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STATE OF CALIFORNIA
BOARD OF EQUALIZATION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law	)	DECISION AND RECOMMENDATION
	)	No. ---- ---
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel Stephen A. Ryan on October 19, 1994, in Santa Ana, California.

Appearing for Petitioner: --- ---- --- ---

Appearing for the Sales and Use Tax Department: Ms. Brenda Turner Tax Auditor
Ms. Connie Norton Senior Tax Auditor

Protested Item

The protested tax liability for the period October 1, 1988 through June 30, 1991 is measured by:

Item	State, Local and County
Ex-tax price paid to purchase fixed assets from out-of-state vendors, or from California vendors pursuant to resale certificates	$ 4,797,282

Petitioner's Contentions

1. All transactions are nontaxable.

2. Acquisition sales and leasebacks occurred. Petitioner has effectively paid use tax on the purchase price it paid to suppliers. The 90-day rule has been met.

3. Only financing transactions occurred in the sale and leaseback transactions with leasing companies.

4. Petitioner has a right to a refund or credit of use taxes paid to leasing companies measured by rental receipts.

5. A credit is allowable to petitioner for the value of attachment on the fixed assets which were attached to the buildings.

Summary

Petitioner has operated a chain of grocery stores since 1988 without any prior Board audit.

Petitioner made many ex-tax purchases of fixed assets from suppliers with the intent to sell the assets to leasing companies and then lease back those assets. Petitioner issued resale certificates to the California suppliers on this basis. From petitioner's own funds, petitioner paid each supplier in full, and took possession of the assets. Petitioner placed these assets in California stores which were being either constructed or remodeled, and functionally used the assets prior to making any sale/leaseback. Each asset allegedly became a fixture upon attachment to a building.

During this audit period, petitioner maintained communication with various leasing companies for the purpose of potential sale/leaseback transactions involving yet to be purchased assets for the store locations herein at issue plus many other locations. Petitioner obtained commitments from various leasing companies for the future sale/leaseback of as of yet unidentified assets to be purchased from suppliers and to be placed at undecided stores. Petitioner's representatives explained that petitioner was always shopping for the best deals with the leasing companies, and did not decide until the last minute which leasing company with which to actually make a sale/ leaseback transaction. The interim time period after petitioner's initial purchase of assets from the supplier until the sale/leaseback with the leasing company was typically more than three months, according to the auditor. Petitioner's representatives were not able to provide any satisfactory evidence on whether or not any sale/leaseback was consummated within 90 days of petitioner's first functional use of any asset. They indicated not knowing either date for any asset.

Petitioner paid use tax to the leasing companies measured by the lease receipts, and those leasing companies allegedly paid use tax to the Board. Several days before this conference, petitioner filed a claim for refund of those particular taxes.

The auditor established a use tax deficiency against petitioner measured by the purchase prices paid by it to the suppliers, and petitioner still has not paid this use tax. The audit did not allow petitioner any credit for the use tax it paid to the leasing companies measured by lease receipts, on the grounds that: the acquisition and sale exclusion in Revenue and Taxation Code Section 6010.65 was not applicable since petitioner had not paid tax on its prices paid to the suppliers for purchases, and because the 90-day test was not met in most cases; true leases were made; no mere financing transaction has been proven; and only the lessors could obtain any potential refund or credit.

In its petition for redetermination, petitioner contended that nothing is taxable because of the sale and leaseback transactions. At the conference, however, petitioner's representatives acknowledged that petitioner incurred use tax on the ex-tax purchase prices paid to the suppliers, but they requested credits for: (1) use tax which petitioner paid to the leasing companies measured by lease receipts; and (2) the alleged value for the attachment of the assets to the grocery store buildings (which petitioner also allegedly leased from the leasing companies).

Petitioner's representatives made various contentions in support of its positions: They argued that Revenue and Taxation Code section 6010.65 excludes the leaseback consideration from tax. After the conference, petitioner's representatives contended that the sale/leasebacks are mere financing transactions pursuant to Cedars-Sinai Medical Center v State Board of Equalization (1984) 162 Cal.App.3d 1182, and they submitted some incomplete copies for some transactions. It appears that as lessee, petitioner needed to pay a fair market value rate to the leasing companies at the end of the lease term if it desired to purchase a leased asset. They indicated that petitioner always needed to pay fair market value if it desired to purchase a leased asset at the end of the lease term. Petitioner contends that it has the right to a credit or refund, not the leasing companies. According to petitioner's representatives, petitioner has paid use tax on the original purchase price paid to suppliers merely because the Board has issued the Notice of Determination to petitioner for the unpaid use tax deficiency, and/or because petitioner has paid use tax measured by nontaxable lease receipts. The representatives believe that an "acquisition sale and leaseback" can result retroactively years after the consummation of a sale and leaseback if use tax is later paid or if use tax is the subject of a Board Notice of Determination measured by the original price paid to the supplier.

Analysis and Conclusions

Petitioner incurred use tax measured by the prices it paid to the suppliers to initially purchase, for cash, the assets in question (Revenue and Taxation Code sections 6201 and 6202). Can it obtain any offset against that unpaid liability?

Revenue and Taxation Code Section 6010.65 reads as follows:

> **"'Sale' and 'purchase'--acquisition sale and leaseback.** (a) 'Sale' and 'purchase,' for purposes of this part, do not include any transfer of title to, nor any lease of, tangible personal property pursuant to an acquisition sale and leaseback. An acquisition sale and leaseback is a sale by a person and leaseback to that person of tangible personal property where both of the following conditions are satisfied:
>
> (1) That person has paid sales tax reimbursement or use tax with respect to that person's purchase of the property.
>
> (2) The acquisition sale and leaseback is consummated within 90 days of that person's first functional use of the property.
>
> (b) 'Sale' and 'purchase' include, for purposes of this part, the transfer of title to a lessee upon termination of an acquisition sale and leaseback.
>
> (c) This section shall apply to acquisition sale and leaseback arrangements executed on or after the operative date of this section... (Emphasis added.)

Petitioner did not meet the provisions of section 6010.65 (effective January 1, 1991) --- --- --- --- In order to have an "acquisition sale and leaseback" so that only one tax is incurred regarding the consideration involved in the original purchase, the later sale, and the leaseback. Thus, petitioner's sales to the leasing companies were "sales" (but excluded from tax as sales for resale), and the leases back to petitioner were "sales" and "purchases" subject to use tax measured by the lease receipts (Regulation 1660 (c)).

The decision on whether or not a sale and leaseback is an "acquisition sale and leaseback" is made only at the time of the sale and leaseback. It is then either a "acquisition sale and leaseback" or it is not. Even the independent authors of the Sales and Use Taxes chapter in California Taxes, 2d edition, 1993, California Continuing Education of the Bar, Berkeley, recognized this timing requirement when they wrote that "[a]n acquisition sale and leaseback is a sale and leaseback to a person who pays sales tax reimbursement or use tax at the time of the original purchase, if the sale and leaseback occurs within 90 days of the first functional use of the property by that person" (pg. 233; emphasis added) .

Petitioner today still has not paid its use tax measured by the prices it paid to purchase these assets from the suppliers. No retroactivity is allowed.

Further, petitioner has not proven the 90-day rule, and the available evidence tends to show a lack of compliance.

We do not agree with petitioner's representatives that petitioner has met the spirit or intent of the Legislature regarding section 6010.65. First, the language speaks for itself. Secondly, in both the Assembly Revenue and Taxation Committee Republican analysis and the Assembly Committee on Revenue and Taxation analysis for AB 3382 regarding then proposed Revenue and Taxation Code section 6010.65 (submitted to us by petitioner), it is written that: (1) then current law resulted in both a use tax on the original purchase and another use tax on the lease if the property was used for any length of time before the sale/leaseback; and (2) under the proposed law, there would be a 90-day limit during which the sale and leaseback must occur.

Petitioner did not finance any of its purchases of assets made from suppliers. It paid cash to those suppliers and began using the assets in the stores. Those were permanent actions. Although petitioner intended to effectively finance its purchases, it waited too long for Sales And Use Tax Law purposes.

Then later in separate transactions, petitioner sold those assets to others and leased back the property. Petitioner has not submitted evidence sufficient to show that any sale/leaseback was merely a financing transaction. The available evidence tends to show that true leases ("sales" and "purchases") occurred, especially since petitioner had the option to pay a fair market value price to the leasing companies to repurchase the assets at the end of the lease terms (see Regulation 1660 (a) (3)). Most importantly as to this petition for redetermination, petitioner would still owe use tax measured by the cost paid to the suppliers on its original purchases even if a later sale/leaseback transaction was deemed to have been a financing transaction. Petitioner would then merely have obtained a loan by using its assets as security. Petitioner would not have made any financing purchase from a supplier as its representatives allege. Lastly, the forum for final decision on the sale/leaseback financing transaction issue would be in a separate proceeding on a timely-filed claim for refund or credit regarding the taxes allegedly paid to the Board by the lessors measured by the lease receipts. First, it would need to be proven that the Board received those taxes, and that timely claims were filed. Then, each sale/leaseback would need to be judged

on the particular factors involved in each specific case. The same is true for any issue relating to the measure of use tax on the lease receipts, including the attachment value contention.

Recommendation

Redetermine without adjustment.

Stephen A. Ryan, Senior Staff Counsel

Date