



STATE BOARD OF EQUALIZATION

1020 N STREET, SACRAMENTO, CALIFORNIA
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March 11, 1982

Dear ---:

Your letter of December 24, 1981 to Mr. Donald Brady has been referred to the undersigned for reply. You have submitted additional facts concerning --- activities.

As we understand it, --- enters into Purchase and Remarketing Agreements with various manufacturers. The manufacturers either sell or lease their equipment to other end users. If leased, the manufacturer can hold the lease paper itself or assign the lease and simultaneously sell the equipment to a third party lessor or financial intermediary such as ---. The manufacturers view --- as another source of financing, in many respects similar to any financial institution.

It is our opinion that your business function is nothing more than that of a financial institution. You expect a certain rate of return on the money you put forth to acquire the lease contract from the manufacturer. However, unlike most financial institutions, your agreement with the manufacturer is structured so that after you achieve a given return, the manufacturer participates equally in any residual income from the agreement. This residual income can be either in the form of rental receipts after the recapture date if the equipment is on lease, or from the proceeds in excess of your expected yield if the equipment is sold.

The agreements are drawn in such a way that both --- and the manufacturer believe there is a very high probability that the manufacturer will share in the residual income generated by the product. It has been your experience that this stage is reached by the majority of portfolios you manage. You believe it is quite obvious from the aforementioned data that the manufacturer has a substantial "interest" in the lease assignment. Furthermore, the Purchase and Remarketing Agreement gives the manufacturer substantial rights in regards to the equipment and the lease assignment. The manufacturer is always appointed ---'s exclusive remarketing agent, which gives him the right to lease or sell the equipment to any third party, subject only to your credit approval. The manufacturer also has the right to "repurchase" a portion of the equipment sold to ---. The manufacturer, by contract, retains the "right" to receive the rental receipts including the use tax from the lessee. As a result, the manufacturer has full use of the tax funds until said funds are remitted to the State.

The manufacturer performs all the functions as if it were the owner of the equipment. The manufacturer collects the rental income including tax (Attachment 9), maintains

the equipment, has the exclusive right to transfer title to third parties, and, in general, services the account of the lessee. In fact, in almost every case, the lessee is not even aware of ---'s existence.

Contrary to what is stated in Regulation 1660(c)(9)(D), ("the assignee has no recourse against the assignor"), under your Purchase and Remarketing Agreements there are numerous instances of recourse by the assignee against the assignor. Among the typical indemnifications (Attachments 8a-8g) given to --- are:

1. Risk of loss or damage to equipment in transit or at lease site.
2. Breach of implied warranties.
3. Breach of express warranties (as per lease or actually made to lessee).
4. Failure of manufacturer to maintain/service equipment.
5. Patent infringement.
6. Termination event – Default in manufacturer's performance under agreement or under lease; malfunction of a certain percent of equipment.
7. Liability insurance and liability for all Sales and Use Taxes.
8. Nonperfecting of U.C.C. financing statements.
9. Modification of standard lease.

Basically, if there is something other than a credit risk that cuts off the rental stream, the manufacturer will indemnify you either by paying the rents itself or paying --- for the value of the equipment.

It is your opinion that the assignor remains liable for the collection and remittance of the use tax to the State and that Regulation 1660(c)(9)(D) does not apply to your circumstances. The manufacturers retain substantial rights and interest in the equipment. In addition, --- has recourse against the manufacturer in a spectrum of ways. Moreover, you believe that none of the sections of the regulation, as it relates to the assignment of leases, applies to your particular situation.

It is your contention that your contractual relationship with your manufacturers is more of a partnership nature. The manufacturer builds, leases, maintains, relets and ultimately sells the equipment. The manufacturer maintains the relationship with the lessee, collecting the rental income, as well as providing other services. --- furnishes the capital and approves the credit. You

are a financing organization and, you have no sales force. After you have achieved a certain rate of return, you divide the residual income with your partner, the manufacturer.

We have reviewed the contentions made in your letter as well as the attachments highlighting various aspects of a typical purchase agreement with various manufacturers. We remain of the opinion that the purchase agreement operates so as to transfer all rights, title and interest in the leased equipment to ---.

The purchase agreement provides for the sale of equipment and the assignment lease covering that equipment by the manufacturer to ---. The manufacturer does not retain rights in the equipment but rather is paid a certain amount by --- for remarketing and administrative duties. Title to the equipment passes to ---. Under the terms of the agreement, the equipment must be identified as ---'s.

The fact that after --- has received 160% of the purchase price, the manufacturer is entitled to share equally (50%) in the lease receipts does not indicate that manufacturer has any right, title or interest in the equipment since the increase in fees is merely indicative of the profit-sharing agreement between the two parties. The fact that --- holds the manufacturer responsible for various warranties and patent infringements is not indicative that --- (assignee) has any recourse against the manufacturer (assignor). As we understand, --- cannot look to manufacturer for lease payments in the event of default by the lessee; therefore, --- has no recourse against the manufacturer.

We would therefore conclude that the repurchase agreement between --- and various manufacturers falls equally within the provisions of Sales and Use Tax regulation 1660(c)(9)(D). As such, --- has assumed the position of lessor and is required to collect, report and pay the tax to the Board.

Finally, based on our opinion as stated in our November 2, 1981, memorandum, you have the following questions concerning your tax liability:

1. As you understand Regulation 1660, the primary liability for the use tax is with the lessee. However, the lessor is required to collect, report, and remit the tax to the State. The lessee is not relieved of the liability until he is given a receipt of the kind called for in Regulation 1686, or the tax is paid to the State. Therefore, since the lessee paid the tax to and received a proper receipt from the undisclosed agent (manufacturer) of --- and the Board of Equalization through audit has accepted the manufacturer's reporting, has not all of ---'s tax liability related to the lease assignment been extinguished?

--- is the one liable to remit the tax. In order to be relieved of past liability, it must secure statements from manufacturers who have remitted the tax to the state that they have done so. In the future, --- is the proper party to remit the tax to the State Board.

2. The plurality of your leased equipment is located in San Francisco, Alameda, Contra Costa, and Santa Cruz counties. All leases are subject to tax on the rental receipts. If the use

tax is the applicable tax, and you are not “engaged in business” in the district other than by having your equipment in said district, are you required to collect, report and remit the transactions tax?

Transactions and Use Tax regulation 1827 provides, in part, that a “retailer engaged in business” in a transit district includes any of the following:

* * *

(3) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in a district.

As a retailer engaged in business in the district, you are required to collect, report and remit the transit district use tax in addition to the state and county (city) use tax.

3. Since you have equipment located in numerous cities and counties in California, will you be required to make a local tax allocation for reporting purposes or is the local tax reportable to the county in which the retailer’s business is located?

Taxpayers that maintain a permanent place of business and whose activities involve long-term leases of fixed personal property where the county of use is identified should allocate local tax to the county of use.

4. Will your representative, with proper authorization from the manufacturer be allowed to analyze the Board of Equalization’s audit workpapers and comments of said manufacturer?

Yes.

Very truly yours,

Mary C. Armstrong
Staff Counsel

MCA:ba

bc: Mr. Don Brady
Santa Rosa District Office