STATE OF CONNECTICUT

DEPARTMENT OF REVENUE SERVICES

SN 2002(15)

25 Sigourney Street
Hartford CT 06106-5032

SPECIAL NOTICE

Sales and Use Taxes on Sale and Leaseback Arrangements

Purpose: This Special Notice describes statutory provisions added in 1999 affecting the application of sales and use taxes to sale and leaseback arrangements.

Effective Date: Effective for original sales, as defined in this Special Notice, occurring on or after July 1, 1999.

Statutory Authority: Conn. Gen. Stat. §12-407(3)(B), codified on and after January 1, 2003, as §12-407(a)(3)(B).

Sale and Leaseback Arrangements Defined: For purposes of this Special Notice, a **sale and leaseback arrangement** is a series of three transactions:

- The first transaction is the sale of a taxable item of tangible personal property by an original retailer (the retailer) to an original purchaser (the purchaser). The first transaction is the **original sale**.
- The second transaction is the sale of the item by the purchaser to a leasing company (the lessor) that will lease the item back to the purchaser. The second transaction is the **sale to the lessor**.
- The third transaction is the lease of the item back to the purchaser by the lessor. The third transaction is the **leaseback**.

Previous Taxation of Sale and Leaseback Arrangements: Before July 1, 1999, the original sale and the leaseback were both taxable. The original sale did not (and still does not) qualify as a sale for resale because the purchaser does not purchase the item for sale in the regular course of its business, but instead purchases the item for its own use. On and after July 1, 1999, under Conn. Gen. Stat. §12-407(3)(B), the original sale is excludible from sales and use taxes, if certain conditions are met.

The leaseback was (and still is) a taxable sale as defined in Conn. Gen. Stat. §12-407(2)(j) (codified on and after January 1, 2003, at §12-407(a)(2)(J)).

The sale to the lessor was not taxable (and still is not), because it was a **casual sale**. Conn. Agencies Regs. §12-426-17(b)(2) provides that "[s]ales of articles of tangible personal property acquired for use or consumption by a seller and not sold in the regular course of business engaged in by such seller" are exempt from tax.

Legislation Affecting Sale and Leaseback Arrangements: 1999 Conn. Pub. Acts 173, §11, added Conn. Gen. Stat. §12-407(3)(B) (the sale and leaseback provisions). The sale and leaseback provisions exclude the original sale of any item of tangible personal property from sales and use taxes when certain conditions are met. The sale and leaseback provisions also exclude the sale to the lessor from sales and use taxes. However, the subsequent lease is taxable.

To exclude the original sale from tax, within 120 days from the original sale the purchaser must either sell or contract to sell the item purchased to a lessor. The lessor must be contractually obligated to lease the item back to the purchaser in a lease that is taxable under Chapter 219 of the Connecticut General Statutes.

For the sale and leaseback provisions, **a lease that is taxable under Chapter 219** is a leaseback that is taxable in Connecticut at its inception. For a leaseback to be taxable in Connecticut at its inception delivery of the tangible personal property must be taken within Connecticut or the property must be leased with the intent to use it in Connecticut and must actually be used initially in this state, regardless of where it is subsequently located and used.

The taxability of the payments from the purchaser to the lessor under the leaseback is governed by Conn. Agencies Regs. §12-426-25.

How Original Sales Are Nontaxable: The sale and leaseback provisions include three ways an original sale may be nontaxable, depending on whether the purchaser meets the necessary conditions:

- An original sale may be nontaxable at the time it takes place;
- A purchaser may obtain a tax refund from the retailer not later than 120 days after the original sale; **or**
- A purchaser may claim a tax refund directly from the Department of Revenue Services (DRS) within three years from the last day of the month after the tax period for which the retailer or the purchaser was required to pay the tax to DRS.

Each situation is discussed in more detail in the three sections that follow.

Purchaser May Obtain Tax Exclusion at the Time of the Original Sale: The purchaser may issue a certificate to the retailer at the time of the original sale certifying that the statutory conditions for the tax exclusion on the original sale have been met. In this case the retailer does not collect sales tax on the original sale.

DRS has issued **CERT-137**, *Sales and Use Tax Certificate for Sale and Leaseback Arrangements*, for use by purchasers and retailers in sale and leaseback transactions.

The only condition in the sale and leaseback provisions for the tax exclusion that a purchaser could meet before or at the time of an original sale would be if the purchaser were contractually obligated to sell the property it is purchasing to a lessor that will lease it back to the purchaser in a lease that is taxable under Chapter 219.

If, at the time of an original sale, the purchaser has contracted to sell the item being purchased to a lessor that will lease it back to the purchaser in a lease that is taxable under Chapter 219, the purchaser must present **CERT-137** to the retailer, with:

- An executed copy of the contract between the purchaser and the lessor (the "sale and leaseback contract"), **or**
- A copy of a binding sale and leaseback letter of agreement between the purchaser and the lessor signed by both the purchaser and the lessor.

The retailer should report the sale on Line 1 of **Form OS-114**, *Sales and Use Tax Return,* and enter the gross receipts from the tax-excluded sale on Line 15 of the reverse side of **Form OS-114** and should keep the certificate and required attachments to the certificate for at least six years from the date of the original sale.

If the purchaser purchases tangible personal property from a retailer that does not collect Connecticut sales or use taxes, the purchaser should still complete and sign **CERT-137.** The retailer should keep the certificate and required attachments for at least six years from the date of the original purchase. The purchaser should report the purchase price on Line 4 of **Form OS-114** and enter the purchase price of the tax-excluded purchase on Line 15 on the reverse side of **Form OS-114.**

Purchaser May Obtain Refund From Retailer: If the purchaser cannot provide the retailer with **CERT-137** at the time of the original sale, the purchaser may certify to the retailer within 120 days of the original sale that the purchaser has met the conditions of the sale and leaseback provisions for the tax exclusion on the original sale, and may obtain a refund of sales and use taxes paid to the retailer.

If, within 120 days of the date of an original sale, the purchaser has contracted to sell or has already sold the item being purchased to a lessor that will lease it back to the purchaser in a lease that is taxable under Chapter 219, the purchaser may present **CERT-137** to the retailer with:

- An executed copy of the sale and leaseback contract, **or**
- A copy of a binding sale and leaseback letter of agreement between the purchaser and the lessor signed by both the purchaser and the lessor.

When the retailer receives **CERT-137** with the appropriate documentation within 120 days of the original sale, the retailer shall immediately refund to the purchaser the sales and use tax collected on the original sale. If the retailer has already remitted the tax to DRS, the retailer may either treat the amount refunded as a credit against the tax due on its next return by reporting the sales price on Line 15 on the reverse side of **Form OS-114**, or may claim a refund of the tax under Conn. Gen. Stat. §12-425.

To claim a refund or credit of tax from DRS, the retailer must follow the procedures in **Policy Statement 98(5)**, *Sales and Use Tax Refund Policy.* The retailer must provide DRS with the **CERT-137** from the purchaser with:

- A copy of the retailer's cancelled check to the purchaser for the refunded amount; **or**
- A receipt from the retailer showing that the retailer has credited the refund amount to the purchaser's account against amounts currently due and payable by the purchaser to the retailer.

If the retailer can show that it remitted sales tax to DRS but did not receive payment of the tax from the purchaser, the retailer need not refund or credit the tax to the purchaser.

Purchaser May Obtain Refund Directly From DRS: If the purchaser paid tax to the retailer on the original sale, or self-assessed use tax on the original sale, the purchaser may apply directly to DRS for a refund under Conn. Gen. Stat. §12-425. The purchaser may claim a refund within three years from the last day of the month after the tax period for which the retailer or the purchaser was required to pay the tax to DRS.

If, within 120 days after an original sale, the purchaser has contracted to sell, or has already sold, the item being purchased to a lessor that will lease it back to the purchaser in a lease that is taxable under Chapter 219, the purchaser may present **CERT-137** to DRS, with:

- An executed copy of the sale and leaseback contract, **or**
- A copy of a binding sale and leaseback letter of agreement between the purchaser and the lessor signed by both the purchaser and the lessor.

If the purchaser paid sales tax to the retailer at the time of sale, the purchaser must also include:

- A bill of sale from the retailer to the purchaser showing that tax was paid to the retailer on the original sale; **and**
- A copy of **Form AU-524**, *Assignment of Retailer's Rights for Refund*, signed by the retailer.

If for any reason the purchaser paid use tax directly to DRS because it did not pay sales or use tax to the retailer, the purchaser must also include:

- An invoice or receipt from the retailer to the purchaser and a cancelled check or other evidence indicating that the sale took place; **and**
- A copy of the purchaser's **Form OS-114** with worksheets that correlate to the use tax paid with the return.

Purchasers should refer to **Policy Statement 98(5)** for details.

When DRS receives **CERT-137** from the purchaser with the appropriate documentation, DRS will refund the sales or use tax paid on the original sale.

Purchaser's Failure to Comply With Sale and Leaseback Provisions: If a purchaser uses **CERT-137** either to make a purchase of tangible personal property without paying tax or to obtain a refund from the retailer or from DRS, but there is no subsequent sale to the lessor and leaseback, the purchaser is liable for and must pay the tax due on the original sale, as of the following dates:

- If the purchaser does not enter into a sale and leaseback contract within 120 days of the original sale, the purchaser will owe use tax on the original purchase price as of 120 days after the original sale, plus statutory interest from 120 days after the original sale.
- If the purchaser does enter into a sale and leaseback contract within 120 days of the original sale, but does not make the sale to the lessor and begin the leaseback within one year of the original sale, the purchaser will owe use tax on the purchase price as of one year after the original sale, plus statutory interest from one year after the original sale. (The Commissioner, in his discretion, may extend this one-year period for reasonable cause.)
- If the leaseback is not a lease that is taxable under Chapter 219 at its inception, then the purchaser will owe use tax on the purchase price of the item as of the beginning of the leaseback, plus statutory interest from the beginning of the leaseback.

In addition to tax and interest, DRS may impose statutory penalties in any of the above instances.

In administering the sale and leaseback provisions, DRS may make an audit assessment against the purchaser within the following periods:

- If the purchaser did not enter into a sale and leaseback contract within 120 days of the original sale, DRS may make an audit assessment within three years from 120 days after the original sale;
- If the purchaser did enter into a sale and leaseback contract within 120 days of the original sale, but does not make the sale to the lessor and begin the leaseback within one year of the date of the original sale, DRS may make an audit assessment within three years from one year after the original sale (or within three years of any extension granted by the Commissioner); **or**
- If the leaseback is not a lease that is taxable under Chapter 219 at its inception, DRS may make an audit assessment within three years of the beginning of the leaseback.

Retailer's Failure to Comply With Sale and Leaseback Provisions: The retailer owes sales tax on the gross receipts from the original sale as of the date of the sale, plus statutory interest from that date and possibly a statutory penalty, if the retailer:

- Does not charge tax on the original sale and does not properly accept **CERT-137** from the purchaser;
- Refunds tax on the original sale and does not properly accept **CERT-137** from the purchaser;
- Accepts **CERT-137** from the purchaser with incomplete or insufficient documentation; **or**
- Knows of any other facts that suggest that the original sale is not excluded from tax or eligible for a refund of tax, as the case may be.

Effect on Other Documents: None affected.

Effect of This Document: A Special Notice is a document that announces a new policy or practice in response to changes in State or federal laws or regulations or to judicial decisions. A Special Notice indicates an informal interpretation of Connecticut tax law by DRS and may be referred to for general guidance by taxpayers or tax practitioners.

For Further Information: Please call DRS during business hours, 8:00 a.m. to 5:00 p.m., Monday through Friday:

- **1-800-382-9463** (in-state), or
- **860-297-5962** (from anywhere)

TTY, TDD, and Text Telephone users only may transmit inquiries 24 hours a day by calling 860-297-4911.

Forms and Publications: Forms and publications are available all day, seven days a week:

- **Internet:** Preview and download forms and publications from the DRS Web site: **www.drs.state.ct.us**
- **DRS TAX-FAX:** Call **860-297-5698** from the handset attached to your fax machine and select from the menu.
- **Telephone:** Call **860-297-4753** (from anywhere), or **1-800-382-9463** (in-state) and select **Option 2** from a touch-tone phone.

Paperless Filing Methods (fast, easy, free, and confidential):

- **For business returns:** Use ***Fast-File*** to electronically file sales and use taxes, business use tax, room occupancy tax, or withholding tax returns over the internet or telephone. Visit the DRS Web site at: **www.drs.state.ct.us** and click on ***Business Taxes Fast File Program***.
- **For resident income tax returns:** Use ***WebFile*** to file personal income tax returns over the Internet. Visit the DRS Web site at: **www.drs.state.ct.us** and click on ***Income Tax Web Filing***.

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