



STATE BOARD OF EQUALIZATION

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December 18, 1992

Mr. [D]
Controller
[R]
XXX --- ---
--- ---, -- XXXXX-XXXX

Dear Mr. [D]:

This is in response to your letter dated October 27, 1992 regarding the amounts which are taxable with respect to the lease of certain computer equipment. You are the lessee of the equipment. The lease requires that a maintenance agreement be in force. You have the option of choosing between two different maintenance agreements. You believe that the charges for maintenance are not subject to tax since you have the option to provide the maintenance yourself.

Under the first type of maintenance agreement, the lessor provides all necessary parts and service as well as providing a full time on-site field engineer. Under the second type of maintenance agreement, the lessor trains your personnel for technical certification on the equipment and provides two on-site inspections by its field engineer. The lessor will also have a field engineer available for maintenance on a per diem basis. You are required to purchase from the lessor a "spares kit" of replacement parts. Either maintenance agreement is for a term of one year, at which time it automatically renews unless you choose to convert your existing agreement over to the other type of maintenance agreement.

Discussion

A lease of tangible personal property is a continuing sale unless the lessor leases it in substantially the same form as acquired and has made a timely election to pay sales tax reimbursement or use tax measured by the lessor's purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1.) A lease that is a continuing sale is subject to use tax measured by rentals payable. The lessee owes that use tax, and the lessor is required to collect it from the lessee and pay it to this Board. (Rev. & Tax. Code §§ 6201, 6202, 6203, 6204, Reg. 1660.) The lease about which you inquire is apparently a continuing sale, which means that you owe use tax measured by the rentals payable. Your question is whether the maintenance charges are included in the taxable rentals payable.

Mr. [D]

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December 18, 1992
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The application of tax to leases of tangible personal property is explained in Regulation 1660, a copy of which is enclosed. As stated in subdivision (c)(1) of Regulation 1660, the rentals subject to tax include any payments required by the lease except, as relevant here, separately stated optional insurance and maintenance charges.

We have previously concluded that where equipment is leased under a contract which provides that the lessee must contract with the lessor for maintenance, the charges for such maintenance are includible in the taxable rentals payable. (Business Taxes Law Guide Annotation 330.3460 (5/19/67).) Similarly, we have concluded that when the lessee is required under the lease contract to obtain insurance, the charge for that insurance by the lessor is excludable from the taxable rentals payable only if they are separately stated and the lessee is not required to obtain the insurance from the lessor but rather is entitled to purchase the insurance from the insurer of the lessee's own choice. (Business Taxes Law Guide Annotation 330.3360 (7/13/66).)

You have not provided us a copy of the actual lease. However, your description is that you must contract with the lessor for the maintenance, but you can choose one of two different types of agreements. That is, my understanding is that the lease contract does not provide you the option of contracting for the maintenance with the person of your own choice, but rather requires that you contract with the lessor for such maintenance. That you have the choice of two types of maintenance agreements does not mean that the maintenance charges are optional within the meaning of Regulation 1660 since, regardless which type you choose, you are required to contract with the lessor for that maintenance. We therefore conclude that the charges must be included in the taxable rentals payable from the lease.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:es