**Opinion Letter**

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| **Letter Number:** | **O-2009-001** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Vehicle leases.** |
| **Keywords:** |  |
| **Approval Date:** | **02/10/2009** |

**Body:**

Office of Policy & Research

February 10, 2009

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RE: Your e-mail dated January 5, 2009

Dear XXXX:

I have been asked to respond to your recent e-mail. It states, in relevant part:

I just leased a new vehicle for my business. In so doing, I turned in my previously leased vehicle. The difference between the trade in value on the old leased vehicle and the unamortized balance on the lease was approximately $53,000. I leased the new vehicle with a cap cost at MSRP, which is $26,000 more than the price actually negotiated. To make up the gap on the trade in, I also wrote a check to the dealer for $27,000 ($26+$27=$53).

The dealership charged my company sales tax on the $27,000. This to me is illogical since the vehicle is clearly worth far less than the lease balance and the “down payment” on which I was charged sales tax represented a negative value.

I told the dealership that I would be contacting the Department of Revenue for clarification.

The leases that you entered into are "operating" leases or "true" leases. Sales tax on an operating lease is charged and collected on each recurring periodic payment, or if the lease agreement does not require recurring periodic payments, on the single up-front payment made by the lessee and on any additional lessee payments required at the end of the lease.

For purposes of Kansas sales tax, "trade-in allowance" means the value assigned by a dealer to a used vehicle taken in trade from a customer to reduce the selling price or lease price of another vehicle. To be considered a trade-in, the vehicle being traded must be titled in the customer's name and the trade-in amount applied to reduce the selling price of the vehicle being sold or leased. A trade-in reduction is not allowed when a leased vehicle is surrendered or when a vehicle whose title is not in the name the lessee or buyer as owner or co-owner is surrendered.

Contrary to what you infer in your e-mail, the dealer did not assign a trade-in value to the first leased vehicle and then apply that amount to reduce the amount owed on your second lease. Instead, the dealer treated your $27,000 payment as satisfying the early buy-out amount that you had agreed to pay if you chose to extradite yourself from the contractual obligations required of you by the first lease. As lessor, the leasing company continued to own the vehicle even after you tendered the $27,000 payment for the early lease buy out. Title to the vehicle was not transferred to you or to the dealership.

In other words, you were not "buying" your first leased vehicle from the leasing company and then trading it in on the second leased vehicle. The lessor continued to own the vehicle. The $27,000 payment simply terminated your obligations under the first lease agreement. From the dealer's point of view, your payments involved two separate, stand alone transactions. The first transaction was your payment of $27,000 for the early buy out of the first lease. This payment is taxable as the final taxable payment under the first lease agreement. The second stand alone transaction was your payment of $26,000, which the dealer applied as a capital cost reduction for the new lease of second vehicle. Capital reduction payments are typically made when a lease is entered into and reduce the amount of a lessee's monthly lease payments. Capital reduction payments and recurring monthly lease payments are both subject to Kansas sales tax.

The dealer charged you sales tax on $27,000, which was the early lease buy-out amount. If this amount was correctly calculated, the fact that the value of the vehicle at the time of the dealer negotiations was less than $27,000 does not effect the amount that was taxed. This is because the first vehicle wasn't a traded-in and its "value" was not used as a trade-in allowance that reduced the selling price of the second vehicle under K.S.A. 79-3602(ll)(2)(D).

If the reverse had happened and you received $27,000 more for the leased vehicle that was being surrendered because it was worth more than the early lease buy-out amount, the difference would be payable to you as profit. The profit would be owed to you even though the early "buy out" of the lease was arranged by a dealer. If the dealer applied part of the $27,000 profit as a capital cost reduction on the new lease, the capital cost reduction amount would be subject to sales tax. The dealer could not apply this "profit" as a trade-in amount that zeroed out the selling price of the second leased vehicle.

From your e-mail, it appears that you were properly charged sales tax on the $27,000 that you paid to buy out of the first lease agreement. The dealer applied the $26,000 amount as a taxable capital reduction payment to reduce the periodic payments you would make under the second lease agreement. As has been discussed, the early buy-out payment, the capital reduction payment, and periodic lease payments are all taxable. The dealer correctly charged you sales tax on both leases.

Your legal remedy, if you do not agree with my analysis, is to file a refund claim for the taxes your believe were paid in error to the dealership. The refund claim should be submitted by using a Form ST-21, which can be downloaded from our web site --- www.ksrevenue.org. You should attach a copy of your e-mail to the department along with a copy of this response. The ST-21 must be completed and supported with a copy of the dealer's invoice that shows that tax was charged on the different transactions. Your refund claim, which will be denied by the department, can be appealed to the Kansas Court of Tax Appeals after a department hearing, and then on to the Kansas appellate courts if you are not satisfied with the Court of Tax Appeals' determination.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 02/11/2009 Date Modified: 02/11/2009**