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May 16, 1994

Ms. C--- C. H---
T--- M--- C--- Corporation
Corporate Tax Department
XXXXX S. --- Avenue
---, CA XXXXX

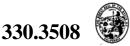Re: **APPLICATION OF TAX TO LEASES**

Dear Ms. H---:

This is in response to your letter of April 04, 1994 in which you request advice as to the application of tax to charges for various items in connection with leases of motor vehicles by T--- M--- C--- Corporation (TMCC).

You state that auto dealers with which TMCC has arrangements will enter into long-term vehicle leases with retail customers. TMCC will then purchase the vehicle from the dealer and the dealer will assign the lease to TMCC. Under the lease agreement, the lessee has the option to purchase "intangibles" such as extended service agreements, life, accident and health insurance, GAP coverage which pays off any remaining lease liability in the event of theft or destruction of the leased vehicle and other charges "which are not part of the cost of the leased vehicle such as the federal excise tax on luxury automobiles."

A lessee wanting to purchase these "intangibles" may pay the total cost of these options and other charges at the time the lease is entered into or the lessee may choose to add the cost of these items to the monthly lease payment. The lease agreement includes a description and total cost of each of the intangibles and other charges to be paid by the lessee. If the lessee chooses to add the cost of the intangibles to the monthly lease payment, the payment amounts attributable to the intangibles are not separately stated.

The two questions posed in your letter were:

1. In the absence of a breakdown on the monthly payment coupon and no separate disclosure in the lease agreement of the portion of the lease payment attributable to intangibles and other charges, and the portion attributable to the

lease of the vehicle, is the total monthly payment or only the portion attributable to the lease of the vehicle subject to sales tax.

2. If a breakdown of the monthly lease payment between amounts attributable to intangibles and other charges and the amount attributable to the lease of the vehicle are disclosed in the lease agreement but not on the monthly payment coupon, or in the monthly payment coupon but not the lease agreement, is the total monthly payment or only the portion attributable to the lease of the vehicle subject to sales tax?

Discussion

I assume that your inquiry relates only to the application of tax to the "intangibles" listed in your letter. I also assume that you are aware that, unless certain requirements are satisfied, the lease of the vehicle in California is a continuing "sale" and "purchase" as these terms are defined in Revenue and Taxation Code sections 6006 and 6010, respectively. Your questions indicate that the leases in question are continuing sales. As such, the leases are subject to use tax measured by the rentals payable. (Sales and Use Tax Regulation 1660(c).) When the lease is assigned from the dealer to TMCC, the rental payments remain subject to tax, without any option to measure tax by the purchase price, and as the lessor, you must collect the tax from the lessee at the time that the rentals are paid by the lessee.

Under Regulation 1660(c), the rentals subject to tax include "any payments _required_ by the lease." The rentals subject to tax do not include "separately stated optional {insurance charges}, maintenance or warranty contracts."

You state that all of the "intangibles" listed in your letter are optional (not required by the lease). The first three examples of "intangibles" listed in your letter (extended service agreements, life, accident and health insurance and GAP coverage) appear to be optional insurance or warranty charges and as such, would not be included in the "rentals payable" subject to tax if separately stated. The separately stated requirement is fulfilled when the lease agreement lists the optional "intangible" and its cost. If the lessee chooses to pay the entire cost of the "intangibles" at the beginning of the lease term, that cost would not be subject to tax. If the cost is allocated to each monthly payment during the term of the lease, the amount attributable to the "intangibles" is excluded from the measure of tax. This calculation may be made similar to the calculation for the luxury tax (discussed below) by dividing the total cost of the "intangibles" by the total number of lease payments (assuming all payments will be equal). The lease agreement should carefully set forth the costs of the "intangibles" and the method used to calculate the amounts attributed to such. If the lease agreement separately states the cost of the optional insurance, maintenance or warranty contracts, we do not believe it is necessary that each monthly payment coupon also set forth the item and its pro rata cost for that month. Of

course, the use tax collected from the lessee must be separately stated, and must be measured by the correct rentals payable (i.e., the full amounts payable less any properly excludable charges).

Please note that in order to exclude the charges for the "intangibles" from the rentals payable, those charges must be separately stated in the documentation pertaining to the lease. If the charges are not separately stated, they will be subject to tax.

The last item about which you inquire are "charges which are not a part of the cost of the leased vehicle such as the federal excise tax on luxury automobiles".

The Board's position on this issue is found in Annotation 295.1252 (12/6/90) which states:

> "Luxury Tax. Effective January 1, 1991, the United States has imposed a new retail excise tax, on the first retail sale of vehicles, boats, aircraft, jewelry and furs, to the extent that the price for such goods exceeds certain specified amounts. The rate of tax is 10 percent. The new tax is excludable from 'gross receipts,' under Revenue and Taxation Code section 6012(c)(4)(A). The amount of any such tax is nontaxable under the Sales and Use Tax Law, whether imposed with respect to a sale involving a transfer of title or a lease transaction which is treated as a 'sale' and 'purchase' under Revenue and Taxation Code sections 6006 and 6010."

Sales and Use Tax Annotations is 295.1257 (6/22/92), further clarifies the treatment of the luxury tax.

> "Revenue and Taxation Code Section 6012 excludes taxes imposed by the United States upon or with respect to retail sales. The federal luxury tax is a tax on retail sales which includes leases. When a lessor of a qualifying lease elects to pay the luxury tax up front, he or she is paying a federal excise tax on the lease which is a retail sale. Qualifying lease is a lease with a term of one year or more. Thus, the luxury tax on the lease is a tax imposed by the United States upon or with respect to retail sale, and is excluded from gross receipts. Assuming that the lease is a continuing sale and purchase, the amount excluded is a portion of each rental payment which, if the rental payments are equal, is calculated by dividing the total amount of the luxury tax by the number of rental payments due under the initial of the lease.

> "Where the luxury tax is imposed on rental payments, the amount of the luxury tax on each rental payment is excludable from the measure of tax whether the luxury tax is separately stated or included in the rental payments set forth in the lease. Also, if the lessor elects to pay the luxury tax up front and the lessee

reimburses the lessor for the tax at the beginning of the lease, the reimbursement is not included in the measure of tax."

If you have any further questions, please do not hesitate to write again.

Sincerely,

Sukhwinder K. Dhanda
Staff Counsel

SKD:plh

cc: --- District Administrator - --