

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 445-5550

WILLIAM M. BENNETT
First District, Kentfield

BRAD SHERMAN
Second District, Los Angeles

ERNEST J. DRONENBURG, JR.
Third District, San Diego

MATTHEW K. FONG
Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

BURTON W. OLIVER
Executive Director

July 9, 1992

Mr. R--- J. I---, Jr.
Administrative Counsel
R---, Inc.
P.O. Box XXX
--- ---, California XXXXX-XXXX

Re: S- -- XX-XXXXXX

Dear Mr. I---:

This is in response to your letter dated June 12, 1992. In order to raise working capital, R--- is considering a transaction in which it leases equipment it currently owns and then leases it back. You ask whether the transaction is subject to sales or use tax.

Facts

R--- owns equipment with respect to which it has already paid sales tax. For purposes of this opinion, I assume that this "sales tax" (actually, it would have been sales tax reimbursement or use tax) was California sales or use tax. R--- will lease this equipment in substantially the same form as acquired by R--- to a financing company ("Financer") for a period of 15 to 20 years. Financer will pay R--- a lump sum on the closing date, which will equal the lease payment stream otherwise payable over the term of the lease, discounted at an appropriate rate. R--- will retain title to the equipment throughout the lease period; Financer will not obtain title to the equipment nor have any option to obtain title to the equipment.

Simultaneously with commencement of that lease, Financer will sublease all the leased equipment to R--- for a period of 7 to 12 years (which is about 75 percent of the useful life of such equipment). At the end of the sublease and at two other times during the sublease, R--- will have the option to "buyout" Financer's remaining interest in the lease.

Discussion

A lease of tangible personal property in California is a continuing sale, and is subject to use tax measured by rentals payable, unless the property is leased in substantially the same form as acquired and the lessor pays sales tax reimbursement or use tax to its vendor or makes a timely

election to pay use tax measured by purchase price. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, Reg. 1660.) You state that the equipment will be leased in substantially the same form as acquired and that R--- paid sales tax. Based on these statements and the assumption made above, we conclude that a lease of the equipment by R--- is not a continuing sale and is not subject to use tax.

Since we have concluded that R---'s lease of the equipment is not subject to use tax, the next question is whether the proposed transaction is a lease. Generally, leases do not provide that the lessee will make all rental payments at the commencement of that lease, but rather usually provide for periodic rental payments. However, based on your description of the transaction, that R--- never passes title to the equipment to Financer and R--- will retain title to the equipment at the end of the contract term, we agree that the proposed transaction is a lease from R--- to Financer.

Financer will sublease the equipment back to R---. The application of use tax to a sublease of tangible personal property is generally the same as the application of tax to a prime lease. That is, a sublease of tangible personal property is a continuing sale, and is subject to use tax measured by rentals payable, unless a timely election to pay tax measured by purchase price has been made and the property is leased in substantially the same form as acquired.

The difference between a prime lease and a sublease is that in a sublease transaction there are two relevant transactions preceding it rather than one. The sublease will not be taxable if a timely tax-paid election is made with respect to either of the previous two transactions (i.e., the prime lessor's purchase or the prime lessee's lease). This is explained in subdivision (c)(5) of Regulation 1660. Since R--- timely paid tax on purchase price, the sublease as well as the prime lease are regarded as tax-paid.

Based on your description of the transaction and the assumption made above, we conclude that neither the lease to Financer nor Financer's lease to R--- is subject to sales or use tax. Please note, however, the importance of my assumption that California sales tax or use tax was paid with respect to R---'s purchase of the equipment to be leased. If this assumption is not accurate, the opinion expressed herein would not be applicable to the proposed transaction.

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

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:cl