STATE BOARD OF EQUALIZATION
(916) 445-8485

September 23, 1982

Mr. J--- C---
M--- E--- Co.
P. O. Box XXXX
--- ---, CA XXXXX

Dear Mr. C---:

SY -- XX-XXXXXX

This is in response to your letter of July 22, 1982. You wondered whether certain payments identified as "interim rent" are subject to tax under the California Sales and Use Tax Law. The amounts in question were paid by M--- [E---] to B---, the ultimate lessor of the equipment. Your description of the transaction is reiterated below, followed by our comments.

> "The facts are as follows. On October 11, 1978, B--- in writing offered its commitment (the 'Offer') to enter into a lease with M--- E--- Co. The leased property would be a new computer which B--- was going to buy. The Offer set out the various terms of the proposed lease. It stated that the term of the lease would begin on the date of execution of a "Schedule to Lease' and continue for five years. Since the actual purchase price of the computer equipment was not then known, the Offer stated the contemplated rent in terms of a cost per thousand of dollars expended; thus, the rate was to be $17.22 per $1,000 of B---'s cost to purchase the computer. Like the rental term, the obligation to pay rent was to being on the date of execution of the "Schedule to Lease.' Prior to that date, however, the Offer called for a smaller payment, denominated 'Interim Rent.' This Interim Rent was at the rate of .26 per $1,000 of cost per day, which equals $7.20 per $1,000 of cost per month or, if phrased as a percentage per annum, 9.49% (.26 x 365). The Offer required acceptance by October 31, 1978. M--- accepted on October 16, 1978.

"Subsequently, on November 22, 1978, the parties entered into a "Lease Agreement' (the 'Agreement'). The Agreement substantially embodied the terms set forth in the Offer. In Section 1, the Agreement stated that B--- 'has ordered or shall order' the computer but would not, as between itself and M---, be obligated to pay for the unit until (Section 1.2) M--- executed and delivered (on or before the 'Availability' or 'Delivery' date, June 30, 1979) an 'Acceptance Supplement … confirming that [the computer] (i) has been accepted by [M---] as of such Delivery Date and (ii) has become subject to and governed by all the provisions of' the Agreement. In the event of M---'s failure to meet that condition, the Agreement provided that M--- would be deemed to have assumed B---'s obligation to pay for the computer equipment. Thus, the relationship between B--- and M--- would be fixed as lessor/lessee, rather than vendor/purchaser, only upon execution of the Acceptance Supplement.

"Section 1.3 of the Agreement went on to state that 'in consideration of the purchase of the [computer, M---] agree[s] that Interim Rent … shall begin to accrue on the date funds for the purchase of such 'computer' are advanced by [B---] at a daily rate of $0.26 per $1,000 of funds advanced, payable monthly until June 30, 1979….' The following section of the Agreement, Section 2, governed the term of the lease and the amount of rent. As set out in an incorporated schedule, the rent was $17.22 per month per $1,000. The rent, thus, was approximately $10 per month higher than the 'Interim Rent' ($17.22 per month per $1,000 versus $7.20 per month per $1,000) and began on the Delivery date, i.e., the date on which B--- became obligated to lease, rather than sell, the computer. The Interim Rent, on the other hand, became effective on the date that B--- committed funds toward the purchase of the computer either for lease or sale, and ended on the date that B--- became obligated to lease rather than sell."

Comments

Generally speaking, leases of tangible personal property in California are deemed "sales" and "purchases" with tax thereon measured by rentals payable (see Rev. & Tax. Code §§ 6006(g) and 6010(e); Reg. 1660(b) and (c), copy enclosed. The granting of possession by B--- to M--- in California is a continuing sale, and the possession by M--- in this state is a continuing purchase for use in this state irrespective of the time or place of delivery of the property to M--- (see Rev. & Tax. Code §§ 6006.1, 6010.1; Reg. 1660(b)(2)).

There seems to be no dispute with respect to the conclusion that a bona fide lease of the equipment was entered into between B--- and M---. The question to be answered then, is whether amounts designated "interim rent" which were paid prior to delivery of the equipment are part of taxable rental receipts.

In our view, the "interim rent" amounts are subject to tax. It has long been the position of the Board that interest charges levied in connection with leased property are includable in the measure of rental payments subject to tax (see BTLG annos. 330.3400, 330.3420). In the instant case, the facts indicate that the "interim rent" was a condition to B---'s willingness to lease, without which the lease would not have been negotiated. As such, they represent part of the total consideration paid for rental of the equipment. The fact that actual delivery of the equipment occurred subsequent to the payment of the "interim rent" does not, as indicated in sections 6006.1 and 6010.1, affect the nature of the entire transaction as a continuing sale and purchase. Likewise, the fact that delivery occurred at a later date than payment of the "interim rent" does not preclude the inclusion of those amounts as part of taxable rental receipts. In our opinion the term "interim rent" properly describes the nature of these payments.

We hope this has answered your questions. If it has not, feel free to contact us again.

Very truly yours,

Les Sorensen
Tax Counsel

LS/at

Enclosures