

M e m o r a n d u m**330.2885**

To: Mr. Richard Gerber
Audit Review and Refunds Unit

Date: April 13, 1990

From: David H. Levine
Tax Counsel

Subject: M--- Corporation
S- -- XX-XXXXXX

This is in response to your mini-memo dated March 23, 1990. Taxpayer leases a computer from IBM and pays IBM use tax measured by rentals payable. After the lease began, taxpayer decided to sublease the computer to a customer in Arizona. Taxpayer had taken a tax-paid purchases resold deduction on its return. You believe that tax is due to IBM on the original lease and that taxpayer is not allowed to take a tax-paid purchases resold deduction because it is not the legal owner of the computer.

We agree that taxpayer may not take a tax-paid purchases resold deduction, but not for the reason you state. I assume that IBM manufactured the leased computer. Under such circumstances, IBM's lease of the computer is a continuing sale, and there is no election available to pay tax on purchase price. (Rev. & Tax. Code §§ 6006(g), 6006.1.) If such leased property is subsequently subleased prior to use by the lessee, the sublease is also a continuing sale if use tax is not paid measured by rentals payable under the prime lease. If use tax is paid on the prime lease, then the sublease is not regarded as a sale and the rentals payable from the sublease are not subject to use tax. (Reg. 1660(c)(5).)

The determination of whether tax is due measured by rentals payable under a prime lease or by rentals payable under a sublease is similar to the determination of whether tax is due measured by purchase price or by rentals payable under a prime lease. A lessor who has elected to pay tax measured by purchase price may not change methods after the lease has commenced and obtain a refund in order to collect tax on rentals payable. Similarly, a lessee who has been paying tax measured by rentals payable under the prime lease may not change methods and treat the lease as for resale in order to collect tax measured by rentals payable under a sublease. That is, once the prime lease has commenced and taxes are paid measured by rentals payable, the sublease is not a sale. The lessee may not change methods and issue the lessor a resale certificate. Therefore, a refund is not allowable on this basis (i.e., tax-paid purchases resold). On the other hand, had the lessee issued the lessor a timely resale certificate, the lessor could properly lease the property tax free and taxes would be due on rentals payable under the sublease. (See BTLG Annot. 330.2880 (8/18/65).) Accordingly, if tax is due on these lease and sublease transactions, that tax must be measured by the rentals payable from taxpayer to IBM

since taxpayer may not change methods. Taxpayer's sublease would not be a sale under the Sales and Use Tax Law and would not be subject to use tax.

Notwithstanding the discussion above, we believe that the lease for the periods at issue is not subject to tax. A lease of tangible personal property outside California is not subject to California sales or use tax (unless it is a taxable lease of mobile transportation equipment). (Rev. & Tax. Code § 6201 (use tax applies to use in this state), Reg. 1660(c)(1) (tax on leases is a use tax on use in this state).) That taxpayer has subleased the computer is irrelevant for this analysis. The property is no longer being used in this state. California use tax is not applicable to the lease for any periods in which the property is not inside California. Use tax collected by IBM from taxpayer and paid to this state with respect to those periods must be regarded as an overpayment of use tax and should be refunded. Regardless of any contractual provisions between IBM and taxpayer (i.e., that the lease is subject to use tax measured by rentals payable), IBM should not collect California use tax on amounts which are not subject to our use tax.

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

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