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Texas Comptroller of Public Accounts STAR System

## 9708683R

STATE OF TEXAS  
COMPTROLLER OF PUBLIC ACCOUNTS  
STATE SALES AND USE TAX

Section 3.294. Rental and Lease of Tangible Personal Property. (Tax Code, secs. 151.005-151.007, 151.055, 151.302).

(a) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Financing lease.

(A) A written lease contract containing either of the following provisions or conditions at the inception of the contract:

(i) title to the property must be transferred to the lessee at the end of the lease; or

(ii) an option to purchase the property at a nominal price is available to the lessee at the end of the lease (a price is nominal which is, at the time the contract is executed, estimated to be less than 10% of the fair market value of the property at the time the option is to be exercised).

(B) A written lease contract containing either of the following provisions or conditions at the inception of the contract will be presumed to be a financing lease:

(i) the lease term is equal to 75% or more of the estimated economic life of the property and the contract makes no provisions for the return of the property to the lessor. For used property, this section does not apply if the beginning of the lease term falls within the last 25% of the total estimated economic life of the lease property; or

(ii) the residual value of the leased property is less than 10% of the property's fair market value at the inception of the lease and the contract makes no provisions for the return of the property to the lessor.

(C) The presumption outlined in subparagraph (B) of this paragraph that the contract is a financing lease may be rebutted by showing that the contract is not merely a security device, that the property will be usable for its intended purpose at the end of the lease term, and that the lessor in good faith intends to reclaim possession of the property at the end of the lease term or to sell the property at the fair market value or to lease it for its fair market rental value.

(2) Lease or rental - A transaction, by whatever name called, in which possession but not title to tangible personal property is transferred for a consideration. In this section, the words lease and rental are used interchangeably.

(3) Operator - A person who actively guides, drives, pilots, or steers tangible personal property. A person who provides maintenance, repair, or supervision only is not an operator for the purposes of this section.

(4) Operating lease - A lease contract which gives the lessee use of the leased property for a certain period. For the purposes of the sales and use taxes, a written contract in the legal form of a lease will be treated as an operating lease unless it meets the definition of a financing lease. All oral leases will be treated as operating leases.

(b) Leases. Tax must be collected from the lessee on all charges contained in the lease unless the charge is separately stated and is nontaxable as provided by this section. See subsection (f) of this section for imposition of tax and time for reporting.

(c) Tangible personal property leased with and without an operator.

(1) Receipts from the lease of tangible personal property without an operator are taxable.

(2) The furnishing of tangible personal property with an operator for which a single charge is made to the customer shall be presumed to be the performance of a service and no tax may be charged to the customer, unless the service is taxable under other provisions of the Tax Code, Chapter 151. Sales or use taxes will be due on the original purchase price of the tangible personal property.

(A) The presumption set forth in subsection (c)(2) of this section may not be rebutted solely by one party to the transaction. The presumption may be rebutted by the following criteria which establish a lease of tangible personal property:

(i) the customer exercised direct control or supervision over the operator of the tangible personal property; and

(ii) the intent of the agreement was to lease a piece of tangible personal property and separately furnish an operator.

(B) If it is established that a lessor who made a single charge to customers did in fact make a lease of tangible personal property, the tax will be due on the fair market rental value of the tangible personal property. If this cannot be determined, the tax will be due on the total charge reduced by the charge attributable to the operator determined from lessor's records. If the charge for the operator cannot be determined from the lessor's records or if it seems unreasonable, the comptroller will make a determination of a reasonable operator charge.

(3) A transaction in which tangible personal property is furnished with an operator, and the customer is charged separately for tangible personal property and operator, shall be presumed to be the lease of tangible personal property and the separate furnishing of an operator; the receipts from the separate charge for the tangible personal property are taxable. The separate charge for the operator will not be taxable unless a taxable service is being provided.

(A) If a nontaxable service is being provided and it is established that the separate charge for the lease of tangible personal property is lower than the tangible personal property's fair market rental value, sales tax will be assessed on the fair market rental value unless the lessor presents convincing evidence to the comptroller as to why the rental charge should be lower than fair market rental value.

(B) If it is established that a lessor who separated charges for tangible personal property and operator nevertheless used the tangible personal property to perform a service, sales tax will be assessed on the fair market rental value if the property was purchased under a valid resale certificate. See subsection (j) of this section.

(d) Other charges related to lease agreements. Operating and financing lease agreements and related billings may contain a variety of charges in addition to the basic rental/lease charges, including charges that occur subsequent to the rental. All charges related to a lease agreement are taxable unless excluded from tax by this section. Some of these charges and their tax consequences are as follows.

(1) Separately stated charges for labor or services rendered in installing, applying, remodeling, servicing, maintaining, or repairing the item being leased are subject to tax.

(2) Damage waiver fees are subject to tax. A charge after the rental for repair to the damaged rental item is subject to tax as a taxable service. See sec. 3.292 of this title (relating to Repair, Remodeling, Maintenance, and Restoration of Tangible Personal Property). Charges for items destroyed or lost by a lessee are not taxable. However, if a lessee is required to purchase an item damaged by the lessee, the charge for the damaged item is taxable.

(3) All transportation charges billed by the lessor to the lessee related to the leased property are taxable. Charges for transportation billed directly to the lessee by third-party carriers are not taxable. See sec. 3.303 of this title (relating to Transportation and Delivery Charges).

(4) Charges in the lease agreement for labor, such as charges for supervision,

set-up, hook-up, assembly or disassembly, erection, and dismantling, are included in the lease price and are taxable.

(5) A charge imposed for the early termination of the lease is included in the lease price and is taxable.

(6) Under an operating lease, any interest charges will be taxable whether or not separately stated unless the interest charge is clearly imposed for late payment or other defaults under the lease.

(7) Under a financing lease, charges for interest by the lessor to the lessee will be taxable unless the rate of interest or the actual interest charged is separately stated in a contract, invoice, billing, sales slip, or ticket to the customer.

(e) Tangible personal property rented for use on residential and nonresidential jobs.

(1) Persons renting equipment for use in the performance of contracts to construct new nonresidential real property or to construct, repair, or remodel residential real property owe tax to the equipment rental company. Tax may not be collected from their customers on a separately stated charge for this reimbursable expense item even if the equipment charges to the customer are separately stated from operator charges. See sec. 3.291 of this title (relating to Contractors).

(2) Persons renting equipment for use in the performance of contracts to repair or remodel nonresidential real property owe tax to the equipment rental company. Tax must also be collected from their customers on the total charge for the job including the amount paid for the equipment rental.

(3) When both remodeling and new construction are being performed under the same contract, the tax to be collected from customers on the rental charges should be determined as provided by sec. 3.357(b)(7) of this title (relating to Labor Relating to Nonresidential Real Property Repair, Remodeling, Restoration, Maintenance, New Construction, and Residential Property).

(f) Imposition of taxes; time for filing; credits.

(1) Leases subject to sales tax.

(A) An operating lease executed while the property is within the state is subject to sales tax. Tax will be due on the total lease amount for the entire term of the lease regardless of where the property is used if the lessee takes delivery in the state. Any renewal of the contract, extensions, or options exercised while the tangible personal property is outside the state will not be subject to Texas tax unless the property reenters the state.

(B) A financing lease executed while the property is within the state is subject to sales tax if the lessee takes delivery in the state. Tax will be due on the total amount of the contract regardless of where the property received in Texas is used during the lease.

(2) Leases subject to use tax. Property brought or shipped into the state for use under the terms of a financing lease or an operating lease will be presumed to be subject to use tax. See sec. 3.346 of this title (relating to Use Tax). The use tax will be due on the lease price for the entire term of an operating lease regardless of where the initial contract was executed. Credit will be allowed against any sales or use tax legally imposed and paid to another state. See sec. 3.338 of this title (relating to Multistate Tax Credits and Allowance of Credit for Tax Paid to Suppliers).

(3) Method and time for filing reports.

(A) Under an operating lease, a lessor must report the rental charges in the period in which they are considered income under the lessor's method of reporting. Under the accrual method of reporting, the rental charges are considered income when the lease amount becomes due under the rental agreement. If the lessor does not collect the tax, the lessee must report the tax in the period in which each lease amount becomes due under the rental agreement.

(B) Under a financing lease, the lessor must collect all tax due under the lease at the time the lessee takes possession of the property or when first payment is due from the lessee, whichever is earlier. Tax must be reported on or before the 20th day of the month following the reporting period in which the tax is collected. If the lessor does not collect the tax, the lessee must report the tax due when the lessee takes possession of the property or when first payment is due, whichever is earlier.

(C) An out-of-state lessor deriving rental receipts from tangible personal property located in Texas is engaged in business in Texas and is required to

collect Texas use tax. Under an operating lease, the use tax must be reported by the lessee if the lessor fails to collect it. The tax must be reported by the lessee based upon the lessee's accounting method used for regular books and records. Under a financing lease, the use tax must be reported by the lessee when the lessee takes possession of the property or when the first payment is due, whichever is earlier.

(g) Sales of leased property under operating leases; credit allowed.

(1) When a lessee buys the property that the lessee was renting under the terms of an operating lease and the lessor allows credit against the sales price for all or part of the lease payments previously made by the lessee on the same property, tax is not due on the amount allowed as credit if the lessor has collected and remitted tax on the prior rental payments. The lessor must collect the tax on the balance of the sales price based on its method of accounting for sales and use tax purposes.

(2) When the lessor sells property to a third party who was not the lessee of that property and allows the third party credit against the sales price for all or part of the lease payments previously made by the former lessee, tax may not be refunded on the amount allowed as credit. The lessor must also collect and report the tax on the sales price of the property to the third party based on its method of accounting for sales and use tax purposes.

(h) Assignment of lease payments under operating leases. A lessor may factor or assign to a third party the lessor's right to receive all lease payments due under the agreement with the lessee. At the time the lease agreement is factored or assigned, tax is due on all lease amounts not yet reported. The lessor is responsible for reporting the tax to the comptroller's department in the report period the lease agreement is assigned or factored. No deduction in the amount of tax due and payable by the lessor is allowed if a transfer at a discount is made to a third party. No tax liability is incurred by the purchaser of the lease agreement. This section does not apply to the pledge of lease contracts by a lessor to a third party as loan collateral under the terms of a bona fide loan agreement.

(i) Assignment of lease payments and property under operating leases. A lessor may assign to a third party the lessor's right to receive all lease payments due under an agreement with the lessee and, in the same transaction, transfer title to the property covered by the lease. At the time the operating lease contract is assigned and title to the property is transferred to the third party, the third party purchaser must begin collecting and remitting tax on the full amount of the taxable rental charges remaining in the lease. The third party purchaser may issue a resale certificate to the lessor as provided by subsection (j) of this section. Tax must be reported by the third party purchaser as provided by subsection (f)(3)(A) of this section.

(j) Sales for resale; resale certificates.

(1) The purchaser of property which is to be held for lease within the United States of America, its territories and possessions, or within the United Mexican States may issue a resale certificate in lieu of the sales or use tax at the time of purchase. Mexican retailers who purchase for resale must show their Federal Taxpayers Registry (RFC) identification number for Mexico on the resale certificate and give a copy of their Mexican Registration Form to the Texas seller. However, if the lessor subsequently uses the property in any manner other than the leasing of it, or display or demonstration of it, the lessor becomes liable at the time of the use for sales tax based on the fair market rental value for the period of time used. The fair market rental value is the amount that a lessee would pay on the open market to rent the item for use. If the fair market rental value of the property cannot be ascertained, tax is due on the original purchase price of the property.

(2) At any time, the lessor using the property purchased under a resale certificate may stop paying tax on the fair market rental value and instead pay sales tax on the original purchase price. When the lessor elects to pay sales tax on the purchase price, credit will not be allowed for taxes previously paid on the fair market rental value. See sec. 3.285 of this title (relating to Resale Certificate; Sales for Resale).

(3) A resale certificate may be issued by a retailer for a repair or replacement part, accessory, or equipment that will be attached to a motor vehicle to be rented or leased under the provisions of the Tax Code, Chapter 152. In this paragraph, the terms "rental" and "lease" are defined by the Tax Code, Chapter 152, rather than by subsection (a)(2) of this section.

(k) Lease of real property with tangible personal property.

(1) If a contract for the lease or rental of real property includes the lease or rental of tangible personal property (such as furniture) as part of the agreement, no sales tax is due on the amount charged the tenant for the lease

or rental of the tangible personal property. A resale certificate may not be issued and sales or use tax must be paid at the time the tangible personal property is purchased.

(2) Sales or use tax is due on the separate lease or rental of tangible personal property by a person or entity not owning or managing the real property in which the tangible personal property is or will be situated. A resale certificate may be issued in lieu of paying the tax at the time of purchase of the tangible personal property for subsequent lease or rental.

(l) Other taxes. For information pertaining to tax on motor vehicle rental receipts, refer to sections promulgated under the Motor Vehicle Sales and Use Tax Act.

(m) Local tax. For proper collection and allocation of city and transit sales taxes, see sec. 3.374 of this title (relating to Collection and Allocation of the City Sales Tax) and sec. 3.424 of this title (relating to Collection and Allocation of Transit Sales Tax).

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