701—26.18 (422,423) Equipment and tangible personal property rental.

26.18(1) *Prior to July 1, 1984, only if tangible personal property was classified as "equipment" was its rental subject to tax.* Effective July 1, 1984, the rental of all tangible personal property, including equipment, is subject to tax.

a. Periods prior to July 1, 1984, equipment rental. Persons furnishing equipment to other persons for their use are rendering, furnishing, or performing a service subject to tax measured by the gross receipts or fees charged for the use of such equipment. In general usage, equipment refers to implements or tools used to produce a final product or achieve a given result. *KTVO, Inc. and KBIZ, Inc. v. Bair,* 255 N.W.2d 111 (Iowa 1977), and *State v. Bishop,* 257 Iowa 336 (1965). Not all tangible personal property is equipment and for the purpose of this rule, equipment will be considered to be an implement or a tool used to produce a final product or to achieve a given result. Thus, "equipment rental" would be applicable to such items as appliances, machinery, and utensils necessary to carry out a given task. It also includes such nonexclusive items as articles of clothing, safety shoes, police uniforms, and hard hats which contribute to the purpose of a person obtaining them for use. Whether the equipment rented functions in a state of rest or in a state of motion, it is taxable.

b. In order to determine whether a particular fee is charged for the use of equipment or for the rendering of a nontaxable service, the department looks at the substance, rather than the form, of the service being rendered. When the possession and use of equipment by the recipient is merely incidental as compared to the nontaxable service performed, all the gross receipts are derived from the furnishing of such nontaxable service and unless a separate fee or charge is made for the possession and use of equipment, no gross receipts are derived from the service of equipment rental. When the nontaxable service is merely incidental to the possession and use of the equipment by the recipient, all the gross receipts are derived from the furnishing of equipment rental and unless a separate fee or charge is made for the nontaxable service, no gross receipts are derived from the nontaxable service. When an equipment rental agreement contains separate fee schedules for rent and for nontaxable service, only the gross receipts derived from the equipment rental service are subject to tax. This rule is not to be so construed as to be a variance with Iowa Code subsection 422.45(2) concerning transportation.

c. When equipment as defined herein is rented for a flat fee per month, per year, or for other designated periods, plus an additional fee based on quantity and capacity of production or use, the entire charge is taxable. The only exception is if the additional fee is a royalty payment. A royalty fee is not subject to tax if (a) it is separately contracted for and separately stated in the contract or on the billing, and (b) the royalty represents a true royalty. In determining whether a particular payment constitutes a true royalty, the following will be considered:

1. The intentions of the parties to the transaction.
2. The existence of a patent.
3. The relationship between the size of the royalty payment and the gross sales or manufacture of the patented equipment.
4. The primary business of the lessor.
5. Whether the royalty was paid for the technical know-how of the patented equipment.
6. Whether the royalty was paid for the privilege of using the patented equipment.

When examining the equipment rental agreement, substance will prevail over form and terminology employed by the parties to the agreement will not, in itself, be determinative of whether a true royalty exists. See *State v. Rockaway Corp.* (Ala. Civ. App. 1977), 346 So.2d 444, Cert. denied, 346 So.2d 451 (Ala. 1977).

d. The portion of this subrule relating to fees based on quantity and capacity of production use is effective for periods beginning on or after July 1, 1978.

26.18(2) *For periods beginning July 1, 1984, rental of tangible personal property.* The gross receipts from the rental of all tangible personal property shall be subject to tax. Tangible personal property is any personal property which is visible and corporeal, has substance and body or can be touched or handled. *RAMCO Inc. v. Director, Department of Revenue,* 248 N.W.2d 122 (Iowa

1976). Electromagnetic waves and other types of waves are not tangible personal property. *RAMCO Inc.* supra. Thus, the receipt of signals from a pay television company does not involve the rental of tangible personal property. See *Indiana Dept. of State Revenue, Sales Tax Division v. Cable Brazil Inc.,* 380 N.E.2d 555 (Ind. App. 1978). At common law, rental consists of consideration paid for the use or occupation of property, but not for passage of title, Black's Law Dictionary 1461 (4th Ed. 1968).

a. Rentals not taxed under previous law. Prior to July 1, 1984, only if tangible personal property consisted of "equipment" was its rental taxable. Equipment rental continues to be a service subject to tax under the present law. Equipment refers to implements or tools used to produce a final product or achieve a given result. *KTVO, Inc. and KBIZ, Inc. v. Bair,* 255 N.W.2d 111 (Iowa 1977) and *State v. Bishop,* 257 Iowa 336 (1965). The rental of certain tangible personal property not considered to be equipment is now subject to tax. As nonexclusive examples, clothing rental, such as tuxedos and formal gown rental, or costume rental; picture, painting, sculpture and other art work rental; plant rental to homes or businesses; and furniture rental are now subject to tax.

b. Rental of real property distinguished from rental of tangible personal property. If a rental contract allows the renter exclusive possession or use of a defined area of real property and, incident to that contract, tangible personal property is provided which allows the renter to utilize the real property, if there is no separate charge for rental of tangible personal property, the gross receipts are for the rental of real property and are not subject to tax.

If a person rents tangible personal property and, incidental to the rental of the property, space is provided for the property's use, the gross receipts from the rental shall be subject to tax. It may at times be difficult to determine whether a particular transaction involves the rental of real property with an incidental use of tangible personal property or the rental of tangible personal property with an incidental use of real property.

c. Rental of tangible personal property and rental of fixtures. The rental of tangible personal property which shall, prior to its use by the renter under the rental contract, become a fixture shall not be subject to tax. Such a rental is the rental of real property rather than tangible personal property. In general, any tangible personal property which is connected to real property in a way that it cannot be removed without damage to itself or to the real property is a fixture. *Equitable Life Assurance Society of the United States v. Chapman,* 282 N.W.2d 355 (Iowa 1983) and *Marty v. Champlin Refining Co.,* 36 N.W.2d 360 (Iowa 1949). The rental of a mobile home or manufactured housing, not sufficiently attached to realty to constitute a fixture, is room rental rather than tangible personal property rental and subject to tax on that basis; see *Broadway Mobile Home Sales Corp. v. State Tax Commission,* 413 N.Y.S.2d 231 (N.Y. 1979). See also rule 701—18.40(422,423).

d. Rental of tangible personal property embodying intangible personal property rights, transactions exempt and taxable. Under the law, the gross receipts from rental of tangible personal property include "royalties, and copyright and license fees." The department interprets the legislature's use of this phrase as evidence of the legislature's intent to tax the rental of all property which is a tangible medium of expression for the intangible rights of royalties, copyright and license fees. Thus gross receipts from the rental of films, video disks, video cassettes, and any computer software (other than rental of custom programs, see 701—paragraph 18.34(3)*"a"*) which is the tangible means of expression of intangible property rights is subject to tax. The rental of such tangible property shall be subject to tax whether the property is held for rental to the general public or for rental to one or a few persons. See *Boswell v. Paramount Television Sales, Inc.,* 282 So.2d 892 (Ala. 1973). See rule 701—17.18(422,423) regarding the exemption from the requirements of this subrule for rental of films, video tapes and other media to lessees imposing a taxable charge for viewing or rental of the media or to lessees who broadcast the contents of this media for public viewing or listening.

e. Deposits. Taxability of a deposit required by an owner of rental property as a condition of the rental depends upon the type of deposit that is being required. A deposit subject to forfeiture for failure to comply with the rental agreement is not subject to tax. This type of deposit is separate from the rental payments and therefore is not taxable as part of the rental service. Such deposits may include those for reservation, late return of the rental property or damage to the rental property. Deposits not subject to

forfeiture which represent part of the rental receipts are considered part of the taxable services and are subject to tax. Such deposits may include a deposit of the first rental payment which is applied to the rental receipts.

This rule is intended to implement Iowa Code sections 422.43 and 423.2.