**Private Letter Ruling**

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| **Ruling Number:** | **P-2004-041** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Financing by "off-balance sheet" transactions.** |
| **Keywords:** |  |
| **Approval Date:** | **07/06/2004** |

**Body:**

Office of Policy & Research  
  
  
July 6, 2004

XXXX  
XXXX  
XXXX  
  
Re: Your Correspondence XXXX  
  
Dear XXXXX:  
  
This letter responds to the above-referenced correspondence. XXXX. Your letter provides the following facts:

We XXXX offer a financing product to our customer referred to as an “off-balance sheet” or synthetic lease transaction. In an off-balance sheet transaction the customer will depreciate the equipment for IRS purposes on their federal and state income tax return. For financial accounting purposes (GAAP), the customer will treat the off-balance sheet transaction as an operating lease. The only indication of property ownership on the books of the customer will be a footnote on their balance sheet. UCC Financing Statements are filed with customer as the owner and XXXX as the holder of the security interest. The monthly “rental” payments made by customer to XXXX are consistent with principal and interest for a typical loan. The customer takes the risk and liabilities of property ownership, as well as risk of loss and the responsibility to maintain the property. The customer indemnifies XXXX for all taxes, assessments and fees associated with ownership of the property.  
  
The end of lease provision allows the lessee on the last day of Basic Term to: A) Purchase all the equipment for the Purchase Option Price. The dollar amount of the purchase price is stated within the range of 1% to 20% of the cost of the equipment. The purchase option may be Fair Market Value or it may be Fair Market Value not to exceed a stated percentage of the equipment cost or a stated dollar amount. B) Terminate the lease and obtain bids for the equipment to sell it to third party. The lessor shall receive all proceeds of the sale and Lessee will pay to the lessor the amount by which the net proceeds of the sale are less than the Purchase Option Price, but no more than the Maximum Lessee Risk. If the equipment is not sold the less will return the equipment to the Lessor and pay to Lessor an amount equal to the Maximum Lessee Risk.

You also indicate that XXXX will not depreciate the asset and has only a security interest in the asset.  
  
You ask, on the purchase of new equipment by XXXX to be financed by an “off-balance sheet” transaction, would sales/use tax be charged to lessee upfront or over the rental stream? If upfront, would tax be based on the equipment cost only or on the total lease receivable?  
  
Response: K.A.R. 92-19-55a sets forth the sales tax treatment for leases. K.A.R. 92-19-55a provides in part: “Any transaction or series of transactions that is in the form of a lease, but is treated as a loan or financing transaction for federal income tax purposes, shall be treated as a loan or financing transaction for sales tax purposes. . . . Periodic payments made under a transaction that is treated as a financing transaction shall not be subject to sales or use tax, since the initial acquisition of the property being financed by the owner-lessor is taxable.” The fact that the lessee, not the lessor, takes depreciation on the equipment for federal income tax purposes would indicate that the “off-balance sheet” transaction described above should be treated as a financing transaction for sales tax purposes, not an operating lease. Sales tax should be charged upfront, based on the equipment cost.  
  
You further ask, on the financing of equipment which was previously purchased and used by the customer for a period of months or years (sales tax paid to the vendor at time of purchase), would sales/use tax be charged again on the rental stream?  
  
Response: Assuming what you are describing is a refinancing transaction and XXXX and your customer treat it as such for federal income tax purposes (i.e., the customer—not XXXX--claims all depreciation deductions or tax credits), sales tax would not be charged on the payments.  
  
This is a private letter ruling pursuant to K.A.R. 92-19-59. It is based solely on the facts provided in your request. If it is determined that undisclosed facts were material or necessary to an accurate determination by the department, this ruling is null and void. This ruling will be revoked in the future by the operation of law without further department action if there is a change in the statutes, administrative regulations, or case law, or published revenue ruling, that materially effects this private letter ruling. If I may be of further assistance, please contact me at (785) 296-3081.  
  
Very truly yours,  
  
  
  
Richard L. Cram  
  
  
  
**Date Composed: 07/06/2004 Date Modified: 01/14/2005**