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**STATE BOARD OF EQUALIZATION**

December 31, 1968

Gentlemen:

As you requested, we have reviewed the sample you provided of your lease agreement for hydraulic bumpers.

Restating the facts as we understand them, you purchased the component parts of the hydraulic bumpers giving a resale certificate to your supplier and therefore not paying any tax at acquisition. You then transfer the parts, disassembled, to your customer pursuant to the lease agreement. The number and kind of parts varies, depending upon the make of the vehicle upon which the bumper is to be installed.

The lessee assembles and installs the bumpers in accordance with printed instructions and the technical assistance of your personnel, who are provided free of charge.

Title to all parts remains in the lessor under paragraph 5 of the lease.

The lease agreement includes a "lease schedule" which shows a "unit price" for the bumpers of \$155, which is the price at which the bumpers would be sold for cash. (However, the bumpers are almost never sold for cash.) Tax is then computed on the total unit price and added thereto to arrive at the "total cost". Some form of interest or carrying charge is added to the total cost to arrive at the "total rental payable". Based on the sample, this charge appears to be slightly in excess of 10 percent per year on the total cost. The total rental is payable in equal installments over a definite period, in the example, 36 months. In other words, the total retail selling price, plus an interest charge, is recovered over the period of the lease.

At the expiration of the lease term, the lessee has the option of continuing the lease for a smaller sum, in this example, \$10 per vehicle per year. The printed lease form has no provision for transfer of title to the lessee; however, the sample supplied was amended in handwriting to provide that after the \$10 annual rental was paid for two years the lessee "would then own the products outright".

Two questions arise. First, is the contract a true lease or a conditional sales contract in the form of a lease? Second, if it is a true lease, are the bumpers leased in substantially the same form as acquired thereby affording you the election provided by Section 6006(g)(5) and Ruling 70(c)(2)(F)?

In determining whether an agreement is a true lease, we look to a number of things, but a major factor, often cited as controlling, is whether title is to remain with the lessor or to pass to the lessee for no additional fee or for a nominal sum at the end of the lease term.

Another factor is the presence of a provision that the lease can terminate the agreement at any time without paying the contract price. Where present, such a provision is evidence that a true lease exists, but its absence is not significant since a continuing obligation for the entire term is consistent with both leases and conditional sales.

In the sample you supplied, then, the transaction is a true lease for the initial term and the first renewal period. However, because the lessee will "own the products outright" at the end of the second year of additional rental after the expiration of the term, a sale occurs when the option is exercised for the second year. Tax is due on the amount of the option price, \$10.

On the other hand, the lease as printed, without the handwritten amendments, is a true lease for the entire term including renewals.

It appears to us that the option to continue the lease for a low annual rental is more consistent with a lease arrangement than with a sale. It is true that, as a practical matter, the bumpers will probably not be returned at the end of the term regardless of the actual payment of the annual rental, but by the terms of the contract, title remains with the lessor and he can legally reclaim the bumpers.

We must then determine whether the property is leased in substantially the same form as acquired, for if it is not, tax would be due on the rental receipts. We have previously held that where the components are fabricated into the final form by independent contractors, the items are in the same form but if employees of the lessor assemble the item, it is not leased in the same form. To be consistent with this ruling, it appears we must hold that assembly by the customer is equivalent to fabrication by an independent contractor, and the items are leased in substantially the same form. The question then arises whether the supervision by the lessor's employees changes the situation. In our opinion, such advice and supervision do not amount to assembly to the lessor, though it does place the transaction somewhere in between assembly by an independent contractor and assembly by employees.

Accordingly, you have the option of: (1) paying tax to your supplier, or paying tax measured by the purchase price at the time the property is first placed in rental service (in either case tax is not due on rental receipts); or (2) paying tax on the rental receipts.

Very truly yours,

T. P. Putnam  
Tax Counsel

By Lawrence A. Augusta

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