

**STATE BOARD OF EQUALIZATION**

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August 3, 1992

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Re: ---

Dear Ms. ---:

I am writing this in response to your letter of June 18, 1992, to Assistant Chief Counsel Gary J. Jugum. You asked if the exemption from the recent tax increases for fixed-price contracts applies to one of XXs leases.

You indicate that you have a customer who executed a lease agreement prior to July 15, 1991, and is refusing to pay use tax at the rates in effect after that date claiming its lease qualifies as a fixed-price lease. You indicate that XX collects use tax measured by the rental payments. You agree with the lessee that the rental payments are fixed pursuant to the Term Lease Agreement, a copy of which you attached to your letter. You note, however, that the mandatory maintenance contract allows for periodic increases in the monthly maintenance costs not to exceed a designated percentage in any given year and ask if this provision negates the exemption.

You attached to your letter a copy of the Term Lease Agreement in question. Paragraph 11, in pertinent part, provides as follows:

"Customer agrees to pay to XX upon invoice, all sales, use, excise, and other taxes ... now or hereafter imposed by any governmental body or agency upon any Equipment Schedule, the Rental Payments due thereunder, and Equipment or the use thereof, exclusive of property taxes and taxes imposed upon the net income of XX."

OPINION

A. Fixed-Price Leases Generally.

As you are aware, on June 30, 1991, the Legislature enacted Assembly Bill 2181, Statutes 1991, Chapter 85. This bill amended Sections 6051 and 6201, and added Sections 6051.2, 6051.5, 6201.2, and 6201.5, which raised the state-wide sales and use tax rate to seven and one-quarter percent. This bill also added Section 6376.1 which provides that leases of tangible personal property that are continuing sales of the property for any period of time for which the lessor is obligated to lease the property for an amount fixed by the lease prior to July 15, 1991, are not subject to the new rates. The exemption does not apply to leases for any period of time in which any party to the lease has the right to terminate it upon notice, whether or not the right is exercised.

In determining whether a lease agreement is for a "fixed-price" we have consistently required that it satisfy the following criteria: (1) it be binding prior to July 15, 1991; (2) neither party has a right to terminate the contract conditioned solely upon notice; (3) the agreement must fix the amount of all costs at the outset; and (4) it must include a provision which fixes the tax obligation on a tax-included basis or sets forth either the amount or the rate of tax and does not provide for an increase in the amount of tax.

The lease (or rental) of tangible personal property in California is a continuing sale unless that property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property. If the lease is a sale under this definition, that lease is subject to use tax measured by rentals payable unless it is specifically exempted by statute. (§ 6203).

B. Tax Consequences to XX

The lease agreement was executed prior to July 15, 1991. XX collects use tax measured by the rental payments, so the lease qualifies as a continuing sale. Since the maintenance agreement is mandatory, it is one of the lease costs incurred by the lessee. We thus agree with you that, because XX reserves the right to increase the amounts of the payments for the maintenance contract, the costs of the lease are not fixed at the outset. Also, Paragraph 11, quoted above, requires the lessee to be responsible for all taxes. XX can pass on any tax increases to its lessees. XX's lease agreements containing this paragraph do not qualify for the fixed-price lease exemption under the criteria set forth above.

I hope the above discussion has answered your question. If you need anything further, please do not hesitate to write again.

Ms. ---

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August 3, 1992  
330.2265

Sincerely,

John L. Waid  
Tax Counsel

JLW:es

bc: Out-of-State District Administrator