

**STATE BOARD OF EQUALIZATION**

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May 7, 1996

Mr. D--- M. D---
A--- S--- T--- C--- Incorporated
XXXX --- Road, Suite XXX
---, CA XXXXX

Re: *Unidentified Taxpayer*

Dear Mr. D---:

This is in response to your letter dated February 22, 1996 regarding the application of tax to leases of mobile transportation equipment (MTE).

I note that the only basis for the Board to relieve a person of otherwise properly due taxes is pursuant to the provisions of Revenue and Taxation Code section 6596. To come within the provisions of that section, the taxpayer must have reasonably relied on the Board's written advice which was in response to a written request for advice that disclosed all relevant facts, including the identity of the taxpayer. Since your client is not identified, this opinion does not come within the provisions of section 6596.

You state:

“Taxpayer corporation is a seller and lessor of MTE. The corporation buys MTE without paying or reporting tax on its initial cost, choosing instead to report use tax measured by fair rental value when it enters into leases.

“In 1990 the taxpayer leased a unit to a California lessee for a five year term. Use tax was properly reported on fair rental value throughout the term of the lease. In 1995, at the end of the lease, the lessee returned the unit to the taxpayer. Three months later, the taxpayer leased the same equipment to a different lessee under a new contract. The taxpayer delivered the equipment to the new lessee’s out-of-state headquarters. Thereafter, the equipment was used outside California and did not enter the state at any time.

“QUESTIONS

- “1. Must the taxpayer report use tax measured by fair rental value throughout the second (out-of-state) lease?
- “2. If so, does the taxpayer have the option to report use tax measured by cost at the inception of the second lease? Would an offset be allowed for the use tax measured by rental receipts which was paid throughout the term of the first lease?
- “3. Assume now that the unit is used outside the state by the second lessee for six months and then brought into California. Will the unit’s reentry into California be considered a taxable event, and, if so, how will the tax apply?”

DISCUSSION

As you know, a lease of MTE is excluded from the definition of "sale" and "purchase" for purposes of the Sales and Use Tax Law. (Rev. & Tax. Code §§ 6006(g)(4), 6010(e)(4).) The sale of MTE to a person who will lease it is the retail sale; therefore, the sale to the lessor, or the use by the lessor (by leasing), is subject to sales or use tax. (Rev. & Tax. Code §§ 6051, 6201.) The lessor is the consumer of the MTE it leases.

With respect to the MTE that is leased, if the use of the MTE will be limited to leasing and the lessor makes a timely election to do so, the lessor may pay its tax liability measured by the fair rental value of the MTE, meaning the amount of rentals required by the lease, if the election is made on or before the due date of a return for the period in which the equipment is first leased. (Reg. 1661(b)(2).) Of course, if the lessor has already paid tax or tax reimbursement measured by the purchase price, the election to pay tax on fair rental value is not available.

I note that some agreements characterized by the parties as leases are actually sales. However, in the situation about which you inquire, since the first lessee returned the unit to the taxpayer, we assume that the lease was a true lease, and was not a sale at inception. (See Reg. 1660(a)(2)(A).) When the lessor elects to pay tax measured by fair rental value, the election is irrevocable and the lessor must continue to report tax on that basis whether the MTE is inside or outside of California. (Rev. & Tax. Code §§ 6094(d), 6244(d).)

Thus, the answer to your first question is “yes,” because once a lessor has made a timely election to pay tax on fair rental value, tax must be paid on that basis without regard to where the MTE is. In answer to your second question, since the taxpayer does not have the option to pay use tax measured by purchase price at the beginning of the second lease, no offset is applicable. In answer to your third question, the taxable event took place at the time of the original sale to or

use by the lessor and the tax fully accrued at the time of that sale or use, and not upon reentry of the MTE into California. Since the lessor elected to spread out the payments on its liability and pay tax on fair rental value rather than on purchase price, the lessor must continue to pay tax on fair rental value regardless of the location of the MTE.

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

Sincerely,

Kelly W. Ching
Staff Counsel

KWC:cl

cc: Ms. Cathy McKowen
--- District Administrator