

**ADMINISTRATIVE GUIDELINES**  
**LEASE AGREEMENT WITH PURCHASE OPTION**  
**Procedure 423**

*69.05.040(23) Sales tax paid on leases under a lease/purchase agreement may be credited toward the payment of the tax due on the exercise of the purchase option in the same proportion as the lease payments are applied to the purchase price; provided, that there will be no refund of taxes paid on the lease.*

During the period of the lease, the lessee makes scheduled rental payments and has the option to:

1. Purchase the property during the period of the lease;
2. Exercise a buy-out and take ownership of the property at the expiration of the lease period or;
3. Not renew the lease.

All or a portion of the rental payments is often credited against the purchase price. The purchase price listed at the end of the lease period is also referred to as the residual amount and is negotiated prior to the commencement of the lease.

Exercise of the purchase option:

Exercise of the purchase option changes the transaction from a lease to a sale and ownership of the property is transferred to the buyer. If the lease payments made over the term of the lease are applied to the purchase price on the exercise of the purchase option, the same proportional amount of sales tax paid over the term of the lease may be credited toward the payment of the tax due on the purchase option.

This exemption allows a buyer to apply the amount of sales tax paid over the term of the lease as a credit towards the amount of tax due on the conversion of the lease to a sale. If the sale qualifies for the “cap on the sales of a single item” under 69.05.040 (21), the taxes paid over the term of the lease can be applied towards the taxes due up to the maximum amount due, providing the lease payments are applied towards the purchase. This requires 1) the lease payment to be applied to the purchase price and 2) the leased item must qualify as a single item for the purposes of the cap exemption. Regardless of the amount of tax paid over the term of the lease, even if it exceeds the amount of the “cap,” there will be no refund of the taxes paid on the lease.

If the lease payments are not applied to the purchase price on the exercise of the purchase option, sales tax is due on the purchase price. Exercise of the purchase buy-out at the end of the lease term for the residual value of the lease item means that the lease payments are not being applied to the purchase price. In this instance, sales tax is due on the full amount of the purchase price. However, the exercise option at this point may still qualify for the “cap on the sale of a single” item exemption provided in 69.05.040 (21).