

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
(916) 445-6493

March 30, 1990

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Leases – sales of rental units to new lessor

Dear ---:

In your March 27, 1990 letter to Mr. E. L. Sorensen, Jr., Senior Tax Counsel, which was referred to me for reply, you write:

“Further to the discussions you and I had last week, we have prepared a description of a transaction which our client (the ‘Company’) proposed to consummate in the near future. The Company is a successor in interest to a taxpayer which, while in bankruptcy a number of years ago, purchased rental property as to which it elected to collect use tax from lessees measured by rental receipts. The Company’s objective in undertaking this transaction is to curtail its customers’ use tax obligation on payments made for the rental of certain tangible personal property, which consists in the aggregate of roughly 25,000 rental units (the units’), by effecting a tax-paid sale of the units.

There is a substantial business purpose for this transaction. The city which franchises the Company’s operations has required the Company to cease collecting use tax from some customers on the rental of the units, since other customers do not have to pay the tax on their rental of comparable units which were purchased tax-paid.

For purposes of this description, assume that the units are subject to existing, individual month-to-month leases. Use tax measured by payments for the rental of the units has been collected from lessees of the units, and remitted to the Board, since the units first entered lease service.

The Company intends to curtail the collection of use tax from lessees of the units by (1) terminating month-to-month agreements for the rental of the units, effective March 31, 1990 and (2) selling the units to a related legal entity (the 'Buyer') at fair market value in an arms-length transaction which will take effect April 1, 1990.

At the time the units are acquired, Buyer intends to (1) pay to the Company, as vendor of the units, sales tax reimbursement measured by the purchase price of the units, which tax payment will be timely remitted to the Board and (2) create new month-to-month agreements for the rental of the units, effective April 1, 1990. [Footnote omitted.]

The units will at all times be leased in the same form as acquired, and will at all times remain on the premises of the lessees. Buyer will, after acquiring the units and creating new agreements with lessees for the rental of the units, contract with the Company to serve as Buyer's billing agent for the collection of payments for the rental of the units.

The Company will, on its own behalf and on behalf of the buyer, transmit for execution to each lessee documents intended to effect the (1) termination of existing month-to-month lease agreements between the lessee and the Company for the rental of the units and (2) creation of new month-to-month lease agreements between the lessee and Buyer for the rental of the units. This notice will state that the rental that the rental amount for the unit does not include sales or use tax on the lessee and that the lessee's continued payments will indicate acceptance of the new lease.

To confirm that the proposed transaction as described, may be effected as a tax-paid sale, terminating the Company's obligation to collect use tax under existing leases as of March 31, 1990, we ask that you reply in writing to this letter no later than March 29, 1990.

### Opinion

We first note that since you have not disclosed the identity of your client, your client may not rely on our response as constituting written advice from Board staff under the provisions of Revenue and Taxation Code Section 6596. Rather, this opinion constitutes advice only on the hypothetical situation you have described in your letter.

With respect to the proposed transaction, subdivision (c)(9) of Regulation 1660 deals with the application of sales and use tax to the situations which arise when a lessor, who has entered into existing leases which are continuing sales and purchases and therefore subject to tax measured by rental receipts, sells all right, title, and interest in the rental property to a successor lessor. Under subdivision (c)(9)(D), the Board will regard the successor lessor as an assignee of the existing leases, and the existing leases remain subject to use tax on the lessee measured by rental receipts for the property leased.

However, under the facts you have described, the current lessor (your client, the Company) will not assign the existing leases to the successor lessor. Rather, the current lessor will terminate the existing leases, and the successor lessor will enter into new leases with each lessee. In this situation, since the successor lessor pays a fair market price for the rental units in an arms-length transaction, and pays sales tax reimbursement to the current lessor for the property acquired, our opinion is that thereafter the successor lessor's leases of the rental units will not constitute continuing sales and purchases under Regulation 1660(c)(2) and no additional tax will be due on the rental receipts collected by the successor lessor.

I enclose Regulation 1660 for your information. Please feel free to contact me if you have any further questions or comments about this letter.

Sincerely,

John Abbott  
Senior Tax Counsel

JA:cl  
Enclosure

bc: San Francisco District Administrator  
Mr. E. L. Sorensen, Jr.