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**STATE BOARD OF EQUALIZATION**

(916) 445-5550

February 6, 1990

Re:

Dear

As you know, the claim for refund you filed on behalf of --- has been referred to me for review. --- Leasing Company leased property to --- then exercised an option to purchase that property and paid sales tax (reimbursement) to --- with respect to those purchases. Your claim is for refund of those amounts.

As discussed in detail below, we conclude that the taxes for which --- claims a refund were properly paid. For your future information, we note that --- does not have standing to file this claim for refund. Although --- has listed the charge to --- as "sales tax," this is actually a charge for sales tax reimbursement. A retailer owes sales tax on its retail sales of tangible personal property in California. (Rev. & Tax. Code § 6051.) A retailer may collect sales tax reimbursement from the purchaser with respect to sales for which the retailer has sales tax liability provided the contract between the retailer and the purchaser provides for that reimbursement. (Civ. Code § 1656.1.) Since the sales tax on the subject sales was actually paid by ---, with --- contractually reimbursing. --- for those taxes, --- is the proper party to file a claim for refund if it paid those taxes in error. Since --- paid ---; sales tax reimbursement, a refund to --- would be conditioned on ---'s refund to ---.

There are three master leases involved: --- (a copy of which is attached to your claim as Exhibit A1), --- (Exhibit A2), and --- Exhibit A3). You have also included as Exhibits 81, 82, B3, and 84 copies of the purchase (buyout) agreements for each lease followed by lease agreement schedules or other documents showing that the amount of sales tax paid by --- was capitalized into the amount of ---'s monthly rental payments. In the case of lease --- you have included in Exhibit B1 copies of the original acquisition documents, i.e., invoices and checks. A review of these documents shows that, with respect to all but two of the transactions for which you have provided us documentation, the checks issued by --- to the vendors of the equipment to be leased to --- include payment of sales tax reimbursement to those vendors on the sales. With respect to the other two transactions, the copies of the checks issued to the vendor, --- Michigan, includes notations that sales tax was paid separately (one notation indicates that the sales

tax was to be paid directly to the state while the other simply states that the sales tax was paid separately).

You provide additional explanation with respect to lease with respect to Schedules A through H, you explain that sales tax had been capitalized into the amount financed. In other words, as with the previous two leases, ---, and --- used its total acquisition cost, which included sales tax reimbursement it paid with respect to its purchases, to calculate the amount of ---'s rentals payable. Beginning with Schedule I of lease --- did not include sales tax in its calculation of ---s rentals payable. Rather, it began to collect from --- use tax measured by the monthly rentals payable on all schedules beginning with Schedule I.

You believe that the leases entered into by --- and --- are financing devices as defined by Cedars Sinai Medical Center v. State Board of Equalization (1984) 162 Cal.App.3d 1182. You believe that since sales tax was paid to the vendor at the time of acquisition by ---, tax should not be imposed at the time of the buyout. We disagree.

A lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases the property in substantially the same form as acquired and has paid sales tax reimbursement to the vendor or has made a timely election to pay use tax measured by the purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1, Reg. 1660.) When the lessor leases the property in substantially the same form as acquired and has paid sales tax reimbursement or use tax measured by purchase price, the lessor's lease of that property is not a sale under the Sales and Use Tax Law and is not subject to sales or use tax. On the other hand, when neither sales tax reimbursement nor use tax measured by purchase price has been paid with respect to that property, the lessor's lease of that property is a continuing sale subject to tax. The tax is a use tax upon the use in this state of the property by the lessee which the lessor must collect from the lessee and pay to this state. (Rev. & Tax. Code SS 6201, 6203, Reg. 1660(c) (1).) The lessee is not relieved from liability for that tax until given a receipt for payment of tax by the lessor or until the tax is paid to the state. (Rev. & Tax. Code § 6202.)

Based upon the information you have provided us, it appears that --- elected to pay tax measured by the purchase price of the property it leased to --- until Schedule I of Lease --- This means that no use tax was due with respect to leases of that property to ---. Accordingly, the documentation you have provided us shows that --- did not collect tax from ---with respect to these leases. It seems virtually mandatory from the business perspective of --- that it use its total Acquisition cost to calculate the amount of rentals it would charge ---. for these leases. That did so does not alter our analysis. --- merely itemized for the benefit of its lessee the specific acquisition costs it used in calculating rents to be paid by ---.

Based upon the information you have provided us, it appears that beginning with Schedule I of Lease --- made a decision to acquire the property to be leased ex tax. As discussed above, this is an election that the lessor is entitled to make. (Of course, --- is

not required to enter into contracts with lessors who refuse to pay tax measured by purchase price. We note, however, that since --- did not pay tax measured by purchase price, the amount of that tax was apparently not included in its calculation of ---s rentals payable and --- therefore presumably paid a lower rent than had paid tax measured by purchase price.) Since tax was not paid measured by purchase price, lowed, and properly collected, use tax measured by the rentals payable.

Having concluded that taxes were properly paid on the lease agreements, we now reach the specific question at issue. You cite Cedars Sinai; however, that case is not relevant to the particular facts involved here. The Cedars Sinai issue arises when a person acquires property, pays sales or use tax with respect to its acquisition, and then uses the property. Sometimes that consumer then decides to finance its acquisition costs of that property and does so by way of an agreement structured as a sale and leaseback agreement. The tax previously paid was properly due and is not refundable. If that arrangement is truly a sale and leaseback, the usual lease rules govern the application of tax as discussed above. This means that though the consumer already paid sales tax reimbursement or use tax with respect to its acquisition of the property, another retail sale occurs and tax must be paid measured by either purchase price or rentals payable. However, when the transaction meets the specific requirements of Cedars Sinai, we treat that transaction as a financing transaction with no sale occurring rather than a true sale and leaseback. This, of course, means that the buyout at the end of the “lease” term is not subject to tax because it is not really a sale under Revenue and Taxation Code Section 6006. As we discussed on January 30, 1990, the Board has amended Regulation 1660 to include this financing transaction exception to the usual sale and leaseback rules. (Reg. 1660(a)(3).)

Note: This of course does not apply to purchase at the end of an acquisition sale of lease back (see R &TS 6010.65 (d).)
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Even though --- entered into these lease arrangements as an alternative to the outright purchase of the property, they are clearly structured as true leases. Section 15 of Lease provides that title to the leased equipment remains in the lessor --- exclusively. (AS relevant here, all the subject leases contain the same provisions, and I will refer to those provisions as numbered in Lease ---) Section 31 states “it is the intent of both lessor and lessee that this agreement is a true lease and not a lease intended as security or a conditional sales agreement. Lessor and lessee also agree to treat this as a true lease for income tax purposes.” Section 32 provides for --- purchase option, which is not an absolute right but is conditioned on --- having faithfully fulfilled all its obligations under the lease. Section 34 provides that lessor has the right to any tax benefits provided to an owner of property under federal and state income tax laws.

These provisions clearly show that --- held true title to all property and did not hold a mere security interest. This is confirmed by the fact that --- changed its method of reporting tax and elected to begin collecting use tax measured by rentals payable under these very master leases. Had these arrangements not been true leases, --- would not have

been entitled to make this election because it would not actually have been leasing the property to ---. (That is, if they were, as you argue, financing arrangements, it would mean that --- owned the property. The owner of this type of property cannot pay the tax based on its payment schedule.) Further, had these arrangements necessitated reference to the financing transaction' exception to the usual sale-leaseback rules, we would conclude that these transactions were true sale-leasebacks since retained the income tax benefits. (Reg. 1660(a)(3).)

---s transfers of title to --- pursuant to ---s exercise of its purchase options were sales under Revenue and Taxation Code Section 6006. Since these were sales at retail, --- sales tax measured by its sales price to --- (Rev. & Tax. Code §§ 6007, 6051.) This is the case whether --- had elected to pay tax measured by purchase price and not collect tax on rentals, or if --- instead collected tax from --- measured by rentals payable since the purchase by --- is a separate retail transaction from the lease. As provided in their contract, --- was entitled to collect sales tax reimbursement (designated by --- as “sales tax”) from --- with respect to the sales tax --- owed on its sales.

By copy of this letter, we are recommending to our Refunds Unit that ---'s claim for refund be denied. If you have further questions, feel free to write again.

Sincerely,

David H. Levine  
Tax Counsel

DBL:wak  
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cc: Mr. Rick Kinoshita,