

SECTION 23 - LEASE OR RENTAL**23-1 LEASE RECEIPTS**

The gross receipts or gross proceeds derived from or the total amount agreed to be paid for the lease or rental, within North Carolina, of all kinds and types of tangible personal property not specifically exempt by statute are subject to the sales or use tax at the same rate that is applicable to the retail sale of such property. The tax shall be computed and paid on such gross receipts, gross proceeds, or rental payable without any deduction whatsoever for any expense incident to the conduct of business including, but not limited to, property taxes, interest, insurance fees, maintenance fees, delivery charges, etc. The tax is due and payable at the time the lessor bills the lessee for rent whether such billing is for the lump sum rental or on a monthly or other periodic basis. The privilege tax imposed under Article 5F applies to the lease or rental of tangible personal property that, if purchased, would be subject to the privilege tax.

G.S. 105-164.3(17) defines “**lease or rental**” as a transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. The term does not include the following:

1. A transfer of possession or control of property under a security agreement or deferred payment plan that requires the transfer of title upon completion of the required payments.
2. A transfer of possession or control of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of one hundred dollars (\$100.00) or one percent (1%) of the total required payments.
3. The providing of tangible personal property along with an operator for a fixed or indeterminate period of time if the operator is necessary for the equipment to perform as designed. For the purpose of this provision, an operator must do more than maintain, inspect, or set up the tangible personal property.

This definition shall be used for sales and use tax purposes regardless if a transaction is characterized as a lease or rental under generally accepted accounting principles, the Internal Revenue Code, or other provisions of federal, state, or local law. It will be applied prospectively from the date of adoption and will have no retroactive impact on existing leases or rentals. This definition shall neither impact any existing sale-leaseback exemption or exclusion nor preclude the adoption of a sale-leaseback exemption or exclusion.

Note: For information regarding the lease or rental of films, videotape cassettes, and other equipment, refer to Sales and Use Tax Technical Bulletin 20-5.

History Note: Authority G.S. 105-164.3; 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: April 1, 2007; July 1, 2005; February 1, 2004.

23-2 ROYALTIES

Royalties paid, or agreed to be paid, either on a lump sum or production basis, for tangible personal property used in this State are rentals subject to the applicable State and any local sales or use tax.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;

Revised: June 1, 2002.

23-3 LOCAL PROPERTY TAXES ON LEASED PROPERTY

Local property taxes imposed on tangible personal property being leased are an expense of conducting business incurred by the owner-lessor. Payments by the lessee to the lessor for property taxes constitute a part of the total consideration paid by the lessee for the lease of the property and, therefore, are includable as a part of the lessor's gross receipts which are subject to sales tax or, in the case of motor vehicles, the alternate highway use tax. It has no bearing on the application of sales tax or highway use tax whether the property tax is assessed against the lessor who bills the lessee as a separate charge or that the taxes are paid by the lessee directly to the taxing authority on behalf of the lessor.

History Note: Authority G.S. 105-164.4; 105-187.5; 105-264;
Issued: June 1, 1996.

23-4 INSURANCE ON LEASED PROPERTY

The gross proceeds derived from or amounts agreed to be paid for the lease or rental of all kinds and types of tangible personal property for storage, use or consumption within this State are subject to the applicable State and any local sales or use tax. The tax shall be computed on the gross receipts, gross proceeds or rental payable without any deduction whatsoever for any insurance charges paid to insure the property of the lessor or to insure the lessor against liability for damages to the property or person of others. When the lessee purchases insurance on his own property or to insure himself against liability for damages to the property or person of others, insurance premiums paid by such lessee directly to the insurer or to the lessor as agent for transmittal to the insurer are exempt from tax. If the lessee pays such insurance premiums directly to the lessor as agent for transmittal to the insurer, such amounts are exempt from tax provided they are separately stated from the charges for the lease or rental of tangible personal property in the lessor's records and on the invoice given to the lessee; otherwise, the total amount charged by the lessor is subject to the tax.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: June 1, 2002.

23-5 MAINTENANCE OF LEASED PROPERTY

- A. Sales of tangible personal property to registered lessors or retailers for the purpose of lease or rental exclusively are wholesale sales and exempt from tax provided properly executed Certificates of Exemption are furnished to the vendors of such property. Sales of lubricants, repair parts and accessories to such lessors or retailers who use them to repair, recondition or maintain such leased or rented personal property are also wholesale sales when properly executed Certificates of Exemption are provided to vendors of this type property. Lessors are responsible for payment of any applicable State and any local sales or use tax on the purchase price of such items if they are used for a purpose other than repairing or maintaining leased or rented property or if they are resold as such. Any tax due thereon is to be paid to the Secretary of Revenue on the lessors' or retailers' sales and use tax returns.
- B. When the lessee purchases lubricants and repair parts to maintain tangible personal property being leased or rented, the lessee is liable for payment of the applicable State and any local sales or use tax on the cost price of such purchases to the vendors or to the Secretary of Revenue.

C. Maintenance Agreements on the Lease of Property**1. Definitions****a. Optional Maintenance Agreement**

A maintenance agreement is optional within the meaning of this Bulletin when the lessee is not required to purchase the maintenance agreement from the lessor and he is free to contract with anyone he chooses to maintain the leased property.

b. Mandatory Maintenance Agreement

A mandatory maintenance agreement is mandatory within the meaning of this Bulletin when the lessee, as a condition of the lease, is required to purchase the maintenance agreement from the lessor.

2. Optional Maintenance Agreement

If a lessor enters into a maintenance agreement to maintain leased property at the option of its customer (lessee) for a flat fee whether the agreement is a separate contract or a part of the lease of the property and no separate charge is made to his customer for parts and supplies which are used in maintaining such property, tax is not due on the receipts derived from the maintenance agreement. The lessor is deemed to be using the repair parts or supplies in the performance of a service and tax would be due on the cost price of the repair parts or supplies used in performing the service. If, however, in connection with maintenance agreements the lessor makes a charge for parts or supplies not covered by the maintenance agreement and bills his customer for the parts or supplies, the lessor would be liable for collecting and remitting the applicable State and any local sales or use tax on such transactions.

3. Mandatory Maintenance Agreement

If the maintenance agreement is required as a condition of the lease of the property, whether it is a separate agreement or a part of the lease of the property, the charge for the maintenance agreement is subject to the applicable State and any local sales or use tax.

History Note: Authority G.S. 105-164.4; 105-164.5; 105-164.6; 105-164.28;
105-264;
Issued: June 1, 1996;
Revised: July 1, 2005; June 1, 2002.

23-6 EQUIPMENT FURNISHED WITH OPERATOR

If the owner of tangible personal property furnishes an operator or crew to operate such property, such owner is not deemed to be renting or leasing the property but is rendering a service and the receipts therefrom are not subject to sales or use tax. Persons purchasing repair parts, lubricants and other tangible personal property for use in rendering such service are liable for payment of the applicable State and any local sales or use tax on the purchase price.

History Note: Authority G.S. 105-164.3; 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: June 1, 2002.

23-7 LEASES OF PROPERTY FOR OUT-OF-STATE USE

If a lessee leases tangible personal property from a North Carolina lessor for the original purpose of using it outside this State and if the property is, in fact, used outside this State, the initial lease payment will be subject to the applicable State and any local sales tax in North Carolina if the property is delivered to the lessee in this State and immediately thereafter taken outside this State for use. In such cases, the lessor's records shall clearly reflect the nature of the transaction. If the property is returned to North Carolina, the receipts from use in North Carolina are taxable. If the face amount of the lease is paid in a lump sum, the face amount is subject to the North Carolina sales tax.

For additional information on sourcing principles for periodic rental payments, refer to Sales and Use Tax Technical Bulletin 23-17 B.

History Note: Authority G.S. 105-164.4; 105-264;
Issued: June 1, 1996;
Revised: April 1, 2007; February 1, 2004; June 1, 2002.

23-8 MOTOR VEHICLE LEASES - HIGHWAY USE TAX AND ALTERNATE GROSS RECEIPTS TAX

For information regarding highway use tax and the alternate gross receipts tax on motor vehicles leased, refer to Sales and Use Tax Technical Bulletin 35-1.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-164.13;
105-187.1 - 105-187.11; 105-264;
Issued: June 1, 1996;
Revised: October 15, 1998.

23-9 EXTENSION OF LEASE PERIOD

When tangible personal property, the sale of which is subject to a maximum tax, is leased for a definite stipulated period of time, the lease payments during the lease period are subject to the maximum tax. If the original lease contains provisions for extension either by notification or by failure to notify the lessor of termination, the extended term of the lease is part of the original lease and the maximum tax would apply to the entire lease including any extension under the terms of the original lease. If, however, the original lease does not contain provisions for extension at the option of the lessee, whether by action or nonaction, but a new lease agreement is subsequently entered into granting an extension or a new lease, there would be a second lease which would not have the benefit of sales tax payments made by reason of the first lease with respect to the maximum tax.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996.

23-10 ASSIGNMENT OF LEASE**A. Assignment of a Lease Contract and Creation of a Security Interest in the Leased Property**

Where upon a recourse basis a lessor assigns a lease contract and gives a security interest in the leased property which is designated as such but retains title to such property, the lessor remains liable for collecting and remitting tax on the lease receipts notwithstanding that the lessor does not receive rental payments directly from the lessee. However, if the assignee enforces the

security agreement and acquires title to the leased property, he becomes the lessor of such property and liable for collecting and remitting tax on the receipts from its lease or rental.

B. Assignment of a Lease Contract Together With its Right, Title and Interest in the Leased Property For Security Purposes

Where for security purposes and upon a recourse basis, a lessor assigns a lease contract together with its right, title and interest in the leased property, but the property will revert to the lessor at the expiration of the lease, the lessor remains liable for collecting and remitting tax on the lease receipts notwithstanding that the lessor does not receive rental payments directly from the lessee.

C. Assignment of a Lease Contract and All Right, Title and Interest in the Leased Property

When a lessor assigns a lease contract together with all right, title and interest in the leased property, the assignment is not for security purposes and the assignor does not retain any ownership rights in the contract or the property. The assignee has no recourse against the assignor. In this situation, the assignee has assumed the position of the lessor. The assignee must be registered for sales and use tax purposes with this State and is liable to collect and remit the tax on the remaining lease receipts. The assignor shall obtain a valid Certificate of Exemption from the assignee bearing the assignee's North Carolina sales and use tax registration number.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: July 1, 2005.

23-11 LEASE WITH OPTION TO PURCHASE

Sales or use tax is due on the gross receipts derived from or the total amount agreed to be paid for the lease or rental of tangible personal property under a lease agreement with an option to purchase. If the agreement provides that the lessee will pay a stipulated amount at the time the option is exercised less a credit for a portion or all of the lease payments, the tax is due on the amount actually paid. For example, when the option is exercised, if the purchase price of the tangible personal property is \$700 and the credit allowed for lease payments under the agreement is \$200 on which the tax has been paid, additional tax is due on the \$500 at the time the option is exercised.

For additional information on the definition of "lease or rental," refer to Sales and Use Tax Technical Bulletin 23-1.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: April 1, 2007; February 1, 2004.

23-12 SALE OF LEASED PROPERTY

When tangible personal property which has been leased is sold at retail, the retail sale is subject to the applicable State and any local sales or use tax without regard to any tax which has been collected and remitted to the Department on receipts from the lease or rental of the property.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: June 1, 2002.

23-13 LEASED DEPARTMENTS

When a store or other business leases any of its departments to other persons from which retail sales of tangible personal property are made, the lessee of each leased department shall register with the Department and unless the Secretary has agreed in writing otherwise, file separate sales and use tax returns. If the lessor keeps the lessee's books for the lessee and makes collections on account of the lessee's sales, the lessor may, as agent for the lessee, file the required separate returns for each lessee and pay to the Department the taxes due. However, the lessee shall not be relieved of his tax liability if the lessor fails to make the proper returns or fails to remit all taxes due by the lessee to the Department.

History Note: Authority G.S. 105-164.16; 105-264;
Issued: June 1, 1996;
Revised: June 1, 2002.

23-14 CONDITIONAL SALES CONTRACT

Lease agreements with option to purchase may contain some provisions which make the instrument a conditional sales contract even though denominated a lease with option to purchase. Such instruments may contain any one of the following provisions:

1. the risk of the property during the term of the lease is that of the lessee;
2. that the lessee is to maintain, restore, or replace the property if damaged or destroyed during the term of the lease;
3. the lessee is to pay the taxes and insurance on the property during the term of the lease.

When any of these elements appear, the lease shall be mailed to the Taxpayer Assistance Division for determination as to whether the instrument is a lease with an option to purchase or a conditional sales contract.

An agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of one hundred dollars (\$100.00) or one percent (1%) of the total required payments does not constitute a lease and is considered to be a conditional sales contract.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: April 1, 2007; July 1, 2005; February 1, 2004.

23-15 BOWLING ALLEY AND SKATING RINK FEES

Charges for the use of a skating rink or bowling alley are not subject to sales or use taxes; however, if such businesses rent tangible personal property, such as skates and shoes, charges for same are subject to sales tax. Sales or rentals of tangible personal property by such businesses are subject to the general rate of State tax and any applicable local sales or use tax.

History Note: Authority G.S. 105-164.3; 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: June 1, 2002.

23-16 GOLF DRIVING RANGE FEES

Charges by golf driving ranges for the use of the range are not subject to sales or use taxes. In such cases, the person who pays the charge is generally entitled to the use of a golf club, basket of balls and the driving range; thus, there is no sale or rental of tangible personal property. Sales or rentals of tangible personal property by such businesses are subject to the general rate of State tax and any applicable local sales or use tax.

History Note: Authority G.S. 105-164.3; 105-164.4; 105-164.6; 105-264;
Issued: June 1, 1996;
Revised: June 1, 2002.

23-17 SOURCING PRINCIPLES

G.S. 105-164.4B contains principles to be used in determining where to source the sale of a product and sourcing principles for periodic rental payments.

1. **General Principles** – The following principles apply in determining where to source the sale of a product. These principles apply regardless of the nature of the product.
 - a. Over-the-counter. - When a purchaser receives a product at a business location of the seller, the sale is sourced to that business location.
 - b. Delivery to specified address. - When a purchaser receives a product at a location specified by the purchaser and the location is not a business location of the seller, the sale is sourced to the location where the purchaser receives the product.
 - c. Delivery address unknown. - When a seller of a product does not know the address where a product is received, the sale is sourced to the first address or location listed below that is known to the seller:
 - (1) The business or home address of the purchaser.
 - (2) The billing address of the purchaser or, if the product is a prepaid telephone calling service that authorizes the purchase of mobile telecommunications service, the location associated with the mobile telephone number.
 - (3) The address from which the tangible personal property was shipped or from which the service was provided.
2. **Periodic Rental Payments** – When a lease or rental agreement requires recurring periodic payments, the payments are sourced as follows:
 - a. For leased or rented property, the first payment is sourced in accordance with the principles set out in Section 1. of this Bulletin and each subsequent payment is sourced to the primary location of the leased or rented property covered by the payment. This provision applies to all property except motor vehicles, aircraft, and transportation equipment.
 - b. For leased or rented property that is a motor vehicle or an aircraft but is not transportation equipment, all payments are sourced to the primary location of the leased or rented property covered by the payment.

- c. For leased or rented property that is transportation equipment, all payments are sourced in accordance with the principles set out in Section 1. of this Bulletin.
 - d. For a lease or rental that does not require recurring periodic payments, the payment is sourced the same as a retail sale in accordance with the principles set out in Section 1. of this Bulletin.
3. **Transportation Equipment Defined** – As used in this section, the term “**transportation equipment**” means any of the following used to carry persons or property in interstate commerce: a locomotive, a railway car, a commercial motor vehicle as defined in G.S. 20-4.01, or an aircraft. The term includes a container designed for use on the equipment and a component part of the equipment.

History Note: Authority G.S. 105-164.4B; 105-264;
Issued: July 1, 2005; February 1, 2004;
Revised: April 1, 2007.

23-18 LICENSE TO USE

A license to use taxable tangible personal property, such as prewritten computer software delivered on a storage medium, is subject to the sales and use tax or privilege tax at the same rate that is applicable to the sale or purchase of such property.

History Note: Authority G.S. 105-164.4; 105-164.6; 105-187.50; 105-187.51;
105-187.51A; 105-187.51B; 105-187.52; 105-264;
Issued: April 1, 2007.