



STATE BOARD OF EQUALIZATION

November 13, 1986

Dear

Effective September 15, 1986, Revenue and Taxation Code Section 6006.3 was amended to include within the definition of "lease" certain concepts theretofor articulated only in Board Regulation 1660. As you know the legislative vehicle for these changes in the law was AB 4417 (copy enclosed).

You asked that we review AB 4417 and render our views as to how the changes in the law affect ---. We will reiterate your description of ---'s current operations and then respond to your questions as to how AB 4417 applies to such operations. Rather than quote at length from the bill, we will cite you to relevant portions of it as necessary in the course of our discussion.

You stated:

"First, for background, we are a lease brokerage firm arranging financing for municipal lessees through our various investor contacts, nearly all of whom are financial institutions. We do often act as Lessor on a temporary basis, assigning our rights to the investor upon funding of the lease. We also have various vendors who often act as Lessor on the same basis, assigning their rights upon funding of the lease contracts. At present: all of our leases include bargain purchase options, with a \$1 buy-out at the end of the lease term, and all are tax-free leases, with sales tax collected by the vendor on the purchase cost at the beginning of the lease. If purchase options are exercised before the end of the lease term, sales tax is charged on the purchase option amount and is collected and paid to the Board of Equalization by the investor."

A final observation is in order prior to stating and responding to your inquiries. One affect of AB 4417 is to treat transactions such as --- as sales rather than leases, however, for purposes of discussion herein and to minimize confusion we will utilize the terms "lease", "lessor" and "lessee" as you did in describing --- operations.

Questions/Responses

Question 1.

Assuming --- purchases the property to be leased to the municipal entity ex-tax by issuing a resale certificate to the vendor, will --- be deemed the retailer and be responsible for payment of sales tax? (These transactions presumably occur after September 15, 1986).

Response 1:

Assuming there is possession of the leased property by the lessee pursuant to its lease with --- prior to --- assignment of its rights under the lease to the financial institution, --- will be deemed the retailer and will be liable for the tax. The subsequent assignment to the financial institution would be considered an assignment of intangible rights. The rationale for this approach is that the retail sale of the property occurs upon delivery of the property to the lessee.

Assuming the lessee obtains possession after the assignment occurs, the financing entity would be considered the retailer liable for reporting the tax. The sale by the vendor to --- under such circumstances would be a sale for resale.

We note that the same general approach applies when the vendor leases the property to the municipal entity and subsequently assigns its rights as lessor to the financial institution. That is to say, assuming possession of the leased property by the lessee prior to the assignment, the vendor is the retailer liable for tax. On the other hand, if the lessee obtains possession after the assignment, the financial institution is the retailer and must pay the tax.

Finally, we note that under the new law, no additional tax will be due upon exercise by the lessee of his option to terminate or buy-out the lease.

Question 2:

Under the above described methods of operations, would it be possible for --- to be the entity always responsible for reporting the tax? (These transactions presumably occur after September 15, 1986.)

Response 2:

As indicated in responding to Question 1 above, if the lessee obtains possession under the lease with ---, --- will be deemed the retailer and will be responsible for the sales tax. If possession by the lessee occurs under the lease with the vendor, the vendor is the retailer/taxpayer. And, if the lessee comes into possession after assignment of the lease to the financial institution, the financial institution is the retailer and must report the tax.

Question 3:

If the property is received by the lessee prior to the effective date of AB 4417 but payment to the lessor occurs after the effective date, how does the tax apply?

Response 3:

Pursuant to Section 1.5 of AB 4417, if the lessor treated the transaction as a lease under prior law, then the transaction will continue to be treated as such until the first quarter of 1987 at which time it will be treated under the new law as a sale under a security agreement from the inception. Any use tax previously paid with respect to the lease will be credited against sales or use tax due on the sale.

Question 4:

If the transaction is complete, i.e., lease funded with lessee in possession, before September 15, 1986, will exercise by the lessee of his option to purchase after September 15, 1986 result in tax liability?

Response 4:

If the lessor has treated the transaction as a lease under prior law and if the option to purchase is exercised by the lessee between September 15 and December 31, 1986, the lessor is liable for tax based on the option price. No tax would be due as a result of exercising the option after December 31, 1986.

Sincerely,

E. Leslie Sorensen, Jr.
Tax Counsel

ELS: rar
Enclosure

Assembly Bill No. 4417

CHAPTER 825

An act to amend Section 6006.3 of the Revenue and Taxation Code, relating to taxation, and declaring the urgency thereof, to take effect immediately.

[Approved by Governor September 14, 1986. Filed with Secretary of State September 15, 1986.]

LEGISLATIVE COUNSEL'S DIGEST

AB 4417, Cortese. Sales and use taxes: leases.

Under the existing Sales and Use Tax Law, the terms "sale" and "purchase" include, with certain exceptions, any lease of tangible personal property for a consideration. For those purposes, a lease is a continuing sale and possession of the leased property by the lessee is a continuing purchase. Existing regulations provide that where a contract designated as a lease binds the lessee for a fixed term and the lessee is to obtain title at the end of the term upon completion of the required payments or has the option to purchase the property for a nominal amount, the contract will be regarded as a sale under a security agreement from its inception and not as a lease.

This bill would codify that regulation, and would further provide that in the case of a contract designated as a lease with any state or local governmental body, or any agency or instrumentality thereof, the lessee shall be treated as bound for a fixed term notwithstanding any right of the lessee to terminate the contract in the event that sufficient funds are not appropriated to pay amounts due under the contract.

The bill would provide that if a transaction entered into prior to the effective date of this bill has been treated by the lessor as a lease, the full term of which has not expired or been earlier terminated, then that transaction shall be classified as a sale under a security agreement occurring in the first calendar quarter commencing more than 90 days after the effective date of this bill, and shall be classified as a lease for all earlier periods. It also would provide that any use tax previously paid on a transaction described in the preceding sentence shall be credited against any sales or use tax due.

Counties and cities are authorized to impose local sales and use taxes in conformity with state sales and use taxes. Exemptions from state sales and use taxes enacted by the Legislature are automatically incorporated into the local taxes.

Section 2230 of the Revenue and Taxation Code provides that the state will reimburse counties and cities for revenue losses caused by the enactment of sales and use tax exemptions.

This bill would provide that no appropriation is made and the state shall not reimburse local agencies for sales and use tax revenues lost by them pursuant to this bill for a specified reason.

The bill would declare that it is to take effect immediately as an urgency statute.

The people of the State of California do enact as follows:

SECTION 1. Section 6006.3 of the Revenue and Taxation Code is amended to read:

6006.3. "Lease" includes rental, hire and license. "Lease" does not include a use of tangible personal property for a period of less than one day for a charge of less than twenty dollars (\$20) when the privilege to use the property is restricted to use thereof on the premises or at a business location of the grantor of the privilege. Where a contract designated as a lease binds the lessee for a fixed term and the lessee is to obtain title at the end of the term upon the completion of the required payment or has the option at that time to purchase the property for a nominal amount, the contract shall be regarded as a sale under a security agreement from its inception and not as a lease. In the case of a contract designated as a lease with any state or local governmental body, or any agency or instrumentality thereof, the lessee shall be treated as bound for a fixed term notwithstanding any right of the lessee to terminate the contract in the event that sufficient funds are not appropriated to pay amounts due under the contract.

SEC. 1.5. If a transaction entered into prior to the effective date of this act has been treated by the lessor as a lease, the full term of which has not expired or has been earlier terminated, then that transaction shall be classified as a sale under a security agreement occurring in the first calendar quarter commencing more than 90 days after the effective date of this act, and shall be classified as a lease for all earlier periods. Any use tax previously paid on a transaction described in the preceding sentence shall be credited against any sales or use tax due.

SEC. 2. Notwithstanding Section 2230 of the Revenue and Taxation Code, no appropriation is made by this act and the state shall not reimburse any local agency for any sales and use tax revenues lost by it under this act because this act is intended as a clarification of existing law, rather than as a change in the law.

SEC. 3. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

In order to ensure that transactions entered into by governmental entities proceed without any uncertainty regarding the classification of those transactions for purposes of the California sales and use tax, it is necessary that this act take effect immediately.