

Sourcing and Attribution of Income on Leases and Rentals of Tangible Personal Property

What does this ETA address?

This Excise Tax Advisory (ETA) addresses the business and occupation (B&O) and retail sales tax reporting responsibilities of a seller (lessor) leasing tangible personal property to a consumer (lessee). For purposes of this ETA, the terms “lease” and “rent” are used interchangeably.

This ETA does not apply to situations where the seller provides tangible personal property with an operator (commonly referred to as a “rental of equipment with operator”). See WAC 458-20-211 for more information on rentals of equipment with an operator.

General lease background

The lease of tangible personal property to a consumer is a retail sale subject to the retailing B&O tax and the retail sales tax unless a specific exemption applies. When a lease requires periodic lease payments, each lease payment is considered a separate retail sale.

When equipment and/or property is leased under circumstances where the consideration paid does not represent a reasonable rental value, the selling price, for retail sales tax purposes, must be determined as nearly as possible according to the value of such use at the places of use of similar products of like quality and character. RCW 82.08.010.

General lease sourcing provisions

RCW 82.32.730 provides the statutory requirements for “sourcing” lease and rental payments. These requirements are based on provisions contained in the Streamlined Sales and Use Tax Agreement (SSUTA). “Sourcing” herein refers to the location (as

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in a local taxing district, jurisdiction, or authority) where a lease is deemed to occur for purposes of a lessor's obligation to collect Washington's retail sales or use tax.

With the exception of transportation equipment, the Department applies the same sourcing methodologies to "attribute" gross proceeds from leasing transactions for purposes of Washington's B&O tax. (See specific instructions for lessors of transportation equipment below.)

As explained in more detail below, the sourcing and attribution of lease income can differ based on:

- Whether the lease requires only a single payment, or requires multiple (periodic) payments; or
- The subject of a lease requiring periodic payments is:
 - "Transportation equipment" as defined in RCW 82.32.730;
 - A motor vehicle, trailer, semitrailer, or aircraft that does not qualify as "transportation equipment";
 - Tangible personal property that does not qualify under the immediately preceding 1 or 2.

The "primary property location" is a key factor used to determine how some leases are sourced. RCW 82.32.730 defines "primary property location" as follows:

The primary property location shall be as indicated by an address for the property provided by the lessee that is available to the lessor from its records maintained in the ordinary course of business, when use of this address does not constitute bad faith. This location is not altered by intermittent use at different locations.

It is important to note that when a periodic lease payment is sourced to Washington, the payment is subject to Washington's B&O and retail sales tax. If the lessee uses the property outside the state within the period covered by a lease payment, the primary property location controls for B&O and retail sales tax purposes. Therefore, when computing B&O and retail sales tax liability, the lease payment is not apportioned based on time spent inside or outside of Washington. (Note: See specific reporting instructions for lessor's of transportation equipment below.)

When a periodic lease payment is properly sourced to a primary property location outside of Washington, the lessor is not required to collect Washington's retail sales tax or pay retailing B&O tax on the income. The lessee may, nonetheless, incur a use tax liability if the lessee uses the property in Washington. (See ETA 3186.2014)

Use of examples The examples provided below are to be used only as a general guide. The tax results of other situations must be determined separately after review of all the facts and circumstances.

All examples presume:

- The use of an address for identifying the “primary property location,” if applicable, does not constitute bad faith;
 - The identified lease payment amounts represent a reasonable rental value for the property; and
 - Unless otherwise stated, no retail sales exemption is provided in law.
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**Single payment
lease sourcing**

The lease of tangible personal property, transportation equipment, and motor vehicles, trailers, semitrailers, or aircraft that do not qualify as “transportation equipment,” that does not require recurring periodic payments, is sourced under the general sourcing provisions of RCW 82.32.730(1). The lessor must source the sale where the customer takes possession of the property, which is generally the lessor’s store location or a delivery location.

Example 1:

Jim rents a yacht from R Rentals for three weeks. The lease agreement requires that Jim make a single \$6,000 payment. Jim takes possession of the yacht in Port Angeles, Washington, and uses the yacht both within Washington State waters and Canadian waters during the three-week period.

The lease is sourced to Port Angeles where possession of the yacht occurred, and the entire \$6,000 lease payment is subject to retailing B&O and retail sales taxes.

**Periodic lease
payment
sourcing for
tangible
personal
property**

Recurring periodic lease payments for tangible personal property (property) other than transportation equipment and those motor vehicles, trailers, semitrailers, and/or aircraft that do not qualify as transportation equipment, are sourced as follows:

- The first payment for the leased property is sourced to the location where the lessee takes possession of the property. This is often the lessor’s store location or a delivery location.
- The remaining periodic payments are sourced to the primary property location.

Example 2:

Big Rentals, located in Walla Walla, Washington, rents an excavator to Grant for a period of 6 months. Grant is required to make an initial payment of \$10,000, with recurring periodic monthly payments of \$10,000 for the remaining 5 months. Grant takes possession of the excavator at Big Rental’s Walla Walla location, but the primary property location of the excavator during the remaining rental period is in Wallowa County, Oregon.

Big Rentals is subject to retailing B&O tax and must collect retail sales tax on the first \$10,000 lease payment. Big Rentals has no additional retailing B&O tax or retail sales tax liability for the remaining 5 lease payments because the primary property location is in Oregon, an out-of-state location.

**Periodic lease
payment
sourcing &
transportation
equipment**

Washington law provides a retail sales tax exemption for leases of transportation equipment (RCWs 82.08.0262 and 82.08.0263).

When a rental of transportation equipment is sourced to Washington but is exempt from sales tax, the lessor remains responsible for B&O tax on periodic lease payments attributed to Washington based on the equipment's primary property location under RCW 82.04.250.

For B&O tax purposes, recurring periodic lease payments are attributed as follows:

- The first payment is attributed to the location where the lessee takes possession of the transportation equipment. This is often a delivery location.
- Periodic payments made subsequent to the first payment are attributed to the primary property location for each period covered by the payment.

Transportation equipment means:

- Locomotives and railcars that are used for the carriage of persons or property in interstate commerce;
- Trucks and truck tractors with a gross vehicle weight rating of ten thousand one pounds or greater, trailers, semitrailers, or passenger buses that are:
 - Registered through the international registration plan; and
 - Operated under authority of a carrier authorized and certificated by the United States department of transportation or another federal authority to engage in the carriage of persons or property in interstate commerce.
- Aircraft that are operated by air carriers authorized and certificated by the United States department of transportation or another federal or foreign authority to engage in the carriage of persons or property in interstate or foreign commerce; or
- Containers designed for use on and component parts attached or secured on the items described above.

Example 3:

Busy Way Inc. leases three passenger buses that qualify as transportation equipment from Jack's Buses in Seattle, Washington. The lease requires 24 monthly periodic payments. Busy Way takes possession of the passenger buses in Seattle, and provides Jack's with a completed Buyer's Retail Sales Tax Exemption Certificate to substantiate its claim that the lease payments are exempt from retail sales tax under RCW 82.08.0262. Busy Way also provides Jack's with two primary property locations. The buses will have a primary property location in Seattle, Washington for the first 12 months of the lease, and in Idaho for the remaining 12 months. While the buses are in Idaho, they are intermittently used in Washington for 5 days.

The lease payments are exempt from retail sales tax as leases of qualified interstate transportation equipment. RCW 82.08.0262.

Jack's is subject to B&O tax under the retailing of interstate transportation equipment classification on the first 12 periodic lease payments. This is true because Busy Way took possession of the buses in Washington (first periodic payment) and had a primary property location in Seattle during the next 11 months.

The 12 remaining periodic lease payments are not subject to B&O tax because the primary property location for each period covered by the payments is outside of Washington. This is true even though the buses were in Washington for 5 days. The tax is based on primary property location alone, and is not attributed to Washington for those 5 days.

Periodic lease payment sourcing & motor vehicles, trailers, semitrailers, and aircraft that do not qualify as transportation equipment

Recurring periodic lease payments for motor vehicles, trailers, semitrailers, and aircraft that do not qualify as transportation equipment must be sourced by the lessor to the primary property location. This type of equipment does not have a "first payment" provision. All payments are sourced to the primary property location provided by the lessee to the lessor. The location where the lessee takes delivery of this type of equipment is immaterial.

Example 4:

LeaseCo leases an airplane, that does not qualify as transportation equipment, to Jeff for three years, with payments of \$5,000 per month. Jeff takes delivery of the airplane in Seattle, but has a primary property location for each of the lease periods in Pend Oreille, Washington. Jeff intermittently uses the airplane in Idaho and Montana over the term of the lease.

LeaseCo is subject to retailing B&O tax and must collect retail sales tax on the entire amount of each lease payment. The primary property location of the airplane is Pend Oreille, Washington, notwithstanding Jeff also uses the airplane in Idaho and Montana intermittently.

Intermittent in-state use of leased property

A lessor has no obligation to pay Washington's retailing B&O tax, or collect Washington's retail sales tax, if the primary property location of leased property is outside Washington. This is true even when the lessee intermittently uses the leased property in Washington. The lessee, however, is responsible for Washington's use tax in these situations, unless a specific exemption applies. See ETA 3186.2014.
