

701—18.36(422,423) True leases and purchases of tangible personal property by lessors.

18.36(1) *True leases and purchases by lessors prior to, on, and subsequent to July 1, 1978.* The definition of a sale specified in Iowa Code subsection 422.42(2) does not include leases. Hence, the exemption from tax on sales for resale is inapplicable to the purchase of tangible personal property for the purpose of leasing such property to others, but not for the purpose of reselling such property. *Cedar Valley Leasing, Inc. v. Iowa Department of Revenue*, 274 N.W.2d 357 (Iowa 1979). However, even though the general rule is that the acquisition cost of tangible personal property purchased for the purpose of leasing it to others is subject to the Iowa sales or use tax, certain transactions are exempted from tax by statute. See subrule 18.36(4).

18.36(2) *General.* Prior to July 1, 1984, tax is due on the lease or rental payments derived from the service of equipment rental only and not from the lease or rental of other tangible personal property. See 701—subrule 26.18(1). Tax would also be due on the gross receipts received on the disposal of the tangible personal property provided no exemption exists. When property is purchased for the purpose of financing under a conditional sales contract, the property is purchased for resale, and the acquisition of the property is not subject to Iowa tax. See rule 701—16.47(422,423).

The gross receipts from the leasing of property for subletting purposes is exempt from tax as a resale of a service, but the lessee must collect tax on the gross receipts from subletting unless such subletting is otherwise exempt from tax.

a. Where a resident or nonresident lessor leases equipment to a resident or nonresident lessee and the lease contract is executed in Iowa and the equipment is delivered to the lessee in Iowa, the rental payments are subject to Iowa sales tax, even if the equipment is taken by the lessee to another state. *Williams Rentals, Inc. v. Tidwell*, 516 S.W.2d 614 (Tenn. 1974).

b. Where a nonresident lessor leases equipment to a resident or nonresident lessee and the lessee uses the equipment in Iowa, the nonresident lessor has the responsibility of collecting Iowa use tax on the lease payments, provided the lessor maintains a place of business in Iowa as provided in Iowa Code sections 423.1(6) and 423.9. Whether the lease agreement is executed in Iowa or not is irrelevant. *State Tax Commission v. General Trading Co.*, 322 U.S. 335, 64 S.Ct. 1028, 88 L.Ed 1309, (1944).

c. Where a lessee is the recipient of equipment rental services as defined in “a” and “b” above and no tax has been collected from such lessee by the lessor, the lessee should remit Iowa use tax to the department of revenue. In the event no tax is remitted, the department, in its discretion, may seek to collect the tax from the lessor or lessee. In the event that the lessee is the recipient of equipment rental services, and the lessor does not maintain a place of business in Iowa and does not collect use tax pursuant to Iowa Code section 423.10, such lessee shall remit tax on its rental payments to the department.

d. Where a resident lessor leases equipment to a nonresident lessee outside of Iowa, and the equipment is delivered to the lessee outside Iowa, the act of leasing is exempt from the Iowa sales tax on the rental payments. However, in the event the lessee brings the equipment into Iowa and uses it in Iowa, Iowa use tax applies to rental payments, but see “g” below.

e. Where a resident or nonresident lessor purchases tangible personal property in Iowa for subsequent lease in or out of Iowa and takes delivery of the equipment in Iowa, the lessor’s purchase is subject to Iowa sales tax. *Dodgen Industries, Inc. v. Iowa State Tax Commission*, 160 N.W.2d 289 (Iowa 1968).

f. When a resident or nonresident lessor purchases tangible personal property outside of Iowa for the purpose of leasing it in Iowa and the equipment is brought into Iowa and used by the resident or nonresident lessee in this state, the lessor is considered as having a “use” of the property in Iowa and Iowa use tax will apply to the lessor’s purchase price of the property, regardless whether or not the lessor makes any physical use of the property in Iowa. *Union Oil Company of California v. State Board of Equalization*, 1963, 34 Cal. Rpts. 872, 386 P.2d 496.

g. If a sales or use tax has already been paid to another state on the purchase price of equipment prior to the use of that equipment in Iowa, a tax credit against the Iowa use tax on the purchase price will be given. After the equipment is brought into Iowa, if a sales or use tax is properly payable and is paid to another state on the rental payments of equipment, for the same time the Iowa tax is imposed on such

rentals, a tax credit against the Iowa use tax on such rental payments will be given. *Henneford v. Silas Mason Co.*, 1937, U.S.577, 57 S.Ct. 524, S1 L.Ed. 814.

18.36(3) Leases relating to vehicles subject to registration.

a. Vehicles as defined in Iowa Code subsections 321.1(4), (6), (8), (9), and (10) (motor trucks, truck tractors, road tractors, trailers, and semitrailers), except when designed primarily for carrying persons, can be purchased free of use tax when purchased for lease and actually leased for use outside Iowa if the subsequent sole use in Iowa is in interstate commerce or interstate transportation.

b. Tangible personal property which by means of fabrication, compounding, or manufacturing becomes an integral part of vehicles as defined in 18.36(3)“*a*” when manufactured for lease and actually leased to a lessee for use outside the state of Iowa, can be purchased free of use tax provided the sole subsequent use of the vehicle in Iowa is in interstate commerce or interstate transportation. (Iowa purchases which would be subject to Iowa sales tax do not qualify for this exemption.) See rule 701—33.7(423).

The provisions of “*a*” and “*b*” are effective for periods beginning on January 1, 1973. Also see 701—Chapter 34 of the rules relating to vehicles subject to registration.

18.36(4) Special rules for lessors on or after July 1, 1978. If tangible personal property is purchased for leasing, the purchase of the property is exempt from tax if the following conditions are met:

a. The person (lessor) purchasing the property is regularly engaged in the business of leasing,

b. The period of the lease is for more than one year for sales or property occurring from July 1, 1978, to May 18, 1997, inclusive; for sales of property occurring on and after May 19, 1997, the period of the lease must be for more than five months, and

c. The lease or rental receipts must be subject to tax under the service of equipment rental.

All three conditions must be met before the exemption applies.

If the exemption is properly claimed, it is lost when the property is made use of for any purpose other than leasing and the person claiming the exemption is liable for the tax based on the original purchase price. Tax paid on the leasing or rental payments would be allowed as a credit against the tax due on the purchase price.

In the following examples, assume, unless stated to the contrary, that the lease or rental receipts are subject to tax. The examples are written on the assumption that the period for an exempt lease is five months or longer. Thus, these examples are basically applicable to the period beginning May 19, 1997; however, the examples illustrate principles which are applicable to the purchase for lease exemption for periods longer than one year which was the requirements for exemption prior to May 19, 1997.

EXAMPLE: A restaurant makes a one-time purchase of office furniture which it leases to an insurance company for a period of four years. The purchase of office furniture by the restaurant would be subject to tax because the restaurant is not regularly engaged in the business of leasing. However, if the restaurant established a pattern of regularly purchasing office furniture or other tangible personal property for lease, the exemption would apply.

EXAMPLE: A company purchases a computer which will be leased for a period of three years, at which time the computer is returned to the company. The sole business of the company is to purchase this one computer for lease. The purchase of the computer is exempt from tax because the company is regularly engaged in the business of leasing.

EXAMPLE: A leasing company purchases three lawn mowers which will be leased to individuals for periods of time less than five months. The purchase of the lawn mowers by the leasing company would be subject to tax because the periods of the leases are for less than five months.

EXAMPLE: A leasing company purchases a computer which will be leased for a period of three years. The purchase of the computer is exempt from tax because the period of the lease is for more than five months.

EXAMPLE: A leasing company buys a computer. The company claims the exemption from tax, but the company uses the computer in its own operations. Tax is due on the original purchase price and the leasing company is liable for the tax due.

EXAMPLE: A leasing company purchases a copying machine which will be leased for a period of two years. After four months, the machine is returned to the leasing company and then the machine is

immediately re-leased without being used by the leasing company for any other purpose. The exemption would apply because it was properly claimed and nothing occurred to cause loss of the exemption.

EXAMPLE: A leasing company purchases a copying machine which will be leased for a period of two years. After four months, the machine is returned and the leasing company then uses the machine in its own business. The exemption would no longer apply and the leasing company would be liable for the tax based on the original purchase price. Credit would be allowed against the tax due on the purchase price for any tax paid on the lease or rental payments. Assume the leasing company paid \$2,000 for the copying machine and charged \$200 per month plus \$10 in tax per month. Since the machine is returned and the exemption is not applicable, the leasing company would owe \$100 on the \$2,000 acquisition cost. However, the leasing company collected \$40 (four months x \$10) tax on the monthly rental charges. Allowing the credit for tax collected of \$40 against the total tax liability of \$100 leaves a net tax liability of \$60 owed by the leasing company.

EXAMPLE: A manufacturer and seller of office furniture also leases office furniture. The leases always run for a period longer than five months and the company usually has only two leases per year. The leasing operation only accounts for 1 percent of the company's total business. The company still qualifies for the exemption because it is regularly engaged in the business of leasing and the period of the lease is for more than five months.

EXAMPLE: A leasing company purchases an airplane from an aircraft dealer and leases it for a period of three years. The lease or rental payments are not taxed because of the exemption for transportation services. The leasing company would owe tax based on the acquisition cost because the lease or rental payments are not subject to tax under the service of equipment rental.

EXAMPLE: A leasing company purchases equipment and leases it to a lessee for a period of 18 months. For the first 3 months, the equipment is used by the lessee in making repairs to existing structures and the lease receipts are taxable. For the remainder of the lease period, the equipment is used in new construction of buildings and structures and the lease receipts are exempt from tax. The acquisition cost of the equipment is exempt because the exemption was properly claimed and was not subsequently lost by a use other than leasing.

EXAMPLE: A leasing company purchases from an Iowa retailer equipment on May 18, 1997, for the purpose of leasing it for a period of six months. The lease receipts will be taxable. The sales tax exemption on the acquisition cost to the lessor cannot be claimed because the sale occurred before May 19, 1997, and, at the time of the sale, no sales tax exemption applied to such acquisition cost. The exemption for acquisition cost should not be given a retroactive effect. *Jones v. Gordy*, 1935, 169 Md. 173, 180 Atl. 272.

EXAMPLE: A leasing company purchases equipment outside of Iowa on May 1, 1997. The lessee brings the equipment into Iowa on June 1, 1997, and uses it in Iowa. The lease period is nine months, and the lessee's use in Iowa is subject to Iowa use tax on the lease payments. Under these circumstances, the Iowa use tax exemption on the lessor's acquisition cost applies because it is the law in effect at the time of use in Iowa, not at the time of sale, which determines whether a use tax exemption applies. *City of Ames v. Iowa State Tax Commission*, 1955, 246 Iowa 1016, 71 N.W.2d 15; *Allis-Chalmers Mfg. Co. v. Iowa State Tax Commission*, 1958, 250 Iowa 193, 92 N.W.2d 129.

EXAMPLE: A leasing company purchases equipment not for resale and leases it to the lessee for a period of more than five months. After three months, the equipment is returned to the leasing company which then sells the equipment. Such sale is not part of the regular course of the leasing company's business. The exemption, though properly claimed, is lost because, by reason of such sale, the leasing company made use of the property for a purpose other than leasing or renting. Had the equipment been returned to the leasing company on or after five months and one day from the commencement of the lease period, and the leasing company then sold the equipment outside the regular course of its business or used the equipment in its business, the exemption for acquisition cost would not be lost. Had the equipment been purchased for resale and leased prior to such resale, the acquisition cost to the leasing company would be exempt from tax. *Herman M. Brown Co. v. Johnson*, 1957, 248 Iowa 1143, 82 N.W.2d 134. If the equipment is traded in toward the purchase price of other equipment by the leasing company, or if the leasing company disposes of the equipment after it is fully depreciated, the exemption for acquisition

cost is not lost. Where sale of equipment outside the regular course of business is made by the leasing company, see also rule 18.28(422) to determine whether the casual sale exemption applies to the receipts from such sale.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee. Assume that the exemption for acquisition cost of the equipment was properly claimed. Thereafter, the lessee makes an assignment of the lease. The exemption is not lost since the assignee stands in the same position as the original lessee and such an assignment does not change the nature of the original lease period. *Berg v. Ridgway*, 1966, 258 Iowa 640, 140 N.W.2d 95.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee in accordance with the criteria creating the acquisition cost exemption. The leasing company sells the lease contracts, as commercial paper, to others. The exemption for acquisition cost can still be claimed and such sales of lease contracts do not cause loss of the exemption.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee in accordance with the criteria creating the acquisition cost exemption. Thereafter, the lease can no longer be performed because the property is destroyed by an act of God. The acquisition cost exemption is not lost.

EXAMPLE: A leasing company purchases equipment which is leased to the lessee in accordance with the criteria creating the acquisition cost exemption. Thereafter, the lessee is adjudged bankrupt and the equipment is returned to the leasing company and is re-leased without being used by the leasing company for any other purpose. The acquisition cost exemption is not lost since the leasing company makes no use for any purpose other than leasing or renting.

EXAMPLE: A leasing company purchases equipment which is leased to a lessee. The criteria for the acquisition cost exemption are present. The lessee then sublets the equipment to another for a period less than five months. The acquisition cost exemption is not lost.

18.36(5) *Lease or rental of all tangible personal property now subject to tax.* On and after July 1, 1984, the lease or rental of all tangible personal property is subject to tax. See rule 701—26.18(422) for information concerning additional transactions subject to tax after that effective date.

This rule is intended to implement Iowa Code sections 422.42(2), 422.43, 422.45, 423.1, and 423.4.