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June 10, 1994

BURTON W. OLIVER
Executive Director

Re: ---

Dear Ms. ---:

I am responding to your letter of April 12, 1994. You inquire about a lease that is a taxable continuing sale. We wrote a previous letter to you, dated April 16, 1990, regarding the tax applicable to such leases. Our letter stated that we did not have enough information to ascertain whether a charge you called a "termination fee" to cover processing fees came within the exception to the general rule that all payments required by the lease are taxable rentals payable.

Our letter indicated that, if you had further questions on this issue, you should send us a copy of your lease containing the termination fee provision and that you should more fully describe the processing fee to which the termination charge relates. You have responded by enclosing a copy of a blank vehicle lease agreement, and you have highlighted section 13a which requires the payment of a termination fee. You state that you explain to your customers that the termination fee is to cover your costs associated with disposing of the returned car or processing the lease payoff. (You have also highlighted section 8b, which is a purchase option fee of \$150 plus other amounts. In our previous letter, we advised you that such amounts are subject to tax.)

As you know, leases which are continuing sales are subject to use tax measured by rentals payable. The taxable rentals payable include any payments required by the lease, with certain exceptions stated in subdivisions (A) through (F) of Regulation 1660(c)(1). Subdivision (c)(1)(D) provides that amounts paid to the lessor by the lessee for the cost incurred in disposing of the leased property at expiration or earlier termination of the lease are not subject to use tax. Section 13a of your lease contract requires the lessee to pay you a "termination fee of \$300" at the end of the lease term. Our experience is that a "termination fee" is usually merely an additional final rental payment. Such a fee would be subject to tax. You indicate that you

advise your lessees that the fees may be to cover your costs associated with disposing the returned cars. However, you have not advised us what the actual disposal costs are to which these fees relate. Further, you state that you also indicate to your lessees that the fees may relate to processing the lease payoff. Charges passed on to your lessees relating to processing the lease payoff are merely overhead expenses which cannot be deducted from the taxable rentals, whether separately itemized or not.

Based on the information you have provided, we conclude that the fees about which you inquire are subject to tax. If you have further questions, please feel free to write again.

Very truly yours,

Victor G. Matl
Tax Counsel

VGM:plh

cc: San Francisco District Administrator - BH