

**North Carolina Department of Revenue  
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## **IMPORTANT NOTICE – LEASE OR RENTAL**

The 2003 General Assembly enacted House Bill 397 that substantially changes the definition of lease or rental and the sourcing principles for periodic lease or rental payments. The changes are effective July 15, 2003. The first section of this document sets out the statutory changes in the sales and use tax laws; the second section explains the effect of the law changes.

### **Section 1: Law Changes**

The following definition has been amended:

**G.S. 105-164.3(17)** Lease or rental – 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:

- a. 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.
- b. 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.
- c. 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 sub-subdivision, an operator must do more than maintain, inspect, or set up the tangible personal property.

The sourcing principles in (b) and (c) have been added:

### **G.S. 105-164.4B** Sourcing Principles

- (a) 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.
  - (1) Over-the-counter – When a purchaser receives a product at a business location of the seller, the sale is sourced to that business location.
  - (2) Delivery to a 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.
  - (3) 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 in this subdivision that is known to the seller:
    - a. The business or home address of the purchaser.

- b. 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.
  - c. The billing address of the purchaser.
- (b) Periodic Rental Payments – When a lease or rental agreement requires recurring periodic payments, the payments are sourced as follows:
- (1) For leased or rented property, the first payment is sourced in accordance with the principles set out in subsection (a) of this section and each subsequent payment is sourced to the primary location of the leased or rented property covered by the payment. This subdivision applies to all property except motor vehicles, aircraft, and transportation equipment.
  - (2) 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.
  - (3) For leased or rented property that is transportation equipment, all payments are sourced in accordance with the principles set out in subsection (a) of this section.
- (c) Transportation Equipment Defined – As used in the 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.

## **Section 2: Effect of Law Changes**

The amendments to the definition of “lease or rental” do not result in any changes to the application of sales and use tax for these transactions. The provisions that set out activities that do not constitute lease or rental are consistent with the Department’s historical position regarding security agreements, conditional sales contracts, and rentals with an operator; however, they were not previously codified in the statutes.

The additions to the sourcing principles generally reflect the Department’s historical position. Sales or use tax is due on the receipts from tangible personal property that is located in the State. If the property is subsequently taken out of the State, tax is not due on subsequent lease or rental payments for the applicable periods.

For motor vehicles and aircraft that are not defined as transportation equipment, the new sourcing principles do represent a change with respect to the initial lease or rental payment. These payments are sourced to the primary location of the property notwithstanding where the lessee takes delivery of the property. For example, if a lessee takes delivery of an airplane in North Carolina but the primary location of the airplane is in another state, all the lease payments will be sourced to the other state and no sales or use tax will be due in North Carolina. The same principle applies to the alternate highway use tax due on motor vehicles.

The provisions for transportation equipment are new. These items will consist of property used by interstate carriers to transport people or property. The lease payments will be sourced in accordance with where delivery of the property occurs.