STATE OF CALIFORNIA **330.5253**

STATE BOARD OF EQUALIZATION

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December 7, 1995

Ms. L--- L---
N---
XXXX --- Road, Suite XXX
---, TX XXXXX-XXXX

Re: N---
No permit number

Dear Ms. L---:

This is in response to your letter dated August 29, 1995 regarding the application of tax to your sale and leaseback of equipment. You state:

> "I am writing to request a ruling in writing regarding a specific tax issue. In the past, we have purchased equipment from a vendor who charges us sales tax. This equipment is then sold by us to a leasing agent and then leased back to us from this agent, who also charges us sales tax on the lease payments. In other words, we are paying sales tax on the same equipment twice.
>
> "N--- is located in Texas as are the vendor from whom we purchase the equipment and the company we sell to and lease the equipment back from. We have established from the State of Texas under what conditions and at what point sales tax should be charged and remitted to the State of Texas. However, some of this equipment will be shipped to and used in the State of California."

You ask a series of questions regarding how tax applies to your sale and leaseback of the equipment:

> "1. If N--- (Company N) is charged sales tax (at Texas rate and remitted to the State of Texas) by the Vendor (Company V), then sells the equipment to the Leasing Agent (Company L) and then leases [it] back from L,

(the equipment is used by N in California) at what point or under what circumstances would N owe California use tax?

"2. If use tax is due, would it be equal to the rate in the California city in which the equipment is being used or only due to the extent the tax rate is greater than the Texas sales tax rate charged initially?"

Retail sales of tangible personal property in California are subject to sales tax, measured by gross receipts, unless specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) A sale includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code § 6006(a).) When sales tax does not apply, the use tax, measured by the sales price of the property sold, applies to the use of property purchased from a retailer for storage, use or other consumption in California, unless such storage, use, or other consumption is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6201, 6401.)

A lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases the property in substantially the same form as acquired and has made a timely election to pay California 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, Reg. 1660(c)(2).) When a lease is a continuing sale and purchase because either or both of the foregoing conditions are not satisfied, the lease is subject to use tax measured by rentals payable. (Reg. 1660(c)(1).) The lessee owes the tax, which the lessor is required to collect from the lessee and pay to this Board. (Rev. & Tax. Code §§ 6202, 6203, 6204; Reg. 1660(c).)

The tax rate applicable to the lease of the property in California is the rate in effect at the location in which the property is leased. The minimum combined state sales and use tax rate is currently 7.25 percent. That amount includes the state and local tax. In some counties, the total sales and use tax rate is higher. Any tax which may be applicable above 7.25 percent would be a tax adopted by a district pursuant to the Transactions and Use Tax Law. (Rev. & Tax. Code § 7251, et seq.) I will refer to such taxes as district taxes. A district's sales tax is applicable to sales occurring in that district unless the sale is otherwise exempt from the district sales tax. A district's use tax is applicable to the use of property purchased outside the district for use inside the district. (Reg. 1827(a).) Pamphlet 71, "California City and County Sales and Use Tax Rates," a copy of which is enclosed, provides detailed explanations regarding district taxes, and includes a list of those counties that have adopted ordinances creating special districts imposing district taxes.

The rate of tax in Texas is not relevant to the determination of the rate of tax due on the rentals. The payment of a tax in Texas would only be relevant to whether the amount of that tax would be applied as a credit against the liability for California tax of the person who paid the Texas tax (or tax reimbursement) on the same transaction with respect to which the Texas tax was paid. (See Rev. & Tax. Code § 6406.)

Here, tax was paid in Texas with respect to the sale of the property to you. If you were to then have brought the property into California for use, and not for sale and leaseback, the credit provisions of section 6406 would be relevant. As discussed below, certain sale and leaseback transactions are treated as financing transactions. When such is the case, the transaction is not treated as a sale and a lease for purposes of sales and use tax. Instead, the original purchaser (i.e., the seller/lessee) is the consumer of the property. Thus, if the sale and leaseback transaction here qualifies as a financing transaction, you would be the consumer of the property. Assuming you brought the property into this state within 90 days of your purchase, you would owe California use tax on your purchase price. (See Reg. 1620, a copy of which is enclosed.) The applicable rate would be the rate in effect at the location of the property's use. It appears that you would be entitled to a credit against that tax for the amount of tax or tax reimbursement you paid when purchasing the property in Texas, not to exceed the California use tax due.

As explained in subdivision (a)(3)(A) of Regulation 1660 (a copy of which is enclosed), sale and leaseback transactions are treated as financing transactions if: 1) the lease transaction is regarded as a sale at inception as defined in Regulation 1660(a)(2)(A); 2) the purchaser-lessor claims no deduction, credit, or exemption with respect to the property for federal or state income tax purposes; and 3) the amount which would be attributable to interest had the transaction been structured originally as a financing agreement would not be usurious under California law. You have not provided sufficient facts for us to ascertain whether the sale and leaseback transaction qualifies as a financing transaction under subdivision (a)(3)(A) of Regulation 1660 or under the special rules of subdivision (a)(3)(B). If not, the transaction will be treated as structured; that is, it will be treated as a sale and a leaseback, for sales and use tax purposes.

I note that Revenue and Taxation Code section 6010.65 excludes from the definition of sale and purchase any transfer of title to, or any lease of, tangible personal property pursuant to an "acquisition sale and leaseback" executed on or after January 1, 1991. As explained in Regulation 1660(a)(3)(D), an acquisition sale and leaseback transaction is defined as a sale by a person and leaseback to that person of tangible personal property where both the following conditions are satisfied: 1) the seller/lessee has paid California sales tax reimbursement or use tax with respect to that person's purchase of the property; and 2) the acquisition sale and leaseback is consummated within 90 days of the seller/lessee's first functional use of the property. Since you paid Texas tax reimbursement, rather than California sales tax reimbursement, on the purchase of the equipment, the sale and leaseback cannot qualify as an acquisition sale and leaseback under section 6010.65.

Assuming the sale and leaseback does not qualify as a financing transaction under Regulation 1660, the general rules applicable to leases of tangible personal property in this state apply. The lease is a taxable continuing sale unless the lessor has timely paid California sales tax reimbursement or use tax measured by the purchase price of the property. Our understanding is that the lessor here has paid no tax or tax reimbursement with respect to its purchase of the equipment. Thus, its lease of the property to you is a taxable continuing sale, and tax is due on the rentals payable at the rate in effect at the location where the property is physically located. As a retailer deriving rentals from a lease of tangible personal property situated in this state, the

lessor will be required to collect that tax from you and to pay that tax to this state. (Rev. & Tax. Code § 6203.)

I note that the credit provisions of section 6406 are relevant when the lessor has paid another state's tax on purchase price under circumstances where the lessor would be regarded as having purchased the property for use in California, as explained in subdivision (c)(8) of Regulation 1660. Since the lessor here paid no tax or tax reimbursement, these provisions are not relevant here.

> "3. Is there a time span between the initial purchase by N and the leasing by N from L that would [a]ffect the answer to the above questions?"

Under the facts stated in your letter, the time span does not appear relevant.

We were not provided with a question number 4. Next, you ask:

> "5. If N is charged sales tax on the lease payments, under what circumstances is N responsible for paying California use tax?"

As discussed above, you owe use tax, not sales tax, on your lease of the equipment. L must collect the tax from you at the time rentals are paid by you, and must give you a receipt of the kind called for in Regulation 1686. You will not be relieved from liability for the tax until you are given such a receipt showing that you remitted California use tax to the lessor, or until the tax is actually paid to the state. (Reg. 1660(c)(1).)

> "6. Again, if use tax is due, would it be equal to the rate in the California city in which it is being used or only due to the extent the tax rate is greater than the rate of tax charged on the lease payments (which is a Texas rate collected by L and remitted to Texas)?"

The answer to this question is the same as the answer to questions 1 and 2.

> "7. Does the point at which the equipment is shipped to California have any bearing on this issue?"

In the present case, the point at which the equipment is shipped to California will not change the fact that the lease is a continuing sale and purchase for which you will owe, and L must collect, tax on the rental receipts.

> "8. Would the answers to any or all of the above questions change depending on whether the lease was a capital lease or an operating lease?"

It is not clear what you mean by the terms "capital lease" or "operating lease." As long as the lease is true lease, meaning it is a continuing sale and purchase, the answers to the above

questions would remain the same. For explanations regarding when transactions are and are not considered leases that are continuing sales and purchases, please see Regulation 1660.

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

Sincerely,

Kelly W. Ching
Staff Counsel

KWC:cl

Enclosures (Regs. 1620, 1660, Pamphlet 71.)

cc: Out-of-State District Administrator