STATE BOARD OF EQUALIZATION
LEGAL DIVISION (MIC: 82)
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April 30, 1998

Mr. G--- S. R---
M--- Partner-In-Charge
--- --- --- LLP
XXX --- Street, N.W.
---, --- XXXXX

Re: Unidentified Taxpayer

Dear Mr. R---:

I am responding to your letter dated November 20, 1997, addressed to Assistant Chief Counsel Gary J. Jugum, but sent by you to the Board of Equalization's Audit Evaluation and Planning Unit. As they informed you, the staff of that section had planned to respond to your letter based upon a similar case which they thought would clarify the issues raised in your letter. However, as you were also informed, the similar case has been postponed for an undetermined length of time. To avoid further delay in addressing your concerns, the Legal Division has been asked to respond to your inquiry.

You request a "Chief Counsel Ruling." We do not issue "rulings," but do respond to inquiries by way of opinion letters. This is consistent with California's Revenue and Taxation Code section 6596 (copy enclosed), which provides that the only basis for relieving a person of liability for sales or use taxes otherwise due is such person's reasonable reliance upon written advice from the Board. However, one of the requirements of section 6596 is that the taxpayer for whom advice is sought must be identified. Since your letter does not identify your client, section 6596 does not apply to this response. In the future, in order to receive section 6596 protection, please provide us with the name of your client when you write.

I also note that you do not include a copy of the agreement ("contract") to which you refer throughout your letter. Without a copy of the contract to review, our ability to give reliable responses to your questions is severely impaired, since our interpretation of the contract and the significance of its various provisions may differ from yours. Thus, while I will respond to your questions as accurately as possible based upon your representations regarding the contract, please be informed that after reviewing the *actual* contract, my responses might be materially different, and, therefore, that this opinion is of limited value. In future correspondence, please include a copy of the contract at issue and any other relevant documents for our review.

Facts

You write that your client ("client") owns and leases automobiles[1] in numerous states, including California. For purposes of this opinion letter, I assume that the automobiles in question are purchased and leased in this state. Client is also licensed as a lessor-retailer in California for sales and use tax purposes. You indicate that client has elected to collect and remit use tax on the rental receipts received from its California commercial lease customers. Therefore, for purposes of this opinion letter, I assume that when client originally purchased the automobiles, it did not pay or remit California sales or use tax measured by the purchase price of those cars. I also assume that the automobiles are leased in substantially the same form as they were acquired by client.

You indicate that client plans to sell to an investor ("investor") a number of its recent model year automobiles which are currently under lease. You state that investor will simultaneously lease the automobiles back to client under a 72-month leveraged lease. You also indicate that while client will transfer "beneficial ownership" of the automobiles to investor, client will not transfer title or possession or control of the automobiles to investor. You further state that the automobiles will be subject to existing leases (all of which are for a shorter period of time than the client-investor leveraged lease) between client and its commercial lease customers. You indicate that investor will be treated as the owner of the vehicles for federal income tax purposes. As such, I assume as concerns this opinion letter, that (since it would be the usual practice) investor will claim depreciation with respect to the automobiles for federal income tax purposes.

You state that under the client-investor leveraged lease, client will be required to repurchase any vehicle from investor if the sublessee of the vehicle elects to terminate its lease with client or if the sublessee is in default. You also state that the client-investor leveraged lease contains a like-kind exchange option which permits client to replace terminating automobiles with tax equivalent automobiles.

You indicate that the client-investor leveraged lease will contain what you characterize as "an early buyout option," but you do not explain this in any further detail. According to your statements, at the end of the 72-month period, client is required to buy back all of the automobiles for 20% of the original "sales" price.

You ask several questions concerning the sales and use tax ramifications of the transactions, and essentially inquire whether the lease transactions between client and its commercial lease customers are the only transactions subject to tax in the above-described scenario.

Discussion

[1]For purposes of this opinion letter, I assume that the vehicles in question are not mobile transportation equipment as that term is defined in the Sales and Use Tax Law. (See Rev. & Tax. Code § 6023.) If the vehicles were mobile transportation equipment, our opinion would be different.

I. Non-Taxable Financing Transaction. You assert that under the authority of *Cedars-Sinai Medical Center v. State Board of Equalization* (1984) 162 Cal.App.3d 1182, the client-investor contract is a non-taxable financing transaction for sales and use tax purposes. California Sales and Use Tax Regulation 1660 was amended in 1989 to include changes necessitated by the *Cedars-Sinai* case. The regulation provisions definitively encompass the *Cedars-Sinai* case for California Sales and Use Tax purposes. Subdivision (a)(3) (A) and (B) define those situations in which transactions structured as sales and leasebacks will be treated as financing transactions. One requirement is that the purchaser-lessor not claim any deduction, credit or exemption with respect to the property for federal or state income purposes. (Reg. 1660(a)(3)(A).) Since investor will claim depreciation on the automobiles, the contract does not qualify under the regulation and the *Cedars-Sinai* case as a non-taxable financing transaction.[2]

II. Non-Taxable Tax Benefit Transaction. You assert that the client-investor contract qualifies as a "tax benefit transaction" under Regulation 1660(a)(3)(C). However, subdivision (a)(3)(C) of the regulation applies to sale and leaseback transactions entered into when former Internal Revenue Code section 168(f)(8), as enacted by the Economic Recovery Tax Act of 1981 (Public Law 97-34), was in effect. That section has been repealed, and, therefore, cannot be applied to the client-investor contract which was not in existence during the lifetime of former section 168(f)(8). Thus, the contract cannot, and does not, qualify as a tax benefit transaction as defined by Regulation 1660(a)(3)(C).

III. Non-Taxable Transaction, Not a "True Lease." You assert that under revenue procedures issued by the Internal Revenue Service (IRS), and adopted by the California Franchise Tax Board (FTB) in its Legal Ruling 419, a transaction which purports to be a sale and leaseback will be disregarded if it fails to meet certain conditions imposed under the IRS revenue procedures and the FTB ruling which define the components of a "true lease." You state that since the client-investor contract fails three of these conditions, "[T]he [client's] lease of the vehicles is not a true lease and the entire sale and leaseback transaction should be treated as a financing transaction."

However, the revenue procedures and rulings of the Internal Revenue Service and the Franchise Tax Board do not control the application of the California Sales and Use Tax Law. The Sales and Use Tax Law employs its own relatively self-contained concepts which are often distinct from those in other areas of law. (See, e.g., *United States Lines, Inc. v. State Board of Equalization* (1986) 182 Cal.App.3d 529, 535.) The IRS and FTB definitions of a "true lease" have no authority and are irrelevant as to the sales and use tax issues in question. Thus, the IRS and FTB positions on same do not control whether the transaction in question is subject to sales or use tax, or not. Whether or not the transaction is a true lease for California *sales and use tax* purposes is discussed below.

IV. Sales for Resale Excluded from Tax.

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[2]I also note that the amount which would be attributable to interest, if the transaction had been structured originally as a financing agreement, must not be usurious under California law. (Reg. 1660(a)(3)(A).) Since you provide no information concerning this aspect of the contract, this may be another area of non-compliance with the requirements of the regulation.

You assert that client's "sales"[3] of its automobiles to investor, and investor's "leases" of the automobiles to client (which are subject to client's subleases to its commercial lease customers) are sales for resale which are not subject to tax.

Under the California Sales and Use Tax Law, a retail sale in California of tangible personal property or a purchaser's use of property purchased from a retailer for use in California is taxable, unless otherwise exempted or excluded by statute. (Rev. & Tax. Code §§ 6051, 6201.) A retail sale is a sale for any purpose other than resale in the regular course of business. (Rev. & Tax. Code § 6007.)

"Sale" means and includes any transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code § 6006(a).) A sale also includes any lease of tangible personal property, in any manner or by any means whatsoever, for consideration, *except* tangible personal property leased in substantially the same form as acquired as to which the lessor or his or her transferor has timely paid sales tax reimbursement or use tax measured by the purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5) & 6006.1; Reg. 1660(b).)

"Lease" includes rental, hire and license. (Rev. & Tax. Code § 6006.3.) It includes a contract under which a person secures for a consideration the temporary use of tangible personal property which, although not on his or her premises, is operated by, or under the direction and control of, the person or his or her employees. (Reg. 1660(a)(1).) Thus, while the property need not be in the actual possession of the lessee, if it is not under the control of the lessee, it is not a true lease. The granting of possession or control of tangible personal property by a lessor to a lessee, or to any other person at the direction of the lessee, is a continuing sale in this state by the lessor, and the possession or control of the property by a lessee, or by another person at the direction of the lessee, is a continuing purchase for use in this state by the lessee. (Rev. & Tax. Code § 6006.1; Reg. 1660(b).) The tax on a lease which is a continuing sale is a use tax owed by the lessee which is measured by the rentals payable on the lease, and the lessor must collect the tax from the lessee and pay it to the Board of Equalization. (Reg. 1660(c)(1).)

Therefore, based upon my understanding of the facts which you describe in your letter, since the contract between client and investor specifies that there is no transfer to investor of title or possession of the automobiles, nor will there be such a transfer at the end of the 72-month agreement, the transaction is not a "sale" to investor according to the definition of that term in

[3] Your letter states that, "California imposes a sales tax of 6% of the gross receipts from the retail sale of all tangible personal property sold at retail in California." For your information, I note that while 6% is the *state* portion of the sales and use tax imposed in this state, an additional 1 1/4% Uniform *Local* Sales and Use Tax is imposed throughout the state, and administered by the Board. Moreover, varying rates of local transactions and use taxes are imposed in various local special tax districts throughout the state, and administered by the Board. As a result, throughout the state a minimum 7 1/4% statewide sales and use tax rate applies, with a maximum possible combined state, local and special district tax rate of 8 1/2% due to local transactions and use taxes.

Revenue and Taxation Code section 6006(a)[4]. Furthermore, although a "lease" is deemed a sale under Revenue and Taxation Code section 6006(g)(5), unless it is a lease of property in the substantially the same form as acquired as to which sales tax reimbursement or use tax was timely paid, the transaction between client and investor cannot be, and is not, a true lease under the California Sales and Use Tax Law since investor will have neither possession nor control of the automobiles during the period of the agreement, nor at its end. (Rev. & Tax. Code § 6006.1; Reg. 1660.)

In other words, what you describe is a transaction where there is no transfer of title, no transfer of possession, and no transfer of control. There is only a transfer of the income stream from the existing commercial leases to investor. If this is so, there is no sale or purchase of tangible personal property between client and investor. If there is no "sale" of the property, there can be no sale for resale of the property.

If my understanding of the facts is correct, the agreement between client and investor is not a sale and/or lease, but rather is an *assignment* by client to investor of the right to the rents due from client's commercial leases. Such an assignment is not subject to tax. However, since client leases (in its commercial leases) the automobiles in substantially the same form as acquired, and collects and remits to this state use tax on the rental payments received from its commercial lease customers, those automobile leases are regarded as continuing sales and purchases, and the use tax must continue to be collected from those commercial lease customers and remitted to the Board.

In closing I note once again that the opinions contained in this letter are of limited value, since upon review of the investor-client contract I might well reach different conclusions. Without seeing the contract, a definitive response is not possible.

I hope this information is of assistance. Please write again if we may answer any further questions. If you should write again, please enclose a copy of the contract or proposed contract between client and investor so that we may answer your questions with more certainty.

Sincerely,

Sharon Jarvis
Senior Tax Counsel

SJ:rz
Enclosure: Rev. & Tax. § 6596

cc: --- District Administrator - --
Mr. Vic Anderson - MIC:40

[4] I note that if the transaction is not a sale and investor does not own the automobiles under the agreement, there appears to be a conflict with investor's claiming ownership for income tax purposes.