



STATE BOARD OF EQUALIZATION

LEGAL DIVISION (MIC:82)
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October 21, 1993

BURTON W. OLIVER
Executive Director

Mr. T--- -. P---
G--- E--- C--- A--- L---, Inc.
P. O. Box XXX
---, -- XXXXX

Re: G--- --- --- ---, Inc.
S- - XX-XXXXXX

Dear P---:

This is in response to your letter regarding the new leasing program of G--- --- --- --- ---
Inc. (G---). We apologize for the delay in writing to you.

In your letter you state:

“It is anticipated that G--- will soon introduce a new lease program, which is best
defined as a prepaid lease, a stark departure from the traditional lease
arrangement. Under this newly proposed lease, the lessee will make all the lease
payments at the time of lease inception, rather than monthly over the lease term as
with a conventional lease. In the typical lease scenario, G--- purchases the
vehicle from a dealership (sales tax exempt), the dealership will execute the lease
document, and, if approved by G---, the lease is automatically assigned to G---.
The lessee will then make his monthly lease payments to G---, on which the
appropriate sales tax is calculated.”

A. Application of Tax to Leases

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by
their gross receipts from retail sales of tangible personal property. Although the sales tax is
imposed upon the retailer, the retailer may collect sales tax reimbursement (usually itemized on
the invoice as “sales tax”) from the purchaser if the contract of sale so provides. Civ. Code
§ 1656.1.

Revenue and Taxation Code section 6201 imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for storage, use, or other consumption in this state. The use tax, which complements the sales tax, is imposed upon in-state leases of tangible personal property. Although the use tax is imposed upon the purchaser, in certain transactions the retailer must collect the use tax from the purchaser and pay it to the state.

Generally a lease is a temporary transfer of the possession of tangible personal property for consideration. "Lease" includes rental, hire, and license. Rev. & Tax. Code § 6006.1. Where a contract designated as a lease binds the "lessee" for a fixed term and the "lessee" is to obtain title at the end of the term upon completion of the required payments or has the option to purchase the property for a nominal amount, the contract will be regarded as a sale under a security agreement from its inception and not as a lease. The option price is regarded as nominal if it does not exceed \$100 or 1 percent of the total contract price, whichever is lesser. Rev. & Tax. Code § 6006.1 and Regulation 1660(a)(2)(A).

In California the general rule is that a lease of tangible personal property is a continuing sale and purchase, and the use tax, which is measured by rental receipts, must be collected by the lessor from the lessee at the time rentals are paid and must be paid by the lessor to the board.^{1/} Rev. & Tax. Code §§ 6006(g), 6006.1, 6010(e), and 6010.1 and Sales and Use Tax Regulation 1660(c)(1).

For certain types of tangible personal property, however, the lessor may elect to pay tax on the purchase price of the property rather than on rental receipts. This is the tax-paid lease exception. It applies to a lease of tangible personal property which is leased in substantially the same form as acquired and upon which the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property. Rev. & Tax. Code § 6006(g)(5) and 6010(e)(5). If the lessor does not pay tax reimbursement or use tax at the time of acquisition and the lessor desires to pay tax measured by the purchase price, the use tax must be reported and paid timely with the return of the lessor for the period during which the property is first placed in rental service. Regulation 1660(c)(2).

B. Issues Raised in Your Letter

In discussing the issues raised in your letter, we assume that G--- or its dealers are entering into true leases with the customers. Without having all of the pertinent documents for a typical transaction, we do not know if this assumption is correct. If this assumption is incorrect, the analysis in this letter does not apply to the transaction. We also assume that the lessees are not insurance companies or the Federal government and that the tax applicable to the leases is use tax.

^{1/}When the lessee is not subject to use tax (for example, insurance companies), the sales tax applies. The sales tax is upon the lessor and is measured by rentals payable. For most leases, however, use tax is the applicable tax.

First Issue:

“G--- wishes confirmation on the sales tax application related to the one time lump sum payment made by the lessee at the beginning of the lease. It is our understanding that this aggregated lease payment is in total subject to sales tax, and that all the tax collected is due and payable at the time the lease is executed.”

Although it is somewhat unusual to require a lessee to make one lump sum payment at the beginning of the lease rather than periodic payments, the contract may still be a lease. Use tax is the applicable tax and is measured by the rentals payable which in this case would be the amount of the lump sum payment. The lessor must collect the tax from the lessee at the time the lump sum payment is made and pay the full amount to the state.

Second Issue:

“An opinion is also requested clarifying which party the state would hold responsible for the collecting and remitting the sales tax. Typically, the lessor (G---) would be required to collect and remit the tax monthly; however, with this new program, the respective dealerships would actually be collecting the total lease payment (and if our understanding on the first issue is correct) all applicable sales tax. Any difference between the purchase price of the vehicle and the total lease payments will be reconciled between the dealer and G---.”

We assume that in the transaction you describe the lease is executed by the dealer and the lessee while the dealer stills owns the vehicle, that the dealer collects the rental payment and tax from the lessee, and that the dealer sells the vehicle and assigns the existing lease to G---. The dealer should collect the full amount of the tax, measured by the single rental payment, from the lessee at the time the lessee pays the rent and remit the tax to the state. The dealer is liable for the full amount of the tax even if it only collects the rent but not the tax from the lessee.

G--- is also liable for tax measured by the amount of rent attributable to the lessee's use of the property during G---'s ownership of the lease. Regulation 1660(c)(9)(D). For example, the dealer enters into a twelve month lease, collects \$2,400 rent, and one month later sells the vehicle and assigns the lease to G---. G--- is liable for tax measured by \$2,200. If G--- collects the entire tax from the lessee, G--- is liable for the full amount of the tax regardless of when the vehicle is sold to it. If the dealer pays the tax in full, G---'s liability is extinguished.

We do not know what the last sentence quoted above means or whether the reconciliation would effect the tax consequences.

Third Issue:

“Thirdly, an opinion is requested on the issue of early terminations. If for whatever reason the lessee terminates the lease prior to its scheduled term date, will the state allow sales tax credits on amounts of unearned lease income refunded to the lessee?”

Although the use tax must be collected on the full amount of rental payment and paid with the return for the quarter during which the rental payment is made, the Board is taxing the lessee’s continuing use of the property in California. If the lessee terminates the lease, the lessee is no longer using the property. Assuming that the lessee receives a refund of the lump sum rental payment pro rated on time not used versus total time originally contemplated by the lease, the Board will refund tax on such amount.

Fourth Issue:

“Lastly, an opinion is requested regarding the state’s position on reciprocity. If after satisfying the total tax liability in the state where the lease originated, the lessee moves to your state, would there be any sales tax obligation on either the lessee or lessor? If so, when would the tax be imposed (at time of registration)? And how would it be determined? If not, what documentation would be required to substantiate tax paid to another state?”

We assume that when G--- purchases the vehicle out-of-state, it does not purchase the vehicle for use in California.

Revenue and Taxation Code section 6406 provides a credit against use tax to the extent that the person (in this case the lessee) has paid a retail sales or use tax or reimbursement therefore imposed with respect to the tangible personal property by any other state prior to the use of the property in this state. We would permit a credit if the following conditions were met:

1. Sales or use tax measured by the rental payment was imposed by another state upon the lessee or sales or use tax measured by the rental payment was imposed by another state upon the dealer or G--- and the dealer or G--- was permitted under state law to reimburse itself for the tax by collecting it from the lessee. The tax must be imposed upon the lease itself. If sales or use tax was imposed upon the dealer’s or G---’s purchase of the vehicle, the credit is not available;
2. The tax paid to the other state was paid as a lump sum amount and not on a periodic basis; and
3. The lessee, the dealer, or G--- is not entitled to a refund or credit from the other state when the property is brought to California, i.e., when the property is removed from the other state.

If the tax rate in the other state is the same or greater than the tax rate applicable to the lease in California, the lessee would be entitled to a full offsetting credit. Otherwise, the credit will not eliminate the lessee's entire liability and the lessee will have to pay the difference. For example, suppose the lease is for a two-year term, the lessee makes a lump sum lease payment of \$2,400 and pays tax to another state in the amount of \$120 (5%). After one year, the lessee brings the vehicle into California and uses it in a county with a tax rate of 7.5%. The entire use tax in the amount of \$90 [$1/2$ ($\$2,400 \times 7.5\%$)] would be due at the time the lessee brought the vehicle into California. However, the lessee would be entitled to a credit of \$60 ($1/2 \times \120).

Use tax is due at the time the vehicle is registered with the Department of Motor Vehicles (DMV). The lessee may obtain the credit, however, by filing a Form BT-106, Vehicle/Vessel or Mobilehome Use Tax Exemption, with his or her local board office. With this form the lessee must submit all of the pertinent documentation and explain all of the facts which entitles the lessee to the credit. If the local board office agrees that the lessee is entitled to the credit, it will issue the lessee a Form BT-111, Certificate of Motor Vehicle and Mobilehome Use Tax Exemption, which the lessee should submit to DMV at the time of registration.

Please note again that the conclusions in this letter are based upon the assumption that the transaction is a true lease. A lump sum rental payment is not an ordinary commercial practice. If the lessee receives title at the end of the term or has the option to purchase for a nominal amount, we would not regard the transaction as a lease.

Also note that section 6596 provides the only basis for relief if someone reasonably relies on incorrect advice from the Board. A person may only rely upon such advice if he or she makes a request in writing and includes all of the relevant facts. You indicate that the lease about which you inquire is a "stark departure" from traditional leases, but you have not provided a copy. We therefore are not certain as to the relevant facts. This letter can only be relied upon based upon the facts given. We might reach different conclusions if we had all of the relevant facts.

We are enclosing a copy of Regulation 1660 for your information. If you have further questions regarding Sales and Use Tax Law, please do not hesitate to write again.

Sincerely,

Elizabeth Abreu
Tax Counsel

EA:cl
Enclosure