COLORADO
Department of Revenue
Taxation Division

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PLR 17-007

August 29, 2017

XXXXXX
Attn: XXXXXX
XXXXXX
XXXXXX

Re: Lost or Damaged Leased Property

Dear XXXXXX,

You submitted on behalf of XXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Department Rule 1 CCR 201-1, 24-35-103.5. This letter is the Department's private letter ruling. This ruling is binding on the Department to the extent set forth in Department Rule 1 CCR 201-1, 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Issue

Is a payment from a lessee to Company for the loss or damage of rental equipment subject to sales or use tax?

Conclusion

Payment from a lessee to Company for the loss or damage of rental equipment is not subject to sales or use tax.

Background

Company is in the business of renting[1] oil drilling equipment to drilling companies. The rental agreement states that if tools are "Lost in Hole", "Lost in Transit", or "Damaged Beyond Repair" while being used by a customer, the agreement terminates with respect to such property and the customer pays Accrued Charges and the "Lost Tool Rate." Accrued Charges are the rental

[1] Company uses the term "rental" and "lease" to refer to different types of arrangements. For our purposes, any right to temporary possession with the expectation of return in reusable or resalable condition is considered a rental or lease and those terms are used here interchangeably. The ruling applies to any such arrangement.

payments that have accrued up to the date that the rental agreement is terminated. The Lost Tool Rate is the value of the tool at the time it is lost or destroyed and does not include rental charges. The Accrued Charge and the Lost Tool Rate charge are stated separately on the invoice.

Company manufactures most of the tools that it rents. Manufacturing occurs outside Colorado. Company collects Colorado sales tax on all rental payments. Most rental periods are less than a year and all are less than three years. Tools and bits are typically returned by the customer to Company and only infrequently are they Lost in Hole, Lost in Transit, or Damaged Beyond Repair. Tools Damaged Beyond Repair are typically sold to a third party as scrap metal.

Drilling bits are rented for a repair cycle and then returned to Company to be repaired, refurbished, and then re-rented to the same or a different customer. There is a limit to how many times bits can be refurbished and once that limit has been exceeded, the bit is typically sold to a third party as scrap metal. Some bits are custom made and are sold, not rented, to the customer.

Discussion

Colorado imposes sales or use tax on the sale or use of tangible personal property in Colorado.[2] A sale occurs when possession or title to tangible personal property is transferred in exchange for consideration.[3] A taxable use occurs when a person stores, uses, or consumes in Colorado tangible personal property.[4] Colorado levies sales tax on payments made pursuant to certain types of rentals of tangible personal property.[5] The issue in this case is whether a customer's payment for the loss or damage to Company's equipment constitutes a taxable sale.

The issue has been addressed, in part, in *Steamboat Springs Rental & Leasing, Inc. v City and County of Denver*, 15 P.3rd 785 (Colo C.A. 2000). The City assessed sales tax on customers' payments to the rental car company for

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[2] § 39-26-104(1) and 202, C.R.S.

[3] Department Rule 1 CCR 201-4, 39-26-102.10 (""Sale" or "sale and purchase" shall mean any transaction, except as provided in 26-102.7(b), whereby a person, in exchange for any consideration, such as money or its equivalent, property, the rendering of a service, or the promise of any of these things: (a) transfers or agrees to transfer all or part of his interest, or the interest of any other for whom he is acting as an agent, in any tangible personal property to any other person; or (b) performs or furnishes, or agrees to perform or furnish, or contracts to have another perform or furnish, any service taxable under this Act for any other person.")

[4] § 39-26-202(1)(a), C.R.S.

[5] §§ 39-26-102(23) and 713(1)(a), C.R.S. For leases for more than three years, the lessor must collect sales tax on lease payments. For leases for a shorter duration, the lessor has the option either to collect sales tax when it acquires the equipment or, with the department's permission, purchase the equipment without payment of tax and collect sales tax on lease payments. For purposes of this ruling, Company has represented that it collects sales tax on rental payments. We proceed on that basis notwithstanding Company's further representation that tax has been paid on some ingredient parts of the manufactured items.

damages to vehicles. The City argued that the payments were part of the "rental payments" and, therefore, taxable. The Court disagreed, concluding that the customer's right to use the car was governed by the original rental agreement and payment for damages was a separate transaction. The Court also concluded that the payment for damages was not a sale because the customer did not receive any additional right to use the vehicle in exchange for the payment of damages.[6] The Court cited with approval the Department's Revenue Bulletin No. 92-14, which states, in part, "[d]amages reimbursement are exempt [from Colorado sales tax] since they are not considered part of the rental transaction."

Tools and bits damaged beyond repair are typically returned to Company. The Damaged Beyond Repair charge is indistinguishable from the compensatory damages discussed in *Steamboat Springs*. However, charges for tools "Lost in the Hole" and "Lost in Transit" are slightly different from the damages discussed in *Steamboat* because these tools are not physically returned to Company. However, the customer does not pay the charges to acquire any additional right of possession or title to property. Therefore, the Department rules that payment of damages in recompense for Company's equipment Damaged Beyond Repair, Lost in Hole, or Lost in Transit are not subject to Colorado sales or use tax.

Miscellaneous

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. The ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling and is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

This ruling applies to the sales and use taxes administered by the Department. This ruling is not binding on sales and use taxes of home rule cities and counties. See Department publication DRP 1002 for a list of state-administered and home rule tax jurisdictions.

This ruling is binding on the Department to the extent set forth in Department Regulation 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

[6] A contract may provide, as in the case of Company's rental contract, that a party agrees to reimburse the other for damage to the former's property. In some sense, this is a part of the rental agreement, but this is not an agreement the purpose of which is to acquire property as is contemplated by the tax code, but, rather, a contractual commitment to reimburse for the loss of value. See, *Steamboat Springs*, supra.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Neil Tillquist
Colorado Department of Revenue

This ruling cannot be relied upon by any other taxpayer other than the taxpayer to whom the ruling is made.