North Carolina Department of Revenue

Beverly Eaves Perdue
Governor

David W. Hoyle
Secretary

April 30, 2012

Account ID: [redacted]
FEIN: [redacted]

[redacted]

Attention: [redacted]

Dear Mr. [redacted]

We have your letters dated August 4, 2011 and January 9,2012, in which you request a ruling from the Department regarding your firm's North Carolina sales and use tax liability for two particular transactions.

N.C. Gen. Stat. § 105-164.3(17) defines "lease or rental, in part, as "[a] transfer of possession or control of tangible personal property for a fixed or indeterminate term for consideration. The term does not include any of 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 an 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-division, an operator must do more than maintain, inspect, or set up the tangible personal property.

Scenario One

Your firm enters into a 60 month fair market value lease contract (non-cancellable, irrevocable) and collects and remits to the Department sales tax based on each monthly lease charge. The

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lessee defaults on the lease contract prior to the end of the term, leaving a deficiency balance of $55,000.00, which your firm charges off to bad debt, in accordance with generally accepted accounting principles. You have inquired whether your firm's subsequent receipt of $20,000.00 as final judgment from litigation or the subsequent receipt of $10,000.00 from a third party guarantor is subject to sales or use tax.

Response

N.C. Gen. Stat. § 105-164.4(a)(2) provides that sales tax applies to the gross receipts derived from the lease or rental of tangible personal property by a person who is engaged in the business of leasing or renting tangible personal property, or is a retailer and leases or rents property of the type sold by the retailer. The applicable percentage rate is the rate and the maximum tax, in any, that applies to a sale of the property that is leased or rented.

The 60 month fair market lease your firm enters into with its customer is a "lease" within the meaning of N.C. Gen. Stat. § 105-164.3(17); therefore, any receipts derived from that lease would be subject to this State's sales tax. Section 45-4.D of the North Carolina Sales and Use Tax Technical Bulletins provides that if a deduction is taken for a bad debt and the debt is subsequently collected in whole or in part, the tax on the amount collected must be paid and reported on the sales and use tax return filed for the period in which the collection occurs. For purposes of reporting collection of the bad debt subsequent to having charged off and deducted such bad debt, any payments on the debt shall be applied first proportionally to the taxable price of the property or service and sales tax thereon, and secondly to interest, service charges, and any other charges. Therefore, a portion of the additional collections should be allocated as sales tax collected by your firm.

Scenario Two

Your firm enters into a 60 month financing agreement (non-cancellable, irrevocable), where title to the taxable tangible personal property being financed is passed to the customer at the beginning of the contract, and sales or use tax on the purchase price of the property is remitted to the Department at the contract commencement date. The customer defaults on the contract prior to the end of the term, leaving a net deficiency balance of $25,000.00, which is charged off to bad debt in accordance with generally accepted accounting principles. No refund request or credit has been requested for the uncollected portion of the sales or use tax that was remitted up front at the beginning of the contract. You have inquired whether your firm's subsequent receipt of $8,000.00 as a final judgment from litigation or the subsequent receipt of $2,000.00 from a third party guarantor would be subject to sales or use tax.

Response

Based on the information provided, the transaction your firm enters into in Scenario Two is not a lease within the meaning of N.C. Gen. Stat. 105-164.3(17). The taxable transaction is the original transaction where title to the financed taxable tangible personal property passed to the customer at the beginning of the contract. If your firm has not requested a refund or credit for sales or use tax previously remitted on the tangible personal property in question, the subsequent receipt of $8,000 as a final judgment from litigation or receipt of $2,000.00 from a third party guarantor is not subject to sales or use tax.

This ruling is based solely on the facts submitted to the Department of Revenue for consideration of the transactions described. If the facts and circumstances given are not accurate, or if they change, then the taxpayer requesting this ruling may not rely on it. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material aspect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that this document is not to be cited as precedent and that a change in statute, a regulation, or case law could void this ruling.

If you have any questions, you may reach me at the number listed below.

Very truly yours,

[redacted]
Administration Officer
Sales and Use Tax Division

[redacted]

cc: [redacted], Director of Sales and Use Tax Division