

**M e m o r a n d u m****330.2955**

To: M. Kitchen  
Audit Review and Refunds

April 15, 1991

From: David H. Levine  
Senior Tax Counsel

ATSS: 485-5550  
(916) 445-5550

Subject: F--- L--- Co., Inc.  
SR – XX-XXXXXX

This is in response to your memorandum regarding a claim for refund filed by F--- Leasing. F--- is a lessor of automobiles and it reported tax measured by rentals payable. Thereafter, it came to F---'s attention that P--- F--- A---, acting as F---'s agent, had paid tax measured by purchase price (although your memorandum states that sales tax was paid to the dealer, it appears that use tax may have been paid to the DMV). F--- has now filed a claim for refund of portions of its payment of tax measured by rentals payable since it had elected to pay tax measured by purchase price.

The staff agrees with the taxpayer based upon the provisions of subdivision (c)(3) of Regulation 1660 which states that payment of tax measured by purchase price at the time of purchase constitutes an irrevocable election not to pay tax measured by rental receipts. You state that:

“It appears taxpayer intended to collect and report tax measured by the rentals payable. Taxpayer timely elected and reported tax on rental receipts beginning with the reporting period in which the vehicle was first leased. Because taxpayer has paid both the tax to vendor and/or rental receipts, does the fact he, in error, paid tax to the vendor constitute an irrevocable election to exclude tax on rentals payable?”

There are two possibilities under these circumstances: the lessor first pays tax measured by purchase price and thereafter timely reports tax measured by rentals payable; or the lessor timely elects to pay tax measured by rentals payable and, because of the timing of the particular transaction, pays tax measured by purchase price in the timely, regular course of business.

Subdivision (c)(3) of Regulation 1660 states, in effect, that once tax is paid measured by purchase price, the lessor may not change over to tax collected on rentals payable even if that amount is reported on a timely return for the quarter in which the property is first leased. If the circumstances were reversed, we could apply the rule that tax paid on cost always takes priority or the rule that the first payment of tax always takes priority. We believe the latter is the better rule, and we believe that the intent of the lessor is irrelevant.

If a lessor has not yet paid sales tax reimbursement or use tax to his vendor or use tax to the DMV, that lessor must make a decision no later than his timely return for the quarter in which the property is first leased. If on that return he fails to report tax measured by purchase price, he may not thereafter avoid the requirement to collect tax measured by rentals payable even if his payment of tax measured by purchase price to his vendor would be timely vis-à-vis their business arrangement. That is, if a lessor pays no tax by the last day he may timely file his return for the period in which the property is first leased, then that lease is a continuing sale subject to tax measured by rentals payable. We see no reason to reach a different result if a lessor timely elects to pay tax on rentals payable and thereafter somehow pays tax on purchase price before the last day of the month following the period in which the property is first placed into rental service.

When a lessor timely reports tax both on cost and on rentals payable, in almost all cases the tax that would have been paid first is the tax measured by purchase price. If these are the facts in this case, then F--- may not only file a claim for refund for taxes paid measured by rentals payable (conditioned on the proper reimbursement to their lessees), but in addition may not continue to collect tax measured by rentals payable. If, on the other hand, F--- timely reported tax measured by rentals payable before its timely payment of tax measured by purchase price, it may file a claim for refund for the taxes paid measured by purchase price and must continue to collect and report tax measured by rentals payable. In short, prior to granting the refund, you should confirm that tax was actually paid measured by purchase price prior to F---'s reporting of tax measured by rentals payable.