



STATE BOARD OF EQUALIZATION

April 26, 1995

Re: Unidentified Taxpayer

Dear:

This is in response to your letter dated February 28, 1995 in which you request a ruling regarding the application of tax to a lessor's use of certain tangible personal property at the termination of a lease for which use tax has been remitted on lease receipts.

I note that the only basis for the Board to relieve a person of otherwise properly due taxes is pursuant to the provisions of Revenue and Taxation Code section 6596. To come within the provisions of that section, the taxpayer must have reasonably relied on the Board's written advice which was in response to a written request for advice that disclosed all relevant facts, including the identity of the taxpayer. Since your client is not identified, this opinion does not come within the provisions of section 6596.

You state:

"Company X purchases for resale various TPP and fabricates and assembles the TPP into fixtures and machinery and equipment. Company X is a construction contractor under California Sales and Use Tax Regulation (Regulation) 1521. Company X transfers the fixtures and machinery and equipment to Company Y (a commencing corporation) solely in exchange for first issue stock. Company X receives a resale certificate from Company Y on the transfer of the fixtures and machinery and equipment. Company Y leases the fixtures and machinery and equipment to Company Z (a related entity). The fixtures are TPP pursuant to California Revenue and Taxation Code (CRTC) § 6016.3. We have assumed that Company Y cannot elect to remit use tax on the purchase price in lieu of remitting on lease receipts, because Company Y acquired the asset from Company X in a tax free transfer to a commencing corporation. Due to this transfer, Company Y cannot lease the assets in the same form as acquired since Company Y would take on Company X's attribute of-being the manufacturer. Therefore, Company Y will remit use tax on the fixtures and machinery and equipment lease receipts. Company Y may eventually make use of the leased TPP either directly upon the termination of the lease or as a result of Company Y being merged into

Company Z at some later date (California Sales Tax Counsel Ruling 395.2150)."

You ask what the measure of use tax will be for Company Y if it uses the property at the termination of the lease.

DISCUSSION

Subdivision (b) (4) of Regulation 1595 explains that tax does not apply to a transfer of property to a commencing corporation in exchange solely for first issue stock of that commencing corporation. Therefore, X's transfer of the fixtures and machinery and equipment to Y solely in exchange for first issue stock does not constitute a sale subject to sales or use tax. This is not an exemption; rather, under the Sales and Use Tax Law, a transaction coming within subdivision (b) (4) of Regulation 1595 is not a taxable sale. This means that X may not purchase property ex-tax for resale if X plans to transfer the property in such a nontaxable transaction.

You state that in the present situation, X did purchase the property ex-tax for resale. If a purchaser who gives a resale certificate for property makes any storage or use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the storage or use is taxable as of the time the property is first so stored or used. (Reg. 1668(a) (2).) Thus, since X purchased the property ex-tax for resale, X owes use tax when it uses the property in transferring it to Y in a nontaxable transaction. Since Y is acquiring the property in a nontaxable transaction, there is no need for Y to issue a resale certificate to X. Y may use the property without incurring any sales or use tax liability.

Y's liability differs, however, when it leases the property. The lease of tangible personal property in California is a continuing sale subject to use tax measured by rentals payable unless the lessor leases the property in substantially the same form as acquired and has either paid California sales tax reimbursement or use tax to its vendor, or has made a timely election to pay use tax measured by purchase price. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, Reg. 1660.) When a lease is a taxable continuing sale, the lessor must collect the tax from the lessee and pay it to the state. (Rev. & Tax. Code § ~203, Reg. 1660 (c) (1) .)

You indicate your belief that Y would "take on X's attribute of being the manufacturer," but Y does not become X or obtain the status of X in any way. That is, Y is not the manufacturer of the fixtures and machinery and equipment, and it is not regarded as the manufacturer for sales and use tax purposes. Y acquired the property fully assembled, so when it leases such fully assembled property it is regarded as leasing the property in substantially the same form as acquired.

However, since Y acquired the property in a nontaxable transaction, it did not have the option of paying tax when it acquired the property. Further, although you indicate your wish for us to consider X's transfer to Y to be similar to an occasional sale

under section 6006.5(b), Y did not in fact acquire the property in a section 6006.5(b) transaction. Thus, X is not a "transferor" as defined in subdivision (g) (5) (A) of section 6006. Y does not "take on" any tax-paid status X might have had, and Y cannot pay tax on an amount X might have paid upon X's acquisition of the property. (Cf. Rev. & Tax. Code § 6094.1.) The lease is a continuing sale, and Y must collect the tax from Z, measured by rentals payable, and pay that tax to this state.

As noted above, only Y's sale of the property (e.g., in a continuing sale) is taxable; its own use is not. Thus, any use by Y of the fixtures and machinery and equipment after leasing the property will be nontaxable, without regard to whether such use occurs upon termination of the lease to Z or after merging into Z. Since Y will owe no use tax on its use after leasing the property and collecting and paying use tax measured by rentals payable, the credit explained in Regulation 1660(c) (6) does not apply.

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

Sincerely,

Kelly W. Ching
Staff Counsel

KWC:cl

cc: Santa Ana District Administrator