

SC PRIVATE REVENUE OPINION #02-2

SUBJECT: Lease of Motor Vehicles in IRC Section 1031 Transactions
(Sales and Use Tax)

REFERENCES: S. C. Code Ann. Section 12-36-910 (2000)
S. C. Code Ann. Section 12-36-1310 (2000)
S. C. Code Ann. Section 12-36-90 (2000)
S. C. Code Ann. Section 12-36-100 (2000)
S. C. Code Ann. Section 12-36-110 (2000)
S. C. Code Ann. Section 12-36-120 (2000)
S. C. Code Ann. Section 12-36-130 (2000, Supp. 2001)
S. C. Code Ann. Section 12-36-950 (2000)
S. C. Code Ann. Section 12-36-2110 (2000, Supp. 2001)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (2000)
SC Revenue Procedure #99-4

SCOPE: A Private Revenue Opinion is a written statement issued to a specific taxpayer by the Department to apply principles of law to a specific set of facts or a particular tax situation. A Private Revenue Opinion does not have the force and effect of law, and is not binding on the person who requested it or the public. It is, however, the Department's opinion limited to the specific facts set forth, and is binding on agency personnel only with respect to the person to whom it was issued and only until superseded or modified by a change in statute, regulation, court decision, or advisory opinion, providing the representations made in the request reflect an accurate statement of the material facts and the transaction was carried out as proposed.

Question:

What are the sales and use tax implications of the following "Like-Kind Exchange" transactions connected with automobile leases involving ABC Company ("Taxpayer") and a qualified intermediary, XYZ Company ("Intermediary"), as described in the Facts?

Scenario #1: At the conclusion of the lease term, the lessee may exercise an option to purchase the leased motor vehicle. In a typical transaction (not a like-kind exchange pursuant to Internal Revenue Code ("IRC") Section 1031), the Taxpayer (i.e., lessor) sells the motor vehicle and collects payment in exchange for the title that is transferred to the lessee. The Taxpayer will remit the appropriate sales and use tax. In a qualified IRC Section 1031 transaction, the Taxpayer will continue to sell (transfer) the motor vehicle, but the purchaser (lessee) will be directed to remit the payment for the vehicle to a Taxpayer and Intermediary joint bank account ("Account").

Scenario #2: At the conclusion of the lease term, the Taxpayer (i.e., lessor) sells the motor vehicle to a wholesaler or retailer for resale. In a typical transaction (not a like-kind exchange pursuant to IRC Section 1031), the Taxpayer (i.e., lessor) sells the motor vehicle and receives payment and a resale certificate in exchange for transferring the title to the motor vehicle to the wholesaler or retailer. No sales or use tax is remitted by the Taxpayer with respect to the transaction. In a qualified IRC Section 1031 transaction, the Taxpayer will continue to sell (transfer) the motor vehicle and receive the resale certificate, but the wholesaler or retailer (i.e., purchaser) will be directed to remit the payment for the vehicle to a Taxpayer and Intermediary joint bank account (“Account”).

Scenario #3: Prior to leasing a motor vehicle, the Taxpayer purchases the motor vehicle. In a typical transaction (not a like-kind exchange pursuant to IRC Section 1031), the Taxpayer (i.e., lessor) purchases the motor vehicle from the seller and supplies a resale certificate or similar written documentation that the vehicle is being purchased for resale in exchange for title for the motor vehicle. In an IRC Section 1031 transaction, the Taxpayer will direct the Intermediary to make payment from a Taxpayer and Intermediary joint bank account (“Account”) to the seller. The taxpayer will continue to supply a resale certificate to the seller and receive title. The related lease will remain unchanged, and the Taxpayer (i.e., lessor) will continue to remit sales taxes upon the lease payments.

Conclusion:

The sales and use tax implications of the “Like-Kind Exchange” transactions connected with automobile leases involving ABC Company (“Taxpayer”) and a qualified intermediary, XYZ Company (“Intermediary”), as described in the Facts are as follows:

In Scenario #1, the Taxpayer, as the retailer, must remit the tax due based on “gross proceeds of sales” (Code Section 12-36-90) in the case of the sales tax or “sales price” (Code Section 12-36-130) in the case of the use tax. The Intermediary never has title or possession of the motor vehicle. The fact that the Intermediary receives payments on behalf of the Taxpayer does not affect the transaction. In other words, the Taxpayer is still responsible for all reporting, remittance and recordkeeping requirements established by the statute and regulations.

In Scenario #2, the Taxpayer is selling the motor vehicle for resale and should obtain a resale certificate from the purchaser (Code Section 12-36-950). No tax is due on this sale. The Intermediary never has title or possession of the motor vehicle. The fact that the Intermediary receives payments on behalf of the Taxpayer does not affect the transaction. In other words, the Taxpayer is still responsible for all reporting, remittance and recordkeeping requirements established by the statute and regulations.

In Scenario #3, the Taxpayer is purchasing the motor vehicle for resale and should provide the seller a resale certificate (Code Section 12-36-950). No tax is due on this purchase. The Intermediary never has title or possession of the motor vehicle. The fact that the Intermediary makes the payment on behalf of the Taxpayer does not affect the transaction. In other words, the Taxpayer is still responsible for all reporting, remittance and recordkeeping requirements established by the statute and regulations.

Facts:

ABC Company (“Taxpayer”) is seeking a determination regarding the application of the sales and use tax to a federal “Like-Kind Exchange.” The taxpayer is a lessor of motor vehicles. The transactions at issue involve the typical purchase, lease, and sale of motor vehicles as modified to qualify under Internal Revenue Code (“IRC”) Section 1031. The Internal Revenue Service has ruled that exchanges of property, including rental property, by a corporation through an intermediary can qualify under IRC Section 1031 as tax-free like-kind exchanges for federal income tax purposes. The taxpayer has entered into an agreement with XYZ Company (“Intermediary”) that qualifies for the federal tax-free like-kind exchange treatment.

During the course of a leasing transaction, events can be divided into the following three segments or categories: (a) the acquisition of the property by the lessor; (b) the term of the lease; and (c) the disposition of the property by the lessor at the conclusion of the lease term. Simply stated, the lease is born, it lives for a period of time, and it terminates. The complexities of IRC Section 1031 only impact the lease transactions at issue when the motor vehicle is (a) sold at the conclusion of the lease, and (b) when a new or replacement vehicle is acquired.

The IRC Section 1031 transaction does not impact the relationship between the lessor and lessee during the term of the lease. The lessee will continue to remit all payments during the term of the lease to the lessor. The lease payments will continue as they currently exist, and the lessor will continue to issue invoices to the lessee. The only change in business operations for the proposed IRC Section 1031 transaction is upon (1) the sale of the motor vehicle at the conclusion of the lease, and (2) the purchase of a newly-leased motor vehicle by the lessor.

On termination of the lease, the Taxpayer disposes of (i.e., sells) the vehicles in one of several ways: (1) the Taxpayer directly sells the motor vehicle through the purchase option of the lease; (2) the Taxpayer sells the motor vehicle to the dealer for resale to the lessee, who exercises the purchase option; (3) the Taxpayer sells the motor vehicle to the dealer for resale to someone other than the lessee; or (4) the Taxpayer sells the motor vehicle at auction to a dealer for purposes of resale. Under any of these described scenarios, the Taxpayer will dispose of the vehicles (“Relinquished Property”) at the termination of the lease through the Intermediary. The Intermediary has been assigned the Taxpayer’s rights (but not its obligations) with respect to the sale of the Relinquished Property at the termination of the lease. The property is sold in accordance with the Taxpayer’s direction and instructions either to (a) the lessee, or (b) the dealer for resale. The Taxpayer controls the disposition of the Relinquished Property, and the title to the property is transferred directly from the Taxpayer to the purchaser. The proceeds from the sale are received in a Taxpayer and Intermediary joint bank account (“Account”) which restricts the Taxpayer’s right to receive or otherwise obtain the immediate benefit of the proceeds. The Intermediary merely serves as a qualified intermediary for federal like-kind exchange purposes, but does not change the basic character of the transaction. For this service, the Intermediary receives a fee.

The Taxpayer also acquires “Replacement Property” using the services of the Intermediary. As with the Relinquished property, the Intermediary has been assigned the Taxpayer’s rights (but not its obligations) with respect to the acquisition of newly leased vehicles (“Replacement

Property”). At the Taxpayer’s direction, the Intermediary pays for the Replacement Property out of the Account with funds from the sale of Relinquished Property. If there is a shortfall (the funds in the Account are less than the purchase price of Replacement Property), the Taxpayer will pay the difference. Replacement Property relinquished in a particular exchange is identified within 45 days of the sale of the Relinquished Property. If an exchange does not occur within the shorter of (a) 180 days or (b) the due date, including extensions, of the Taxpayer’s federal income tax return, the Taxpayer will recognize gain on the exchange for federal income tax purposes. As in the sale of Relinquished Property, the role of the Intermediary in the purchase of the Replacement Property is merely to provide a service to the Taxpayer. The title for the motor vehicle is transferred directly from the dealer to the Taxpayer and never rests with the Intermediary.

The following represents the three typical scenarios involving the sale or purchase of a motor vehicle:

Scenario #1: At the conclusion of the lease term, the lessee may exercise an option to purchase the leased motor vehicle. In a typical transaction (not a like-kind exchange pursuant to Internal Revenue Code (“IRC”) Section 1031), the Taxpayer (i.e., lessor) sells the motor vehicle and collects payment in exchange for the title that is transferred to the lessee. The Taxpayer will remit the appropriate sales and use tax. In a qualified IRC Section 1031 transaction, the Taxpayer will continue to sell (transfer) the motor vehicle, but the purchaser (lessee) will be directed to remit the payment for the vehicle to a Taxpayer and Intermediary joint bank account (“Account”).

Scenario #2: At the conclusion of the lease term, the Taxpayer (i.e., lessor) sells the motor vehicle to a wholesaler or retailer for resale. In a typical transaction (not a like-kind exchange pursuant to IRC Section 1031), the Taxpayer (i.e., lessor) sells the motor vehicle and receives payment and a resale certificate in exchange for transferring the title to the motor vehicle to the wholesaler or retailer. No sales or use tax is remitted by the Taxpayer with respect to the transaction. In a qualified IRC Section 1031 transaction, the Taxpayer will continue to sell (transfer) the motor vehicle and receive the resale certificate, but the wholesaler or retailer (i.e., purchaser) will be directed to remit the payment for the vehicle to a Taxpayer and Intermediary joint bank account (“Account”).

Scenario #3: Prior to leasing a motor vehicle, the Taxpayer purchases the motor vehicle. In a typical transaction (not a like-kind pursuant to IRC Section 1031), the Taxpayer (i.e., lessor) purchases the motor vehicle from the seller and supplies a resale certificate or similar written documentation that the vehicle is being purchased for resale in exchange for title for the motor vehicle. In an IRC Section 1031 transaction, the Taxpayer will direct the Intermediary to make payment from a Taxpayer and Intermediary joint bank account (“Account”) to the seller. The taxpayer will continue to supply a resale certificate to the seller and receive title. The related lease will remain unchanged, and the Taxpayer (i.e., lessor) will continue to remit sales taxes upon the lease payments.

Discussion:

Code Section 12-36-910(A) imposes the sales tax and reads:

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail.

Code Section 12-36-1310(A) imposes the use tax and reads:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State.

Therefore, in order for the sales tax or the use tax to be applicable, there must be a retail sale.

Code Section 12-36-100 defines the term “sale” to mean:

any transfer, exchange, or barter, conditional or otherwise, of tangible personal property for a consideration including:

- (1) a transaction in which possession of tangible personal property is transferred but the seller retains title as security for payment, including installment and credit sales;
- (2) a rental, lease, or other form of agreement;
- (3) a license to use or consume; and
- (4) a transfer of title or possession, or both.

Code Section 12-36-110 defines the term “retail sale” to mean in part:

Sale at retail and retail sale mean all sales of tangible personal property except those defined as wholesale sales. The quantity or sales price of goods sold is immaterial in determining if a sale is at retail.

Code Section 12-36-120 defines the term “wholesale sale” to mean, in part, a “sale of ... tangible personal property to licensed retail merchants, jobbers, dealers, or wholesalers for resale, and do not include sales to users or consumers not for resale.”

In the “like-kind exchange” transactions described in the Facts, the Intermediary never has title or possession of the motor vehicle. The fact that the Intermediary receives or makes payments on behalf of the Taxpayer does not affect the transactions. In other words, the Taxpayer is still responsible for all reporting, remittance and recordkeeping requirements established by the statute and regulations. The Taxpayer is the party selling the motor vehicles in Scenarios #1 and #2 and is the party purchasing the motor vehicle in Scenario #3. As such, the transactions should be handled in the same manner as if the Intermediary was not involved.

Therefore:

In Scenario #1, the Taxpayer, as the retailer, must remit the tax due based on “gross proceeds of sales” (Code Section 12-36-90) in the case of the sales tax or “sales price” (Code Section 12-36-130) in the case of the use tax.

In Scenario #2, the Taxpayer is selling the motor vehicle for resale and should obtain a resale certificate from the purchaser (Code Section 12-36-950). No tax is due on this sale.

In Scenario #3, the Taxpayer is purchasing the motor vehicle for resale and should provide the seller a resale certificate (Code Section 12-36-950). No tax is due on this purchase.

In all three scenarios, the Taxpayer must maintain proper records of the transactions.

Note: Code Section 12-36-2120 establishes a maximum tax of \$300.00 on the retail sale of a motor vehicle. However, in order for a retail lease of a motor vehicle to qualify for the \$300.00 maximum tax the lease must be in writing and must specifically state a term of, and remain in force for, a period of 90 continuous days.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Elizabeth Carpentier
Elizabeth Carpentier, Director

March, 2002
Columbia, South Carolina

CAVEAT: This advisory opinion is issued to the taxpayer requesting it on the assumption that the taxpayer’s facts and circumstances, as stated, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting the advisory opinion may not rely on it. If the taxpayer relies on this advisory opinion, and the Department discovers, upon examination, that the facts and circumstances are different in any material respect from the facts and circumstances given in this advisory opinion, then the advisory opinion will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this advisory opinion, changes in a statute, a regulation, or case law could void the advisory opinion.