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Director

PRIVATE TAXPAYER RULING LR07-001

March 19, 2007

This private taxpayer ruling is in response to your letter dated February 9, 2006, in which you requested a private taxpayer ruling on behalf of your client, ... ("Taxpayer"). You request a ruling concerning whether Taxpayer's "Leases" qualify as "leases" under Arizona Revised Statutes ("A.R.S.") § 42-5071, in order to qualify for an exemption from transaction privilege tax. Pursuant to A.R.S. § 42-2101, the Department may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

Statement of Facts:

Your February 9, 2006 letter presents the facts relating to Taxpayer's business as follows:

"Taxpayer" enters into an arrangement with its customer, (the "Customer") which is referred to as a "Lease." One of two "Leases" may be entered in to. Lease #1 and Lease #2 both provide, in pertinent part, as follows: (i) the lease is intended to constitute a true lease for commercial law purposes, (ii) the lease is intended to be treated as a financing transaction and not as a true lease for federal income tax purposes and accordingly the lessee is entitled to all cost recovery deductions associated with the leased property, (iii) the leased property will be titled in the name of the lessor, (iv) the lessee is required to insure and assumes all risk of loss (including theft, destruction and risk of damage) with respect to the leased property, (v) the lessee is required to pay any fees, taxes, levies or assessments levied against the leased property, and (vi) the lessee indemnifies and holds lessor harmless against any liability claims arising from the leased property.

The primary distinction between Lease #1 and Lease #2 is the end of lease options. Both Leases provide that at the end of the lease term, the lessee may either (i) return the leased property to the lessor or (ii) purchase the leased property from the lessor. However, Lease #1 provides for a purchase option (of \$1.00); and, Lease #2 provides for a purchase option price equal to ten percent (10%) of the adjusted capitalized cost of the leased property.

Your Position:

Your position as stated in your February 9, 2006 letter is as follows:

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Both Lease #1 and Lease #2 will be treated as a “finance lease” or a “capital lease” and not a “true lease” for federal income tax purposes. Based on LR96-012, it appears that the Leases are leases for TPT purposes.

Conclusion and Ruling:

A.R.S. § 42-5061 imposes the transaction privilege tax on the business of selling tangible personal property at retail. The tax base is the gross proceeds of sales or gross income derived from the business.

A.R.S. § 42-5071 imposes transaction privilege tax on the business of leasing or renting tangible personal property for a consideration. The tax base for the personal property rental classification is the gross proceeds of sales or gross income derived from the business.

Transaction privilege tax is imposed on the business of leasing or renting tangible personal property for a consideration. A.R.S. § 42-5071. Several factors may be examined in making the determination of the taxability of a transaction under the transaction privilege tax. Some of the facts presented by Taxpayer suggest the agreements are leases for purposes of transaction privilege tax and some suggest they are not. For example, the fact that the parties choose to call an agreement a lease is a factor that suggests the agreements are leases. The stated intent to treat the income derived from an agreement for federal income tax purposes as income from a financing agreement, suggests the agreements are not leases for the purposes of the application of Arizona’s transaction privilege tax to the transaction.

Two significant factors which are examined to make the determination of taxability of the proceeds are: which party holds title to the property and the terms under which ownership of the property may be vested in the lessee at the end of the lease term.

Where other factors do not strongly suggest another result, an agreement that provides that the lessor holds title to the property and requires the exercise of a fair market value purchase option for the lessee to purchase the property at the end of the lease term is considered to be a lease for transaction privilege tax purposes. The gross income from such an agreement is subject to transaction privilege tax under the personal property rental classification. Income received from a lessee’s exercise of a purchase option is subject to tax under the retail classification. Note, as with other factors, whether or not title is vested in “lessor” is not, alone, dispositive. However, the existence of a purchase option that requires payment of more than a nominal amount is a strong indication of a lease.

The agreement between Taxpayer and Customer provides that the leased property will be titled in the name of the Taxpayer; but, Customer shall retain possession of the property and all benefits and risk of loss during the 60 month term of the Lease. And, under the anticipated purchase options of the agreement, Lease #1 provides for a purchase option of one dollar (\$1.00); and, Lease #2 provides for a purchase option price equal to ten percent

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(10%) of the adjusted capitalized cost of the leased property. For purposes of this ruling, based on the documentation provided, the adjusted capitalized cost is the same as the "Time Balance." The purchase option price under Lease #1 is a nominal, pre-determined amount of \$1.00, not a fair market value purchase price. The purchase option price under Lease #2 is an amount representing more than a nominal purchase price.

Considering all the facts presented by Taxpayer, the Department rules that Lease #1 is not a lease for Arizona transaction privilege tax purposes and Lease #2 is a lease for purposes of Arizona's transaction privilege tax.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your correspondence dated February 9, 2006.

This response is a private taxpayer ruling and the determinations herein are based solely on the facts provided in your request. The determinations are subject to change should the facts prove to be different on audit. If it is determined that undisclosed facts were substantial or material to the Department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different Department position.

The determinations in this private taxpayer ruling are applicable only to the taxpayer requesting the ruling and may not be relied upon, cited nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.