STATE BOARD OF EQUALIZATION
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August 1, 1990

Mr. P--- T. C---
A--- S--- T--- C---
XXXX ---Road, Suite XXX
---, CA XXXXX

Dear Mr. C---:

This is in response to your letter dated June 27, 1990 in which you ask for confirmation of advice given to you by Assistant Chief Counsel Gary Jugum. Company A acquired mobile transportation equipment (MTE) which it used in both intrastate and interstate commerce. Some of the MTE was acquired ex-tax and some of these were leased. All the ex-tax MTE qualified for the interstate commerce exemption pursuant to the four tests set forth in Business Taxes Law Guide Annotation 570.0430. With respect to the remaining MTE, Company A paid tax on costs. Company A now wants to lease all of its MTE to Company B, and your questions relate to Company A's tax liability for such leases.

A lessor of MTE is always regarded as the consumer of that MTE. (See Rev. & Tax. Code §§6006(g)(4), 6010(g)(4).) Thus, a sale of MTE to a person who will lease that MTE is the retail sale subject to sales or use tax. However, rather than paying tax on purchase price, the lessor may make an election to pay the tax liability that arose at the time of the purchase measured by fair rental value. (Rev. & Tax. Code §§6092.1, 6094(d), 6243.1, 6244(d).) In summary, a lessor of MTE is always regarded as the consumer of that MTE even if the lessor elects to pay use tax measured by fair rental value.

Company A held some of the MTE in question tax paid. Regardless of the manner that Company A consumes that MTE, no further sales or use tax is due, even if Company A chooses to consume that MTE by leasing it. The remainder of this opinion relates to the MTE that Company A does not hold tax paid.

By your reference to qualifying for the interstate commerce exemption pursuant to Annotation 570.0430, I assume that the relevant facts are as follows. Company A purchased the subject MTE outside California and sales tax therefore does not apply. The MTE was not first functionally used in California. (If it were, it fails the first test of Annotation 570.0430 and use tax applies.) The MTE was brought into California within 90 days from the date of purchase, raising the presumption that it was purchased for use in California. Use tax would apply unless test 3 or 4

is satisfied. The subject MTE did satisfy either test 3 or 4. That is, for a test period of six months after the MTE entered California, the MTE was used more than one-half the time outside California, or the MTE was first functionally used in interstate commerce outside California, entered California in the course of such use, and then was continuously used in interstate commerce for at least six months after the MTE entered California. (I note that with respect to any MTE failing both tests 3 and 4, Company A would owe use tax measured by purchase price. I assume that all MTE in question satisfied either test 3 or 4.)

Based on the assumptions made above, Company A acquired the subject MTE in transactions which were exempt from sales or use tax. As the consumer of that MTE, even if the MTE is leased, Company A owes no sales or use tax since it acquired the MTE in transactions exempt from these taxes and will not transfer the MTE in a transaction constituting a sale under the Sales and Use Tax Law. That is, the lease of the MTE by Company A does not effect the MTE's exempt status, without regard to the location of delivery to the lessee or how or where the equipment is used by the new lessee, and no tax liability is incurred by Company A.

Additionally, you asked for confirmation that even if the lease of the MTE from Company A to Company B occurred before the six-month test period had ended, the fact that all or part of the six-month test was after the lease began would not negate the interstate commerce exemption or create any tax liability on Company A. As mentioned above, Company A is regarded as the consumer of the MTE whether it consumes the MTE by using the MTE itself or by leasing the MTE to Company B. If the MTE is leased to Company B, Company B's use of the MTE will be regarded as the use by Company A for purposes of ascertaining whether Company A qualifies for the exemption. For example, if Company A leases the MTE to Company B after having used the MTE for four months, two and one-half months inside California and one and one-half months outside California for the next two months, Company A will have no tax liability because the presumption of purchase for use in California will have been overcome. On the other hand, if Company B were to use the MTE solely inside California for the next two months, that two months would be added to Company A's previous two and one-half month's use in California for a total California usage in the test period of four and one-half months. Use tax would apply because Company A would be regarded as having purchased the MTE for use in California. (I note that you mention a sublease. I am not certain how the sublease relates and therefore do not answer that question. If you have a question regarding subleases in this context, please write again with a more complete description.)

You also ask for confirmation that as far as Company B is concerned as a lessee of Company A, Company B incurs no sales or use tax liability. We agree. If Company A's use of the MTE is not subject to use tax, as discussed above, then Company B incurs no tax liability. Even if Company A's use of the MTE is not subject to use tax, as discussed above, then Company B incurs no tax liability. Even if Company A's use of the MTE incurs a use tax liability, that liability would be on Company A. Although Company A may collect use tax measured by fair rental value from its lessees under certain circumstances, the actual liability is on Company A and not Company B. (See generally Reg. 1661.)

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

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