COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
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GIL-17-004

February 17, 2017

XXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXX
XXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXX

Re: Change Orders Related to Long Term Leases

Dear XXXXXXXXXX,

You submitted on behalf of your client ("Company") a request for guidance regarding the application of sales and use taxes to change orders related to long term leases.

The Colorado Department of Revenue ("Department") issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues, but is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department Rule 1 CCR 201-1, 24-35-103.5.

The Department treats this request as a general information letter. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not binding on the Department. If Company would like the Department to issue a private letter ruling on the issue raised here, Company can submit a request and pay the fee in compliance with Department Rule 1 CCR 201-1, 24-35-103.5.

Issue

What is the proper application of sales and use tax for various types of change orders relating to long term leases?

Background

Company is in the business of leasing tangible personal property for more than three years in duration. During the initial term of the lease, the lessee may request certain changes to the lease, such as replacement equipment (to replace obsolete equipment) that either increases the amount of the monthly lease payment or has no effect on the amount of the monthly lease payment. Customer may also request additional equipment during the original lease period that requires an increase in the lease payment for the duration of the lease period.

Structure of Analysis

To determine whether Company's transactions are treated as a short term or long term lease for sales tax purposes, the Department will examine the following question:

1. When a lessor adds or replaces new equipment to an existing long term lease at a time when there is three years or less remaining on the long term lease, does the modification require lessor to treat the replaced or new equipment as a short term lease, which requires lessor to pay sales tax on such property at the time lessor acquires the replacement or additional equipment, or can lessor continue to collect sales tax on the lease payments pursuant to §§39-26-102(23) and 713(1)(a), C.R.S.?

Discussion

The question presented here is whether the addition of property to a long term lease (leases for more than three years) at a time when there is three years or less remaining on the lease means that the new property should be treated as a short term lease or whether the lessor can treat the property as part of the long term lease. Company represents that the duration of the initial term of existing lease remains unchanged when property is added to the lease.

The replacement of existing equipment with new equipment does not alter the fact that the lease is a long term lease. If a lessor enters into a long term lease for a printer and guarantees the performance of the printer, the lease is not converted to a short term lease simply because near the end of the long term lease, the printer is replaced with a new printer. Colorado treats long term leases of tangible personal property as an installment sale of the property and requires the lessor to collect sales tax on each lease payment.[1]

However, if the property does not simply replace the existing property but is more correctly viewed as additional property added to the lease, then the addition of the new property in the last three years of a lease is properly viewed as a short term lease. For example, if the original lease was for a single printer and the lessee decides within three years of the lease expiration that it would like to add an additional printer under the lease, then the lease of that additional printer is a short term lease. The Department would likely have the same view if the original lease expressly stated that the lessee to has the option to add more leases. Colorado does not treat short term leases of tangible personal property as an installment sale. Instead, the lessor is treated as the consumer of the leased property and must pay sales tax when it acquires the leased property. However, the Department may grant the lessor permission to acquire the leased property exempt from tax and collect the sales tax on the lease payments throughout the lease.[2] The Department liberally grants this permission.

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

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[1] § 39-26-102(23), C.R.S.

[2] § 39-26-713(1)(a), C.R.S.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/tax for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter 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 letter.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue