STATE OF NORTH DAKOTA
OFFICE OF STATE TAX COMMISSIONER
Cory Fong, Commissioner

Memorandum

To: Farm Machinery Implement Dealers and Leasing Companies

From: Sales and Special Taxes Compliance Section

Date: June 6, 2013

Subject: Farm Machinery Gross Receipts Tax on Leases Effective July 1, 2013

House Bill 1236, which was approved by the 2013 North Dakota Legislative Assembly, modifies the definition of "used" farm machinery and changes the way farm machinery gross receipts tax applies to farm machinery leases. The new law applies to all farm machinery lease agreements entered into after June 30, 2013.

Two significant changes were made to the taxation of farm machinery lease agreements effective July 1, 2013.

1. For all leases of new farm machinery, tax must be collected on three years of lease payments or on the *equivalent value* of three years of lease payments if the actual term of the lease is less than three years. Farm machinery leased under these terms will qualify as exempt used machinery after the required tax has been collected on the original lease.

2. A trade-in credit will be available to farmers that own or lease farm machinery if the farmer replaces the owned or leased machinery with new farm machinery that will be leased.

Farm Machinery Gross Receipts Tax on Lease Transactions

The farm machinery gross receipts tax law defines a lease as "an agreement with a term of more than eleven months between two persons for the possession and use of property and which may or may not include provision for a transfer of ownership of the property." An agreement for a term of eleven months or less is defined as a rental. Rental agreements are taxed differently than leases.

Under the new law, a lease of farm machinery may be taxed using either of the two following methods:

Method 1: The leasing company may pay the 3 percent farm machinery gross receipts tax on its purchase price of the equipment to be leased to a farmer for agricultural purposes. If the gross receipts tax is paid by a leasing company on its purchase price, no tax is due on the individual lease payments.

Method 2: The leasing company may purchase the farm machinery for resale without payment of tax and collect the 3 percent farm machinery gross receipts tax from the farmer on three years of lease payments.

1. If the lease is for a period of three years or more, tax must be collected on the first three years of lease payments.

2. If the lease is for a period of less than three years, tax must be collected on the *equivalent value of three years of lease payments*. The equivalent value of three years of lease payments is calculated as follows: Sum the value of all the lease payments under the term of the lease. Divide the sum of the lease payments by the number of months in the term of the lease to calculate an equivalent monthly payment. Multiply the equivalent monthly payment by thirty-six.

   a. When tax is collected from the farmer under method 2, the leasing company may collect and remit all of the tax due on the lease at the time the lease agreement is entered into or the leasing company may collect and remit the tax on each lease payment as the farmer makes the payment.

   b. The leasing company will report the transaction and remit the tax in the reporting period when the tax was collected. If the tax is being collected on each payment for the equivalent value of three years of lease payments because the lease term is less than three years, the total tax should be allocated over the lease payments collected.

   c. If a lease is terminated at any point before the entire amount of tax due on the lease has been collected from the farmer, the leasing company must collect the balance of the tax due on the lease and remit it in the reporting period when the lease was terminated.

Under the new law, any farm machinery leased after June 30, 2013, and subjected to tax as described above, will qualify as used farm machinery and will be exempt from farm machinery gross receipts tax on all future sale, lease, or rental transactions.

Charges for rental of new farm machinery (agreement period of eleven months or less) are subject to 3 percent gross receipts tax until the equipment has been rented for three years. After three years of rental, farm machinery will qualify as used and is exempt from tax on all future sale, lease, or rental transactions.

Trade-in Allowance for Farm Machinery Lease Transactions

For lease agreements entered into after June 30, 2013, a trade-in credit will be available when a farmer that owns or leases farm machinery replaces that farm machinery with new farm machinery that will be leased. The trade-in will reduce the taxable purchase price of the new equipment to be leased. To qualify for a trade-in, the following must occur:

1. A farmer must possess farm machinery that he currently owns or leases.
2. A farm machinery dealer must purchase the farm machinery that is owned or leased by the farmer in item 1 above. The purchase price paid by the farm machinery dealer for the used farm machinery is the *trade-in value*.
3. The same farm machinery dealer that purchased the used equipment in item 2 above must also sell new farm machinery to a leasing company for the purpose of leasing the equipment to the farmer in item 1 above.

4. The leasing company that purchases the farm machinery for lease must pay tax on the purchase price of the new replacement farm machinery less the trade-in value determined in item 2 above.
5. Both the leasing company and the farm machinery dealer must maintain records that document the purchase of the old equipment in the possession of the farmer, the sale of new replacement equipment to a leasing company and the relationship of the two transactions that create the trade-in.
6. No tax will be due on the lease payments of the new farm machinery because tax is required to be paid on the “net trade-in value” of the new replacement machinery.
7. After the leasing company has paid tax on the net trade-in value of the new replacement farm machinery, the machinery will qualify as used farm machinery and will be exempt from gross receipts tax on all future sale, lease, or rental transactions.

Example Transactions

The following examples demonstrate the new application of farm machinery gross receipts tax to the lease of farm machinery effective July 1, 2013.

Example 1: Farmer A enters into a lease with Farm Lease Inc. for a new combine. The terms of the lease require Farmer A to make a down payment of $10,000 at the time the lease is signed and to make annual payments of $25,000 for 5 years. Farmer A may return the combine to Farm Lease Inc. at the end of the lease or he may purchase the combine for an additional payment of $120,000. Because this is a new combine, the purchase or lease is subject to 3 percent farm machinery gross receipts tax.

To satisfy the farm machinery gross receipts tax requirement, Farm Lease Inc. is required to do one of the following: 1) pay 3 percent tax on its purchase price of the combine, 2) collect $2,550 of tax from Farmer A at the time the lease is signed [3% X ($10,000 + $25,000 + $25,000 + $25,000)], or 3) collect 3 percent tax on the $10,000 down payment and each of the first three $25,000 payments as they are collected from Farmer A.

After Farm Lease Inc. has paid tax on its purchase price or has collected the tax from Farmer A on the first three years of lease payments, the combine qualifies as used farm machinery and is exempt from farm machinery gross receipts tax on all future lease, rental or sale transactions including the lease payments for years 4 and 5 and any purchase option payment at the end of the lease term.

Example 2: The same facts as Example 1. Farm Lease Inc. has elected to collect the 3 percent tax on each lease payment as Farmer A makes the payments. After making the down payment and lease payment 1, Farmer A decides to terminate the lease early. Farm Lease Inc. must collect the $1,500 of tax that remains due on the balance of the lease ($25,000 X 2 payments X 3 % tax rate) and remit it with the return for the reporting period when the lease was terminated.

Example 3: Farmer B entered into a two-year lease agreement on July 1, 2013, for a new farm tractor. The terms of lease require a down payment of $4,000 and two lease payments of $10,000 each on June 30, 2014, and June 30, 2015. The total of the lease payments in the two-year period is $24,000. Because tax must be paid on the equivalent value of three years of lease payments, the total tax due on the lease is calculated as $24,000 ÷ 24 months X 36 X 3% = $1,080. The tax may be collected and reported at the time the lease is signed or may be allocated and a portion collected with each lease payment.

Example 4: Farmer C owns a used tractor that she uses in her farming operation. Farmer C wants to replace the used tractor with a new tractor and lease the new tractor from Ag Lease Company. Farmer C enters into an agreement with Bill's Implement for two separate but related transactions. Bill's Implement agrees to purchase the used tractor from Farmer C for $25,000 and also agrees to sell a new tractor for $150,000 to Ag Lease Company for the purpose of leasing it to Farmer C. Bill's Implement must document in its records that the two transactions are related and that the $25,000 purchase of the used tractor will reduce the taxable sales price of the new tractor when sold to Ag Lease Company for the purpose of leasing it to Farmer C. A sales invoice, purchase order, and/or other agreement identifying the relationship between the two transactions will adequately document the trade-in allowance.

Ag Lease Company must pay 3 percent farm machinery gross receipts tax on the $125,000 net purchase price of the new tractor at the time of purchase ($150,000 selling price of new tractor less $25,000 purchase price paid by Bill's Implement to Farmer C). Ag Lease Company may pay the $3,750 of tax to Bill's Implement or may provide Bill's Implement a properly completed resale certificate and accrue and pay the $3,750 of tax on its sales, use and gross receipts tax return. Ag Lease Company's records must also contain sales invoices, purchase orders, or other agreements that adequately document the relationship between the purchase of the used tractor by Bill's Implement and the sale of new replacement equipment by Bill's Implement to Ag Lease Company.

The lease payments made by Farmer C to Ag Lease Company will not be subject to farm machinery gross receipts tax. In addition, the tractor leased to Farmer C will qualify as used farm machinery and will be exempt from gross receipts tax on all future sales, lease, or rentals of the tractor.

If you have any questions regarding the application of farm machinery gross receipts tax on lease transactions, please contact the sales tax compliance section at 701.328.1246 or email salestax@nd.gov for further clarification.

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