

Oakland - Compliance (HLT)

March 31, 1970

Tax Counsel (JHM)

We have reviewed the material sent with your memo of March 13, 1970.

The question raised by "W" is the effect of the BART transactions and use tax on leases which that company entered into prior to April 1, 1970. "W" enters into two types of leases, one of which they call a "finance" lease and the other a "straight" lease.

With respect to the "finance" leases entered into and prior to April 1, 1970, we understand that the lessee is obligated to pay rent for a minimum of six months. Paragraph 6 of the lease provides that the lease shall terminate (a) upon expiration of the term of the lease, (b) following a default by the lessee upon lessor's election, and (c) in addition, at any time after six monthly lease payments have been made, the lessee may terminate if he has fully performed the lease, given the lessor 30 days' written notice, the vehicle is surrendered in good condition and any "rental adjustments" are paid.

Paragraph 7 of the lease provides that upon expiration of the lease and surrender of the vehicle the lessor will offer the vehicle for sale to not less than three licensed wholesalers. If the net proceeds of the sale plus accumulated depreciation reserve exceed the original value of the vehicle, the lessor will pay such excess to the lessee. If the original value exceeds the net proceeds of sale plus the accumulated depreciation reserve, the lessee will pay such excess to the lessor.

Paragraph 11 provides, in part, that the lessee shall pay "all taxes now or hereafter assessed of every kind or nature by whomsoever payable on or relating to the vehicle and the ownership, leasing, purchase, sale, use, and operation thereof. Any of these amounts paid for by the lessor shall be repaid by the lessee upon demand."

The BART ordinance contains a provision to the effect that the possession of tangible personal property under a lease which is a continuing purchase is exempt from tax for any period of time for which the lessee is obligated to lease the property for an amount fixed by a lease prior to the operative date of the ordinance. A similar provision is required for transactions tax purposes under Section 7261 if the lessor is obligated to lease the property for an amount fixed by the lease prior to the operative date of the ordinance. Property shall not be deemed obligated pursuant to a lease for any period of time for which any party to the lease has the unconditional right to terminate.

Questions which are posed by the "W" lease are:

First, is the lease one under which the lessee is obligated to lease the property for an amount fixed by the lease? This raises the question of what is the effect of section 11 which provides that the lessee shall pay all taxes now existing or hereafter assessed.

March 31, 1970

Under the partial exemption given to certain construction contractors (Section 6376), we held that a fixed price contract did not include a contract calling for a price "plus all applicable sales and use taxes." Similarly, in Bulletin 67-12 it was stated that "fixed price...means a price which a contractor may not increase by reason of an increase in the sales and use tax rate." If this line of reasoning is followed, it would appear that under section 11 the "W" finance lease agreement is not a contract for a "fixed price".

Parallel construction of the first sentence and the second sentence of Section 7262 would require a similar construction of "an amount fixed".

Second, another question that arises is whether under paragraph 6 of the lease, the lessee has "an unconditional right to terminate". Upon termination of the lease by lapse of time or upon notice by the lessee a "rental adjustment" under paragraph 7 is to be made. As indicated above, the rental adjustment may involve a payment by the lessee to the lessor or by the lessor to the lessee. Since this adjustment is to be made regardless of whether the lease runs its full term or is earlier terminated by the lessee, it seems to me that this is not "condition" within the meaning of Sections 7261 and 7262.

For the foregoing reasons, I think the "W" finance leases do not fall within the grandfather clause.

The second type of lease agreement used by "W" is for a straight 24-month period. It may be terminated by the lessor upon default of the lessee, but the lessee is not given the right to terminate. Paragraph 7 of the terms and conditions of the straight lease is the same as paragraph 11 of the finance lease to the extent that it provides that the lessee shall pay "all taxes of every kind and by whomsoever payable (other than federal and state income taxes) on or relating to said vehicle and the ownership, leasing, purchase, sale, use, or operation thereof."

In view of the position taken above with respect to paragraph 11 of the finance lease, it is my opinion that the BART tax applies to the "W" straight leases.

Attached to the "W" letter of March 10 is a "sales tax exemption certificate". This certificate would indicate that the BART tax does not apply (1) if the vehicle is garaged outside the BART district or (2) if it will be used only occasionally or incidentally in that district.

The BART use tax applies for any period of time that the leased vehicle is physically in the district in the possession of the lessee. Thus, it would appear that the tax should be apportioned based upon the percentage of time the vehicle is within and without the district. However, any minimal or incidental use of the vehicle in the district may be ignored. Accordingly, the exemption certificate as framed is not acceptable.

JHM:ab [1b]