

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-90(8)S
Sales Tax
March 12, 1990

STATE OF NEW YORK

COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S891031C

On October 31, 1989, a Petition for Advisory Opinion was received from Eastman Kodak Company, 343 State Street, Rochester, New York 14650.

The issues raised by Petitioner, Eastman Kodak Company, are:

1. Whether payments made by Corporation A to Corporation C under a lease agreement, a copy of which was submitted as part of the Petition for Advisory Opinion, are subject to sales tax as receipts from a lease of tangible personal property or constitute non taxable payments under a security agreement?
2. Whether the sales taxability of such payments differ if the tangible personal property is used by Corporation A in an activity which is exempt from sales tax?

Corporation A purchases tangible personal property from Corporation B. Corporation A takes possession of the property and obtains legal title to the property. Subsequently, Corporation A finances the tangible personal property through Corporation C pursuant to a lease financing program. Under the terms of a transfer of rights agreement, Corporation A (the lessee) will sell, assign, transfer and convey to Corporation C (the lessor) all of Corporation A's right and beneficial interest, but not legal title, in the property. Corporation A's conveyance pursuant to the transfer of rights and retention of legal title to the property will not in any way alter its obligations under the lease.

In determining whether the "lease" agreement between Corporation A and Corporation C is a true lease or constitutes a security agreement, the pivotal issue is to ascertain whether Corporation C is acting as a financing agency or as a vendor. The proper method for analyzing the transaction in question is to examine the intent of Corporation A and Corporation C and the facts and circumstances existing at the time of the agreement. Sherwood Diversified Services, Inc., Debtor, 382 F. Supp. 1359 (S.D.N.Y. 1974).

In making this determination, the following factors and applicable sections of the lease agreement between Corporation A and Corporation C are pertinent:

1. Purchase Option - Where a lease is intended as a security device, the lessee usually becomes or has the option to become the owner of the leased equipment.

Section 1-201 (37) of the Uniform Commercial Code provides that "... the inclusion of an option to purchase does not of itself make the lease one intended for security..." However, it also states that "... an agreement that

upon compliance with the terms of the lease, the lessee shall become or has the option to become the owner of the property, for no consideration or for a nominal consideration does make the lease one intended for security."

Pursuant to Section 13 of the lease agreement between Corporation A and Corporation C, Corporation A as lessee, has the right, upon ninety (90) days notice to Corporation C, as lessor, to purchase the lessor's ownership interest in any unit of equipment for an amount equal to its adjusted acquisition cost or its fair market value. Under Section 1 of the lease, adjusted acquisition cost is defined as acquisition cost less the aggregate amount of all monthly rent components paid as portions of basic rent for such unit of equipment prior to the time of determination.

2. Risk of Loss or Damage - If a lease is intended to be a security device, the lessee often bears the risk of loss or damage to the property. In such a case the lessee would be required to make payments under the lease regardless of loss or damage to the property. The lessee would, however, receive the proceeds of any insurance payment resulting from such loss or damage. If the transaction is a true lease, then the lessor would be expected to receive any insurance proceeds. Similarly, if the property is sold to a third party, the lessee may be entitled to any surplus if the transaction is a sale with retained security interest while the lessor would be so entitled if the transaction is a true lease.

Pursuant to Section 15 of the lease agreement between Corporation A and Corporation C, Corporation A, as lessee, assumes all risk of loss of or damage to equipment, however caused. No loss of or damage to any equipment shall impair any obligation of Corporation A under the lease, which shall continue in full force and effect with respect to any lost or damaged equipment. Section 10 and Section 15 of the lease agreement also provide that Corporation C, as lessor, will receive any insurance proceeds which result from equipment damage, loss, theft, destruction, seizure, confiscation or the equipment being rendered unfit for use or damaged beyond repair, such proceeds to be applied against amounts owed to Corporation C by Corporation A with any proceeds received by Corporation C in excess of the amounts owed by Corporation A to be paid by Corporation C to Corporation A. Similarly, Section 12 of the lease provides that if Corporation A elects to terminate the lease of any unit of equipment, upon proper notification to Corporation C, Corporation A may arrange, at its own cost and expense, for the sale of such equipment in an arms length transaction, the receipts from such sale to be delivered to Corporation C. Upon application of such receipts to any amounts due Corporation C from Corporation A, any excess receipts from such sale shall be paid to Corporation A by Corporation C.

3. Recorded Security Interest - The filing of a security instrument by the "lessor" pursuant to the provisions of Article 9 of the Uniform Commercial Code in an attempt to perfect the security interest tends to indicate that the intention of the parties was other than to create a leasehold interest since a true lease creates no interest which could be subject to an Article 9 security interest. However, a lessor may record his interest, even though a true lease is intended, as a means of protecting his claim in the event a court characterizes the

transaction as a sale governed by the provisions of Article 9.

Pursuant to Section 1 of the lease between Corporation A and Corporation C, "lien" is defined as any security interest ... (including, without limitation, any... title retention agreement, any financing lease having the same economic effect as any of the foregoing, and the filing of any financing statement under the Uniform Commercial Code or comparable law of any jurisdiction in respect of any of the foregoing).

4. Selection, Maintenance and Use of Property - A requirement, under the terms of the lease, that the lessee has full responsibility to select, order, take delivery, set up, operate and maintain the property is an indication that the transaction is a sale rather than a lease. The presence of only a single factor (i.e., responsibility for maintenance) is considerable less persuasive.

Maintenance of the property by the lessor or establishment of maintenance standards by the lessor to be followed by the lessee tends to indicate a lease rather than a sale unless there exists a separate maintenance charge or contract. Similarly, restrictions on the lessee's use of the property or the right to sublease or assign tend to indicate a true lease.

Section 5 of the lease between Corporation A and Corporation C provides that Corporation A, as lessee, shall select the equipment on the basis of its own judgment and shall ensure that the installation or erection of any equipment is in accordance with the specifications and requirements of the vendor thereof.

Section 9 of the lease provides that the lessee shall pay all costs, expenses, fees and charges incurred in connection with the ownership, use and operation of any unit of equipment and that the lessee shall at all times, at its own expense, and subject to reasonable wear and tear, keep equipment in good operating order, repair, condition and appearance.

5. Duration of Lease - A true lease is ordinarily of a definite duration. If the terms of the lease do not provide for the expiration or termination of lessee's payments, other than by purchase of the leased equipment, this tends to indicate that the lease was intended to be a security device.

Pursuant to Section 6 of the lease, the initial term of the lease for each unit of equipment shall not exceed 75% of its economic useful life. Section 13 of the lease grants Corporation A the right to purchase Corporation C's ownership interest in any unit of equipment on the last basic rent payment date of the initial term or on any basic rent payment date during any month of an extended term for an amount equal to the greater of its adjusted acquisition cost or its fair market value; or, on the last basic rent payment date of an extended term or on any basic rent payment date during any month of a renewal term, for an amount equal to its fair market value.

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Based on the above factors and the pertinent sections of the lease agreement between Corporation A and Corporation C, it is determined that the lease between Corporation A and Corporation C provides or infers that:

1. Corporation A (lessee) has the option to become the owner of the leased equipment;
2. Corporation A assumes all risk of loss or damage to the equipment, however caused, and will receive any surplus insurance proceeds resulting from equipment damage, loss, theft, destruction, seizure, confiscation, or being rendered unfit for use or damaged beyond repair;
3. Corporation C will file a financing statement under the Uniform Commercial Code;
4. Corporation A will have the responsibility to select and insure that the installation or erection of any equipment is in accordance with the specifications and requirements of the vendor thereof and that as lessee shall at all times, at its own expense, keep equipment in good operating order, repair, condition and appearance;
5. Corporation A has the option to purchase Corporation C's ownership interest in any unit of equipment.

The combined effect of these factors supports the conclusion that the equipment lease transactions between Corporation A and Corporation C will be security agreements and that Corporation C will act as a financing agency and not a vendor.

Accordingly, payments made by Corporation A to Corporation C under such lease agreement will constitute payments under a security agreement and will not be subject to New York State or Local Sales or Use Tax.

Since the agreement between Corporation A and Corporation C has been determined to be a security agreement, issue "2" is moot, and need not be addressed in this opinion.

DATED: March 12, 1990

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.