



STATE BOARD OF EQUALIZATION

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May 6, 1993

Mr. G--- L. T---
C---, Inc.
XXXX --- Avenue, Suite XX
---, -- XXXXX

Re: Interstate Commerce Exemption and Repairs of MTE

Dear Mr. T---:

This is in response to your letter dated April 6, 1993, in which you inquire about the interstate commerce exemption and the application of tax to repairs of mobile transportation equipment. Before we discuss these issues, the following is a summary of the application of sales and use tax to sales and purchases of tangible personal property and of mobile transportation equipment.

A. Sales and Use Tax - Generally

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property occurring in California. The sales tax is imposed upon the retailer, but the retailer may collect sales tax reimbursement (usually itemized on the invoice as "sales tax") from the purchaser if the contract of sale so provides. Civ. Code § 1656.1.

Revenue and Taxation Code section 6201 imposes an excise tax, commonly referred to as the use tax, on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for storage, use, or other consumption in this state. The use tax complements the sales tax and is most frequently imposed upon in-state leases, out-of-state purchases of property for use in California, and use of property purchased with a resale certificate.

Sales or use tax does not apply to a transaction which is exempt by statute or under the provisions of the United States Constitution.

B. Motor Transportation Equipment

The application of tax to sales and leases of mobile transportation equipment (MTE) is different from other tangible personal property. The regulation which governs leases of MTE is Regulation 1661. Regulation 1660, which applies to leases of other tangible personal property, does not apply.

A lease of MTE is never a sale and purchase. Rev. & Tax. Code § 6006(g)(4) and 6010(e)(4). Thus, a sale of MTE which the purchaser subsequently leases is not a sale for resale. Under the Revenue and Taxation Code, however, a purchaser of MTE who limits his or her use of the MTE to leasing may issue a resale certificate when purchasing the MTE and make an election to pay use tax measured by the fair rental value of the MTE. The election is made by reporting tax measured by the fair rental value on a timely filed return for the period in which the MTE is first leased. Tax must thereafter be paid with the return for each reporting period, measured by the fair rental value, whether the MTE is within or without the state. The election may not be revoked with respect to the MTE as to which it is made. Rev. & Tax. Code §§ 6092.1, 6094(d), 6243.1, and 6244(d).

C. Interstate Commerce Exemption

With respect to this exemption you state:

"Currently, our client leases eighty truck-tankers that run interstate commerce through California. The trucks fall under the definition of 'mobile transportation equipment' found in Section 6023. Moreover, for registration purposes, all of the trucks are based in California, but are domiciled in another state. It should also be noted that the lease is not an arm-length transaction. The tankers are only used for two reasons: (1) to supply fuel to gas stations located in and outside California; and (2) pick up gas and oil, both inside and outside California. A majority of the trucks receive or deliver in California; therefore, the majority of the trucks are engaged in interstate commerce. However, there is a small majority which, on occasion, receive and deliver orders in California.

"We understand that the only way this type of commerce may be considered interstate is when they receive an order, inside California, and deliver supplies while traveling to another state. For example, it may be considered interstate commerce if a truck received an order in San Francisco, and while traveling to Nevada, dropped off an order in Sacramento without receiving more commerce. Overall, a majority of the trucks are engaged in interstate commerce and a small majority, on occasion, are occupied in intrastate transportation.

"After reading Regulation 1661(f) of the Business Taxes Law Guide we assume that the leased mobile property, which runs interstate commerce, is exempt from sales and use tax. Below is a list of conditions which lead us to believe that our client's trucks would be considered exempt. These conditions are: (1) the lease is held inside the state of Utah; (2) delivery and sale of the interstate vehicles took place outside the state of California; (3) the vehicles were first used in taking commerce into the state of California; and (4) the majority of the trucks have been used exclusively in interstate commerce. It is our understanding that when these qualifications are met, the interstate vehicle is exempt from sales and use tax, regardless if the vehicle is sold or leased.

Regulation 1620(b)(2)(B) reads:

"Use tax does not apply to property purchased for use and used in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce both within and without California and not exclusively in California."

The requirements for exemption from use tax on property purchased for use in interstate commerce are:

1. The property must be first functionally used in interstate commerce outside of California. "Functional use" with respect to vehicles is defined in Sales and Use Tax Annotation 570.0430 as "use for which the vehicle was designed." If the only use of a truck outside of California were to drive it empty into California to pick up any payload it could find, the first functional use would be in California, not outside of California.
2. The property must be used in interstate commerce when it enters California. Anno. 570.0430. A vehicle is regarded as functionally used in interstate commerce if it is dispatched empty to California to pick up a specific payload, not just any payload.
3. After entry into California, the property must be continuously used in interstate commerce both within and without California and not exclusively in California. Anno. 570.0430. The Board uses a test period of six months after the vehicle enters California to determine if it is continuously used in interstate commerce.

Annotation 570.0430 further provides:

". . . A vehicle is used in interstate commerce so long as any part of its cargo is interstate in nature, even though part of the cargo on a given trip may be intrastate in nature. A vehicle may be engaged in interstate commerce while operating entirely within the state if any part of its cargo has an origin in one state and a

destination in another. A vehicle is regarded as used in intrastate commerce if the origin and final destination of its entire cargo is within California."

We would agree that the use in California of the leased MTE is exempt from use tax where the three requirements set forth above are met. However, if during the six month test period any leased MTE is used in an intrastate operation, the interstate commerce exemption does not apply to that particular equipment. If this exemption does not apply because of an intrastate operation, the use will still not be subject to tax if the MTE is first functionally used outside of California before entering the state and the MTE is used or stored outside of California one-half or more of the time during the six month period immediately following its first entry into this state. (The out-of-state principal use exclusion.) Regulation 1620(b)(3).

If the interstate commerce exemption and out-of-state principal use exclusion do not apply, the use of the MTE in California is subject to tax. Use tax is measured by the sales price of the MTE to the lessor. But as noted above, the lessor can elect to pay use tax measured by the fair rental value of the MTE. A problem arises, however, if the lessor wants to pay tax on fair rental value if the use is taxable. The lessor does not know for sure until six months have passed after the MTE first enters the state if the use of the MTE will meet the interstate commerce exemption or the out-of-state principal use exclusion. The election to measure tax by fair rental value must be made on a timely filed return for the period in which the property is first leased. If the lessor wishes to preserve its election to pay use tax on the fair rental value of the MTE in the event the use in California is subject to tax, the lessor should file a timely return for the period in which the MTE first enters the state and, following six months after the MTE enters the state, file a claim for refund if the interstate commerce exemption or out-of-state principal use exclusion applies.

Fair rental value means the rentals required by the lease except where the Board determines the rental receipts are nominal. Regulation 1661(e)(2)(A). The Board may scrutinize a lease which was not entered into in an arms-length transaction to determine if the rentals are nominal. Rentals include amounts paid by the lessee under a mandatory maintenance agreement.

D. Repairs

With respect to this issue you state:

"Frequently the trucks need repair inside California. It is strictly maintained in our clients lease agreement that the lessor is responsible for all repairs and maintenance. As a result the lessor adds an additional amount to the lease which compensates her for the repairs and maintenance. For example, if the lease for the truck is \$1,500 per month, the lessor will add \$300 to the base rental, in order to cover the repairs and maintenance. Therefore, both the lease and the repairs and maintenance are combined to make the total lease \$1,800.

"Under normal circumstances we believe our client would be able to purchase the repair and maintenance exempt from tax under Regulation 1660. However, pursuant to Sections 6006 and 6010 the lessor is considered the user of the leased mobile transportation equipment; therefore, Regulation 1660 does not apply. Our client is fairly concerned about this matter. Currently, our client spends two million dollars on repair and maintenance, and at this point in time we suggested that she repair her trucks in another state where she would save substantial dollars. However, it is convenient for our client to repair her trucks in California, since that is the state most visited by the leased trucks. . . ."

The interstate commerce exemption we discussed above applies to use tax, not sales tax. There is an interstate shipment exemption for sales tax that applies to sales that occur in California where the retailer is required by contract to ship and, in fact, does ship the property out-of-state by its own transportation facilities or by mail or common carrier. Rev. & Tax. Code § 6396. If the purchaser or its agent (or in the case of leased MTE, the purchaser's lessee) takes delivery of the purchased property in California, neither the interstate shipment exemption (sales tax) nor the interstate commerce exemption (use tax) applies.

With respect to the facts you gave, if the transfer of the parts furnished in connection with the repairs is a sale under the repair rules set forth in Regulation 1546(b), the sale of such parts are not exempt under the interstate shipment exemption since the parts are delivered to the lessor of the MTE in California when they are installed on the MTE. Nor can the interstate commerce exemption apply since this is a sales tax transaction, not a use tax transaction. This is true even if the lessor's use of the MTE in California is not subject to tax because of the interstate commerce exemption or the out-of-state principal use exclusion.

Under the repair rules, if the retail value of the parts furnished in connection with repair work is more than 10 percent of the total charge or if the repairer makes a separate charge for such parts, the repairer is the retailer of the parts, and tax applies to the fair retail selling price of the parts. Although the tax is imposed upon the repairer, generally the repairer by contract will collect sales tax reimbursement from the customer. If the retail value of the parts is 10 percent or less of the total charge, the repairer is the consumer of the parts. This means that the sale of the parts to the repairer is taxable or, if the repairer gave a resale certificate, the repairer must pay use tax on the parts measured by his or her purchase price. Regulation 1546.

Assuming the repairer is the retailer of the parts furnished in connection with a repair, the tax consequences may be summarized as follows:

1. If, for whatever reason, the lessor of the MTE is not paying tax on fair rental of the MTE, the repairer has made a taxable retail sale to the lessor. The lessor may not issue an exemption certificate or resale certificate, and by contract the repairer may charge sales tax reimbursement on the fair retail selling price of the parts.

2. If a lessor of the MTE is paying tax on the fair rental value of the MTE, the lessor may issue a resale certificate whenever it purchases parts which will become a part of the MTE. Therefore, the lessor may issue a repairer a resale certificate.

Revenue and Taxation Code section 6596 provides the only basis for relief from tax if a taxpayer relies on incorrect written advice from the board. The primary conditions to qualify are that the request for opinion must be in writing and must disclose all relevant facts, including the identity of the taxpayer. Since you have not identified your client, this opinion does not come within the provisions of section 6596 but rather is simply general advice regarding a set of hypothetical facts.

If you have further questions regarding Sales and Use Tax Law, please do not hesitate to write again.

Sincerely,

Elizabeth Abreu
Tax Counsel

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bc: --- District Administrator