

**STATE BOARD OF EQUALIZATION**

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May 19, 1992

Mr. T--- J. W---
[X] Corporation
West Coast Tax Operations
XXXX E. --- Street
Suite XXX
--- ---, CA XXXXX

Re: Local Use Tax Allocation for Lease Payments

Dear Mr. W---:

Assistant Chief Counsel Gary J. Jugum has asked me to respond to your letter to him of March 6, 1992. You are questioning the instructions that you received from Mr. Clay Cowan of our Local Tax Unit regarding allocation of the Bradley-Burns component of the payments which [X] receives from its equipment lessees to the place of use of the equipment.

Our Local Tax Unit has informed you that [X] should be allocating the local tax component of the use tax which it collects with certain of its equipment leases to the place of use of rather than to the place where [X] purchased the equipment as it is doing now. You have, for reasons which offer a pleasing field for speculation, taken issue with that instruction. On July 2, 1991, you wrote to Board Member Ernest J. Dronenburg, Jr., requesting clarification of this issue. Mr. Dronenburg asked the Local Tax Unit to investigate, and on February 6, 1992, Local Tax Audit Supervisor Clay Cowan wrote you re-iterating that [X] was incorrectly allocating the local tax to the place where the vendor sold the equipment to [X]. You then wrote Mr. Jugum again questioning the instruction and indicating you would not alter the allocation method unless we supplied you statutory or regulatory support. You attached copies of your letters to Messrs. Dronenburg and Cowan to your letter to Mr. Jugum.

I. FACTUAL BACKGROUND

In your letter to Mr. Dronenburg, you described the leasing operations in question in part as follows:

"... The confusion we have involves the local sales tax distribution from leasing transactions under our term-lease (lease-purchase) agreements and regular lease agreements.

"The majority of our leases are term-lease agreements. Term lease allows a customer to select a 2, 3, 4 or 5 year non-cancelable contract inclusive of [X] service and a purchase option. At the conclusion of the initial term, the customer has three options. The customer may exercise his purchase option at which time title to the property is transferred to the customer. Or the customer may return the equipment to [X] and the agreement is terminated. The last option is that the customer may renew the agreement for one additional year at the same terms and conditions and at the end of that year, the equipment must be returned to [X]. The option-to-purchase is generally 10% of the original purchase price, which exceed \$100. Customers are billed monthly and sales tax is billed on the entire amount invoiced, although maintenance charges may appear as a separate line item on the invoice.

"Under our regular lease contracts, equipment may be leased initially for 90 days, then renewed automatically from month to month and cancelable with 30 days notice. One and two year lease plans offering considerable lower monthly payments are available with liquidation charges for early cancellation. Maintenance is included in the monthly lease payment. A partial rental credit is allowed up to a specified number of months (generally ranging from 12 to 24 months, depending on the equipment model)."

II. OPINION

A. Collection of Use Tax on Rental Payments Generally

The lease (or rental) of tangible personal property in California is a continuing sale unless that property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property. (Rev. & Tax. Code § 6006(g)(5), Reg. 1660.) If the lease is a continuing sale under this definition, that lease is subject to use tax measured by rentals payable unless it is specifically exempted by statute. (Reg. 1660(c)(1).)

B. Allocation of Bradley-Burns Use Tax

Because Section 6009 ties taxable uses to the ownership of the property, the possession of tangible personal property by a lessee is considered to be a continuing purchase of the property for use in this state. (Reg. 1660(b)(2). Sales and Use Tax Regulations are Board promulgations which have the force and effect of law.) The applicable tax is thus a use tax measured by the rental payments upon the use of the leased property in California. The lessor collects the tax in addition to the rental payments. (Reg. 1660(c)(1).) Where a lease is a

continuing purchase for the purpose of the state use tax, it shall be a continuing purchase for the purpose of local tax. (Reg. 1803(d).)

Regulation 1803 prescribes the lessor's duty to collect local use tax, in part, as follows:

(b) USE TAX. State administered local use tax applies if the purchase is made from a retailer on or after the effective date of the local taxing ordinance and the property is purchased for use in a jurisdiction having a state-administered local tax and is actually used there, provided any one of the following conditions exist:

* * * *

(3) The place of sale is in a jurisdiction having a state-administered local tax and there is an exemption of the sale of the property from the sales tax but there is no exemption of the use of the property from the use tax;

(4) The property is purchased under a valid resale certificate.

* * * *

(c) COLLECTION OF USE TAX BY RETAILERS. Retailers engaged in business in this state and making sales of tangible personal property, the storage, use or other consumption of which is subject to a state-administered local use tax, are required to collect the tax from the purchaser. It is immaterial that the retailer might not be engaged in business in the particular county or city in which the purchaser uses the property.

* * * *

C. Tax Consequences to [X]

Your letter to Mr. Dronenburg demonstrates that [X] has elected to treat its leases of equipment as continuing sales and purchases under Section 6006(g)(5). It must then abide by the consequences of that election.

Under Regulation 1803(b) the local use tax being collected is that of the jurisdiction having a state-administered local tax where the property is "actually used." Under Regulation 1803(c), it is immaterial that the lessor may not be engaged in business in the particular jurisdiction where the lessee uses the property. It is thus clear that, with certain exceptions discussed in Mr. Cowan's letter, [X] must collect the use tax of the jurisdiction where the property is located. As Mr. Cowan pointed out in his letter, the leases in question are generally for a long term, at a fixed location, and for a material amount. [X] is already maintaining in its records all the information that it needs to properly allocate the local use tax. There appears to be no reason why the tax is being misallocated. The local tax should be

allocated to the county of use, for distribution by the Board as part of the countywide unallocated pool.

Therefore, we conclude that [X]' current system of allocating local use tax to its place of business is contrary to statutory and regulatory authority. [X] must allocate local use tax to the county where the property is being used. I am by copy of this letter informing the Local Tax Unit of this result and suggesting that they reallocate the tax to the proper county under the terms of Section 7209.

In your letter you indicate that [X] is relying upon a statement in Tax Tip Pamphlet No. 46, "Leasing of Tangible Personal Property in California," for authority for its current allocation. A tax tip pamphlet is a guide only and is not authority. However, it is our opinion that the pamphlet sets forth the correct rule where the place of use cannot be identified. However, where, as here, the lessor has a long-term lease of a fixed item, the lessor can identify the county of use. In the latter case, the rules set forth above apply.

For your information, I have enclosed a copy of Regulation 1803. I hope the above discussion has answered your question. If you need anything further, please do not hesitate to write again.

Sincerely,

John L. Waid
Tax Counsel

JLW:es

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Enc.: Regulation 1803

cc: Honorable Ernest J. Dronenburg, Jr.