

**Revenue Ruling
No. 05- 003
June 28, 2005**

**Corporation Income and Franchise Taxes
Capitalized Lease Assets in the Property Factors**

Purpose: The purpose of this Revenue Ruling is to address the different treatment of capitalized lease assets for corporation income and franchise tax property factor purposes.

Analysis/Discussion: In Statement of Acquiescence No. 04-001, the Department found that when a capitalized lease is a “true” or “genuine” lease, capitalized lease assets would not be included in the property factor for franchise tax purposes. This leads to the question of inclusion of capitalized lease assets in computing the property factor for corporation income tax purposes.

Louisiana’s corporation income tax piggybacks the federal corporation income tax scheme. The question of what is an item of income or expense or what is an asset is determined beginning with the federal income, expenses or assets. In the federal tax scheme it is necessary to determine who has ownership, and therefore, who is entitled to the depreciation deduction in leasing arrangements. The IRS has published guidance through a number of rulings. The primary rulings are Rev. Rule 55-540 and Rev. Procedure 75-21.

Basically, where the lease arrangement poses as a financing tool for an ultimate purchase, federal law will regard the transaction as a purchase financed through the lease agreement. The lessee is treated as the owner of the asset and will be entitled to depreciation deductions on the property and interest expense on the loan. In this type of lease arrangement, the lessee will not take a deduction for rental payments. In the case of an operating lease (lease represents an agreement to pay rent for the use of property for a specified period of time), the lessee is not treated as the owner of the asset and will deduct the periodic payments under the lease. Ownership of the property remains with the lessor, who would be entitled to the asset depreciation and any interest expense incurred from financing.

Conclusion:

The Department’s Statement of Acquiescence No. 04-001 is applicable for franchise tax purposes only. A capitalized lease asset is treated as a true rental for corporation franchise tax purposes. The leased property is not considered an asset and is not included as property for purposes of the property factor of the allocation ratio.

For corporation income tax purposes, in accordance with the federal treatment, a capitalized lease asset that is considered owned by the taxpayer for federal income tax purposes is an asset for Louisiana income tax purposes. It is included in the property factor of the apportionment ratio if it is used to produce apportionable income. A capitalized lease asset that is not treated as owned by the taxpayer for federal income tax purposes is not included in the Louisiana corporation income tax property factor. Whenever a capitalized lease asset is considered owned for federal income tax purposes it is considered owned for Louisiana income tax purposes. In addition to property factor considerations, when the capitalized lease asset is considered owned it must also be considered in any attribution of indirect interest expense to allocable and apportionable income.

Cynthia Bridges
Secretary

A Revenue Ruling is issued under the authority of LAC 61III.101 (C). A Revenue Ruling is written to provide guidance to the public and to Department of Revenue employees. It is a written statement issued to apply principles of law to a specific set of facts. A Revenue Ruling does not have the force and effect of law and is not binding on the public. It is a statement of the department's position and is binding on the department until superseded or modified by a subsequent change in statute, regulation, declaratory ruling, or court decision.