STATE BOARD OF EQUALIZATION
(916) 445-5550

February 21, 1992

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Re: Amendment of Regulation 1660

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This is in response to your letter dated January 15, 1992 regarding the application of Revenue and Taxation Code section 6010.65.

You note that the section is in effect until January 1, 1995. If a taxpayer enters into a sale and leaseback transaction prior to that date but the lease itself extends past January 1, 1995, you ask whether the lease payments made after January 1, 1995 would be taxable. You also inquire as to the tax treatment of a repurchase of the equipment after January 1, 1995 if the repurchase were pursuant to an option granted in the contract signed prior to January 1, 1995.

Subdivision (c) states that section 6010.65 applies to acquisition sale and leaseback arrangements executed before January 1, 1995. Thus, if the acquisition sale and leaseback arrangement is executed prior to January 1, 1995, the leaseback portion comes within the terms of section 6010.65 and is not regarded as a continuing sale subject to use tax. With respect to repurchases, the date of the repurchase is irrelevant, regardless of when the option is granted. Subdivision (b) of section 6010.65 specifically states that "sale" and "purchase" include, for purposes of sales and use tax, the transfer of title to a lessee upon termination of an acquisition sale and leaseback. That is, there is no exemption or exclusion under section 6010.65 with respect to a sale at the end of the lease term.

You ask what happens if the lessee sells its business and the lease is assigned to the new buyer along with the option to acquire the property at termination of the initial lease contract. Assuming the lease is pursuant to a qualifying acquisition sale and leaseback, the lease is not regarded as a sale for purposes of sales and use tax. You ask whether the rentals to the assignee are exempt. I assume you are asking whether the rentals paid to the lessor are not taxable since the

assignee is not the lessee (that is, the assignee in your question is the lessee and is not receiving rents but rather is paying them). As noted above, if the acquisition sale and leaseback qualifies under section 6010.65, the lease receipts are not taxable rentals.* You ask whether the exercise of a purchase option on the equipment by the assignee would be subject to tax. As noted above, the exercise of the option to purchase is not exempt or excluded from taxation under section 6010.65 no matter who exercises the option.

Your final questions relate to use of the property upon termination of the lease when the lessee does not exercise an option to purchase. You ask whether subsequent use of the rental property by the lessor is subject to tax. since the lessor acquired the property in a transaction not subject to tax, its use of the property is not subject to tax, regardless of whether that use occurs before or after January 1, 1995. On the other hand, when the lessor leases that property to a different lessee, that lease is a continuing sale and purchase and is subject to use tax measured by rentals payable. I note further that there is no election for the lessor to pay tax measured by purchase price since there is no specific statutory authority to do so. (See, e.g., Rev. & Tax. Code § 6094.1 (specific authority to pay tax measured by purchase price when lessor acquires property in an exempt occasional sale).)

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

Sincerely,

David H. Levine
Senior Tax Counsel

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bc: Culver City District Administrator

*If the leaseback portion of the transaction is a true lease (as opposed to a sale at inception), then no tax applies to the rentals paid by the new lessee and the assignment is not taxable. If, however, the leaseback portion is a sale at inception, the assignment of the "lease" is actually a sale of the property. That sale is taxable, but the "lease" receipts paid by the new lessee are not taxable.
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State of California **Board of Equalization**
Legal Division MIC:82

M e m o r a n d u m

330.1874

To : Mr. Robert Nunes
MIC:40

Date: April 1, 1994

From : David H. Levine

Subject: Annotation on section 6010.65

I wrote a letter dated February 21, 1992 related to the interpretation of Revenue and Taxation Code section 6010.65. One question I addressed was a lessee's assignment of a lease that had been the leaseback portion of an acquisition sale and leaseback within the meaning of section 6010.65. I concluded that the rentals payable by the new lessee would not be taxable. The leaseback portion of a qualifying acquisition sale and leaseback is not a sale for purposes of the Sales and Use Tax Law, and the rentals payable from such lease are not taxable. I concluded that such rentals payable by the new lessee (assignee) were also not taxable. The basis for this conclusion was that the original lease was not taxable, and the assigned lease was, in fact, the original lease.

Upon review of the letter, I conclude that my original answer was correct. However, I have concluded that it would be helpful to also address in the annotation the implications of assigning a “lease” that is actually a sale at inception. I note that the analysis in my original letter remains accurate under either circumstance, but some persons reading the annotation may overlook the fact that there are additional ramifications when a “lessee” under a sale at inception assigns its rights thereunder as opposed to a lessee's assignment of rights under a true lease.

The leaseback portion of a qualifying acquisition sale and leaseback may be a true lease, but it may also be a transaction which would constitute a sale at inception under subdivision (a)(2)(A) of Regulation 1660. When a person designated as a lessee under a sale at inception “assigns the lease,” he or she is actually selling the property. Thus, the applicable transaction that would be subject to tax (or not) is the sale of tangible personal property by the “lessee” and not the amounts paid to the “lessor.” Such a sale of tangible personal property by the “lessee” is subject to tax even when the “lease” was created as part of a qualifying acquisition sale and leaseback. That sale is not covered by the exclusions provided by section 6010.65 because the “assignment” is actually a new retail sale. The “lease receipts” of course are not taxable.

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