



# MAINE REVENUE SERVICES SALES, FUEL & SPECIAL TAX DIVISION INSTRUCTIONAL BULLETIN NO. 20

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## Lease and Rental Transactions

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This bulletin is intended solely as advice to assist persons in determining and complying with their obligations under Maine tax law. It is written in a relatively informal style and is intended to address issues commonly faced by those involved in lease and rental transactions in Maine. Taxpayers are responsible for complying with all applicable tax statutes and rules. Although bulletins issued by Maine Revenue Services (“MRS”) do not have the same legal force and effect as rules, justifiable reliance upon this bulletin will be considered in mitigation of any penalties for any underpayment of tax due. This bulletin is current as of the last revision date shown at the end of the document.

The Sales and Use Tax Law is found in Part 3 of MRSA (“Maine Revised Statutes Annotated”) Title 36. Both Title 36 and all MRS rules may be seen by clicking on “laws and rules” on the MRS website.

The Sales and Use Tax Law provides that every lessor engaged in the leasing of tangible personal property located in this State is responsible for the sales/use tax in connection with the leasing of that property. The correct application of sales/use tax to any specific lease transaction depends upon the terms of the lease. The following information applies to most property and is intended as a guideline for determining the correct tax application.

For most items, the applicable sales tax rate is the general rate established by 36 MRSA § 1811. Section 1811 establishes a separate higher rate for the short-term rental of automobiles. Any person engaged in leasing automobiles, either on a short-term or long-term basis, should also see Instructional Bulletin No. 24 (“Vehicle Dealers”).

### 1. TYPES OF LEASING TRANSACTIONS

**A. Straight (True) Lease.** In a “straight” or “true” lease, the lessor enters into a lease agreement with a lessee for a stated period of time (including day-to-day, week-to-week, and similar leases) and the property is to be returned to the lessor at the conclusion of the lease term. The lessor is **making a taxable use** of the property through the derivation of rental income in this State. The lessor is therefore liable for a sales/use tax when the property enters this State (generally at the beginning of the lease), based on the purchase price paid by the lessor for the property. If sales tax was not paid directly to the vendor when the property was purchased, the lessor must report the use tax directly to Maine Revenue Services. **No sales tax is charged to the lessee, and the lease payments are not subject to sales/use tax.** If the property is returned to the lessor and leased to another Maine customer, no additional use tax is due.

**B. True Lease with Option to Purchase.** In a true lease that offers the lessee a bona fide option to purchase the property at the conclusion of the term of the lease or at

any time during the lease, the lessor is liable for a sales/use tax based on the purchase price of the property, just as in the “straight lease” situation described above. If the lessee elects to exercise the option, **a taxable sale occurs at that time** and sales tax must be paid at that time based on the option price (unless exempt by statute), including any amounts previously paid as rentals and applied to that price. This paragraph does not apply to a lease that is deemed by the State Tax Assessor (“Assessor”) to be in lieu of purchase.

**C. Lease in Lieu of Purchase.** Any lease, including a lease of an automobile, that is deemed by the Assessor to be a lease “in lieu of purchase” is treated as a sale for tax purposes. The sale occurs at the commencement of the lease. The sale price on which tax is based is the total of all of the projected lease payments. Separately stated finance charges may be excluded from the taxable base.

The Assessor may review the specific terms of a particular lease in order to determine whether it is a lease “in lieu of purchase.” A lease will generally be considered a lease “in lieu of purchase” under any of the following circumstances: when the terms of the lease create a security interest as defined by 11 MRSA § 1-1201(35); when the lease contains an option to purchase the leased property for \$1.00 or other nominal consideration; when the lessee must assume responsibility for the disposition of the property at the end of the lease term; and when the lease is a so-called TRAC (Terminal Rental Adjustment Clause) lease.

If a lease is determined to be a lease in lieu of purchase and the term of the lease is indeterminable in advance, sales tax should be collected on each lease payment as it is made. If a lease in lieu of purchase is for a determinable period, but has an option to continue for a further indeterminable term, sales tax should be collected up front on the determinable amount. When this period is complete, sales tax must then be collected on each subsequent lease payment as it is made.

If you are not sure whether a particular lease is a lease “in lieu of purchase,” contact Maine Revenue Services.

#### **D. Rent-to-Own Businesses**

**i. Taxable rentals.** “Rent-to-own” businesses regulated by 9-A MRSA , Article 11, must apply the Maine Service Provider Tax on the rentals of audio media, audio equipment, and furniture, as defined by 36 MRSA §§ 2551(1) and (4). Tax must be applied to each rental payment as the payment is made. If a customer elects to purchase the product being rented, sales tax must be collected on the buy-out price at the time of the sale. The Maine Service Provider Tax is a tax imposed upon the provider of the rental services as opposed to the customer. The statute allows the provider to pass on the tax to the customer, but it must be separately stated and identified clearly as service provider tax.

When a rent-to-own business purchases of any of these products, the rental of which is subject to tax, the purchase should be made exempt from tax by providing a resale certificate to the vendor.

For more information on resale certificates, see Instructional Bulletin No. 54. For more information on the Maine Service Provider Tax, see Instructional Bulletin No. 55.

**ii. Non-taxable rentals.** “Rent-to-own” businesses should not collect sales tax or report service provider tax on the rental of products not included in paragraph (1). This includes, without limitation:

Electronic devices rented to businesses	Computers rented to businesses
Office equipment	Fixtures affixed to realty
Tools & equipment	Decorative furnishings

When a rent-to-own business purchases any of these products, sales tax should be paid, based on the purchase price, at the point of purchase. If these products are purchased without paying sales tax for any reason, use tax must be reported directly to Maine Revenue Services based on the purchase price.

**iii. Option to Purchase.** If a customer elects to purchase a product being rented, sales tax is due on the transaction based on the buyout price. No credit is allowed for the sales/use tax previously paid by the lessor on the original purchase of the product or for the service provider tax paid by the lessor on the lease payments. If a customer elects to continue renting a product to the end of the term of the contract and the contract provides that at the end of the rental term, after the last payment is made, the customer will own the item, the last rental payment is deemed to represent the “sale price” upon which sales tax is due.

**E. Interim Rentals.** A retailer that purchases tangible personal property for resale, then removes the property from inventory to rent out, is generally required to pay a use tax based on its cost of the property. However 36 MRSA § 1758 allows the retailer, in lieu of paying this use tax, to collect a sales tax on all the rental payments received if the rental qualifies as an “interim rental.” In order to qualify for this provision:

- (1) The property must be purchased for resale; and
- (2) The property cannot be rented to any one person for more than 12 months.

If retailers wish to execute interim rental transactions, they must maintain adequate records for audit purposes, detailing when the item is withdrawn from inventory, to whom the property is rented, the duration of the rental, and the amount of rental income and tax collected. If, after electing to execute an interim rental, a retailer makes any other taxable use of the property, including the rental to one customer for more than a year, the retailer becomes liable for the use tax based on the purchase price of the property less the amount of tax collected on the rentals.

**F. “Sale/leaseback” Transactions.** A “sale/leaseback” transaction occurs when a person purchases property, sells the property to a leasing entity, then leases the property back from the lessor. This type of financing arrangement is generally a combination of three separate transactions. The application of sales tax upon these transactions depends on a number of factors and, due to the complexity of these factors, each arrangement

must be analyzed based on its own set of facts. Generally, however, the transaction will transpire as follows:

- (1) The original purchase of the property is the first transaction. This transaction is generally a taxable transaction, unless a statutory exemption applies.
- (2) The sale of the property from the purchaser to the leasing entity is the second transaction. This is generally considered to be a casual sale, which is not typically subject to tax unless it is an item listed in Section 1764 of the Sales Tax Law.
- (3) The lease of the property back to the purchaser by the leasing entity (lessor) is the third transaction. The application of the sales tax to the lease of the property back to the purchaser is determined primarily by the type of lease executed between the leasing entity and the purchaser.

For a discussion of sale/leaseback transactions involving machinery and equipment used in production (manufacturing), see Instructional Bulletin No. 22 (“Manufacturers”).

## **2. RENTAL/LEASE OF SPECIFIC PRODUCTS**

**A. Rental of Video Media & Equipment.** Rentals of video tapes, video games, DVDs, and video equipment used to record or playback video tapes or games by any retailer are subject to the Maine Service Provider Tax. A late charge in the form of an additional day’s rental, and movie passes redeemable for a certain number of DVDs or video tapes, are also subject to the Service Provider Tax. An insurance or damage waiver fee is taxable since it is a fee for a service that is part of the primary service being provided.

The statutory definitions of “video media” and “video equipment” specifically exclude commercial video tape and equipment rentals. Movies rented to theaters are not subject to tax.

The statutory definition of “retail sale” specifically excludes the “sale of video media or video equipment, to a person engaged in the business of renting video tapes and video equipment.” Therefore, video rental businesses need not pay sales tax on their video products purchased for subsequent rental. If these products are eventually sold after having been rented for a period of time, such sales are subject to sales tax.

**B. Automobiles.** The Sales and Use Tax Law treats the rental and leasing of automobiles differently from the rental and leasing of other vehicles. The term “automobile” includes a pickup truck or van with a registered gross vehicle weight of 10,000 pounds or less; see 36 MRSA § 1752(1-B).

**i. Short-term rentals.** Short-term rentals of automobiles are taxable at the higher rate established by 36 MRSA § 1811. “Short-term” means a period of less than one year. A person that makes short-term rentals of automobiles may purchase the automobile free of tax and must collect tax on each rental payment. Notwithstanding the basic definition of “automobile” cited above, the short-term rental rate also applies to pickup trucks and vans with a gross vehicle weight of up to 26,000 pounds, but only when the rental or lease is by a person engaged primarily in the business of renting automobiles. The short-term rental tax does not apply to vehicles with more than four wheels, motorcycles, and pickup trucks and vans weighing 26,000 pounds or more.

All rental payments made pursuant to a rental agreement executed in Maine are subject to tax regardless of where the rented automobile is to be used. The tax is based on the value of the rental, which means the total rental charged to the lessee for time and mileage including any other fees or services associated with the rental of the property, without any deduction for separately itemized charges. Separately-stated fees associated with the rental of the vehicle that are taxable include but are not limited to the following:

- (a) Maintenance and service contracts
- (b) Drop-off or pick-up fees
- (c) Airport surcharges
- (d) Intercity fees
- (e) One-way charges
- (f) Collision damage or loss damage waiver (“CDW” or “LDW”) charges
- (g) Young driver charges
- (h) Additional driver charges
- (i) Additional keys
- (j) Mileage fees
- (k) Cost recovery fees, such as license recovery fees, concession recovery fees, title or registration fees, and other governmental fees
- (l) Rentals of additional equipment such as infant seats, ski racks or GPS systems
- (m) Standard/automatic cleaning fees

Separately stated fees that are not part of the taxable rental of the vehicle are not included in taxable rental charge include but are not limited to reimbursement of tolls, charges for goods and services sold after the rental has terminated (such as additional cleaning fees or fuel sales), and sales of optional insurance coverage for the protection of the lessee or of the lessee’s personal property (such as additional liability insurance, personal accident insurance, or personal effects protection).

**ii. Long-term rentals.** Long-term rentals of automobiles are subject to the general sales tax rate established by 36 MRSA § 1811. “Long-term” means 12 months or more. The tax is due in the month in which the lease begins. The tax base consists of the total of the monthly lease payments plus the equity of any trade-in plus any cash down payment. Total monthly lease payments are arrived

at by multiplying the dollar amount of each lease payment by the number of payments in the lease term. Trade-in equity is the value of any trade-in that reduces the cost of the lease; unlike sales of automobiles, no deduction is allowed for trade-in allowances. Cash down payment means any initial cash payment that reduces the cost of the lease. Cash down payment includes rebates applied to the lease, but does not include pre-payment of lease payments or sales tax, excise tax, registration fees, and other required “up front” costs that are disbursed by the lessor.

Taxes, such as excise taxes and sales taxes, are allowable exclusions from the tax base. Ancillary services such as registration fees, life/disability insurance, warranties, and management services, are excluded from the tax base only if separately stated from the lease payment. A fee charged when the lessee opts to return a vehicle to the lessor rather than exercising the option to purchase it (sometimes called a “disposition fee”) is not subject to sales tax.

Nonresidents of Maine that enter into a long-term lease of an automobile with a Maine dealer may sign an “Immediate Removal Affidavit” stating that they are going to immediately remove the automobile from the State. If such an affidavit is signed and presented to the dealer in good faith, the dealer is not required to collect sales tax on the lease transaction.

Automobile dealers and lessors should see Instructional Bulletin No. 24 for more information.

**C. Motor Homes and Camper Trailers.** The rental or lease of a camper trailer or a motor home is a taxable service subject to the general sales tax rate established by 36 MRSA § 1811. The statutory definition of “retail sale” specifically excludes the sale of a camper trailer or a motor home to a person engaged in the business of renting these items. Therefore, such businesses need not pay sales tax when they purchase motor homes and camper trailers for subsequent rental nor accrue use tax when withdrawing a unit out of resale inventory or when locating a unit in Maine for rental. If these products are eventually sold after having been rented for a period of time, such sales are subject to sales tax.

For purposes of this paragraph, “camper trailer” means a camper trailer as defined in 36 MRSA § 1481(1-A) but without restriction on length; and “motor home” means a motor home as defined in 29-A MRSA § 101(40). “Motor home” does not include a mobile home.

**D. Software Licenses.** Software licenses are generally treated as leases and are taxable to the lessor based upon the purchase price. If the software lessor is also the developer of the software, the taxable cost of the product is based upon the lessor’s material costs

Software licenses that must be renewed on an annual basis are considered to be one-year licenses. The software is taxable to the lessor based upon the lessor’s purchase price at the time of the original licensing transaction. The lease amount and the cost of subsequent renewals have no sales/use tax consequences.

If the software license is perpetual or for 10 years or more (with no annual renewals), it is considered to be a lease in lieu of purchase. The lessor may purchase the software without paying sales tax, but must then collect sales tax from the lessee at the start of the lease based upon the total amount of the lease payments. Separately-stated finance charges may be excluded from the taxable base.

### **3. EXEMPT ORGANIZATIONS AND ACTIVITIES**

The purchase of tangible personal property that is then leased to a governmental entity or to an exempt organization, or used by a lessee in an exempt activity under the terms of a straight lease or a lease with an option to purchase, is taxable to the lessor based on the purchase price. The fact that the property is rented by an exempt organization or used by a lessee in an otherwise exempt activity does not relieve the lessor from liability for use tax.

Leases in lieu of purchase to agencies of the U.S. government and the State of Maine, and to exempt organizations, and leases in lieu of purchase of property used in an exempt activity are exempt from sales tax. See Section 1(C) above.

Certain purchases of depreciable machinery and equipment for lease to customers who are engaged in commercial agricultural production, commercial aquacultural production, commercial fishing, or commercial wood harvesting are eligible for a refund of sales or use tax. See Instructional Bulletins No. 44 (commercial fishing), 45 (commercial agriculture), 48 (commercial wood harvesting), and 49 (commercial aquaculture).

Purchases of portable classrooms or tangible personal property to be physically incorporated in a portable classroom for lease to schools are exempt under 36 MRSA § 1760(16). When repair or replacement parts for leased property are purchased by the lessee and the lessee is an exempt organization or engaged in an exempt activity, the lessee may purchase these repair or replacement parts tax exempt.

For more information on exempt sales to governmental agencies and exempt organizations, see Rule 302 and Instructional Bulletin No. 36.

### **4. OTHER**

**A. Assignments (lessor).** The transfer of title to leased property from one lessor to another lessor constitutes a taxable transaction (sale) between the two lessors. However, if one lessor is assigning only the financing arrangements, no taxable transaction has occurred. Since leases in lieu of purchase are considered sales to the lessee (title being held by the lessee), a lessor's assignment of such a lease to another lessor does not constitute a taxable event and no sales tax liability is incurred by such an assignment.

**B. Prior Use Outside of Maine.** Property that is used outside of Maine more than 12 months prior to being used in Maine is not subject to use tax. This includes leases executed outside of Maine since lessors are the "users" of the leased property. If a lessee subsequently makes use of the leased property in Maine, no use tax is due from the lessor.

MRS has historically taken the position that any use in Maine during the first 12 months subjects the property to the use tax. Recently, the Maine Supreme Judicial Court has held that, in the context of aircraft, the § 1760(45)(B) exemption applies if the use of the property outside of Maine during the 12 months after it was purchased was sufficiently substantial. Whether the use of property outside of Maine during that period was sufficiently substantial is a case-specific determination depending upon all of the facts and circumstances.

## **5. ADDITIONAL INFORMATION**

The information in this bulletin addresses some of the more common questions regarding the Sales and Use Tax Law faced by your business. It is not intended to be all-inclusive. Requests for information on specific situations should be in writing, should contain full information as to the transaction in question, and should be directed to:

**MAINE REVENUE SERVICE  
SALES, FUEL & SPECIAL TAX DIVISION  
P.O. BOX 1060  
AUGUSTA, ME 04332-1060  
TEL: (207) 624-9693  
V/TTY: 7-1-1**

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