



This Week in State Tax (TWIST)

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New York: Appellate court holds sales tax refunds due on certain leases

In a recent decision, the New York Supreme Court, Appellate Division considered the sales tax implications for motor vehicle leases containing terminal rental adjustment clauses (TRACs). These leases require lessees to make provisional monthly payments based on estimated residual values at the end of the lease, with the final payment amount adjusted at lease-end to reflect the vehicle's actual value. The taxpayer, the lessor in this case, collected and remitted sales tax at the outset for the first 32 months of the lease, based on the estimated rental value for that period. If the lease extended beyond 32 months, the taxpayer would collect rent until the termination of the lease at which time the taxpayer would adjust the rent value up or down, based on the actual condition of the vehicle. If the rent value was adjusted upward, the lessee would pay additional rent and tax; if adjusted downward, the lessee received a refund. The taxpayer claimed credits on its sales tax returns for instances in which the value was adjusted downward, and a refund was made to the lessee at lease termination.

Following an audit, the Department of Taxation and Finance concluded that the taxpayer was not entitled to these credits and that the initial estimated receipts constituted the taxable base. The taxpayer appealed. An Administrative Law Judge (ALJ) upheld the Department on the basis that tax was due at the outset of the lease and there was no provision for a credit such as that sought by the taxpayer. The New York Tax Appeals Tribunal affirmed the ALJ holding that tax was due at the inception of the lease and adjustments at the termination of the lease did not alter the taxable value. The taxpayer sought review by the appellate court.

The appellate court's analysis centered on the interpretation of the law governing leases, specifically the statutory phrase that tax is due on the "consideration...contracted to be given." The court reasoned that TRAC payments are inherently provisional and subject to final reconciliation, meaning that amounts refunded at the end of the lease were never truly part of the final consideration "given" under the lease agreement. The court emphasized that adoption of the taxing authority's interpretation would ignore the conditional nature of the TRAC payments, create a tax that is incapable of precise measurement, and tax consideration that the taxpayer was legally obligated to return. Ultimately, the court concluded that the lease payments required to be paid at lease inception were provisional estimates, but only the net amount actually owed following the lease-end reconciliation constituted the consideration for the transaction. The taxpayer was entitled to recover overpaid sales tax on amounts that were ultimately refunded to lessees. For any questions regarding [Gelco Corp. v. New York Tax Appeals Tribunal](#), please contact [Judy Cheng](#) or [Jenn White](#).

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