

# S&U-12 Leases and Rentals

## ***Introduction***

*This publication explains how sales and use tax applies to lease and rental transactions in New Jersey. It provides information on the difference between rentals and leases and the correct procedures for charging, collecting and remitting tax on both types of transactions. It also explains who is responsible for paying sales and use tax and which transactions are exempt from tax.*

## **General Information**

The rental or lease of most tangible personal property in New Jersey is subject to the State's 6% sales and use tax. Tangible personal property means physical property other than real property (land and buildings).

Use tax is a compensating tax which the buyer must pay directly to the State whenever sales tax has not been collected on a taxable product or service. Use tax is calculated at the same rate as sales tax. Request publication ANJ-7, *Use Tax in New Jersey*, for more information about use tax.

## **Registration**

Every vendor of taxable goods or services maintaining a place of business in New Jersey, employing workers in this State, owning any business property here or otherwise conducting business in this State is required to register with New Jersey by filing a business registration application (Form NJ-REG). "Vendor" includes anyone who purchases tangible personal property for lease (or rental), whether in this State or elsewhere. Having leased tangible personal property present in New Jersey constitutes having a place of business in this State. Accordingly, out-of-State businesses which own leased property located in New Jersey must register and remit tax.

## **Rentals vs. Leases**

The New Jersey Sales and Use Tax Act makes a distinction between rentals and leases. Although both are agreements for the temporary posses-

sion and/or use of tangible personal property, a **rental** is a short term transaction with an original contract term of no more than 28 days, while a **lease** has an original contract term longer than 28 days. A **lessor** is any owner of property which is leased or rented to others. A **lessee** is someone who leases or rents property from a lessor. The term **renter** is often substituted for lessee when referring to someone who rents (rather than leases) property.

**NOTE:** A lessee who subleases the property he is leasing is also a lessor.

## Rentals

Rental transactions are treated as retail sales. The renter is considered to be the end user of the property being rented and is responsible for paying sales tax on the amount of each rental payment. The lessor collects the tax from the renter and remits it to the State.

### Example

Ann rents a car for one week. The rental agency must collect 6% sales tax from Ann on the rental charge and remit it to the State by the date the agency's next sales and use tax return is due.

## Leases

Leases are treated differently than rentals for sales and use tax purposes. Under the law, the **lessor** is considered to be the end user of leased property and the one responsible for paying use tax *when the property is leased*. The lessor does *not* collect sales tax from the lessee. However, nothing in the law prohibits a lessor from increasing the lessee's monthly payment to recover this tax expense. Lessors may elect to pay use tax by using either:

1. The Original Purchase Price Method;  
or
2. The Total Lease Payments Method.

Regardless of the method selected, the tax is due in full up front.

### Option 1 — Original Purchase Price Method

Under this method, use tax is paid only once on the property. The lessor's use tax liability is calculated on:

- The amount paid by the lessor for the property which will be leased, **less**
- Any separately stated charges for transportation to the lessor's place of business, **plus**
- The cost of any accessories or options installed, or any services performed, by the lessor (or others on the lessor's behalf) on or in connection with the property being leased.

The value of any trade-in allowance received by the lessor at the time the property is acquired *may not* be deducted from the purchase price when computing use tax. Where the lessor is also the manufacturer of the leased property, the purchase price is considered to be the price at which items of the same kind are ordinarily sold in the regular conduct of business.

### Option 2 — Total Lease Payments Method

If this method is used, use tax must be paid *every time* the property is leased. The lessor's use tax is calculated on:

- The total of the lease payments **less**
- The total interest expense or lease service charge of a financial institution which accepts assignment of the lease; and/or
- The amount of the lessee's trade deficit paid off through the lease.

When the total of lease payments method is used to determine the lessor's use tax, the amount of any cash buy down payment or the value of a

trade-in that reduces the cost of the lease to the lessee must be added back to the total lease payments before calculating the use tax due.

**Example**

A lessor pays \$16,500 for a new vehicle after being given an \$800 trade-in allowance on an older vehicle. The price included \$975 in transportation costs. The manufacturer's suggested retail price (sticker price) of the new vehicle is \$19,100. The lessor enters into a 60 month lease with a lessee who requests that \$1,800 worth of additional options be installed in the vehicle. The lessee makes a \$2,500 cash buy down payment and the lessor pays off the \$3,210 balance of the lessee's existing lease. Total interest and non-taxable fees amount to \$4,740, which brings the monthly lease payments to \$339.

The lessor may choose either of the following methods to determine the amount of use tax due:

**Option 1 — Original Purchase Price Method**

Lessor's purchase price	\$16,500.00
Lessor's trade-in allowance	+ 800.00
	17,300.00
Transportation charge	- 975.00
	16,325.00
Lessor installed options	+ 1,800.00
	18,125.00
Lessor's tax base	18,125.00
New Jersey use tax @ 6%	x .06
Lessor's use tax due	\$1,087.50

**Option 2 — Total Lease Payments Method**

Lease payments	(\$339 x 60)	\$20,340.00
Interest and fees	(\$79 x 60)	- 4,740.00
		15,600.00
Cash buy down		+ 2,500.00
		18,100.00
Trade deficit		- 3,210.00
		14,890.00
Lessor's tax base		14,890.00
New Jersey use tax @ 6%		x .06
Lessor's use tax due		\$893.40

*Once use tax is paid on the property's purchase price, it is never again due from the same lessor of that particular item of property, no matter how many times the property is subsequently leased.*

*If tax is paid on the total of the lease payments, each time a lease ends and a new lease begins the lessor must again choose whether to pay tax on the purchase price (not the fair market value at the time) or on the total of the new lease payments.*

## Remitting Sales and Use Tax

Whichever method is chosen to compute use tax, the total amount of tax must be remitted in full to the State by the due date of the lessor's next quarterly sales and use tax return (Form ST-50) or monthly remittance (Form ST-51). The lessor must provide the lessee with a properly completed Sales and Use Tax Lessor Certification (Form ST-40) to verify that the use tax obligation has been satisfied. Request Tax Topic Bulletin S&U-7, *Filing Sales and Use Tax Returns*, for information on how and when to remit sales and use tax.

## Assigned Leases

When the original lessor (assignor) assigns the rights to a lease over to an assignee, whether the assignment is of all rights and title to the leased property or only of the rights to the remaining lease payments, the assignor is obligated to pay the lessor's use tax as the first person purchasing property for lease. The assignee should obtain a Lessor Certification (Form ST-40) as proof that tax was paid by the original lessor.

## Purchasing Property Intended for Lease

Lessors do not pay sales tax when purchasing property they intend to rent or lease. They issue a valid New Jersey Resale Certificate (Form ST-3) to their registered New Jersey supplier instead. The lessor then either (1) collects sales tax from the renter on each rental payment; or (2) if the property is leased, remits use tax based on either the original purchase price or the total lease payments as described above.

## Open-Ended Rentals

Whether a transaction is a lease or a rental often depends not only on the 28 day criterion but also on the normal business practices of the lessor and the intent of the parties to the agreement. For instance, property leased to many lessees over its life may indicate that the lessor's normal business practice is to rent rather than lease the property, even though a particular customer may use the property for several months before returning it. Likewise, property use agreements that have a stated term not greater than 28 days but which can be extended by the renter for any number of successive 28 day periods or portions thereof, are still considered rentals subject to the payment of sales tax by the renter, not leases subject to the lessor's use tax.

## Conditional and Installment Sales

Certain property use agreements, although cast in the form of a lease, may in substance actually be installment or conditional sales contracts. This determination can only be made by an examination of the facts existing at the time the agreement is entered into, including the intention of the parties thereto. In general, however, financing or capital leases are considered to be sales rather than lease transactions. So too are agreements which provide for:

- The lessee to acquire title to the property after a required number of lease payments.
- The property to be acquired by the lessee for a nominal sum at the end of the lease term. (Amounts less than 10% of the lessor's acquisition cost are considered nominal.)

Sales tax must be *collected* from the purchaser by the vendor on the contract price of such sales

and remitted in full to the State by the due date of the vendor's next quarterly sales and use tax return (Form ST-50) or monthly remittance (Form ST-51). Since these are sales transactions rather than leases, the lessor's use tax does not apply.

## **Exempt Transactions**

Transactions involving the lease or rental of certain kinds of property or of property intended for certain specific uses or by certain lessees are exempt from New Jersey sales tax by law. If a lease or rental transaction qualifies for exemption, the lessee will issue the appropriate, properly completed exemption certificate to the lessor. When a valid exemption certificate is issued, no New Jersey sales or use tax is due.

If the leased property is subsequently leased for a nonexempt use or is leased to a nonexempt lessee or is converted to a nonexempt use, use tax is due from the lessor.

A New Jersey Sales and Use Tax Lessor Certification (Form ST-40) should always be issued by the lessor, even when the transaction is exempt from tax. The exemption certificate issued by the lessee should be attached to the lessor's copy of Form ST-40 and retained for at least four years.

## **Property Exempt Due to Its Use**

The law stipulates that certain property is exempt from tax when rented or leased with the intention of being used for a particular purpose. For example, certain machinery and equipment used directly and primarily to produce tangible personal property is exempt because of its use. Heavy trucks and trailers as well as buses for public transportation, are also exempt. When renting or leasing such property, the lessee issues

a valid Exempt Use Certificate (Form ST-4) to the lessor. Request Tax Topic Bulletin S&U-4, *New Jersey Sales Tax Guide*, for more information about which products and services are subject to tax. Tax Topic Bulletin S&U-6, *Sales Tax Exemption Certificates*, contains further information about exemption certificates.

## **Exempt Organizations**

Many churches, hospitals and other exempt organizations are not required to pay sales tax on rentals or leases of property for the exclusive use of the organization. The Division of Taxation issues a New Jersey Exempt Organization Certificate (Form ST-5) to those organizations which apply and qualify for exempt status with the State of New Jersey. When a lessor rents or leases to an exempt organization, he must obtain a photocopy of the organization's ST-5 certificate as evidence of the exempt nature of the transaction.

Agencies of the Federal government, the United Nations and the State of New Jersey (as well as its political subdivisions) are also exempt from paying sales tax. Since they are not issued ST-5 certificates, a valid purchase order or contract, signed by an authorized official, is adequate evidence of these organizations' exempt status. If the amount involved is \$150 or less, a New Jersey Exempt Use Certificate (Form ST-4) may be accepted from these government agencies in place of a purchase order or contract.

## **Urban Enterprise Zones**

A qualified business located within a designated urban enterprise zone is exempt from paying sales tax on many items it rents or leases for its own use. In the case of a rental or lease to an urban enterprise zone business, the lessor must ob-

tain a properly executed Urban Enterprise Exempt Purchase Certificate (Form UZ-5) from the lessee.

**NOTE:** The urban enterprise zone exemption is not valid for transactions which involve automobiles, telecommunications services, room rentals or admissions. Thus, a qualified business *cannot* use the UZ-5 to obtain a tax exemption on the purchase, rental or lease of a motor vehicle.

### **Out-of-State Lessees**

When a New Jersey lessor leases property to an out-of-State lessee who takes delivery of the property outside of New Jersey, the lessor is not liable for the New Jersey lessor's use tax provided the lessee does not bring the property back into New Jersey for use in this State. If the property is brought back into New Jersey, use tax is due.

### **Property Leased Out-of-State Brought into New Jersey for Use in This State**

When property which was leased outside of New Jersey is brought into New Jersey for use in this State, the lessor must pay use tax unless he can claim a credit for tax paid to the other

state. A reciprocal credit for use tax legally paid to another State is available *only* if the other state also treats it as a tax primarily on the lessor, rather than the lessee. New Jersey will not allow a credit for tax paid in another state by the lessee to the account of the lessor.

If a credit cannot be claimed, the lessor's tax is based on either the original purchase price of the property or the remainder of the lease payments attributable to the number of months the property is used in New Jersey. For example, an automobile is brought into New Jersey in mid-lease. The lessor elects to pay use tax based on the lease payment option which amounts to \$400 on a 48 month lease. If the property is used in New Jersey for one year, the lessor would pay \$100 New Jersey use tax.

### **Property Leased in New Jersey Transferred Out-of-State**

When property leased in New Jersey is subsequently transferred out of State, the lessor of the property is not eligible for a refund of any New Jersey use tax which was paid up front at the time of the lease. No refund is warranted in such instances because the tax is based on the purchase of the leased property by the *lessor*.

**Taxpayers' Bill of Rights**

The New Jersey Taxpayers' Bill of Rights ensures that taxpayers are accorded fair and equitable treatment and receive the information and assistance they need to understand and meet their State tax responsibilities. To find out more, contact the Division of Taxation.

**For More Information**

For more information about leases and rentals, contact the Division's Tax Hotline at 609-292-6400, or write to:

NEW JERSEY DIVISION OF TAXATION  
TECHNICAL SERVICES  
TAXPAYER SERVICES BRANCH  
PO BOX 281  
TRENTON NJ 08646-0281

Many State tax forms and publications are now available, both by fax and through the World Wide Web. Call NJ TaxFax at 609-826-4500 from your fax machine's phone, or access the Division's home page via your computer's modem at:  
**<http://www.state.nj.us/treasury/taxation/>**