Motor Vehicle Leases

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Payments due up front

Since October 1, 2005, sales tax is due as an up-front tax on the total lease price for most leases of licensed motor vehicles. (In the past, all vehicle leases were treated as a series of sales with tax due on each payment.) The up-front tax applies to:

- vehicles, such as cars, vans, pickups, trucks, trailers, and motorcycles, that require a license plate and have a manufacturer's gross vehicle weight rate of 10,000 pounds or less
- both new and used vehicles
- vehicles for both business and personal use
- vehicles principally garaged in Minnesota; local tax also applies if the vehicle is principally garaged in an area with a local tax

For certain vehicles, tax is still due on each lease payment. The up-front tax does not apply to rentals of vehicles for 28 or fewer days or to vehicles with a manufacturer's gross vehicle weight rating of more than 10,000 pounds. The federal excise tax on certain heavy trucks is subject to sales tax, even if it is separately stated. The sales tax law allows an exemption for any separately stated taxes legally imposed directly on the consumer (the lessee), but not on the lessor. Since the federal excise tax is imposed on the lessor at the time of the lease, it is part of the taxable base subject to sales tax.

Who collects the tax?

Sales tax is collected by the lessor named on the lease. Typically, the initiating dealer is shown as the lessor on the lease; the dealer may later assign the lease to a leasing company. Lessors must report and pay the tax directly to the Revenue Department on their sales and use tax return (do not pay the tax to a deputy registrar). Report the tax with tax from any other taxable sales, leases and rentals that your business makes. If you have local tax to report, report it on the applicable local tax line.

Excess mileage fees imposed at the end of the lease should be collected by the lessor holding the lease contract and reported on the lessor's sales and use tax return.

When a vehicle is sold to the lessee at the end of the lease term, the lessee is responsible for paying the tax on the buyout amount to the Department of Public Safety upon registration (transfer of title) of the vehicle.

How to calculate the tax

The total lease price subject to sales tax is calculated as shown. A description of terms follows.

vehicle value
- rebate
- residual
- trade in
+ add ons
+ interest/finance chg
= taxable amount
x tax rate
= sales tax due

Vehicle value is the agreed upon selling price of the vehicle and is taxable. It is not necessarily the manufacturer's suggested retail price. The vehicle value is not reduced by any cash down payment or capitalized cost reduction, except rebates and trade-in allowances described below.

Rebate is any manufacturer rebate, or any incentive, coupon, discount, check, or credit, regardless of origin. Rebates are not taxable.

Residual is the value of the leased property at the end of the lease term and is not taxable. The amount is documented in the lease at the time the lease is drawn up.

If the lessee buys the vehicle at the end of the lease for the residual amount, that amount is taxable. If the residual amount is adjusted, sales tax applies to any additional amount collected by the lessor at the time the lessee makes payment. For example, if the residual amount is adjusted at the end of the lease because of excess mileage, the additional amount is taxable.

Trade in allowance is not taxable. This is the total amount allowed by the dealer for a motor vehicle against the agreed value of the vehicle. If the vehicle is owned by the customer, the payoff amount to a lender does not reduce the amount allowed on the trade-in, even if the payoff amount is included in the new lease transaction.

To qualify as a trade in, a vehicle must be owned (not leased) by the lessee and traded in to the lessor named on the lease agreement. Typically, the initiating dealer is

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shown as the lessor on the lease; the dealer may later assign the lease to a leasing company.

Add ons are goods and services that are added to a leased vehicle, such as rustproofing or detailing, and are taxable.

Separately stated charges for the following items are not taxable:

- acquisition fee
- documentary fee
- gap and service contract premiums
- insurance
- maintenance or extended warranty contracts
- refundable security deposit
- title/registration fees

Interest/finance charge (rent) is the cost to carry the amount capitalized under the lease and is taxable. The below example shows how to calculate tax on a lease.

Vehicle value	$25,000.00
Rebate	- 1,000.00
Residual	- 10,000.00
Trade in	- 5,000.00
Add ons	+ 400.00
Interest	+ 2116.00
Taxable amount	$11,516.00
Sales Tax	x 6.5%
Total up-front tax due	748.54

If the lessor finances the up-front tax amount, the finance charge attributable to the tax should not be included in the taxable amount. For example:

Taxable amount	$11,516.00
Term of lease	÷ 36 mo
Base monthly payment	$319.88
Capitalized tax amount (748.54 ÷ 36)	+ 20.79
Interest on capitalized tax	+ 1.50
Total monthly lease payment	$342.17

Taxable amount is the amount after all the above calculations have been made. This is the amount that you multiply by the tax rate. This amount is also entered on your sales tax return.

Tax rate is the 6.5 percent state tax plus any local tax, if the vehicle will be garaged in an area with a local tax.

Sales tax due is the amount collected up front from the lessee.

Note: Some leases use the term "capitalized cost reduction." Capitalized cost reduction can be one amount or a combination of amounts, such as a cash down payment, trade-in allowance, rebate, discount or credit, that reduce a monthly payment. Check each individual component of the lease to determine taxability.

Renewals

A lease renewal is treated the same as a new lease – the tax is due up front.

Terminating a lease

Within 90 days or Lemon Law. Sales tax may be refunded when a lease is terminated within 90 days or when the vehicle is returned to the manufacturer under Minnesota's "Lemon Laws." The lessee may request from the lessor, a refund of the total sales tax paid minus any amount of tax due for the period the vehicle was used by the lessee.

After 90 days. If a lease is terminated after 90 days, a credit, rather than a refund, applies. The credit must be used within 30 days on the lease or purchase of another vehicle.

The amount of the credit equals the amount of upfront sales tax paid on the cancelled lease times a ratio:

The number of full months remaining in the lease when terminated

divided by

the initial term of the lease that determined the sales tax paid.

For example, a 36 month lease is terminated after 12 months, leaving 24 month remaining. Tax paid up front on a $20,000 car was $1,300. The ratio is: 24/36 = .67

$1,300 x .67 = $871. The credit that may be applied to the new lease or purchase of a vehicle is $871.

Be sure to keep documentation of the lease cancellation, including:

- origination date, initial term, and amount of sales tax paid on the cancelled lease
- date of cancellation of the old lease
- how the credit was calculated

Leases originating in another state

If a lease originates in another state and later the vehicle is transferred to and is principally garaged in Minnesota, sales tax may be due in Minnesota. The lessor would collect this sales tax and remit it to Minnesota.

- If the tax on the lease in the other state was paid up front, credit is allow for that tax. However, if the tax rate paid was less than the tax rate due in Minnesota, the difference in tax rates applies to the remaining lease payments due after the vehicle was required to be registered in Minnesota.
- If the tax on the lease in the other state was due on each lease payment, the lessor must calculate Minnesota tax on the remaining lease payments due after the vehicle was required to be registered in Minnesota.

References:
M. S. 297A.815, Motor vehicle leases
M. S. 297A. 61, Subd. 7, Sales Price
Revenue Notice 96-20, Exemption for Rebates Used to Purchase Motor Vehicles
Code of Federal Regulations, title 12, section 213.4

Also see: Local Sales and Use Taxes, Fact Sheet 164