

M e m o r a n d u m**330.2112**

To: Mr. Jerry Cornelius

October 21, 1988

From: E. L. Sorensen, Jr.

Subject: A--- M--- and H--- C--- Inc.

As requested, we have reviewed A---'s suggestion regarding changing the tax status of a piece of equipment in its rental inventory. The equipment in question was apparently purchased ex-tax but a timely election was not made, pursuant to Regulation 1660(c)(2), to report tax upon the purchase price.

Since all of A---'s other rental equipment is in a tax paid status, A--- would like to convert the item in question to a tax paid status, as well. It proposes to accomplish this result by "selling" the property for fair market value to an unrelated "liquidation company" for immediate "resale" back (presumably at the same price) to A---. It is suggested tax would be paid by the "liquidation company" and the equipment could then be leased tax paid by A---.

Revenue and Taxation Code Sections 6006(g)(5) and 6010(e)(5) provide, in essence, that tangible personal property which is leased in substantially the same form as acquired and as to which the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property are not "sales" or "purchases". Regulation 1660(c)(2), interprets and applies the statutes by requiring that in order to elect to pay the tax measured by purchase price such election must be made by the lessor with the return for the period during which the property is first placed into rental service. If the election is not made timely, tax must be paid based on rentals payable (Rev. & Tax. Code §§ 6006(g), 6010(e), 6201; REg. 1660(c)(1)). In Action Trailer Sales Inc. v. State Board of Equalization, 54 Cal.App.3d 125, the court confirmed that the provisions of Regulation 1660 in issue here are reasonable and consistent with Legislative intent.

It is well settled that the incidence of taxation with respect to a transfer of property depends on the substance of the transaction, and is not controlled solely by the means employed to transfer the title (Commissioner v. Court Holding Co., 324 U.S. 331). Nevertheless, a taxpayer may carry out his business transactions in a fashion calculated to minimize the tax

liability so long as the transfer has business substance and is not a mere sham (see U.S. v. Cumberland, 338 U.S. 451).

In our view, the sole purpose of A---'s proposal is to subvert the clear intention of the law that, unless a timely election is made to pay tax based upon the purchase price, tax on leased property is due based on rentals payable. There is no business substance to the proposal and, accordingly, we should recognize it as a sham and should not give it any effect for sales and use tax purposes.

E. L. Sorensen, Jr.

ELS:rar

Attachment