STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 445-5550

April 26, 1991

Mr. G. M--- W---
M--- Financial Corporation
P. O. Box XXXX
--- ---, California XXXXX

Re: SR -- XX-XXXXXX

Dear Mr. W---:

This in response to your letter dated March 5, 1991 regarding the application of use tax to a lease of equipment.

The subject agreement was for a lease of equipment for 36 months commencing January 1, 1989, and provided for use tax to be collected from the lessee measured by the monthly rental payments. The lessee complied with this agreement for 24 months.

You state that from the inception of the agreement, the lessee subleased the equipment and collected sales/use tax measured by the rental value at the appropriate rate. I assume you mean that lessee collected tax from the lessee measured by the monthly rentals payable. I assume also that the lessee reported and paid to the Board the amount of the tax it collected. You ask whether the following request from the lessee is appropriate, which would commence with the 25th month of the 36-month lease:

> "1. On January 1, 1991, since the lessee has been charging the sales tax each time the storage bins are rented, he claims a 'for resale' exemption on any further assessment for sales/use taxes by the Lessor. The Lessee also hears a valid Seller's Permit and issues his resale card in support of his request.
>
> "2. He requests a refund from the lessor of all of the sales and use taxes paid to Lessor along with rental payments to date under the Agreement.

"3. The Lessor makes a refund to Lessee of the amount collected to date under the Agreement and debits his following monthly Sales/Use Tax Return to the State Board of Equalization for an equal amount to offset."

Initially, with respect to your subparagraph 3, it is never appropriate for a taxpayer to take an offset on its sales and use tax return from amounts which the taxpayer may have overpaid with an earlier return. Rather, the taxpayer must report and pay the tax actually due, with no offset, and may file a claim for a refund of the amounts it asserts were overpaid.

Tax does not apply to subleases of tangible personal property. If the tax is paid by the lessee/sublessor measured by rentals payable under the prime lease. (Reg. 1660(c)(5).) However, a lessee may lease tangible personal property from the lessor ex tax by issuing the lessor a timely resale certificate and then collecting tax on rentals payable on the sublease provided the lessee/sublessor makes no use of that property except to sublease it. (Business Taxes Law Guide Annot. 330.2880 (8/18/65).) In other words, the same rules applicable to whether a lease is subject to tax or not are applicable to determine whether a sublease is subject to tax or not.

When property is leased in substantially the same form as acquired, payment of tax or tax reimbursement at the time the property is acquired measured by the purchase price constitutes an irrevocable election not to pay tax measured by rentals payable, and the lessor may not change its election by reporting tax on rentals payable and claiming a tax-paid purchases resold deduction. (Reg. 1660(c)(3).) Again, the same rule is applicable to subleases. When a lessee contracts to lease property and pays use tax to the lessor measured by rentals payable, that lessee has made an irrevocable election not to pay tax measured by rentals payable from a sublease. The lessee/sublessor may not change its election by reporting tax on rentals payable and claiming a tax-paid purchases resold deduction.

Applying these rules, the lessor will be unable to accommodate the lessee/sublessor. As long as the lease of required payment of tax measured by rentals payable by the lessee, the lessee is regarded as having made an irrevocable election to pay tax measured by rentals payable and not to collect tax measured by rentals payable from the sublease. The lessee/sublessor may not change that election. Of course, in future leases, if the lessee will sublease the equipment without making any other use of it, it may issue the lessor a resale certificate at the time the lease commences and collect tax measured by rentals payable from the sublease.

As mentioned above, the lessor may not take an offset for the claimed overpayment on its sales and use tax return. Rather, it must file a claim for refund of any amounts it claims it overpaid. However, if it files a claim for refund of taxes reported on these leases, that claim will be denied for the reasons discussed above. Therefore, we recommend that the lessor not refund those amounts to the lessee since the Board will not refund those amounts to the lessor. I note also that since the lessee is subleasing the equipment in a lease that is not subject to tax, the sublessor may not collect an amount from the sublessee represented as tax. Such amounts are excess tax reimbursement and must be refunded to the sublessee or paid to the state. This is

discussed in Regulation 1700, a copy of which is enclosed. The lessee/sublessor must immediately cease collecting such amounts from its sublessees. If the sublessor wishes to reimburse itself for the amount of tax it pays the lessor under the prime lease, the sublessor must do so by increasing the amount of rentals payable and not by separately stating an amount represented as tax.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:cl

Enclosure

bc: --- District Administrator