



CDTFA
CALIFORNIA DEPARTMENT OF
TAX AND FEE ADMINISTRATION

Leasing Tangible Personal Property

Preface

This publication is designed for lessors of tangible personal property in California and provides basic information on the application of the California Sales and Use Tax Law to lessors.

If you cannot find the information you are looking for in this publication, please visit www.cdtfa.ca.gov or call our Customer Service Center at 1-800-400-7115 (CRS:711). Customer service representatives are available to answer your questions Monday through Friday between 8:00 a.m. and 5:00 p.m. (Pacific time), except state holidays.

This publication complements [publication 73](#), *Your California Seller's Permit*, which includes general information about obtaining a permit; using a resale certificate; collecting and reporting sales and use taxes; buying, selling, or discontinuing a business; and keeping records. Please also refer to our [website](#) or the [For More Information](#) section for the complete list of California Department of Tax and Fee Administration (CDTFA) regulations and publication.

We welcome your suggestions for improving this or any other publication. If you would like to comment, please provide your comments or suggestions directly to:

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Please note: This publication summarizes the law and applicable regulations in effect when the publication was written, as noted on the cover. However, changes in the law or in regulations may have occurred since that time. If there is a conflict between the text in this publication and the law, the application of tax will be based on the law and not on this publication.

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Leases—An Overview

The term lease, for sales and use tax purposes, may differ from how the term is used by other government agencies and professional groups. The information in this section is designed to clarify the definition of the term lease, and provide general guidance on the application of tax to leases.

Lease defined

The term lease, is generally a contract in which a person receives temporary possession and control of tangible personal property for consideration. The term lease includes rental, hire, and license of tangible personal property. The person who owns the tangible personal property being leased is considered the lessor. The person who pays for the temporary use of the property is considered the lessee.

Transactions that would otherwise be regarded as leases may be transactions specifically excluded from the definition of a lease by sales and use tax law or regulation. The following are not considered leases:

- A contract in which it is mandatory that the owner provide an operator with the equipment or other tangible personal property. For example, a crane company contracts with a customer to furnish a crane and an operator. The transaction is a lease if the customer has the option to provide their own operator. The transaction is not a lease if it is mandatory that the owner's employee operates the crane.
- A restricted grant of privilege to use tangible personal property for less than one continuous 24 hour period, for less than a \$20 charge, and for the restricted use on the premises or at a business location of the grantor of privilege of the property (see [Restricted grant of privilege](#)).
- A sale at inception, also known as a sale under a security agreement. This includes contracts, designated as leases, that bind the lessee for a fixed term, and the lessee obtains title to the property at the end of the contract or has the option to purchase the property for a nominal amount (see [Sales under a security agreement](#)).

Sales or use tax may apply

In general, retail sales of tangible personal property in California are subject to sales tax. Examples of tangible personal property include items such as furniture, tools, hot food products, toys, antiques, clothing, etc.

Whether or not the retailer is reimbursed by the customer for sales tax depends solely on the terms of the sales agreement between the customer and retailer. Normally the retailer adds the sales tax reimbursement to the sales price as evidenced by the tax shown on the sales check or other proof of sale. In any case, the law holds the retailer responsible for the sales tax.

The use tax complements the sales tax and is imposed upon consumers in California. It is an excise tax imposed on the "storage, use, or other consumption," referred to as "use," of tangible personal property in California purchased from any retailer. The use tax generally applies to the use of property purchased from retailers outside of California. Use tax also applies to purchases of vehicles, vessels, and aircraft from sellers who are not engaged in the business of selling such property.

Generally, the tax imposed in lease transactions is a use tax on the lessee measured by rentals payable. This is true when the lease is one that is considered a continuing sale and purchase. If the lessee is exempt from the use tax, as in the case of insurance companies (see [Insurance Company](#)), the tax imposed is the sales tax. In those transactions, the sales tax is imposed on the lessor and is measured by the rentals payable.

INSURANCE COMPANY

Question

I am leasing equipment to an insurance company. The insurance company informed me that they are exempt from use tax as required by [Regulation 1567](#), Banks and Insurance Companies. Should I charge them tax?

Answer

Because there is a gross premium tax imposed on insurance policies in California, insurance companies are exempt from most other taxes, including the California use tax. Thus, the insurance company is correct that your lease to it is exempt from the use tax. However, Regulation 1567 states that in such cases, the sales tax will be imposed on the lessor. That is, while the insurance company does not owe use tax on the rentals, as the lessor, you owe sales tax on rentals to the insurance company. Therefore, you may collect sales tax reimbursement from the insurance company for the amount of sales tax you owe if the contract so provides.

General application of tax

The general rule applicable to taxable leases of tangible personal property located in California is two-fold:

- The lease is a continuing sale and purchase, and
- The lessee is liable for use tax measured by rentals payable.

The lessor, however, must collect the use tax from the lessee at the time rentals are paid by the lessee, give the lessee a receipt, and report and pay the tax to the CDTFA.

In addition to the general rule, there are three basic ways that the tax can apply to your leases, depending on the means by which you obtained the property, the type of contract between you and the lessee and the type of property being leased. These are:

- Leases taxed based on the cost of the property to you.
- Leases taxed based on rental receipts.
- Leases taxed based on fair rental values.

Generally, as a lessor, you have the option to choose whether the tax is based on the purchase price (see [Tax based on purchase price](#)), rental receipts (see [Tax based on rental receipts](#)), or fair rental value for mobile transportation equipment, (see [How tax applies](#)), provided the election is made timely (see [Timely election](#)). If no election is made, or if the election is not made timely, a default tax application will automatically apply depending on the type of property leased. Rules and restrictions regarding the elections options are discussed in [Application of Tax to Leases](#), and [Specific Types of Leases](#).

Rentals payable (also referred to as rental receipts) include any payments required by the lease, including amounts paid for personal property taxes on the leased property (except when the lessor is a bank or financial corporation), whether assessed directly against the lessee or against the lessor. Certain amounts, such as payments for late charges and collection costs, are not included in the measure of tax.

PROPERTY TAX

Question

I am a lessee of equipment and have been separately billed for the property tax by the lessor. The lessor has charged me use tax on the property tax for the equipment. Is this correct?

Answer

This is correct. The Sales and Use Tax Law imposes the tax based upon the lease receipts of the retailer without any deduction for any expenses. The property tax is a business expense of the retailer and therefore not excluded from the measure of tax.

Application of Tax to Leases

The information in this section is designed to help you determine the proper tax application to leases and components of leases. Before determining how tax is applied to your lease, you may want to determine whether the transaction is exempt from tax. For information on leases exempt from tax, see [Exemptions](#). The following information applies to leases subject to tax.

Special reporting requirements

For some leases, you do not have the option to choose whether tax is due on the rental payments or the purchase price. Sales or use tax must be paid based on the purchase price of the property (your cost) and cannot be paid based on rental payments. If the seller has a California seller's permit or is registered to collect use tax, you must either pay the sales or use tax to the seller or you must pay the use tax directly to the CDTFA.

Leases of the following categories of items are not considered to be continuing sales and purchases. You must pay sales tax or report use tax on the purchase price of these items when purchased for leasing:

- Motion pictures or animated motion pictures, whether or not they are productions complete in themselves. This includes television, films, and tapes. This does not include leases of video cassettes, videotapes, and videodiscs for private use under which the lessee or renter does not obtain or acquire the right to license, broadcast, exhibit, or reproduce the cassette, tape, or disc.
- Household furnishings as part of a lease of the living quarters in which they are to be used. This rule applies when the living quarters are real property (as opposed to tangible personal property, such as a mobilehome).
- Linen supplies and similar articles—including items such as towels, uniforms, coveralls, shop coats, and dust cloths—when an essential part of the lease is the recurring service of laundering or cleaning of these articles leased.
- A restricted grant of privilege to use tangible personal property for less than one continuous 24 hour period and the charge is less than \$20. The use of the property is restricted to use on the premises or at a business location of the grantor of privilege of the property (see [Restricted grant of privilege](#)).
- Videotapes and videodiscs leased or rented for commercial purposes (see [Videotapes and videodiscs](#)).
- Mobilehomes originally sold new after June 30, 1980. For more information on mobilehomes, please refer to [publication 47, Mobilehomes and Factory-Built Housing](#).

If you are not required to pay sales tax or use tax on your purchase price, as previously described above under the special reporting requirements for a lessor, you can generally choose reporting tax based on the purchase price or based on the rental payments. See [Mobile transportation equipment \(MTE\)](#).

Tax based on purchase price

No tax is due on the rental receipts if the property is leased in substantially the same form as acquired by the lessor and the lessor has paid either the sales tax or has timely reported and paid use tax (measured by the purchase price of the property).

Timely election. As a lessor, if you lease the property in substantially the same form as acquired and wish to pay tax on the purchase price, but the supplier does not collect California sales tax from you, you must timely pay use tax on the purchase price on your sales and use tax return for the first reporting period in which the property is placed into lease service. If you do not make such a timely election, you must report and pay tax based on rental payments received.

Once you elect to pay tax based on your purchase price of the property, you cannot change your reporting method to tax based on rental payments.

To pay under this method, the tangible personal property must be leased in substantially the same form in which you acquired it. If the property is altered such that it is not leased in substantially the same form as acquired, tax must be based on rental payments.

Please note: Property is not leased in substantially the same form as acquired when:

- You make significant changes to the property after you acquire it that affect functional capabilities, characteristics, or form.
- A relatively significant amount of fabrication labor has been performed on the acquired property.
- An appreciable change in value accompanied by a change in configuration of functional capabilities has occurred after purchase.

If you purchase property from a supplier who has a California seller's permit and you do not issue a resale certificate, that supplier will generally pay tax to the CDTFA based on the sales price to you and charge you sales tax reimbursement. If such is the case and you lease the property in substantially the same form as acquired, you are not required to report tax based on rental or lease payments.

FABRICATION LABOR

Question

We acquired some material and paid sales tax on the purchase price to the vendor. Subsequently, an outside party fabricated it into equipment and charged us sales tax on the fabrication labor. We are now leasing the equipment.

Does tax apply?

Answer

No. If tax has been paid by a lessor on the full purchase price of the property consisting of the cost of materials and outside fabrication labor, no tax is due on the rental receipts from the leasing of the property.

If the material had been fabricated using your own labor, the property would not be considered leased in substantially the same form as acquired and tax would apply to the rental receipts. A tax paid purchase-resold deduction would be allowed on the tax-paid material.

TIMELY ELECTION

Question

Our company has attempted to purchase all leased equipment tax paid (not MTE). We have found that several pieces of equipment currently being leased were purchased without tax and we inadvertently neglected to report the purchase price and pay use tax in the period the equipment was placed in rental service. Can we now make a retroactive adjustment and pay tax on the cost of the equipment or must we collect and report tax based on rental receipts?

Answer

The election to pay tax on the cost of the equipment and payment of that tax must be made timely. A timely election means the tax must be reported and paid timely with the return of the lessor for the period during which the leased equipment first enters lease service. Because no timely election was made to pay tax on the cost of the equipment, you are required to collect and report tax on rental payments.

Tax based on rental receipts

For leases of Mobile Transportation Equipment (MTE), see [Mobile Transportation Equipment \(MTE\)](#).

If tax has not been paid based on the purchase price for the property, tax must be reported based on the rental payments. You must report the amount collected in the period in which the rental receipts were received. This type of lease is considered a continuing sale and purchase.

Please note: A lessor of one-way rental trucks may elect to report tax measured by the rental receipts for the period in which the truck is first put into rental service. If the lessor does not make this election on a timely basis, the truck will be regarded as MTE and tax will be due based on the purchase price of the truck. One-way trucks are defined as motor trucks required to be registered under the Motor Vehicle Code, (not exceeding the manufacturer's gross vehicle weight rating of 24,000 pounds), that are principally employed by a person in the rental business and are leased for short-term periods of not more than 31 days to individual customers for one-way or local hauling of personal property of the customers.

PROPERTY ACQUIRED IN EXEMPT OCCASIONAL SALE

Question

I am engaged in the business of leasing machinery and equipment and recently acquired a machine through an exempt occasional sale. Am I obligated to pay tax on the lease receipts?

Answer

Due to the number, scope, and character of their selling activities, some vendors are not considered to be in the business of selling merchandise and are not required to hold a permit or report sales tax. If you acquire property in an exempt occasional sale, you may use the property without paying tax. However, if you lease the property, tax would then be due based on your rental receipts. In such instances, the law provides that you may make the timely election to pay tax on your purchase price instead of paying tax on your rental receipts if you will be leasing the property in substantially the same form as acquired.

Common charges associated with leases subject to tax

The following items are generally considered to be included in rental receipts and are subject to tax when you elect to pay tax on rental receipts.

License, royalty, and reproduction rights. If a rental or lease agreement calls for a royalty to be paid based on units produced or for use of the property, such royalties are subject to tax. For example, a photocopier is leased for a monthly rate plus an additional amount for every copy produced by the machine (often called a "click charge"). All amounts paid for the lease including the unit usage charge (click charge) would be included in the lease receipts subject to tax (see [Photographs and artwork](#) for special rules on royalty and reproduction rights associated with artwork and photographs).

Advance rental payments. Advance rental payments received by the lessor at the time the lease begins are subject to the tax at the time the amounts are paid by the lessee. It is immaterial that the advance rental payment is designated as applicable to the final period of the lease. Generally, if the amount collected at the beginning of a lease is designated as a security deposit rather than an advance rental, the amount collected would not be subject to tax until it is actually applied to a rental payment.

Charges designated as interest. When equipment is actually leased and not sold on credit, the amounts designated as interest are included in the rental payments subject to tax.

Property tax. When a lessee is required by the rental contract to pay for any personal property taxes assessed on the lease property, the amounts will be regarded as part of the taxable rental receipts whether the tax is assessed directly against the lessor or the lessee. Such charges are considered to be part of the gross receipts and are subject to tax. However, charges to the lessee are not subject to tax when a bank or financial corporation is the lessor.

Mandatory charges. Additional charges are included in the taxable rental receipts when the lessee, under the lease contract, is required to use your services. For instance, these services may include equipment maintenance, warranty, assembly, and disassembly. However, if the lease contract merely requires that the lessee maintain the property, the lessee's maintenance costs are not included in taxable rental receipts.

Another example of mandatory charges is the collision damage insurance supplement generally offered by car rental companies. If it is required that the customer purchase the insurance as part of the rental agreement, the charges are included in taxable rental receipts.

Deficiency charges. These charges generally represent the difference between the actual value of the property returned to you by the lessee at the end of the lease and the value of the property described in the lease contract. Additional deficiency charges are included in taxable rental receipts. On the other hand, credits to lessees represent a reduction in rental receipts if these adjustments are required in the lease contract.

Delivery charges. When delivery of leased property is made by your facilities (rather than from a common carrier), the delivery charge is subject to tax. If the transportation occurs after the right to possession is granted to the lessee and the delivery charges are separately stated on the invoice, the delivery charge is not subject to tax.

Return transportation charges. Transportation charges at the termination of a lease for the return of rented property from the lessee to you are subject to tax. The exception would be when the lessee has the option to provide their own return transportation. Charges must be separately stated and not included with the delivery charges.

Common charges associated with leases not subject to tax

The following items are generally considered not to be included in rental receipts subject to tax:

Optional charges. Additional charges are not included in taxable rental receipts when the lessee is not obligated under the lease contract to use services provided by the lessor. Such services include equipment maintenance, warranty, assembly, reassembly, disassembly, etc. For example, a daily car rental company does not require collision damage insurance, but offers the insurance to a lessee should they choose to purchase it. Because the lessee is not obligated to purchase the insurance, such a charge is not subject to tax.

Late charges. An additional payment made by a lessee for failing to pay the rental payment timely is not regarded as part of the taxable rental receipts. However, a charge for late return of the property is an additional charge for use of the property and is subject to tax.

Automobile annual license fees. The annual license fees and taxes on motor vehicles are not included in taxable rental receipts whether paid by the lessor or the lessee. This differs from the treatment of property tax. The annual license fees and taxes on vehicles are specifically excluded by law from the measure of tax.

Airport concession fees. "Customer facility charges" required by an airport to be collected from customers of rental car companies operating in or near the airport are not subject to tax.

Purchases of repair parts used to maintain leased property

As a lessor, if you have a mandatory maintenance contract subject to tax (that is, because the lease is taxable), you may purchase repair parts used to maintain leased property with a resale certificate and without payment of tax.

If you enter into an optional lump sum maintenance agreement with the lessee, you are the consumer of the parts and therefore, your purchases of parts are subject to tax. The same rule applies when the lease is not taxable. You should pay sales tax reimbursement to the supplier of the parts or report the purchases on your sales and use tax return, under "Purchases Subject to Use Tax." *If you make a separate charge to the lessee for repair parts used to maintain leased property, you are considered the retailer of the parts and may purchase the parts without tax under a resale certificate; however, you must report the sale of the parts on your tax return.*

Exemptions

This section discusses only a sample of the leases that qualify as exempt. The number of exemptions for leases vary as widely as the number of exemptions for sales. Generally, transactions that qualify for an exemption as a sale will qualify for an exemption as a lease. As a lessor, you will be required to obtain a resale or exemption certificate from your customer to document a non-taxable lease to the lessee. For more information on resale and exemption certificates, refer to [Regulation 1667](#), Exemption Certificates, and [Regulation 1668](#), Sales for Resale.

Leases to the U.S. government

Tax does not apply to leases of tangible personal property (including automobiles) to the United States government, the American National Red Cross, federal credit unions, federal reserve banks, federal home loan banks, federal land banks, federal intermediate credit banks, federal financing banks, the Federal Home Loan Mortgage Corporation, the Export-Import Bank of the United States, and certain other federal instrumentalities that are constitutionally exempt from state taxation. However, this exemption does not extend to leases to agents of the United States government, United States construction contractors, national banks and leases of MTE to any of the entities mentioned above.

There is no exemption as a result of leases of MTE to the United States government. As the lessor of MTE, you are considered to be the consumer when leasing to the United States government (see [Mobile transportation equipment \(MTE\)](#) for more information on MTE).

Tax applies to the rental of automobiles to *employees* of the United States government (including military personnel) even though the federal employees may be traveling on government business. Rentals to federal employees are not considered rentals to the United States except in certain circumstances that require specific documentation.

If a rental agency has a General Services Administration (GSA) vehicle rental contract, automobiles rented under the contract to federal employees are regarded as having been rented to the United States. Such rentals are exempt from the tax even though the federal employees may pay by cash or personal credit card.

Car rental agencies claiming rentals under a GSA contract as exempt from tax should retain the credit card receipt containing the imprint of the credit card and the sales invoice to support exempt transactions to the U.S. Government. Unless there is a clear indication that the automobile is being rented according to a contract between the automobile rental agency and a federal government agency, the rental is subject to tax.

Interstate leases

As a lessor, if the leased property (other than MTE) is located outside California, tax does not apply to the rental payments. If the leased property is located inside California during any portion of the lease term, tax applies for the period of time it is located in California, unless a timely election is made to pay the California tax on the purchase price of the property at the time it is first leased.

Teleproduction or other postproduction service equipment

Effective January 1, 1999, leases of machinery and equipment to a “qualified person” may qualify for a partial exemption from the use tax. To claim the exemption the lessor must obtain an exemption certificate from the lessee in substantially the same form as prescribed in [Regulation 1532](#), *Teleproduction or Other Postproduction Service Equipment*. Generally, a lessee will not be allowed to issue an exemption certificate for the partial exemption unless the lessee is a qualified person—that is, one whose line of business is primarily engaged in teleproduction or other postproduction activities, as defined in Regulation 1532.

Farm equipment and machinery partial exemption

Effective September 1, 2001, leases of farm equipment and machinery to a “qualified person” may qualify for a partial exemption from the use tax. To claim the exemption the lessor must obtain an exemption certificate from the lessee in substantially the same form as directed in [Regulation 1533.1](#), *Farm Equipment and Machinery*. Generally, a lessee will not be allowed to issue an exemption certificate for the partial exemption unless the lessee is a qualified person—that is, one whose line of business is primarily engaged in producing or harvesting agricultural products. For a more detailed description of a qualified person, please see Regulation 1533.1.

Timber harvesting equipment and machinery partial exemption

Effective September 1, 2001, leases of off-road commercial timber harvesting equipment and machinery to a “qualified person” may qualify for a partial exemption from the use tax. To claim the exemption the lessor must obtain an exemption certificate from the lessee in substantially the same form, as described in [Regulation 1534](#), *Timber Harvesting Equipment and Machinery*. Generally, a lessee will not be allowed to issue an exemption certificate for the partial exemption unless the lessee is a qualified person—that is, one whose line of business is primarily engaged in commercial timber harvesting operations, as defined in Regulation 1534.

Racehorse breeding stock partial exemption

Effective September 1, 2001, leases of racehorse breeding stock to a “qualified person” may qualify for a partial exemption from the use tax. To claim the exemption the lessor must obtain an exemption certificate from the lessee in substantially the same form as directed in [Regulation 1535](#), *Racehorse Breeding Stock*. Generally, a lessee will not be allowed to issue an exemption certificate for the partial exemption unless the lessee is a qualified person—that is, a person who purchases racehorse breeding stock solely with the intent and purpose of breeding, as defined in Regulation 1535.

Special categories

The following categories of leases are tax-exempt:

- A lease of any form of animal life, the products of which ordinarily constitute food items that people eat. (See [Regulation 1587](#), *Animal Life, Feed, Drugs and Medicines*.)
- Composed type, reproduction proofs, or impressed mats leased by a typographer to another person for use in the preparation of printed matter, except when the reproduction proof is a component part of a “paste-up,” “mechanical,” or “assembly.” (See [Regulation 1541](#), *Printing and Related Arts*.)
- Rail freight cars used exclusively in interstate or foreign commerce. (See [Regulation 1620](#), *Interstate and Foreign Commerce*.)
- Mailing lists if the contract restricts the transferee or user to use the mailing list one time only. (See [Regulation 1504](#), *Mailing Lists and Services*.)
- Aircraft leased for use as common carrier of persons or property, or leased to foreign governments or nonresidents of this state who will not use the aircraft in this state other than in the removal of such aircraft from this state. (See [Regulation 1593](#), *Aircraft and Aircraft Parts*.)
- Watercraft leased for use in interstate or foreign commerce involving the transportation of persons or property for hire or for use in commercial deep-sea fishing operations outside the territorial waters of this state by persons who are regularly engaged in commercial deep-sea fishing. (See [Regulation 1594](#), *Watercraft*.)
- Medical oxygen delivery systems, including, but not limited to, liquid oxygen containers, high pressure cylinders, and regulators, when leased or rented to an individual for personal use as directed by a licensed physician. (See [Regulation 1591](#), *Medicines and Medical Devices*.)
- Wheelchairs, crutches, canes, quad canes and walkers when leased to an individual for his or her personal use as directed by a licensed physician. (See [Regulation 1591](#), *Medicines and Medical Devices*.)
- Original works of art leased for 35 years or more, if both the lessor and lessee are nonprofit organizations. (See [Regulation 1586](#), *Works of Art and Museum Pieces for Public Display*.)

For more information on medical supplies, please refer to [publication 45](#), *Hospitals and Other Medical Facilities*.

Mobile Transportation Equipment (MTE)

This section discusses leases of Mobile Transportation Equipment (MTE). One difference between leases of MTE and other types of equipment is that the lessor is considered the consumer of the MTE and must report tax based on the purchase price of the equipment unless he/she makes a timely election to report tax based on fair rental value. This default tax application is the opposite for equipment that is not considered MTE.

MTE is defined as equipment (and component parts thereof) which are used for the transportation of persons or property over substantial distances. Mobile transportation equipment includes items such as railroad cars and locomotives, trucks (including pickup trucks), truck tractors, truck trailers, buses, aircraft, ships, dollies, bogies, chassis, and reusable cargo-shipping containers. The term “ships” only includes vessels 30 feet or more in length.

Mobile transportation equipment does not include:

- Passenger vehicles (including house cars) which are designed for carrying not more than ten persons including the driver.
- Trailers and baggage containers designed for hauling by passenger vehicles.
- One-way rental trucks (see [Tax based on rental receipts](#)).

How Tax Applies

As a lessor of MTE, you are considered to be the consumer of the MTE you lease. You have the option to report your tax liability based on “fair rental value,” to pay tax to the vendor, or to accrue and pay use tax timely on the purchase price of the equipment.

Fair rental value normally refers to the rental payments that are required by the lease, whether or not those payments have actually been received. Fair rental value does not include any payment made by the lessee to reimburse you for your use tax, whether or not the amount is separately stated. Lump-sum charges to the lessee will be assumed to include reimbursement for your use tax whether or not any statement to that effect is made to the lessee.

As a lessor of MTE, you have the option to pay your use tax liability measured by the fair rental value of the MTE. Such election must be made on or before the due date of a return for either the period in which the equipment is first leased or the period in which the equipment first entered California, whichever is later. When the election is made to use fair rental value as the measure of tax, the tax is due whether the equipment is in or outside California. The election is irrevocable. If the election is not made timely, the option is lost and tax must be paid on the purchase price of the equipment.

Reporting the Proper Tax Rate for Leases of MTE

If you make a timely election to report your use tax liability measured by the fair rental value of MTE, you must pay tax at the rate in effect, including any applicable district taxes, at the time (and place) that the MTE is first leased. Even if there is a subsequent change in the district tax or state tax rate, you must continue to report and pay at the tax rate in effect during the period that the MTE was first leased. This means that subsequent leases in other districts or outside districts, even outside of California, are subject to the rates in effect at the time of the very first lease of the MTE.

District tax rate changes:

If the applicable *district tax* rate decreases or increases, you will need to make an adjustment on your sales and use tax return to report and pay tax at the proper rate. When filing online, use the “Adjustments” column to make adjusting entries for district tax rate changes. If completing [CDTFA-531-A2, Schedule A2, Long Form](#), use the “Add / Deduct” column (A6/A7) to enter your adjustments.

Statewide tax rate changes:

If the applicable *state* tax rate *decreases*, you will need to make an adjustment on your sales and use tax return to pay your liability at the proper rate. For example, on January 1, 2017, the statewide tax rate decreased by .25 percent from 7.50 percent to 7.25 percent. If you first leased the MTE prior to January 1, 2017, when the statewide tax rate was 7.50 percent, you must continue to report your tax liability at the 7.50 percent statewide rate (plus any applicable district tax). When you file your sales and use tax returns for periods beginning January 1, 2017, on which tax is computed at the 7.25 percent rate, you should report the additional .25 percent as “excess tax reimbursement.” These amounts are not actually “excess tax reimbursement” because they are legally due, but this is the accepted method to report the additional tax.

For *state* tax rate *increases* or additional questions regarding how to report the proper rate for your leases of MTE, please contact our Customer Service Center at 1-800-400-7115 (CRS:711) for assistance.

Component Parts

Tangible personal property which is or becomes a component part of mobile transportation equipment, is included in the definition of such equipment, and the sales and use tax laws and same rules discussed in the previous section apply. Examples of component parts are:

- Repair and replacement parts.
- Attached items such as cranes, air compressors, and cement mixers.
- Any item that becomes permanently affixed to mobile transportation equipment.

MTE – REPAIR PARTS

Question

Our company is currently leasing mobile transportation equipment. The equipment was purchased for resale and we report use tax based on its fair rental value. Does sales tax apply to repair parts purchased for this equipment from our California supplier?

Answer

No. A lessor who has properly elected to measure use tax by fair rental value may properly purchase repair parts placed on such equipment without paying tax by issuing a resale certificate.

Tax Reimbursement

Leases of MTE, like rentals of motion pictures, linen supplies, etc., are not “sales” or “purchases” under the Sales and Use Tax Law. Unlike leases of motion pictures or linen supplies, however, if you are a lessor of MTE and have elected to timely report your tax liability based on fair rental value, you are allowed to pass your use tax liability on as a separately stated item to the lessee. The separately stated tax will not be considered excess tax reimbursement and will not be included in the fair rental value.

As a lessor of MTE, you must pay tax on the purchase price of the MTE if you don’t report tax based on fair rental value, or if you collect tax based on the fair rental value but fail to timely pay the tax to the CDTFA. If you are required to report tax based on the purchase price of the MTE, you are allowed to collect tax reimbursement from your customer to the extent that the tax reimbursement collected on fair rental value doesn’t exceed the tax liability measured by the purchase price. Should you collect tax in excess of the value of the purchase price, it must be returned to the lessee or paid to directly to the CDTFA.

For example, you purchase MTE for \$20,000 and lease it to a lessee for \$500 per month. Because you did not timely elect to report tax on the fair rental value of the MTE, you are required to report tax based on the purchase price of the MTE. In this case you must report tax based on the \$20,000 purchase price in the period in which it is first used.

If the tax rate in effect is 8 percent, you are required to report tax of \$1,600. You are allowed to collect \$40 of tax per month, measured by the \$500 fair rental value, up \$1,600. Any tax collected above \$1,600 is considered excess tax reimbursement and must be refunded to the customer or paid directly to the CDTFA.

Leases of MTE to the U.S. government

The application of tax to leases of mobile transportation equipment, as explained in this section, is also applicable to such leases to the U. S. government. Since lessors are considered to be consumers of mobile transportation equipment they lease, there is no exemption for a sale to the U. S. government.

MTE – USE TAX

Question

If our company is leasing mobile transportation equipment and paying use tax based on fair rental value, can we separately state and collect this use tax from our lessee?

Answer

Yes, provided you explain the charge and do not simply itemize it as “use tax.” The lessor of mobile transportation equipment is allowed to exclude the use tax element from fair rental value. On the other hand, lump-sum charges to the lessee will be assumed to include reimbursement for the lessor’s use tax whether or not any statement to that effect is made to the lessee.

MTE – RESALE CERTIFICATE

Question

Our company is a dealer in mobile transportation equipment. Can we accept a resale certificate from a lessor who is not also a retailer of mobile transportation equipment?

Answer

Yes. A lessor of mobile transportation equipment whose use of the MTE will be limited to leasing may issue a resale certificate to you for the limited purpose of reporting its tax liability based on the fair rental value.

MTE – INTERSTATE COMMERCE

Question

A lessee takes possession of mobile transportation equipment outside of California and enters California with a load picked up out of state. Subsequently, the lessee uses the equipment exclusively in interstate commerce but not exclusively in California. Does the lessor or lessee have a California tax liability?

Answer

No. The equipment is first functionally used outside the state and is used continuously thereafter in interstate commerce. No tax applies.

Specific Types of Leases

You have the option to report tax either on the purchase price or on the rental receipts. This section explains how tax applies to leases of property, which have their own special reporting requirements. Please also refer to [Special reporting requirements](#), for a list of property for which you must pay sales tax or report use tax when purchased for leasing.

Motor vehicles

The general rules regarding the application of tax to leases apply to vehicle leases. However, in order for tax to be reported based on rental receipts (or on fair rental value, in the case of MTE), leased vehicles must be registered (as directed by California Vehicle Code section 4453.5) in the name of the lessor or in the name of the lessor and lessee jointly. If vehicles are registered in the name of the lessee only, tax liability may not be measured by rental receipts. The transaction will be regarded as a retail sale subject to tax.

A transfer of a vehicle to a lessee by a lessor, as defined in Vehicle Code section 372, is presumed to be a sale for resale if the lessee transfers title and registration to a third party within ten days from the date the lessee acquired title from the lessor at the expiration or termination of a lease. The presumption may be rebutted by evidence that the sale was not for resale prior to use. Transfer of title and registration occurs when the lessee endorses the certificate of ownership. In this type of multiple transfer, the Department of Motor Vehicles (DMV) will, at the time of registration, only collect use tax from the final purchaser and then flag all such transactions for review by the CDTFA.

In virtually all retail motor vehicle lease transactions conducted by new and used motor vehicle dealers, the dealer is initially the owner of the leased vehicle and appears on the lease contract as the lessor. At the beginning of the lease, the dealer usually collects from the lessee the first month's lease and various other "up front" charges. Sometime after initiating the lease contract, the dealer may assign the lease contract to a third party. The dealer is responsible for collecting and reporting tax on all taxable rentals for which payment was received from the lessee. The party to whom the contract is assigned is responsible for collecting and reporting tax on all subsequent lease payments after the lease is assigned.

Some of the charges made by the dealer which are subject to tax are capitalized reduction costs, document preparation charges, bank fees, acquisition fees, and booking fees. At the close of the lease, tax applies to charges such as renegotiation fees, assumption fees, deferral fees, and excessive wear and use charges (for instance, as excessive mileage fees). Refundable security deposits are not taxable when received by the dealer at the inception of the lease. Title and registration fees are also specifically excluded from tax. While late charges for late payments of the lease are not subject to tax, late charges for failing to return the vehicle timely are subject to tax as this is a legitimate charge for the use of the vehicle.

Leases to foreign consulars. Rental receipts of vehicles to foreign consular officers are exempt from tax if the purchaser provides a valid Tax Exemption Card (Personal or Mission) or a protocol identification card to the retailer; and the retailer contacts and obtains a letter directly from the Office of Foreign Missions (OFM) stating that the vehicle sale or lease to the purchaser is eligible for exemption from tax.

Gasoline or diesel furnished by the lessor. A "wet rental" is the lease of a vehicle in which the rent charge includes gasoline furnished by the lessor. The sale of the gasoline to the lessor may or may not be subject to tax. Whether or not the sale of gasoline to the lessor is subject to tax will depend on:

- *The type of vehicle being leased, and*
- *How the lessor reports and pays tax with respect to the leased vehicle.*

However, if you make a separate charge to the lessee for the fuel, you are the retailer of the fuel.

If tax is reported based on the rental receipts of vehicles that are not MTE, the lessor of the vehicles is considered a retailer of the fuel furnished with wet rentals. As a result, the lessor can issue a resale certificate when purchasing gasoline that is furnished for wet rentals. A resale certificate can be issued to a vendor registered with the CDTFA as a fuel supplier or wholesaler. Not all sellers of fuel qualify as a fuel supplier or wholesaler. For example, service station operators who purchase fuel to resell to end consumers typically are not considered fuel suppliers or wholesalers; as such they should not accept a resale certificate on the sale of gasoline that is being purchased for resale.

If a lessor is a retailer of fuel but is unable to issue a resale certificate when purchasing gasoline furnished for wet rentals, it is possible for the lessor to claim a deduction for the sales tax paid. When tax is reported based on total rental receipts, without a deduction for the gasoline, the lessor may claim a deduction for tax-paid purchases resold on its sales and use tax return.

When taking a deduction for tax paid purchases resold, keep in mind the sales tax rate on gasoline is at a lower tax rate than other taxable sales. The sales tax rate for gasoline is 2.25 percent, plus applicable district tax. When filing your sales and use tax return electronically with an account coded as a seller of fuel, the program is set up to calculate the tax-paid purchases resold deduction at the rate for gasoline. Remember to subtract the sales tax paid from your cost of the gasoline purchased before entering your tax-paid purchases resold deduction.

The deduction for tax paid purchases resold on diesel is at a higher rate than other taxable sales. The sales tax rate for diesel is 9.25 percent, plus applicable district tax. When filing your sales and use tax return electronically with an account coded as a seller of fuel, the program is set up to calculate the tax-paid purchases resold deduction at the rate for diesel. Remember to subtract the sales tax paid from your cost of diesel purchased before entering your tax-paid purchases resold deduction.

For additional information please see [Fuel Tax Swap - Frequently Asked Questions \(FAQ\)](#), or call our Customer Service Center at 1-800-400-7115 (CRS:711).

Lessors of MTE and lessors of vehicles that are not MTE who do not report tax based on rental receipts are typically consumers of fuel furnished in wet rentals. Thus, the sale of gasoline to such lessors to furnish as part of wet rentals is generally taxable. The lessor should not issue a resale certificate for that purchase. For leases of MTE, this is true whether tax is reported based on the cost of the vehicle or fair rental value. The exception is when a *separate charge* is made to the lessee for the gasoline. In this case, tax applies to the sale of gasoline to the lessee. Please note that the sales tax rate for the sale of gasoline is different than the rate of your lease.

When a lessor is the retailer of fuel, as discussed above, a resale certificate can be issued to a vendor registered with the CDTFA as a fuel supplier or wholesaler. Not all sellers of fuel qualify as a fuel supplier or wholesaler. For example, service station operators who purchase fuel to resell to end consumers typically are not considered fuel suppliers or wholesalers; as such they should not accept a resale certificate on the sale of gasoline. As a retailer you are liable for tax on the amount charged to the lessee for the fuel. When reporting sales on your sales and use tax return, you must include the fuel charges as part of the total gross sales for the reporting period (you can be reimbursed by the lessee for the tax). If you are unable to issue a resale certificate, you may take a deduction on your tax return, under "Cost of Tax-Paid Purchases Resold Prior to Use" in the period in which the fuel is sold.

For lessors of MTE, if tax is reported based on the fair rental value, and there is no separate charge for the gasoline that is furnished, tax should be reported only on that portion of the rental charge that is attributable to the lease of the equipment, do not include the value of the gasoline.

You can also find information on leases in [publication 34, Motor Vehicle Dealers](#), which includes the *General Application of Tax on Fuel with Leased Vehicles*, chart on page 22, to assist you with the correct application of tax on wet rentals.

Restricted grant of privilege

Certain restricted grants of a privilege to use property are excluded from the term, lease. To fall within the exclusion, the use must be for a period of less than one continuous 24-hour period, the charge must be less than \$20, and the use of the property must be restricted to use on the premises or at a business location of the grantor of the privilege to use the property.

Examples of such businesses include:

- Laundromats.
- Operators of coin-operated amusement devices.
- Golf courses that furnish golf carts for use on the course.
- Horseback riding stables where horses are restricted to the area owned or leased by the grantor of privilege.

For these types of transactions, you are considered the consumer of the tangible personal property that you are leasing. You are required to either pay sales or use tax to your vendor or report use tax on the purchase price directly to the CDTFA.

Photographs and artwork

The lease of tangible personal property by photographers and artists, such as prints, slides, or logos, are subject to tax. Although the use may be restricted, the transaction is still considered a lease. The lessee may not issue a resale certificate because the lessee is not reselling that actual tangible property. Instead, the lessee is merely using it for reproduction. The application of tax to the use of photographs and artwork can be complicated. For more detailed information, see [publication 68](#), *Photographers, Photo Finishers, and Film Processing Laboratories*, and [publication 38](#), *Advertising Agencies*.

Portable toilets

Rental payments from rentals of portable toilets are subject to tax. This is true whether or not you have paid tax based on the cost of the portable toilets. If a cleaning service is provided at the option of the lessee, a separately stated charge for that service would not be included in rental receipts subject to tax.

Videotapes and videodiscs

Rental receipts from rentals of videotapes, video cassettes, and videodiscs (including DVDs) for private, noncommercial use are subject to tax. This is true whether or not you have paid tax based on the cost of the property. An amount designated as a late charge is considered to be a charge for continued possession of the property and is subject to use tax, regardless of whether the payment is designated as a rental or a penalty.

Collecting and Reporting Tax

This section discusses the requirements for collecting and reporting sales and use tax on leases. The information in this section is especially useful in determining the proper tax rate to charge and the proper local tax jurisdiction to allocate tax collected. For more information on obtaining a seller's permit, refer to [publication 73](#), Your California Seller's Permit.

Permit requirement

Every person engaged in the business of selling (or leasing under a lease defined as a continuing sale and purchase) tangible personal property is required to hold a seller's permit for each place of business in this state.

OUT-OF-STATE LESSOR

Question

Our company is located outside of California and leases property to California lessees. The property will be situated in California. What is our obligation?

Answer

Because you are deriving rentals from a lease of tangible personal property situated in this state, the provisions of the California Sales and Use Tax Law apply to your company. Out-of-state lessors leasing property in California are required to obtain a seller's permit, or certificate of registration—use tax, as applicable, collect the applicable tax, and pay the tax to the CDTFA.

Total sales

For property that is not MTE, any rental receipts that are due but have not been paid to you by the lessee are not considered gross receipts. You should report rental receipts only after payment has been received. Accordingly, you are required to report rental receipts from leases of tangible personal property, other than MTE, on your sales and use tax return for the period in which the lessee made the payment.

For leases of MTE, if you choose not to elect to pay tax measured on your purchase price, you are required to report the fair rental value for all periods during which the MTE is leased. This applies whether the MTE is inside or outside of California and even if the lessee might not have made the rental payments.

Self-consumed merchandise

Self-consumed merchandise should be reported under, Purchases subject to use tax, on your sales and use tax return if California sales or use tax has not been paid on your cost of the merchandise. For example, you purchase property to be leased without tax and choose to pay tax on the purchase price rather than rental receipts. This purchase should be reported timely on the return for the period during which the property is first placed in rental service. Other items to be reported may include repair parts and gasoline (if you are the consumer and you purchase the items without sales or use tax).

A lessee is liable for use tax on the lease of merchandise in the reporting period in which the lessor collected no tax unless the lessee has a statement from the lessor that would allow the lessee to regard the lease receipts as nontaxable.

As a lessor, when you make use of property other than leasing or demonstration and display for which tax has been paid based on rental receipts, the entire purchase price of the property must be reported as purchases subject to use tax. In such case, any rental receipts for which tax has been previously reported may be offset against the purchase price. Should the rental receipts exceed the purchase price, no refund of the excess is allowed and no additional tax would be due on the purchase price. Subsequent rental receipts remain taxable, but if tax measured by the purchase price exceeds tax measured by the prior rentals, the excess may be used as an offset against an equal amount of tax on subsequent rentals.

For example, you purchase equipment for \$5,000 and lease it for \$150 per month for 12 months. After 12 months you remove the equipment from lease inventory and use it for personal use. Once you make a taxable use of the equipment, you are required to report the entire purchase price of \$5,000 as purchases subject to use tax. You are, however, allowed to offset the 12 months' worth of previous rental payments; in this case \$1,800 (\$150x12). After the offset, you are only required to report \$3,200 as purchases subject to use tax. If you place the equipment back into rental service after you have paid use tax on the full purchase price, you are still required to report tax based on rental receipts. However, you are allowed to offset up to \$3,200 against any subsequent rental receipts of the leased equipment.

If you had the same scenario as above, but removed the equipment from lease inventory for personal use after 36 months of rental service, the proceedings change. You are required to report purchases subject to use tax of \$5,000, however you have accumulated 36 months of rental service equaling \$5,400. Since your credit for rental service cannot exceed the purchase price of the equipment, you are only allowed to take credit for \$5,000. You owe no additional use tax for the personal use of the equipment. If you place the equipment back into rental service, you are still required to report tax based on rental receipts and are not allowed to offset any purchases subject to use tax.

Tire and electronic waste recycling

In addition to sales and use tax, other fees may apply to leases of tangible personal property. If you lease tires, including tires on motor vehicles, farm equipment or construction, the California tire recycling fee may apply to some of your leases. Additionally, if you lease new or refurbished computer monitors, televisions, portable DVD players or bare cathode ray tubes, the electronic waste recycling fee may apply to some of your leases as well. For more information on these fees, please contact our Customer Service Center at 1-800-400-7115 (CRS:711).

Deductions

Deductions should be claimed only for exempt or nontaxable amounts included on the sales tax return. You should claim deductions for those rental receipts received from nontaxable leases which are not continuing sales and purchases as previously discussed in this publication.

Any resale transactions supported by valid resale certificates should be claimed. This includes sales of equipment along with subleases where the sublessor has issued a timely resale certificate and has elected to report tax on rental receipts from the sublease.

Other deductions include optional charges such as insurance in which the lessee is not obligated to use the lessor's service, separately stated installation labor, late payment charges, and automobile annual license fees.

Change in tax rate – fixed priced contracts

Generally, fixed priced contracts are not exempt from state-wide sales tax increases (such as the rate increase that took effect April 1, 2009). There are, however, tax rate increases in which the lease contract may not be subject to the tax rate increase (such as when voters approve a new district tax). In order to be exempt from this type of tax increase, all of the following terms must apply to the contract:

- The price of the contract is fixed and cannot be changed.
- Neither party has the unconditional right to terminate the contract or lease.
- The amount of tax or tax rate in effect at the time the lease commences is specifically stated in the contract or lease agreement.
- There is no provision in the contract or lease agreement for an increase in the amount of tax.

If the contract or lease agreement meets all of the above requirements, the correct rate is the rate when the lease began. These rules apply only if the new rate is higher. If the new rate is lower, however, the correct rate for lease payments for lease periods after the effective date of the rate change is the new lower rate.

Allocation of the one percent local tax

The tax on leases of tangible personal property is generally use tax. Therefore, local tax on rental receipts should be reported to the local taxing jurisdiction where the property is used. For many lessors, because of the type and characteristics of property leased and the method of recordkeeping, it may be extremely difficult or even impossible to determine the precise location where the property is actually used. Accordingly, administrative guidelines have been established to determine the reporting of local use tax on leases of equipment other than motor vehicles.

Regardless of whether those leases are negotiated in state or out of state, the local use tax is reported in the county of use on the taxpayers' return. For taxpayers who maintain a single permanent place of business and make short-term leases of tangible personal property, the local use tax should be reported to the taxpayer's place of business. See Table 1 for more information.

Table 1
Local Tax Allocation Guidelines for Leases

| Lease Type and Place Negotiated | Allocation Guidelines |
|---|--|
| Mobile Transportation Equipment (MTE): Lease negotiated in-state. | Local use tax allocated to lessor's place of business on Schedule C. |
| MTE: Lease negotiated out-of-state. | Local use tax allocated on Schedule B opposite county of use. |
| General equipment: Lease negotiated in-state or out-of-state. | Local use tax allocated on Schedule B opposite county of use. |

Long-term leases of new passenger motor vehicles

Revenue and Taxation Code [section 7205.1](#) establishes rules for local tax reporting regarding long-term leases of passenger motor vehicles, and certain types of MTE. A long-term lease is defined as a lease for a term exceeding four months. The provisions of section 7205.1 are summarized as follows:

- If the lessor is a California new motor vehicle dealer (defined in section 426 of the Vehicle Code), the place of use for reporting the local use tax is the dealer's place of business.
- If the lessor is a leasing company, as defined in Table 2 (see [next page](#)), the place of use for reporting local use tax is the lessor's place of business.
- If the lessor is not a California new motor vehicle dealer or a leasing company and purchases a vehicle from a California new motor vehicle dealer, the place of use for reporting the local use tax is the business location of the dealer from whom the lessor purchases the vehicle.
- In the case of an out-of-state lessor who purchases a vehicle from an out-of-state source and arranges for a courtesy delivery by a California dealer, the local tax will be reported as follows:
 - (1) If the vehicle is taken from the in-state dealer's resale inventory, the local tax should be reported to the dealer's place of business.
 - (2) If the in-state dealer does not hold title to the vehicle but merely serves to prepare the vehicle for delivery and process documentation, the local tax should be reported to the lessee's jurisdiction via the countywide pool.
- Lessors are required to report the local use tax to the location of the dealer on their return.

Table 2
Local Tax Allocation for Motor Vehicle Leases,
Effective January 1, 1999
(Except One-Way Rental Trucks)

| Type of Lessor | Type of Transaction | 1% Local Tax Allocation to: | |
|---|--|--|---|
| | | Leases Exceeding Four Months | Leases of Four Months or Less |
| California New Motor Vehicle Dealer/Lessor | Lease of motor vehicle* | Dealer/Lessor's sales location | Dealer/Lessor's sales location |
| California "Leasing Company" (as defined)** | | Lessor's place of business | |
| California Lessor (other than a new motor vehicle dealer or leasing company as defined)** | Lease of a motor vehicle* purchased from a California new motor vehicle dealer | Dealer/Lessor's place of business (Schedule F) | Lessor's place of business |
| | Lease of a motor vehicle* purchased from someone other than a California new motor vehicle dealer | Lessee's place of registration (Schedule B) | |
| | Lease of MTE*** purchased from a California new motor vehicle dealer (except new pick-up trucks rated less than one ton) | Lessor's Place of business | |
| Out-of-State Lessor | Lease of a motor vehicle* purchased from a California new motor vehicle dealer | California Dealer's place of business (Schedule F) | Lessee's place of registration (Schedule B) |
| | Lease of a motor vehicle* and MTE*** purchased from someone other than a California new motor vehicle dealer | Lessee's place of registration (Schedule B) | |

* **Motor Vehicle** means any (new or used) self-propelled passenger vehicle (other than a house car) or pick-up truck rated less than one ton.

** **Leasing company** means a motor vehicle dealer/lessor that originates lease contracts and does not sell or assign the lease contracts and that has annual motor vehicle lease receipts of \$15 million or more annually for each business location.

*** **MTE** means equipment used for transporting persons or property for substantial distances such as railroad cars, buses, trucks, and truck trailers. For a complete listing of MTE, please see [Regulation 1661](#), *Leases of Mobile Transportation Equipment*.

Lessors who are not California new motor vehicle dealers or who do not purchase motor vehicles from California new motor dealers shall report the local use tax due on long-term leases to the lessee's jurisdiction through the countywide pool on their return.

Collection of district tax

Voters throughout California commonly approve new transactions and use taxes in their city or county. These taxes are often called district taxes. When you elect to report tax on rental receipts, district tax applies only while the leased property is used in the district. Leased property which is moved from a district is no longer subject to that district's tax. If moved into another district, the property would be subject to the district tax imposed at the new location; if moved to a non-district location, no district tax would apply. Similarly, leased property which is first used outside a district and then moved into a district becomes subject to the district tax.

As a lessor, if you elect to pay tax on the purchase price of property, you may be liable for the district tax where the property is first used if both the following conditions apply:

- The property is first leased in a district.
- You paid no district tax or paid district tax at a rate less than that imposed in that district.

If, for example, you pay tax when you buy property in County A (which has a district tax rate of 0.50 percent) and you first lease it at a location in County B where the district rate is 1 percent, you owe County B district use tax at a rate of 0.50 percent of the purchase price.

When you pay tax on the purchase of MTE, the application of district tax follows the same rules as any other sale of tangible personal property. That is, district tax is due on the sale if the property is either delivered or first used in a tax district.

If you elect to pay tax on the fair rental value of the MTE, district tax applies if the first use of the equipment is in a special taxing jurisdiction. Equipment that is part of a resale inventory located in a tax district is generally subject to district tax at the time it is withdrawn from inventory for lease. However, district tax will not apply if:

- The only use of the equipment in the district is its transport to a lessee located outside a tax district, and
- From then on the equipment is used solely outside any tax district.

For more information on district taxes, please refer to [publication 44, District Taxes \(Sales and Use Tax\)](#).

DISTRICT TAX

Question

My customers pick up property (not mobile transportation equipment) that they lease from me in Santa Clara County for use at their place of business in Alameda County. Which district tax do I charge them?

Answer

The Alameda County district tax should be charged, as the district tax is charged based on the district in which the leased property is used. This holds true, even if the customer picks up the property in Santa Clara County for use in Alameda County.

Keeping records

State law requires you to maintain records that adequately support the amounts you report on our sales and use tax returns. When requested, you must make these records available for examination by one of our representatives. If the representative is unable to verify your reported amounts based on your records, you may be subject to penalties.

Your records should include your normal books of account. This includes all schedules or working papers used in connection with the preparation of the tax return. Besides your summary records, you should keep all sales and purchase invoices, lease contracts, and any other documents that support the returns you have filed. To ensure that your records adequately support the amounts you report, you should make sure of the following:

- All exempt or non-taxable sales or payments are fully supported by resale or exemption certificates or other related documentation.
- Purchase invoices of leased equipment are available to document whether or not tax was paid on the original purchase.

How long should I keep my business records?

You should keep required records for at least four years unless we give you specific, written authorization to destroy them sooner.

Exception: Records that cover reporting periods before January 1, 2003, may be covered by an extended statute of limitations if you did not participate in the 2005 Tax Amnesty Program. You must keep those records for at least ten years.

If you are being audited, you should retain all records that cover the audit period until the audit is complete, even if that means you keep them longer than four years. In addition, if you have a dispute with us about how much tax you owe, you should retain the related records until that dispute is resolved. For instance, if you appeal the results of an audit or another determination (billing), or you file a claim for refund, you should keep your records while that matter is pending.

For more information, you may obtain a copy of [Regulation 1698, Records](#), or [publication 116, Sales and Use Tax Records](#), from our [website](#) or our Customer Service Center at 1-800-400-7115 (CRS:711).

Commonly Questioned Transactions

This section discusses sales and use tax issues related to leases which are not covered in other sections. If the topic you are looking for is not covered in this publication please call our Taxpayer Information Section for assistance.

Sale of leased property

Your sale of leased property is subject to sales or use tax in the same manner as general sales transactions. The election you choose at the beginning of the lease does not alter the tax application to the sale of leased property. Where a lessee exercises a purchase option under the lease agreement, a sale occurs. Tax is due based on that sale at the time the option is exercised. The tax applies to the entire amount paid by the lessee for the sale regardless of whether you paid tax on the cost of the property at the inception of the lease or paid tax on rental receipts.

PURCHASE OPTION

Question

I elect to timely report use tax on the purchase price of leased equipment (non MTE). I do not charge tax on the rental receipts. When a customer exercises a purchase option or I withdraw the equipment from lease inventory and sell it in the normal course of business, is the sale taxable?

Answer

Yes, the sale is taxable unless it is exempt for another reason such as a sale for resale or sale to the U.S. government. Tax applies whether the original election was made to report tax on the purchase price or on rental receipts. The election you choose at the beginning of the rental service has no bearing on the tax application of the subsequent resale of the equipment.

Property affixed to realty

Property affixed to realty remains tangible personal property subject to tax when you lease:

- Certain property that is affixed to realty,
- You are not the lessor of the realty, and
- You have the right to remove the property upon breach or termination of the lease contract.

Examples include refrigeration equipment, communication systems, and irrigation systems, among others.

This type of property is normally furnished under a contract to furnish and install property and the tax application is governed by [Regulation 1521](#), *Construction Contractors*. This regulation discusses three main categories of tangible personal property and their different tax applications as explained below.

Materials means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property which, when combined with other tangible personal property, lose their identity and become an integral and inseparable part of the real property. Generally speaking, construction contractors are consumers of materials. Therefore, tax applies to their cost of materials.

Fixtures include items that are an accessory to a building or other structure and do not lose their identity as accessories when installed. Construction contractors are retailers of fixtures. Tax applies to their selling price of the fixtures. If there is an itemized charge for the fixture, this charge is the taxable selling price. Otherwise, the taxable selling price is the cost price as defined in Regulation 1521.

Machinery and equipment includes property to be used directly or indirectly in the production or manufacturing process. Construction contractors are retailers of machinery and equipment, and tax applies to the selling price.

Construction contractors usually contract on a lump-sum basis and do not itemize tax on their billings. If you are a lessor of realty, you should not collect tax from the lessee with respect to rental receipts attributable to materials installed to become part of real property. Also, you may not purchase such materials for resale. If you are also leasing fixtures, the fixtures are regarded as a component part of the realty and rental receipts are not taxable. The tax would apply on the contractor's sale of the fixtures to you.

If you are a lessor of fixtures, but not a lessor of the realty, you may elect to pay tax or tax reimbursement on the price of the fixtures. If you wish to pay tax on the purchase price of the fixtures, you should have the contractor itemize and collect the appropriate sales tax reimbursement. If you wish to collect tax on the rental receipts of the fixtures, you should have the contractor itemize the price of the fixtures separately from the other line items and you should issue a resale certificate to the contractor for the fixtures.

For more information on construction contractors, please refer to [Regulation 1521, Construction Contractors](#), or [publication 9, Construction and Building Contractors](#).

Assignment of leases

When a lease is assigned by a lessor (assignor) to another person (assignee), the tax status of the lease is as follows:

- If tax is being collected from the lessee, it will continue to be collected from the lessee.
- If tax is not being collected from the lessee because the lease is not a continuing sale and purchase, tax should not be collected from the lessee following the assignment. If title to the property passes to the assignee, the lessor is making a taxable sale to the assignee.

[Regulation 1660, Leases of Tangible Personal Property—In General](#), considers three types of assignments of leases, which are continuing sales and purchases:

- Assignment of a right and creation of a security interest.
- Assignment of the contract with transfer of right, title, and interest for security purposes.
- Assignment of the contract and all right, title, and interest.

Assignment of a right and creation of a security interest

This type of assignment is an assignment by the lessor of the right to receive the rental payments together with the creation of a security interest in the leased property. Assignees have recourse against the lessor-assignors. If lessor-assignors have been collecting tax on rental receipts, they are still liable for payment of the tax. However, assignees are obligated to pay to the CDTFA any amounts paid to them by the lessees as tax.

There is no sale of tangible personal property between lessor-assignor and assignee.

Assignment of the contract with transfer of right, title, and interest for security purposes

This type of assignment is an assignment by the lessor-assignor of the lease contract together with the transfer of the right, title, and interest in the leased property for security purposes. After the termination of the lease, the property usually reverts to the original lessor. The assignment contract may specify that the transfer is for security purposes, or the circumstances may otherwise demonstrate it (for example, a separate agreement that the property will be returned to the lessor-assignor at the termination of the lease). The assignee has recourse against the lessor-assignor.

In this situation, the assignee has assumed the position of a lessor. When tax is being collected, measured by rental receipts, the assignee is required to hold a seller's permit and is obligated to collect, report, and pay tax to the CDTFA. The lessor-assignor should obtain a resale certificate, covering the property in question, from the assignee.

Assignment of the contract and all rights, title, and interest

This situation is similar to the assignment of the contract and all rights, title, and interest for security with these exceptions:

- The assignment is not for security purposes.
- The lessor-assignor does not retain any substantial ownership rights in the contract or property.
- The assignee has no recourse against the lessor-assignor.

In this situation, the assignee has assumed the position of the lessor-assignor. When tax is being collected, measured by rental receipts, the assignee is required to hold a seller's permit and is obligated to collect, report, and pay tax to the CDTFA. The lessor-assignor should obtain a resale certificate, covering the property in question, from the assignee.

Assigned leases that do not constitute continuing sales or purchases

In this situation, the assignee does not have the election to collect tax from the lessee measured by rental receipts. Generally speaking, if title to the leased property is transferred, the assignment by the lessor-assignor to the assignee is a sale and tax applies to that sale.

Subleases

If the prime lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property, no additional tax is due on rental receipts if the property is subleased in substantially the same form as acquired by the prime lessor. In this case, the prime lessor must indicate on the receipt to the lessee/sublessor that tax has been paid measured by the prime lessor's purchase price of the property and the lessee/sublessor must similarly indicate this on the receipt to the sublessee.

If the prime lessor charges tax on rental receipts to the lessee/sublessor, no additional tax is due on the rental receipts on the sublease. This is true, even if the sublessor marks up the rental receipts when subleasing the property. On the other hand, a lessee/sublessor may elect to issue a resale certificate to a prime lessor and pay tax based on rental receipts to the sublessee.

Sales under a security agreement

When a contract designated as a lease binds the lessee for a fixed term and the lessee is to obtain title at the end of the term upon completion of the required payments or has the option to purchase the property for a nominal amount, the contract will be regarded as a sale under a security agreement from its inception and not a lease. The option price will be regarded as nominal if it does not exceed \$100 or one percent of the total contract price, whichever is the lesser amount.

Such contracts are often referred to as sales at inception, or conditional sales. They often use terms such as lessor and lessee, however the transactions are considered financing agreements and not true leases.

Sale and leaseback transactions

In general, the goal of a person who purchases property, and then sells it and leases it back (usually for financing purposes) is to avoid two taxes on the series of transactions. If that person makes no use of the property prior to the sale and leaseback transaction, then it is considered a purchase for resale to the purchaser/lessor. When this happens, tax applies to the sale to the purchaser/lessor based on the selling price, or on the leaseback to the original purchaser.

However, when the original purchaser has used the property prior to the sale and leaseback, the purchaser cannot go back to the equipment vendor and retroactively issue a resale certificate. The first transaction remains taxable.

The sale to the purchaser/lessor, or the leaseback from the purchaser/lessor, will be taxable unless one of the rules discussed below applies.

Financing transactions. When a transaction structured as a sale and leaseback is treated as actually being solely a financing transaction, it is not regarded as a sale or lease and tax does not apply. Instead, the original sale to the person who then sells the property and leases it back is the taxable transaction (this is true whether that person enters into the sale/leaseback transaction before or after making any use of the property).

In general, a transaction structured as a sale and leaseback will be regarded as a financing transaction (rather than a sale and lease) if all three of the following conditions are met:

- The leaseback transaction would be regarded as a sale under a security agreement from its inception (see [Sales under a security agreement](#)).
- The purchaser-lessor does not claim any deduction, credit or exemption with respect to the property for federal or state income tax purposes.
- The amount which would be attributable to interest, had the transaction been structured originally as a financing agreement, is not exorbitant under California law.

A sale and leaseback transaction will also be regarded as a financing transaction if all of the following requirements are met:

- The initial purchase price of the property has not been completely paid by the seller-lessee to the equipment vendor.
- The seller-lessee assigns to the purchaser-lessor all of its rights, title and interest in the purchase order and invoice with the equipment vendor.
- The purchaser-lessor pays the balance of the original purchase obligation to the equipment vendor on behalf of the seller-lessee.
- The purchaser-lessor does not claim any deduction, credit or exemption with respect to the property for federal or state income tax purposes.
- The amount which would be attributable to interest, had the transaction been structured originally as a financing agreement, is not exorbitant under California law.
- The seller-lessee has an option to purchase the property at the end of the lease term, and the option price is fair market value or less.

Acquisition sale and leaseback transactions. Tax does not apply to the sale or lease of tangible personal property according to an acquisition sale and leaseback, which is a transaction that satisfies all three of the following conditions:

- The seller-lessee has paid California sales tax reimbursement or use tax with respect to that person's purchase of the property.
- The acquisition sale and leaseback is consummated within 90 days of the seller/lessee's first functional use of the property. A period of storage after the purchase but before the first functional use is not used to calculate the 90-day period.
- The acquisition sale and leaseback transaction is consummated on or after January 1, 1991.

Tax paid to another state on leased property

Generally speaking, if you have paid sales or use tax to another state, political subdivision of a state, or to the District of Columbia, for property you plan to lease, you may take a credit against any use tax imposed by California. To qualify for the credit, you must make a timely election to pay tax measured by the purchase price of the property and the property must be leased in substantially the same form as acquired.

For More Information

For additional information or assistance, please take advantage of the resources listed below.

CUSTOMER SERVICE CENTER

1-800-400-7115

CRS:711

Customer service representatives are available Monday through Friday from 8:00 a.m. to 5:00 p.m. (Pacific time), except state holidays. In addition to English, assistance is available in other languages.

OFFICES

| City | Telephone Number |
|---------------|------------------|
| Bakersfield | 1-661-395-2880 |
| Cerritos | 1-562-356-1102 |
| Culver City | 1-310-342-1000 |
| El Centro | 1-760-352-3431 |
| Fairfield | 1-707-862-3501 |
| Fresno | 1-559-440-5330 |
| Glendale | 1-818-543-4900 |
| Irvine | 1-949-440-3473 |
| Oakland | 1-510-622-4100 |
| Rancho Mirage | 1-760-770-4828 |
| Redding | 1-530-224-4729 |
| Riverside | 1-951-680-6400 |
| Sacramento | 1-916-227-6700 |
| Salinas | 1-831-754-4500 |
| San Diego | 1-858-385-4700 |
| San Francisco | 1-415-356-6600 |
| San Jose | 1-408-277-1231 |
| Santa Clarita | 1-661-222-6000 |
| Santa Rosa | 1-707-890-6267 |
| Ventura | 1-805-856-3901 |
| West Covina | 1-626-671-3702 |

Out-of-State Offices

| | |
|----------------|----------------|
| Chicago, IL | 1-312-201-5300 |
| Houston, TX | 1-713-739-3900 |
| New York, NY | 1-212-697-4680 |
| Sacramento, CA | 1-916-227-6600 |

Motor Carrier Office

| | |
|---------------------|----------------|
| West Sacramento, CA | 1-800-400-7115 |
|---------------------|----------------|

INTERNET

www.cdtfa.ca.gov

You can visit our website for additional information—such as laws, regulations, forms, publications, industry guides, and policy manuals—that will help you understand how the law applies to your business.

You can also verify seller's permit numbers on our website (see [Verify a Permit, License, or Account](#)) or call our automated verification service at 1-888-225-5263.

Multilingual versions of publications are available on our website at www.cdtfa.ca.gov.

Another good resource—especially for starting businesses—is the California Tax Service Center at www.taxes.ca.gov.

TAX INFORMATION BULLETIN

The quarterly *Tax Information Bulletin* (TIB) includes articles on the application of law to specific types of transactions, announcements about new and revised publications, and other articles of interest. You can find current TIBs on our website at www.cdtfa.ca.gov/taxes-and-fees/tax-bulletins.htm. Sign up for our [CDTFA updates](#) email list and receive notification when the latest issue of the TIB has been posted to our website.

FREE CLASSES AND SEMINARS

We offer free online basic sales and use tax classes including a tutorial on how to file your tax returns. Some classes are offered in multiple languages. If you would like further information on specific classes, please call your local office.

WRITTEN TAX ADVICE

For your protection, it is best to get tax advice in writing. You may be relieved of tax, penalty, or interest charges that are due on a transaction if we determine that we gave you incorrect written advice regarding the transaction and that you reasonably relied on that advice in failing to pay the proper amount of tax. For this relief to apply, a request for advice must be in writing, identify the taxpayer to whom the advice applies, and fully describe the facts and circumstances of the transaction.

For written advice on general tax and fee information, please visit our website at www.cdtfa.ca.gov/email to email your request.

You may also send your request in a letter. For general sales and use tax information, including the California Lumber Products Assessment, or Prepaid Mobile Telephony Services (MTS) Surcharge, send your request to: Audit and Information Section, MIC:44, California Department of Tax and Fee Administration, P.O. Box 942879, Sacramento, CA 94279-0044.

For written advice on all other special tax and fee programs, send your request to: Program Administration Branch, MIC:31, California Department of Tax and Fee Administration, P.O. Box 942879, Sacramento, CA 94279-0031.

TAXPAYERS' RIGHTS ADVOCATE

If you would like to know more about your rights as a taxpayer or if you have not been able to resolve a problem through normal channels (for example, by speaking to a supervisor), please see [publication 70](#), *Understanding Your Rights as a California Taxpayer*, or contact the [Taxpayers' Rights Advocate Office](#) for help at 1-916-324-2798 or 1-888-324-2798. Their fax number is 1-916-323-3319.

If you prefer, you can write to: Taxpayers' Rights Advocate, MIC:70, California Department of Tax and Fee Administration, P.O. Box 942879, Sacramento, CA 94279-0070.

Regulations, forms, and publications

Lists vary by publication

Selected [regulations](#), [forms](#), [publications](#), and [industry guides](#) that may interest you are listed below. Spanish versions of certain publications are also available online.

Regulations

- 1502 *Computers, Programs, and Data Processing*
- 1504 *Mailing Lists and Services*
- 1521 *Construction Contractors*
- 1528 *Photographers, Photocopiers, Photo Finishers and X-Ray Laboratories*
- 1532 *Teleproduction or Other Postproduction Service Equipment*
- 1533.1 *Farm Equipment and Machinery*
- 1534 *Timber Harvesting Equipment and Machinery*
- 1535 *Racehorse Breeding Stock*
- 1541 *Printing and Related Arts*
- 1567 *Banks and Insurance Companies*
- 1586 *Works of Art and Museum Pieces for Public Display*
- 1587 *Animal Life, Feed, Drugs and Medicines*
- 1591 *Medicines and Medical Devices*
- 1593 *Aircraft and Aircraft Parts*
- 1594 *Watercraft*
- 1595 *Occasional Sales—Sale of a Business-Business Reorganization*
- 1610 *Vehicles, Vessels, and Aircraft*
- 1614 *Sales to the United States and Its Instrumentalities*
- 1616 *Federal Areas*
- 1620 *Interstate and Foreign Commerce*
- 1660 *Leases of Tangible Personal Property—In General*
- 1661 *Leases of Mobile Transportation Equipment*
- 1667 *Exemption Certificates*
- 1668 *Sales for Resale*
- 1686 *Receipts for Tax Paid to Retailers*
- 1698 *Records*
- 1700 *Reimbursement for Sales Tax*
- 1701 *“Tax-Paid Purchases Resold”*
- 1821 *Foreword—District Taxes*

Publications

- 9 *Construction and Building Contractors*
- 34 *Motor Vehicle Dealers*
- 44 *District Taxes (Sales and Use Taxes)*
- 45 *Hospitals and Other Medical Facilities*
- 47 *Mobilehomes and Factory-Built Housing*
- 61 *Sales and Use Taxes: Exemptions and Exclusions*
- 70 *Understanding Your Rights as a California Taxpayer*
- 73 *Your California Seller’s Permit*
- 74 *Closing Out Your Account*
- 75 *Interest, Penalties, and Collection Cost Recovery Fee*
- 76 *Audits*
- 77 *Out-of-State Sellers: Do You Need to Register with California?*

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