

Rentals or Leases

About this Guide

The information in this *Guide* explains how Retail Sales Tax (RST) applies to rentals or leases. Please note that this *Guide* replaces *RST Guide 502 - Rentals* dated November 1995.

Taxable Rentals or Leases

An item that is taxable when sold to the end user is also taxable when rented or leased.

Collection and Payment of RST

RST at the rate of 8% is charged on the **total** rental or lease amount including:

- charges to install, assemble, or dismantle goods (see exceptions under Non-Taxable Rentals or Leases)
- collision damage waiver charges
- delivery and handling charges
- finance or interest charges
- maintenance, repair, or damage charges
- service contract charges
- surcharges based on the length of the rental, distance travelled by vehicles, etc.
- tax for fuel conservation.

RST does not apply to the federal Goods and Services Tax (GST) that may be charged on rentals or leases.

The lessor is not required to pay RST on the purchase of goods which will be rented or leased to customers (see exceptions under Non-Taxable Rentals or Leases).

RST must be collected on the due date of each rental or lease payment and paid to the Ministry of Finance (Ministry) on the RST return covering the period in which the rental or lease payment is due, even if the RST has not been paid by the lessee. If the first and last rental or lease payments are made when the lease is signed, RST must be collected and paid to the Ministry on both payments at this time. RST does not apply to refundable deposits.

Options to Purchase and Conditional Sales

Under some lease agreements, lessees have an “option to purchase” the item being leased or rented when the lease or rental term ends. If a lessee decides to buy the item, RST applies to the amount paid, even though the lessee may be buying the item for resale purposes.

Options to Purchase and Conditional Sales (Continued)

In some cases, the lease contract may provide for a nominal or bargain option price (e.g., one dollar) to be paid at lease termination. The application of RST will depend on whether the transaction is a true lease or a conditional sale.

The Ministry considers a lease to have occurred when lease financiers, in their ordinary course of business, write leases on lease paper in specific lease language. This applies even if the lessee is entitled to purchase the asset at a nominal amount at the end of lease.

Where it cannot be readily determined from the wording of a contract whether it is a lease or conditional sale, the transaction as a whole must be considered. Any or all of the following criteria can be used to determine if the transaction is a lease or a conditional sale:

- the intention of the parties to the agreement
- the role of the parties
- substance of the transaction
- compensation for use of goods or credit payment
- amortization schedule
- circumstances surrounding the transaction.

No single criteria is necessarily conclusive in any particular transaction.

Under some agreements, the “leased” item **must** be bought by the purchaser when the agreement ends. This type of agreement is a conditional sales contract and is **not** a lease or rental agreement. RST must be collected and paid to the Ministry on the total amount payable by the purchaser when the conditional sales contract is signed and **not** when the payments are due. For example, if monthly payments of \$300 are to be made for 36 months, RST must be collected on the total amount of \$10,800 (\$300 x 36) and paid when the **agreement is signed**, not when the monthly payments of \$300 are due.

- Under a conditional sales contract, RST would not apply to any finance charges, carrying charges or interest charges provided these charges are separated on the invoice or bill of sale, or are billed separately to the customer. If these charges are not separated, then RST would apply to the total amount payable.

Lease Termination Payments

Lease termination or damage payments are lump sum payments made to terminate a lease agreement. In some cases, these payments are settlement payments made in the context of a potential lawsuit for the breach and repudiation of a lease and are not rental payments under a lease agreement.

Lease termination or damage payments are **not** taxable when all of the following conditions are met:

- (a) consumption and use of tangible personal property (TPP) has ended and the TPP has been returned to the lessor
- (b) lease payments cease
- (c) the lease is repudiated, and
- (d) lease termination payments are made to “terminate” all relationships (both contractual and litigation) between the parties.

Lease Termination Payments (Continued)

Rental payments must equate to the use of the property by the lessee. Therefore, once the lease has been terminated and the goods are returned to the lessor, further payments, even if they are periodic, relate to the lessor's claim for damages and not to payments made for the use of the TPP.

With regard to the condition (d), the relationship between the lessor and the lessee does not have to cease entirely. It is the relationship, specific to the TPP that has been returned, that must cease entirely.

In some cases, the parties may have agreed upon early termination of the lease. Payments in respect of previously agreed upon termination charges would still be considered lease termination or damage payments as long as the other conditions are met. Once the lease has been terminated, even if contemplated by the parties beforehand, payments in the nature of damages are not taxable because they do not relate to the use of the TPP.

If RST is paid in error on lease termination or damage payments, taxpayers can apply for a refund by completing a "General Application for Refund of Retail Sales Tax" form. Refund claims must be received by the Ministry within four years of paying the RST.

Non-Taxable Rentals or Leases

RST does not apply to the rental or lease of:

- fixtures, such as water heaters permanently attached to real property. (The person who buys and installs these fixtures pays RST at the time the items are bought.) *
- real property, such as land and buildings. *

* **RST Guide 206 - Real Property and Fixtures** has further information on how RST applies to these items.

A person who buys a taxable item such as a motor home or a boat, and occasionally rents it out, is not in the business of leasing. This person is not required to collect RST on the occasional rental, but RST must be paid on the full purchase price when the item is bought.

While the rental or lease of scaffolding and cranes is taxable, charges to install, assemble, or dismantle these items are not subject to RST if:

- the rental items are used in the construction, renovation, maintenance, restoration or repair of real property; and
- these charges are shown separately from the rental of scaffolding and cranes.

Lessee Moves from/to Ontario

There are instances where an item is being leased by a lessee who moves outside of Ontario during the term of the lease period. RST will not apply if, on the due date of a rental payment, the lessee has removed the item for **permanent use by the lessee outside the province**. The lessor is required to keep supporting documents on file to verify that the item has been permanently removed from Ontario. The documents must include proof that the applicable tax has been paid to another Canadian jurisdiction.

When a person brings an item into Ontario that he/she has leased in another jurisdiction, that person is required to pay RST on the monthly rental payments to the lessor, or directly to the RST Branch if the lessor is not a registered Ontario vendor.

Non-Taxable Service

There are situations where the item being rented or leased may be incidental to the provision of a non-taxable service. In these instances, RST does not apply to the rental or lease of the item but must be paid by the lessor when the item is purchased. The following are examples of non-taxable services:

- equipment, such as a bulldozer, where the charge includes an operator provided by the lessor
- rental of ice fishing huts
- rental of portable sanitary toilet services.

You should contact your nearest Ontario Ministry of Finance Tax Office if you are not certain whether you are providing a non-taxable service or renting or leasing taxable goods on which RST must be charged.

For Further Information

The information contained in this publication is only a guideline. For further information, please contact the nearest Ontario Ministry of Finance Tax Office listed under Taxes - Provincial (Retail) Sales Tax in the blue pages of your telephone directory, call our TAX FAX Service at 1-877-4-TAX-FAX (1-877-482-9329), or visit our Web site at www.trd.fin.gov.on.ca.

*Ce guide est disponible en français sous le nom « Locations, n° 502F ».
Vous pouvez obtenir un exemplaire en appelant le 1-800-668-5821.*