

M e m o r a n d u m**330.3634**

To : Mr. J. W. Cornelius, Supervisor
Audit Evaluation and Planning Section
(MIC:40)

Date: January 24, 1997

From : Sophia H. Chung
Tax Counsel

Telephone: 324-2614

Subject: *F--- C--- Leasing*
SS -- XX-XXXXXX

Your memorandum dated November 26, 1996, addressed to Mr. David H. Levine, Supervising Tax Counsel, has been referred to me for response. You request a legal opinion regarding the application of tax to the F--- C--- Leasing's ("FCL") proposed transfer of certain leased property, together with an assignment of the lease, to its wholly-owned subsidiary. With your memorandum, you furnished us with a copy of a letter dated October 28, 1996, from Ms. C--- C---, Accounting Manager of FCL. In that letter, Ms. C--- provides the following factual background:

"F--- C--- Leasing (FCL) is an out of state lessor which has made a timely election to pay sales/use tax upfront based on the cost of the equipment (office furniture and computers) being leased under a true lease transaction. Approximately one year later, FCL will transfer the lease, including all rights, title, and interest in the equipment, to a newly formed subsidiary which will continue to lease the equipment to the same end user. Although the new subsidiary will be registered to bill/collect/remit tax as a leasing company, there will be no new lease documentation between the lessee and the new subsidiary. An assignment document between FCL and new subsidiary will be used to substantiate the transfer of title."

DISCUSSION

As you know, retail sales of tangible personal property in California are subject to sales tax, measured by the gross receipts, unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax, measured by the sales price, applies to the use of tangible personal property purchased from a retailer for storage, use, or other consumption in California, unless the use is exempt from taxation by statute. (Rev. & Tax. Code §§ 6201, 6401.)

Sales and Use Tax Regulation 1595(b)(4) provides that tax does not apply to a transfer of property to a commencing corporation in exchange solely for first issue stock of the commencing corporation. Thus, if FCL transfers assets directly to its wholly-owned subsidiary solely in exchange for first issue stock of the subsidiary, such transfer is not subject to tax. To the extent that FCL receives consideration other than the commencing corporation's first issue stock, such consideration constitutes gross receipts which are subject to tax. (*Id.*)

With regard to the assignment of the lease, we assume that none of the property transferred constitutes mobile transportation equipment. A lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases the property in substantially the same form as acquired and timely pays sales tax reimbursement or use tax measured by the purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1; Reg. 1660 (b)(1) and (c)(2).)

Our understanding is that the lessor, FCL, timely paid the applicable sales or use tax measured by the purchase price of the property. The payment of the tax or tax reimbursement by FCL at the time the property was acquired constituted an irrevocable election not to pay tax measured by rentals receipts. (See Reg. 1660 (c)(3).) Thus, the lease between FCL and the lessee is not a continuing sale and purchase under the Sales and Use Tax Law.¹ When property subject to an existing tax-paid lease is transferred, together with an assignment of the existing lease, as in this case, the rental payments received by the assignee during the term of that lease are not subject to tax. (Reg. 1660 (c)(9).) For example, if the term of the existing lease between FCL and the lessee is for a period of one year, the rentals received by the assignee, FCL's wholly-owned subsidiary, during the one-year period would not be subject to tax. However, a renewal of the existing lease or any new lease would generally be a continuing sale and purchase, subject to use tax measured by rentals payable. (See Reg. 1660(c)(1).)

SHC:cl

cc: --- --- District Administrator

¹We note that a purchaser of property subject to an existing tax-paid lease cannot collect tax on rentals, but rather is required to pay tax on cost. (Rev. & Tax. Code §§ 6006(g)(5), 6010(e)(5), 6094.1; Reg. 1660(c)(9).) Here, however, FCL's wholly-owned subsidiary is not a purchaser since the transfer of the property to the subsidiary is solely in exchange for first issue stock of the commencing corporation.