



301 Gervais Street, P.O. Box 125, Columbia, South Carolina 29214

SC PRIVATE LETTER RULING #88-5

TO: XYZ Leasing Corporation

SUBJECT: Lease Cancellation Fees

REFERENCE: S.C. Code Ann. Section 12-35-30 (1976)
S.C. Code Ann. Section 12-35-510 (1976)
S.C. Code Ann. Section 12-35-810 (1976)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #87-3

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request. Private Letter Rulings have no precedential value and are not intended for general distribution.

Question:

Are "cancellation fees" subject to the State's sales and use taxes pursuant to Code Sections 12-35-510 and 12-35-810?

Facts:

XYZ Leasing Corporation (Lessor) enters into lease contracts allowing businesses (Lessee) to use equipment owned by the Lessor for a fixed term for a specified amount of periodic rent. Once the Lessee accepts delivery of the equipment, the contract is non-cancelable for the term of the lease.

The Lessee may later find that the equipment is no longer needed and may request to return such equipment and be relieved of any further obligation under the lease. The lessor has the option to do any of the following:

1. Hold the Lessee to the terms of the contract and refuse all concessions.
2. Release Lessee from the terms of the lease free and clear.
3. Agree to release Lessee from the terms of the lease upon the payment of a "cancellation fee". The amount of the fee is based upon the discretion of the Lessor and may be determined by such factors as the remarketability of the equipment, future business relationship with the Lessee and the value of the equipment versus the unrecovered investment.

Upon payment of a "cancellation fee", the contract is cancelled and the Lessee is relieved of all future obligations.

Discussion:

Code Section 12-35-510 imposes "upon every person engaged or continuing within this State in the business of selling at retail any tangible personal property...an amount equal to four percent of the gross proceeds of sales of the business" (emphasis added). An additional sales tax of one percent was imposed pursuant to Code Section 12-35-515 in 1984.

Code Section 12-35-30 defines the term "gross proceeds of sales", in part, as:

...the value proceeding or accruing from the sale of tangible personal property (and including the proceeds from the sale of any property handled on consignment by the taxpayer), including merchandise of any kind and character without any deduction on account of the cost of the property sold, the cost of material used, labor and service cost, interest paid or any other expenses whatsoever and without any deductions on account of losses;....

Code Section 12-35-810 imposes an excise or use tax "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 four percent of the sales price of such property" (emphasis added). This tax was also increased by one percent pursuant to Code Section 12-35-515.

Code Section 12-35-120 defines "sales price", in part, to mean:

The total amount for which tangible personal property is sold, including any services (including transportation) that are a part of the sale, valued in money, whether paid in money or otherwise, and includes any amount for which credit is given to the purchaser by the seller, without any deduction therefrom on account of the cost of the property sold, the cost of the materials used, labor or service cost, interest charged, losses or any other expenses whatsoever.

In State v. Byrnes 219 SC 485, 66 S.E.2d 33 (1951) the Supreme Court of South Carolina stated:

In general, the sales tax is an imposition upon the privilege of the business of selling at retail and measured by the amount of business done, which is a clear case of an excise tax...(emphasis added).

The use tax is also "measured by the amount of business done" in that the use tax is complementary to the sales tax.

Commission Decision S-D-92 was an analogous situation that dealt with the "inclusion in the taxable proceeds of sales of the face value on notes payable to the taxpayer and received by it in settlement of amounts due of lease agreements that were broken by the lessee." The Commission ruled that such notes payable a part of the proceeds subject to the sales or use tax.

In a Commission Decision dated May 27, 1986 it was concluded that a "property damage waiver fee" charged by a rental shop was part of the taxable lease proceeds. In addition in Meyers Arnold Inc. v. South Carolina Tax Commission 285 SC 303, 328 S.E. 2d 920 (1985), App) the court held that non-refundable layaway fees were a part of the "gross proceeds of sales."

The court stated:

But for the layaway sales, Meyers Arnold would not receive the layaway fees. The fees are obviously charged for the service rendered in making layaway sales. For these reasons, this court holds the lay-away fees.....subject to the sales tax.

In addition, the California State Board of Equalization in Ruling Number 330.3307 stated that "amounts paid by a lessee to obtain an early termination of his lease contract are includable in gross receipts (11/15/78)" Commerce Clearing House California State Reporter - Paragraph 60-263 (emphasis added).

California's definition of "gross receipts" is very similar to South Carolina's definition of "gross proceeds of sales", "gross receipts" and "sales price." California defines "gross receipts" in part as "the total amount of the sale or lease or rental price...of the rental sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of...(2) the cost of the material used, labor or service cost, interest paid, losses, or any other expense."

The Vermont Department of Taxes in Ruling 87-13 dated September 28, 1987 held that a "lease cancellation fee" under similar facts was a receipt from the rental of tangible personal property. The Department stated:

...the cancellation fee you have described is a "receipt" from the rental of tangible personal property and is therefore subject to tax. In effect the Lessor has simply agreed to accept less than it is legally entitled to receive under the lease agreement. The amount that is paid, whether it is nominated rental payments or a "cancellation fee," is subject to tax as part of the consideration for the lease.

Conclusion:

The "cancellation fees" in question are part of the "gross proceeds of sales" and "sales price" and therefore subject to the State's sales and use taxes.

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.
S. Hunter Howard, Jr., Chairman

s/John M. Rucker
John M. Rucker, Commissioner

s/A. Crawford Clarkson Jr.
A. Crawford Clarkson, Jr., Commissioner

Columbia, South Carolina
January 27, 1988