



STATE BOARD OF EQUALIZATION

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June 11, 1993

BURTON W. OLIVER
Executive Director

Mr. R--- J--- H---
S---, M---, R--- & H---
--- Floor, XXX South --- Street
--- ---, CA XXXXX

Dear Mr. H---:

This is in reply to your April 15, 1993 letter regarding the application of sales and use tax to a proposed equipment leasing transaction under the following facts you provided:

- "(a) Lessee acquired the equipment in May and June, 1992. Lessee paid the full price of the equipment at that time, including reimbursement for sales taxes.
- "(b) Lessee installed the equipment in September, 1992, and its first functional use occurred at the end of September.
- "(c) By a letter agreement dated December 16, 1992, (hereinafter referred to as the 'Commitment Letter'), Lessee and Company X agreed to enter into an equipment lease financing. A true copy of the Commitment Letter, with identifying information removed, is attached hereto as Exhibit A.
- "(d) Lessee and Company X always contemplated that Company X might assign its rights under the Commitment Letter to another equipment financing company.
- "(e) Company X approached Lessor in January, 1993, at which time Lessor and Lessee attempted to finalize the transaction specified in the Commitment Letter.
- "(f) It is now proposed that Company X will assign its rights under the

Commitment Letter to Lessor, and Lessor and Lessee will enter into a Master Lease substantially in the form of Exhibit B attached hereto (hereinafter referred to as the 'Master Lease').

- "(g) Pursuant to the Master Lease, Lessor will lease the Equipment to Lessee.
- "(h) Title to the Equipment will remain in the Lessor at all times during the Lease.
- "(i) For financial statement purposes, the Lessee will treat the transaction as an 'off balance sheet' transaction; that is, Lessee will not depreciate the equipment.
- "(j) The sum of Lessee's lease payment to Lessor under the Master Lease exceeds Lessor's equipment cost.
- "(k) Lessee bears the risk of any loss or damage to the Equipment, and is required to obtain and carry, at Lessee's expense, casualty and public liability insurance with respect to the Equipment.
- "(l) Lessee will indemnify and hold harmless the Lessor with respect to taxes.
- "(m) If the Board of Equalization determines that the transaction is a financing transaction rather than a true sale and leaseback, then Lessor and Lessee intend that the Master Lease will not be a lease for income and sales tax purposes and will so treat it. The parties intend that the Lessor will be treated for tax purposes as having made a loan to Lessee and that the security for such loan is the Equipment.
- "(n) The Lessor's Equipment cost is \$4,540,907, and such amount is a reasonable estimate of the current fair market value of the Equipment.
- "(o) The Term of the Master Lease will be 5 years, unless terminated earlier pursuant to Lessee's exercise of its option as described below.
- "(p) So long as no Event of Default has occurred, upon 30 days' notice, after 36 months following commencement of the lease term, the Lessee may terminate the Master Lease and purchase all of the Equipment by paying to the Lessor the Termination Option Price.
- "(q) The Termination Option Price will equal a fixed percentage of the Equipment cost (less any applicable taxes), which percentage is based on

the discounted present value of remaining payments.

- "(r) The fair market value of the Equipment at the end of the Term is reasonably anticipated to be 12-13% of the equipment cost or greater.
- "(s) At the end of the Term, if the Master Lease has not previously been terminated, Lessee must irrevocably elect one of the following two options: (1) Lessee may purchase the equipment on the terms explained below, or (2) Lessee may return the Equipment to Lessor on the terms explained below.
- "(t) Lessee has an option to purchase the Equipment from Lessor at the end of the Term at a purchase price equal to its fair market sale value but not greater than 20% nor less than 15% of original cost.
- "(u) In the alternative, Lessee may return the Equipment upon payment of a Return Fee of \$454,090.
- "(v) The amount that would be attributable to interest, had the contemplated transaction been structured as a loan with a security agreement, is not usurious under California law."

Given this information, you asked:

- "(a) Whether the transaction constitutes a qualified acquisition sale and leaseback pursuant to Section 6010.65 of the California Revenue and Taxation Code (hereinafter 'R&T Code')."

We do not believe the transaction you described qualifies for exclusion from "sale" and "purchase" under Revenue and Taxation Code section 6010.65, because that section requires, inter alia, that an acquisition sale and leaseback be consummated within 90 days of the purchaser's first functional use of the property. Under the facts you described, the purchaser made its first functional use of the property in September, 1992, and had not consummated the sale and leaseback by January, 1993. We do not view the Commitment Letter which outlines the basic terms and conditions of the lease to be a "consummation of the lease."

- "(b) Whether the transaction should be considered a financing transaction rather than a true sale and leaseback, such that sales and use taxes would not be applicable to the transaction."

In this regard, you believe that the transaction may be viewed as a financing transaction based on the court's holding in the case, Cedars-Sinai Medical Center v. State Board of

Equalization (1984) 162 Cal.App.3d 1182. The State Board of Equalization's interpretation of the court's holding in the Cedars Sinai case is provided at subdivision (a)(3)(B) of Sales and Use Tax Regulation 1660, Leases of Tangible Personal Property-In General:

"Special application. Transactions structured as sales and leasebacks will also be treated as financing transactions if all of the following requirements are met:

"1. The initial purchase price of the property has not been completely paid by the seller-lessee to the equipment vendor.

"2. The seller-lessee assigns to the purchaser-lessor all of its right, title and interest in the purchase order and invoice with the equipment vendor.

"3. The purchaser-lessor pays the balance or the original purchase obligation to the equipment vendor on behalf of the seller-lessee.

"4. The purchaser-lessor does not claim any deduction, credit or exemption with respect to the property for federal or state income tax purposes.

"5. The amount which would be attributable to interest, had the transaction been structured originally as a financing agreement, is not usurious under California law.

"6. The seller-lessee has an option to purchase the property at the end of the lease term, and the option price is fair market value or less."

Since, under the facts you provide, lessee had paid the full price of the equipment, and lessor would not pay the balance of the original purchase obligation to the vendor on behalf of the lessee, the transaction does not qualify as a financing transaction under subdivision (a)(3)(B).

As you noted, given that the transaction would not be regarded as a sale at inception under paragraph (a)(2) of Regulation 1660, the transaction does not qualify as a financing transaction under subdivision (a)(3)(A) of the regulation.

We hope this answers your questions; however, if you need further information, feel free to write again.

Very truly yours,

Ronald L. Dick
Senior Tax Counsel

RLD:sr