

**M e m o r a n d u m****235.0115**

To: Glenn Bystrom  
Principal Tax Auditor

Date: June 22, 1992

From: Elizabeth Abreu  
Tax Counsel

(916) 324-8208  
ATSS 454-8208

Subject: Application of Federal Retail Excise (Luxury) Tax to Car Leases

This is in response to your memorandum dated May 15, 1992, regarding the application of the federal luxury tax to automobile leases

Section 4001(a) of the Internal Revenue Code (26 U.S.C.) imposes on the first retail sale of a passenger vehicle an excise tax, known as the luxury tax, equal to 10 percent of the price for which the vehicle is sold to the extent such price exceeds \$30,000. I.R.C. § 4001(a) defines "first retail sale" as the first sale, for a purpose other than resale, after manufacture, production, or importation.

Under I.R.C. § 4001(c) a retail sale includes a lease, including any renewal or any extension of a lease or any subsequent lease of a vehicle. The sale of a passenger vehicle to a person engaged in a leasing or rental trade or business of vehicles of leasing by such person in a qualified lease (a lease for a term of one year or longer) shall not be treated as the first retail sale of the vehicle. I.R.C. § 4001(c)(2)(A).

If a lease of a taxable vehicle is treated as the first retail sale of the vehicle, the luxury tax is imposed on the lease of the vehicle and is paid by the lessor. Prop. Treas. Reg. §48.4011-3(b). The total tax imposed is equal to the amount of the luxury tax that would have been imposed it, at the beginning of the lease term, the lessor had sold the vehicle for the "lease price," which is the lowest price for which the vehicle is sold by retailers in the ordinary course of trade. Prop. Treas. Reg. §48.4011-6(a)(6) and (7).

With respect to a qualified lease of a vehicle, unless an election is made, the tax is imposed on each lease payment due under the lease during the initial term of the lease and is equal to the total tax imposed multiplied by the percentage obtained by dividing the amount of the lease payment by the aggregate amount of payments due under the lease during the initial term of the lease. In other words, if a rental payment represents one-sixtieth of the total rental payments due, the tax on that rental payment is one-sixtieth of the total tax due. Prop. Treas. Reg. §48.4011-6(a)(2).

If a qualified lease of a taxable vehicle is canceled, or the vehicle is sold or otherwise disposed of, before the total tax imposed on the qualified lease is paid, the balance of the tax is imposed on the date of the cancellation, sale, or disposition. The balance of the tax is the difference between the tax imposed on prior payments received under the lease and the total tax imposed on the lease. Prop. Treas. Reg. §48-4011-6(a)(5).

A lessor of a qualified lease may elect to pay the total tax imposed on the lease at the beginning of the lease term. If the lessor makes this election, the total tax is imposed at the inception of the lease. The election may be made for any lease and once made is irrevocable with respect to that lease. Prop. Treas. Reg. §48-4011-6(a)(4).

The definitions of "gross receipts" and "sales price" exclude the amount of any tax (excepting certain manufacturers' or importers' excise taxes) imposed by the United States upon or with respect to retail sales whether imposed upon the retailer or consumer. Rev. & Tax. Code §§ 6012(c)(4) and 6011(c)(4). Regulation 1617 provides that gross receipts subject to sales tax and the sales price subject to use tax do not include the amount of any federal tax imposed upon or with respect to retail sales whether imposed upon the retailer or upon the consumer and regardless of whether the amount of federal tax is stated to the consumer as a separate charge.

We have concluded in several letters that where the luxury tax is imposed on rental payments, the amount of the luxury tax on each rental payment is excludable from the measure of tax whether the luxury tax is separately stated or included in the rental payments set forth in the lease. We have also concluded that if the lessor elects to pay the luxury tax up front and the lessee reimburses the lessor for the tax at the beginning of the lease, the reimbursement is not included in the measure of tax.

We have not, however, addressed in writing the issue of the measure of tax where the lessor elects to pay the luxury tax up front but does not require reimbursement for the entire tax from the lessor at the beginning of the lease. Nor have we issued a written opinion concerning daily and short term rentals and leases.

Revenue and Taxation Code section 6012(c)(4)(A) excludes taxes imposed by the United States upon or with respect to retail sales. The luxury tax is a tax on retail sales which include leases. When a lessor of a qualifying lease elects to pay the luxury tax up front, he or she is paying a federal excise tax on the lease which is a retail sale. Thus, that tax on the lease is a tax imposed by the United States upon or with respect to a retail sale, and it should be excludable from the gross receipts. Assuming that the lease is a continuing sale and purchase, the amount excluded is a portion of each rental payment which, if the rental payments are equal, is calculated by dividing the total amount of the luxury tax by the number of rental payments due under the initial term of the lease.

Neither the Internal Revenue Code nor the proposed Treasury Regulations clearly state how luxury tax applies where a lessor uses the vehicle for daily and short term rentals. The background statement, however, for the proposed regulations contains the following:

“Nonqualified leases (such as short-term rentals) are generally taxed in one of two ways. If the article is purchased by the lessor for leasing in a nonqualified lease, then the luxury tax is paid by the person who sells the vehicle to the lessor. If the article is sold to the lessor for resale or for lease in a qualified lease, but the first lease of the article is a nonqualified lease, then the total luxury tax is paid by the lessor at the beginning of the lease term.”

Thus, where the lessor does not lease the vehicle under a qualifying lease, the first retail sale is the sale of the vehicle to the lessor and the luxury tax is imposed on that sale, not on the lease. It is our opinion that where the luxury tax is not imposed on the transaction subject to sales or use tax, the luxury tax cannot be passed through to that subsequent taxable transaction and excluded from the gross receipts of that transaction. Therefore, no amount of the rentals on daily or short term rentals is excludable from the measure of tax.

Please call me if you wish to discuss this matter further.

EA

**Elizabeth Abreu**