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March 24, 1993

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Mr. A--- M---, CPA
XXXX --- ---, Suite XXX
--- ---, CA XXXXX

Dear Mr. M---y:

This is in response to your letter of February 8, 1993, which was referred to this office on March 18, 1993 by Ms. Kristie Marinello of Mr. Brad Sherman's office.

We understand that your client, a corporation owned by a single shareholder, uses heavy equipment, including trucks, which the corporation owns or leases from independent leasing firms. The firm does not have a resale permit (seller's permit). The firm paid sales tax reimbursement at the time it acquired the equipment which it owns. Apparently, the equipment lessors pay tax at the time of their acquisition of the leased equipment, and thus tax is not being collected based upon the rental amounts charged to the client.

The corporation is now negotiating a cost plus contract, and finds that charges related to equipment use would be greatly simplified if the corporation could lease all the equipment used on the job. The corporation intends to transfer all of the heavy equipment owned by it to a proprietorship and leaseback all this equipment.

You inquire as to the sales and use tax consequences of the described proposed transaction.

Apparently, the corporation will sell the heavy equipment in question to the proprietorship.

Your client has two planning opportunities. Your client may place the heavy equipment (including the trucks) on a tax-paid basis by paying use tax based upon the purchase price of the property to the proprietorship. Use tax on the trucks would be paid directly to the Department of Motor Vehicles. Use tax on the other heavy equipment must be paid directly to this agency in the calendar quarter in which the equipment is first placed in leased service. If tax is paid on the

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cost of all the heavy equipment, the rental charges made by the proprietorship to the corporation will be nontaxable as to all of the equipment.

Alternatively, the proprietorship may apply to this agency for a seller's permit and may acquire all of the heavy equipment for resale. If this approach is taken, the proprietorship would have to collect tax from the corporation based upon rental receipts paid by the corporation to the proprietorship as to all of the equipment.

If your client does not chose to follow one of these two approaches, this is what will happen: The proprietorship will be required to pay use tax measured by the purchase price for the trucks at the time the trucks are re-registered at DMV. The client will be required to collect and pay tax as to the lease of heavy equipment (other than trucks), based upon the rental receipts measured. In other words, the client would have a "mixed inventory" of tax-paid and ex-tax equipment. The basic rules are that the sale of heavy equipment, other than trucks, qualifies as an occasional sale (tax free), but the sale of the trucks is taxable. The lease of the heavy equipment (other than trucks) would be taxable, because the client would not have paid tax measured by the purchase price under Revenue and Taxation Code section 6094.1. The lease of the trucks would be nontaxable, because the client would have paid use tax measured by the purchase price of the vehicles.

The proprietorship would not benefit from the fact that the corporation may have purchased the heavy equipment in a taxable transaction.

It is immaterial that the lessor may be a corporation (rather than a proprietorship) wholly owned by the same stockholder who owns the lessee.

Very truly yours,

Gary J. Jugum
Assistant Chief Counsel

GJJ:sr