

M e m o r a n d u m**315.0158**

To: Out-of-State – Principal Auditor

Date: October 30, 1986

From: HQ – Legal (TLA)

Subject: S---T---
SZ -- XX-XXXXXX

I am writing in response to your memo of September 25, 1986 regarding the application of sales and use tax to maintenance services rendered under a lease agreement between the County of --- and S--- T--- (S---T---). Pursuant to our telephone conversation I am responding to you and not to the taxpayers, as originally directed in your memo.

The subject maintenance agreement arises out of a request for bids (RFB) issued by --- County on December 20, 1982 for the lease of printer sub-system and magnetic tape storage devices. The RFB contained the following maintenance specifications:

“The bidder shall select one of the following approaches to equipment mainenance:

“1. The bidder may be responsible for maintenance for the period of the contract.

“2. The bidder may quote the equipment manufacturer’s price for maintenance. If this approach is selected award of contract under this RFB will be contingent on execution of a contract for maintenance of the bid equipment between the County and the equipment manufacturer within 30 days of execution of the lease contract with bidder.

“3. The bidder shall state in the bid response which option has been selected. If the second option is chosen, then the bidder must also submit evidence that the equipment manufacturer is willing to provide this service.”

The successful bidder was S---T--- and the parties entered into a lease in June 198. The County of --- has not been paying sales tax reimbursement on the maintenance charges in the belief that the maintenance contract included in the lease is an optional maintenance contract and therefore not subject to tax. S---T--- was audited by the State Board of Equalization in January of 19XX wherein S---T--- was advised by Grant Elliott, Senior Tax Auditor, that the leases with the County of --- included mandatory maintenace contracts which are subject to tax. In speaking with Mr. Elliott, I learned that the basis for his decision was the language contained

in the RFB prepared by the lessee. Mr. Elliott also stated that S---T--- occasionally leases equipment without providing maintenance.

Analysis

Included in the measure of taxable rental receipts are charges for any services that are rendered as part of the sale (see Rev. and Tax. Code §§6011(b)(1) and 6012(b)(1)). Charges for a “mandatory maintenance contract” are subject to tax whereas charges for an “optional maintenance contract” are not subject to tax (Reg. 1546(b)(3)). In other words, an optional maintenance contract does not constitute services which are considered to be rendered as a part of the original sale or lease of the tangible personal property.

A maintenance contract is considered to be mandatory if the buyer or lessee is required to purchase the maintenance contract from the seller or lessor as a condition of the sale or lease. A maintenance contract is considered optional if the buyer or lessor is free to contract for maintenance with anyone he or she chooses.

The regular business practice of the lessor is the determining factor in deciding whether a maintenance contract is optional or mandatory. If a lessor is willing on occasion to lease equipment without requiring the lessee to purchase the maintenance, the maintenance services generally will be viewed as optional. Language contained in a RFB prepared by a lessee will only be determinative if the RFB clearly states that maintenance services will be contracted for separately.

The County of ---, as the lessee, specified in their RFB that maintenance services were to be included with the lease. The RFB further allowed the lessor to either provide maintenance under the contract or to arrange with the manufacturer of the equipment to provide maintenance. However, as Mr. Elliott disclosed, S---T--- on occasion leases equipment without providing maintenance. We will therefore assume that the County of --- had the option of obtaining a lease of the S---T--- equipment without maintenance services. The election by the County of --- to obtain maintenance services from S---T--- does not alter the optional status of the maintenance contract. The maintenance services will therefore not be deemed to be a part of the lease and tax will not be imposed upon the charges for the maintenance.

In order to preserve the nontaxable status of the charges rendered pursuant to the optional maintenance contract, these charges should be separately stated in the lease agreement (Sales and Use Tax Annotation 330.3460). This requirement is necessary in order to support the contention that the maintenance services are separate and apart from the lease of the equipment and to ensure proper accounting. Exhibit A-4 of the lease agreement entered into between S---T--- and the County of --- separately lists the charges for maintenance. The maintenance charges under the subject lease are not subject to the imposition of tax.