.100 regarding leases with options to purchase for nominal consideration.

FACTS AND ISSUES:

Pree, A.L.J. -- The taxpayer requests two interpretations regarding leases with purchase options for nominal amounts. In the first case, the option is granted to the lessee. In the second case, the option is granted to an independent third party. In the past, the taxpayer indicated that the purchase option at the end of the lease term was the fair market value and relied on WAC 458-20-211 (Rule 211) as authority to defer payment of the tax over receipt of the lease payments. Now the taxpayer requests an interpretation of that rule if the purchase option is for a nominal amount.

DISCUSSION:

[1] A lease with a purchase option for nominal consideration has been found to be in substance a sale rather than a lease. See Courtright Cattle Co. v. Dolson Co., 94 Wn.2d 645, 619 P.2d 344 (1980). The department of revenue considers the following factors in determining whether a lease will be treated as an installment sale including but not limited to:

- (1) Whether the lessee is given an option to purchase the equipment, and, if so, whether the option price is nominal;
- (2) Whether the lessee acquires any equity in the equipment;
- (3) Whether the lessee is required to bear the entire risk of loss; or
- (4) Pay all the charges and taxes imposed on ownership;

(5) Whether there is a provision for acceleration of rent payments, and

(6) Whether the property was purchased specifically for lease to this lessee.

See Rainier Nat'l Bank v. Inland Machinery, 29 Wn. App. 725, 732, 631 P. 2d 389 (1981).

Under the lease agreement submitted, the lessee pays all charges and taxes including insurance and bears the risk of loss. The lease contains an acceleration clause. The equipment is purchased specifically for lease to the lessee. With a nominal option to purchase granted to the lessee, that lease would constitute an installment sale.

If the transaction is a sale rather than lease, WAC 458-20-198 (Rule 198) requires that the total selling price be reported in the tax period in which the sale was made. In this situation, that is when the lease agreement is executed. The lease is treated as a conditional sale and there is no refund of any of the sales tax if the purchase option is not exercised or if the lease is terminated early. No additional retail sales tax is due when the lease payments are made.

[2] The department of revenue will consider a portion of the lease payments as financing charges provided the lessor complies with WAC 458-20-109 (Rule 109 -- . . .). Rule 109 provides that the amount segregated as interest would be subject to service B&O tax. The principal portion of the lease must be at least the fair market value of the leased asset at the inception of the lease. If the lessor is purchasing the asset specifically for lease to the lessee as stated in the phone conference, the fair market value is the lessor's cost and that would be the principal portion subject to retail sales tax. The balance due under the lease would constitute interest. B&O tax at the service rate would be due on that amount ratably over the term of the lease as the payments fall due.

[3] When a nominal option to purchase is granted to an independent, unrelated third party, the department of revenue will treat the transaction as a lease governed by WAC 458-20-211 (Rule 211). The lessor will be responsible to collect the sales tax over the term of the lease. If the option is exercised, retail sales tax should be collected on the total consideration paid by the person exercising the option unless the purchase is for resale.

This legal opinion may be relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(18) and is based upon only the facts that were disclosed by the taxpayer. In this regard the department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed were actually true. This legal opinion shall bind this taxpayer and the department upon those facts. However, it shall not be binding if there are relevant facts which are in existence but not disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DATED this 30th day of November 1988.