

State of California

Board of Equalization
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Memorandum

To: Ms. Barbara Bolda, Area Administrator
Chicago Area Office

Date: October 26, 2009

From: Andrew J. Kwee
Tax Counsel
Tax and Fee Programs Division (MIC:82)

Subject: *Section 6406*
Assignment: 09-132

This is in response to your request for clarification of our recent legal opinion dated June 15, 2009. The request relates to a current administrative appeal matter concerning the Chicago Area Office's reaudit of REDACTED TEXT, Inc. and REDACTED TEXT Financial Company LLC (collectively taxpayer) pursuant to the Appeals Division's Decision and Recommendation and Supplemental Decision and Recommendation.

You requested clarification of our June 15, 2009, opinion letter with respect to Iowa, New York, and New Jersey (states where we previously determined that a Revenue and Taxation Code section (Section) 6406 credit may be available). Your letter states that:

I have reviewed the [taxpayer's] documents and have instances involving some leases originating in the states of [Iowa, New York and New Jersey] where the tax computed on lease payments at inception is capitalized or "built into" the monthly payment. The lease agreement does not show separately stated tax, but does show a lump sum amount that includes "fees, license, title and registration and taxes." The dealer's worksheet, however does most often show the separately stated tax.^[1] Would this qualify as separately stated and be allowable as a 6406 credit?

I also have a few instances where the tax on the lease payments is "built into" the monthly payment, but the tax on the down payment is separately stated on the lease agreement. Would the separately stated tax on the down payment be allowable?

We also understand that your request for clarification is based on a July 15, 2009, email in which the taxpayer's representative objected to the Legal Department's June 15, 2009, opinion letter to the extent it denies a Section 6406 credit to the lessee for tax that the lessor paid based on the purchase price of a leased vehicle and that was not imposed on the lease transaction by the other state. The email stated: "In your

¹ The dealer's worksheet is not provided to the lessee. The auditor also indicated that it is not always possible to determine how the amount itemized as "tax" on the dealer's worksheet correlates to the lump-sum amount listed for "fees, license, title and registration and taxes" on the lease agreement.

Opinion, you indicate that taxes paid to another state that are imposed on the lease transaction are the only taxes eligible for the lessee credit. However, we disagree”

The taxpayer’s email went on to request clarification of our June 15, 2009, opinion letter regarding Oklahoma and Virginia (also states where we previously determined that a Section 6406 credit may be available):

Regarding Oklahoma, there is only one level of tax on a lease of a motor vehicle at issue for [taxpayer]. Pursuant to Okla. Stat. 68 Sec. 1355(6), “[l]eases of twelve (12) months or more of motor vehicles in which the owners of the vehicles have paid the vehicle excise tax levied by Section 2103 of this title are specifically exempted from the tax levied pursuant to the provisions of Section 1350 [Oklahoma Sales Tax Code] et seq. of this title.”

Similarly, regarding Virginia, [l]ong[-]term vehicle leases are not subject to a sales and use tax of 4 percent of the “gross proceeds” as you indicated in your Tax Opinion. Va. Admin. Code 23 Sec. 10-210-990(a) states that “[g]enerally Sales, leases, and rentals of motor vehicles are not subject to the retail sales and use tax provided they are subject to the Virginia motor vehicle sales and use tax administered by the Department of Motor Vehicles and further provided that such tax has been paid. Any type of motor vehicle which is not subject to the motor vehicle sales and use tax shall be subject to the retail sales and use tax when sold, leased or rented.” Therefore, only the retail sales and use tax or the motor vehicle sales and use tax applies, but not both. With respect to the leases of motor vehicles at issue for [taxpayer] and most companies in the industry, the Virginia tax does not apply to lease transactions as you have defined them in the Tax Opinion. Please clarify the tax and credit treatment in Oklahoma and Virginia in your Tax Opinion.

The purpose of this memorandum is to clarify the advice provided in our June 15, 2009, opinion letter, provide further guidance as to whether a Section 6406 credit is available for taxes imposed on down-payments or capitalized tax or tax reimbursement, and address the type of documentation needed to substantiate that a lessee paid creditable tax or tax reimbursement.

The Taxpayer’s Section 6406 Concern

The taxpayer believes that a Section 6406 credit should be available for taxes that are imposed when a lessor purchases a motor vehicle and which are measured by the lessor’s purchase price in Arkansas, Illinois, Maryland, Oklahoma, Texas, and Virginia. Section 6406 provides in pertinent part that:

6406. Credit for tax paid to another jurisdiction. A credit shall be allowed against, but shall not exceed, the taxes imposed on any person by [California’s Sales and Use Tax Law] by reason of the storage, use, or other consumption of tangible personal property in this state to the extent that the person has paid a retail sales or use tax, or reimbursement therefore, imposed with respect to that property by any other state, political subdivision thereof, or the District of Columbia prior to the storage, use, or other consumption of that property in this state. The credit shall be apportioned to the taxes against which it is allowed in proportion to the amounts of those taxes.

As discussed in our June 15, 2009, opinion letter, a lessee is only entitled to claim a Section 6406 credit against taxes California imposes on lease receipts when the lessee has paid tax or tax reimbursement to the lessor for tax another state imposed on the same lease receipts. Tax imposed on the lessor's purchase or registration of a vehicle is imposed on a separate transaction that is not subject to California tax and is not creditable against California taxes measured by lease or rental receipts.² Specifically, California Code of Regulations, title 18, section (Regulation or Reg.) 1660, subdivision (c)(8) interprets Section 6406 and explains that:

A lessor who leases property in substantially the same form as acquired and who has paid a retail sales or use tax, or reimbursement therefore, imposed with respect to that property by any other state, political subdivision thereof or the District of Columbia prior to leasing the property in this state may credit the payment against any use tax imposed on him or her by this state because of such lease. However, to be entitled to the credit the lessor must make a timely election to measure any tax liability for the property by its purchase price, unless the out-of-state tax equals or exceeds the tax imposed on him or her by this state. If the out-of-state tax equals or exceeds the tax imposed on him or her by this state, the lessor will be deemed to have made a timely election and the rental receipts will not be subject to tax provided the property is leased in substantially the same form as acquired. If a timely election is not made, no credit will be allowed because the tax due will be a use tax measured by rental receipts and imposed directly against the lessee, a person other than the one who paid the out-of-state tax or tax reimbursement.

Accordingly, in cases where tax is paid to another state by the lessor based on their purchase price and the lessor does not make "a timely election [to pay California's tax based on the lessor's purchase price], no [Section 6406] credit will be allowed because the tax due will be a use tax measured by rental receipts and imposed directly against the lessee." Therefore, the lessee cannot receive a Section 6406 credit to offset an out-of-state tax imposed on the lessor based on the purchase price of a leased vehicle against California use tax imposed on a lessee based on the lease payments for the periods that the vehicle is in California.

New Jersey Leases Entered into Prior to October 1, 2005

We previously stated that a Section 6406 credit might be available to a lessee for tax reimbursement paid on New Jersey leases. However, we understand that all of the New Jersey leases at issue were entered into prior to October 1, 2005. We understand that, prior to October 1, 2005, the New Jersey tax was imposed on the lessor regardless of whether the lessor elected to pay the tax based on the purchase price of a vehicle or on the subsequent payments due under a lease of the vehicle. Further, we understand, based on a publication³ provided on the New Jersey Division of Taxation's Web site and on a communication with the New Jersey Division of Taxation, that the lessor was prohibited from collecting tax reimbursement from the lessee by separately stating the tax in the lease agreement between the lessor and the lessee. Therefore, no lessee could have paid creditable New Jersey tax or tax reimbursement and no Section 6406 is available for lease transactions entered into in New Jersey prior to October 1, 2005.

² Further, in any event, we also note that a Section 6406 credit is not available because such a tax imposed on the purchase or registration of the vehicle in the lessor's name for leasing purposes would be apportioned and allocable entirely to a period prior to the storage, use, or other consumption of the property in California. (See Rev. & Tax. Code, § 6406). Specifically, such a tax would be allocable entirely to the out-of-state purchase or registration of the vehicle.

³ <http://www.state.nj.us/treasury/taxation/pdf/njcar.pdf>

New Jersey Leases Entered into on or after October 1, 2005

We also understand that effective October 1, 2005, New Jersey's Sales and Use Tax Law was amended so that: (A) sales tax is imposed on lessees; (B) the sales tax may be measured by the original purchase price of leased property or the total of the payments due under a lease; (C) lessors must separately state the sales tax in their lease agreements, invoices, billing slips, and other documents given to lessees; and (D) lessors must collect such taxes from their lessees and remit them to New Jersey.⁴ Therefore, there may be some New Jersey taxes imposed on lessees for leases that were entered into on or after October 1, 2005, that would qualify for a Section 6406 credit.

Capitalized Tax or Tax Reimbursement

In other states where tax is paid in full at lease inception measured by the total of the rentals payable due under a lease, and the tax is imposed on the lessee, or the tax is imposed on the lessor but the lessor is permitted to collect tax reimbursement from the lessee, a Section 6406 credit may be available. This is true even if the lessor finances the tax or tax reimbursement and adds the financed amount (i.e., capitalized as to principal only) to the lease payments, rather than requiring the lessee to pay the tax or tax reimbursement in cash at lease inception. There is no legal distinction between tax or tax reimbursement that is paid in cash and tax or tax reimbursement that is paid with borrowed funds for purposes of determining whether a Section 6406 credit is available.

Identifying Tax Reimbursement

An amount will only qualify as creditable tax reimbursement if:

- There is evidence in the lease agreement that the lessee has agreed to pay tax reimbursement to the lessor; and
- The amount of tax reimbursement can be determined by reference to a separately stated amount in the lease agreement or supporting contemporaneous documentation, such as a dealer's worksheet that is drafted contemporaneously with the lease agreement and that calculates the exact amount of creditable tax reimbursement for that particular lease.

For example, a provision in a lease agreement indicating that the lessee has agreed to pay a separately stated lump-sum amount for taxes, fees, license and registration could be evidence of such an agreement, assuming the amount of tax reimbursement can be determined. If not readily determinable, the Department should review all of the documentation provided for a particular lease to see if there is sufficient evidence to establish that the lessee agreed to pay tax reimbursement to the lessor and the amount of that tax reimbursement. However, the lessor has the burden of establishing that the lessee agreed to pay tax reimbursement and the amount of the tax reimbursement, including the creditable portion of the tax reimbursement that is attributable to taxes measured by amounts subject to California use tax. In situations where there is no contemporaneous documentation explaining how a lump-sum amount for taxes, fees, license, and registration was calculated (i.e., where the lessor cannot establish the exact amount of creditable tax reimbursement paid), if reasonably feasible, the Department should estimate the amount of tax reimbursement, if any, based on the best evidence available. This would be the case where the total amount of taxes and fees, including the amounts shown for license and registration, included on a dealer's

⁴ <http://www.state.nj.us/treasury/taxation/pdf/ssutlease.pdf>

worksheet is different than the lump-sum amount listed in the lease agreement for taxes, fees, license, and registration.

Tax Imposed on a Downpayment

When a lessee leases a vehicle outside of California and then brings the vehicle into California, the lessor is required to collect California use tax on the lease payments received while the vehicle is in California, unless the lessor elects to pay tax in this state on the purchase price of the leased vehicle. (See Reg. 1660, subds. (b)(1)(E), (c)(1), (2) & (8); see also, e.g., Sales and Use Tax Annotation (Annot.) 330.3700 (8/11/65).) On the other hand, the rental receipts a lessor receives before a vehicle enters California or after such a vehicle has left California are not taxable. (See Rev. & Tax. Code, §§ 6051, 6201; see also, e.g., Annot. 330.3770 (2/17/93).)

You indicate that in some leases a separately stated amount for tax is collected on the down-payment made by the lessee at lease inception (or signing), while the leased vehicle is outside California, to reduce the total amount of the payments due under the lease. A down-payment paid to a lessor in another state, such as New York, for a period when the property is in the other state would not be subject to California use tax, as explained above. Therefore, a Section 6406 credit would not be available for taxes another state imposed on the lessor or lessee that were measured by a down-payment.

Application of Tax in Oklahoma

Our June 15, 2009, opinion letter indicated that a Section 6406 credit may be available for Oklahoma sales or use tax measured by payments due under a lease, but that no credit would be available for the Oklahoma excise taxes imposed upon a lessor at the time of vehicle registration. The taxpayer has now indicated that all of the Oklahoma leases at issue exceeded 12 months in length and that the lessor paid the Oklahoma excise tax at the time the leased vehicles were registered in Oklahoma. We understand that these types of leases are expressly exempt from Oklahoma sales and use tax pursuant to Okla. Stat. 68 Sec. 1355, subdivision (6), which states that “[l]eases of twelve (12) months or more of motor vehicles in which the owners of the vehicles have paid the vehicle excise tax levied by Section 2103 of this title are specifically exempted.” Therefore, based on the additional facts provided by the taxpayer and our understanding of Oklahoma law, no Section 6406 credit is available for the leases at issue because they were not subject to creditable Oklahoma sales or use tax.

Application of Tax in Virginia

Under Virginia law there is a motor vehicle sales and use tax administered by the Department of Motor Vehicles in addition to a retail sales and use tax administered by the Department of Taxation.⁵ Regarding Virginia’s Motor Vehicle Sales and Use Tax Law, tax applies to a sale or rental of a motor vehicle, but tax does not apply to a long-term lease of a motor vehicle. (Va. Code. Ann. § 58.1-2402.)⁶ The vehicle must be titled in the name of the lessor, and the tax is measured by the sales price (i.e., the total price the lessor paid for a motor vehicle). (See Va. Code Ann. § 58.1-2401; Va. Admin. Code 23 § 10-210-

⁵ The tax systems administered by the Virginia Department of Motor Vehicles and by the Virginia Department of Taxation both qualify as a “retail sales and use tax” for purposes of Section 6406.

⁶ The sale to or use by a person for rentals for periods of less than 12 months as an established business or part of an established business is not subject to the motor vehicle sales or use tax based on the sales price; however, the gross proceeds from the rentals are subject to the motor vehicle sales and use tax. (*Ibid*; Va. Admin. Code 24 § 20-100-10.) Further, if the vehicle ceases to be used for rental purposes, then it will also be subject to the motor vehicle sales and use tax measured by the sales price. (Va. Code. Ann. § 58.1-2402, subd. (B).) We understand that all of the leases at issue were for periods of 1 year or longer.

990; see also Virginia “Sales and Use Tax Audit Procedure.”⁷) Further, “[t]he tax on the sale or use of a motor vehicle shall be paid by the purchaser or user of such motor vehicle and collected by the Commissioner at the time the owner applies to the Division of Motor Vehicles for, and obtains, a certificate of title.” (Va. Code. Ann. § 58.1-2404.) A motor vehicle subject to the motor vehicle sales and use tax would include “every vehicle . . . which is self-propelled or designed for self-propulsion.” (Va. Code. Ann. § 58.1-2401; Va. Admin. Code 23 § 10-210-990, subd. (B).) In summary, we understand that every lessor who purchases a motor vehicle for long-term lease in Virginia must pay the motor vehicle sales or use tax, measured by the sales price to the lessor, at the time the lessor applies for a certificate of title in Virginia.

Generally, a sale, lease or rental of a motor vehicle is not subject to Virginia’s retail sales and use tax provided that the transaction was subject to the motor vehicle sales and use tax and further provided that the motor vehicle sales and use tax has been paid.⁸ (Va. Admin. Code 23 § 10-210-990, subd. (A).) Any type of motor vehicle which is not subject to the motor vehicle sales and use tax shall be subject to the retail sales and use tax when sold, leased or rented. (*Ibid.*) When a lease is subject to Virginia’s retail sales and use tax (such as when the motor vehicle sales and use tax was not paid), tax applies to the lease transaction and is measured based on “four percent . . . [o]f the gross proceeds derived from the lease.” (Va. Code. Ann. § 58.1-603, subd. (2).) Therefore, a transaction involving a motor vehicle will either be subject to the retail sales and use tax or the motor vehicle sales and use tax, but not both.

On June 24, 2008, we issued an internal memorandum explaining our position with respect to the Section 6406 issue for the reaudit of taxpayer. This memorandum explained that a Section 6406 credit would be available for an up-front Virginia tax imposed on a lease transaction at lease inception if the tax was measured by “the total amount of all the payments stated in the lease.” Later, in an opinion letter dated June 15, 2009, we further elaborated that a Section 6406 credit would be available for Virginia leases to the extent taxpayer’s “[l]ong[-]term vehicle leases are also subject to a [retail] sales and use tax of 4 percent of the ‘gross proceeds’ (Va. Code. Ann. § 58.1-603, subd. (2) [citing the Virginia Retail Sales and Use Tax Law].”

The taxpayer subsequently requested clarification based on the fact that the leases at issue were not subject to a retail sales and use tax measured by four percent of the gross proceeds from the lease. Specifically, because the lessor had paid the motor vehicle sales and use tax based on the lessor’s purchase price, there was no tax imposed on the lease transaction under either the retail sales and use tax or the motor vehicle sales and use tax. Therefore, because under the facts of this case tax did not apply to the leases at issue in Virginia, a Section 6406 credit is not available with respect to taxpayer’s Virginia leases. Accordingly, based on our better understanding of the application of Virginia law to the facts at issue, we no longer believe that any possibility for Section 6406 credit exists with respect to any of the Virginia lease transactions in dispute.

⁷ http://www.tax.virginia.gov/web_pdfs/FieldAuditGuidelines.pdf

⁸ We understand that this is in the nature of a back-up tax (i.e., a purchaser is not given the option to elect to pay the tax administered by the Department of Taxation in lieu of the tax administered by the Department of Motor Vehicles).

Please feel free to contact me with additional questions.

AJK/yg

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Encl: Letter dated June 15, 2009

cc: Ms. Denise Colin (OHA)
Mr. Joe Lehnert (OHA)

Mr. REDACTED TEXT
Jacksonville, FL 32202-2646

Ms. REDACTED TEXT
Tampa, FL 33602



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June 15, 2009

RAMON J. HIRSIG
Executive Director

Mr. REDACTED TEXT
Jacksonville, FL 32202-2646

Re: Tax Opinion Request 08-441
REDACTED TEXT , Inc.
SS OHA REDACTED TEXT ; Case ID: REDACTED TEXT
REDACTED TEXT Financial Company LLC
SR OHA REDACTED TEXT ; Case IDs: REDACTED TEXT

Dear Mr. REDACTED TEXT :

This is in response to your letter dated November 17, 2008, in which you request additional guidance as to the proper application of California's Sales and Use Tax Law to certain leases of motor vehicles owned by your clients, REDACTED TEXT, Inc. and REDACTED TEXT Financial Company LLC (collectively taxpayer). After reviewing your letter and discussing this matter with you in a telephone conversation, I understand the pertinent facts and questions to be as follows:

A lessor (taxpayer) entered into various lease transactions throughout the United States. All of the leases involved motor vehicles. Some of the lease transactions were subject to tax in a state other than California, either on a "periodic" basis measured by rentals payable, or on an "up-front" basis measured by the total amount of payments due under the lease. At issue are leased vehicles which were initially leased outside this state and were subsequently brought into California, where they became subject to California's use tax, which taxpayer, as the lessor of all the vehicles in question, was required to collect from the lessees under Revenue and Taxation Code section (Section) 6203, subdivision (b). Upon audit, it was determined that taxpayer failed to collect the correct amount of use tax from lessees with respect to leased vehicles that were either physically present in California or that were brought into California soon after the inception of the lease.

Taxpayer asserts that its responsibility for collecting the California use tax under Section 6203 should be reduced to the extent that the lessees are entitled to a Section 6406 credit against California use tax due on the periodic lease payments. Taxpayer further asserts that the lessees are entitled to a Section 6406 credit with respect to amounts listed in the lease as "tax" or "tax reimbursement" that the lessees must pay and did in fact pay to taxpayer or to a state other than California. Specifically, taxpayer requests advice whether a Section 6406 credit is available for amounts identified in the lease as "tax" or "tax reimbursement" and paid by taxpayer or the lessee to the following jurisdictions: (1) Arkansas, (2) Illinois, (3) Iowa, (4) Maine, (5) Maryland, (6) North Dakota, (7) New Jersey, (8) New York, (9) Oklahoma, (10) South Dakota, (11) Texas, (12) Vermont, and (13) Virginia. Taxpayer requests an opinion describing the circumstances required for tax or tax reimbursement paid to any of the above listed jurisdictions to be creditable for purposes of Section 6406.

Before discussing your questions in more detail below, I note that the facts you provided are not sufficiently complete. Therefore, I have made assumptions throughout this opinion letter to answer your questions. If the actual facts differ from the facts summarized in this letter, or if any of the assumptions I have made are incorrect, the opinions expressed in this letter may not be reliable. Provided that the facts in this letter (both summarized and assumed) are accurate and verifiable by audit, the taxpayer may rely on this response for purposes of Revenue and Taxation Code section (Section) 6596. (See Cal. Code Regs., tit. 18, (Regulation or Reg.) § 1705, subd. (b) [describing the circumstances under which relief from liability is available for reasonable reliance on written advice given by the Board].)

I note that taxpayer is currently under audit by the Chicago Area Office of the Board of Equalization's Out-of-State District for several issues including the failure to collect use tax on unreported vehicle leases as required by Section 6203, with respect to 155 vehicles that were brought into California after lease inception. The specific issue presented to us concerns vehicles for which the Appeals Division found that a timely election to pay tax on cost was not made but where the lessee might have paid tax or tax reimbursement to another state. The Appeals Division issued a Decision and Recommendation (D&R) in this matter on February 10, 2004, and a Supplemental D&R on May 10, 2006. Specifically, the May 10, 2006, Supplemental D&R states: "If petitioner proves that a lessee is entitled to his or her own section 6406 credit against his or her own California use tax liability, then petitioner is not responsible for remitting California use tax measured by the amount of such credit" (the Section 6406 issue). Subsequently, the Legal Department issued an internal memorandum on June 24, 2008, explaining our position with respect to the Section 6406 issue. This letter adopts and expands upon the advice provided in our June 24, 2008, memorandum. This letter offers advice solely with respect to the issue presented to the Legal Department. Nothing in this letter should be construed so as to contradict any recommendation by the Appeals Division or advice given in our June 24, 2008, memorandum.

I assume that taxpayer acquired the vehicles at issue from a third party at fair market value and that all the subsequent lease transactions involve passenger vehicles¹ leased for a term of one year or longer. I further assume that in all transactions the lessee paid a separately stated and identified amount to taxpayer for “tax” or paid tax directly to another jurisdiction. I also assume that none of the vehicles are leased to persons who are statutorily exempt from paying use tax when they purchase property for use in this state, as may be the case with leases to insurance companies, as one example. (See Reg. 1567, subd. (b).) In transactions where the lessees paid amounts for “tax” or tax reimbursement to taxpayer, I assume that taxpayer remitted the full amount of “tax” or tax reimbursement collected to the taxing jurisdiction.

DISCUSSION

As a starting point, California imposes sales tax on a retailer’s gross receipts from the retail sale of tangible personal property in California unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code, § 6051.) A sale includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for consideration. (Rev. & Tax. Code, § 6006, subd. (a).) The sales tax is imposed on the retailer, who may then collect reimbursement from its customer if the contract of sale so provides. (Civ. Code, § 1656.1; Reg. 1700.)

When sales tax does not apply, use tax may be imposed measured by the sales or rental price of property purchased from a retailer for storage, use, or other consumption in California. (Rev. & Tax. Code, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (Rev. & Tax. Code, § 6202, subd. (a).) A retailer engaged in business in California is required to collect this tax from its customers and remit it to the Board. (Rev. & Tax. Code, §§ 6202, 6203.) Further, a retailer deriving rentals from the lease of tangible personal property situated in California is a retailer engaged in business in this state. (Rev. & Tax. Code, § 6203, subd. (c)(3).)

I. Taxation of Transactions Involving Leased Property

Your letter states that all of the transactions involve leases.² Leases of tangible personal property in California are regarded as continuing sales and purchases subject to tax unless: (1) the lessor has paid California sales tax reimbursement at the time of the sale or has timely reported and paid California use tax measured by the purchase price of the property by the time it was first placed in rental service and (2) the lessor subsequently leases the property in substantially the same form as acquired. (Rev. & Tax. Code, § 6006, subd. (g)(5); Reg. 1660, subd. (c)(2); see Rev. & Tax. Code, §§ 6006.1, 6010, subd. (e)(5), 6010.1.) To be timely, the lessor must pay California sales tax reimbursement or must report and pay use tax based on the purchase price with the return for the period during which the leased property is first placed in rental service. (Reg. 1660, subd. (c)(2); *Action Trailer Sales, Inc. v. State Bd. of Equalization* (1975) 54 Cal.App.3d 125, 132 [use tax must be paid by due date of tax return for the quarter the rental property is placed in service].) Leases regarded as continuing sales and purchases as defined above are subject to California use tax measured by the rentals payable. (Reg. 1660, subd. (c)(1).) The term “rentals payable” includes any payments required by the lease. (Reg. 1660, subd. (c)(1).) The liability for the tax is imposed on the lessee but the lessor is required to collect it from the lessee and remit it to the Board. (Rev. & Tax. Code, §§ 6202, 6203, subd. (b), (c)(3); Reg. 1660, subd. (c)(1).)

¹ For purposes of this letter I use the term “passenger vehicle” to mean a vehicle defined in Section 465 of the California Vehicle Code. This opinion does not apply to leases of mobile transportation equipment as defined in Section 6023.

² The term “lease” includes rental, hire and license. (Rev. & Tax. Code, § 6006.3; Reg. 1660, subd. (a)(1).)

It is not disputed that the transactions identified by taxpayer involve leases regarded as continuing sales and purchases (as defined above) which are subject to use tax in California on a periodic basis measured by rentals payable for the lease periods the leased vehicles are situated in this state. (See Rev. & Tax. Code, §§ 6006.1, 6010.1, 6203, subd. (c)(3).) Consequently, taxpayer, as the lessor, is required to collect the use tax and remit it to the Board, but taxpayer's liability for failing to collect the California use tax from a lessee is reduced to the extent that the lessee is entitled to a credit for California tax with respect to a lease period that was subject to tax in California and in another jurisdiction. (See Rev. & Tax. Code, § 6203, subd. (b); Reg. 1684, subd. (a).) Therefore, your request focuses entirely on the question of when a credit is available to a lessee for a payment of tax imposed on a lease transaction³ by a state other than California (lease state).⁴

1. The Section 6406 Credit

Section 6406 generally provides that a credit is allowed against California sales or use tax imposed on a transaction, if the retailer or purchaser has paid a retail sales or use tax, or reimbursement therefore, that was previously⁵ imposed on the same transaction with respect to that property⁶ by another jurisdiction. (Rev. & Tax. Code, § 6406.) Further, an otherwise allowable credit will not be permitted for out-of-state tax imposed on, allocable to, or paid for a tax or lease "period prior to the storage, use, or other consumption of the property" subjecting the receipts to tax in California. (*Ibid.*) Thus, for example, if a state other than California imposes a tax at lease inception on the total proceeds due under a lease and that same lease transaction is subsequently subject to California use tax based on rentals payable, then the tax paid to another state shall be apportioned to all the lease periods and proportionately creditable only for those periods for which the lease is actually subject to tax in California. (See *Ibid.*)

2. Multistate Tax Issues

A lessor that paid tax or reimbursement for tax imposed by a state other than California on the sale of the property to that lessor, because the property was purchased and initially leased outside this state, may elect to pay California use tax based on the lessor's purchase price by timely filing a return and taking a Section 6406 credit for the tax that the lease state imposed on the sale of the property to the lessor. (Reg. 1660, subd. (c)(8).) The lessor is deemed to have made this election if the amount of out-of-state tax imposed on the sale of the property to the lessor equals or exceeds the use tax imposed in California. (Reg. 1660, subd. (c)(8).) As discussed earlier, even if California use tax is paid on the purchase price the lease receipts for the subsequent lease transaction are still subject to California use tax unless the property is leased in substantially the same form as acquired. (Rev. & Tax. Code, § 6006, subd. (g)(5); Reg. 1660, subd. (c)(8).)

When the requirements discussed above are not met, then the lease receipts will be subject to use tax in California measured by rentals payable for periods that the property is situated in California. (Reg. 1660,

³ The tax imposed on the lease transaction refers (collectively) to the tax imposed on the individual lease receipts, which may be subject to tax in the lease state when they are paid to the lessor or up-front based on the total number of lease periods specified in the lease agreement (discussed below).

⁴ I use the term "lease state" to refer to any jurisdiction where a lease transaction originates, other than California, that is either a part of the United States, a political subdivision of that state, or the District of Columbia. (See Rev. & Tax. Code, § 6406.)

⁵ In other words, a Section 6406 credit is not available unless the lease state first imposed a tax on the lease transaction which was at a time "prior to the storage, use or other consumption of the" leased property in California that subjected the lease to tax in California. (See Rev. & Tax. Code, § 6406.)

⁶ The relevant out-of-state tax imposed with respect to the property is tax imposed upon a payment (lease receipt) which is made or required to be made by the lessee to the lessor for a lease period involving that leased property.

subds. (b)(1)(e), (c)(8).) In this situation, if the out-of-state tax was imposed on the sale to or use of the property by the lessor and the lease receipts were not subject to tax in the lease state, then the Section 6406 credit will not be available to either the lessor or the lessee “because the tax due [in California] will be a use tax measured by rental receipts and imposed directly against the lessee, a person other than the one who paid the out-of-state tax or tax reimbursement.” (Reg. 1660, subd. (c)(8).) The lessee can only claim a credit for tax or reimbursement for tax imposed on the subsequent lease transaction (e.g., lease proceeds or lease receipts) by the lease state. (Rev. & Tax. Code, § 6406.) In other words, the lessor’s purchase or use (or registration) of property and the lessor’s subsequent lease transactions involving that property are treated as entirely separate transactions for purposes of the Section 6406 credit for tax paid to another state. (See Rev. & Tax. Code, § 6406; Reg. 1660, subd. (c)(8).) Therefore, while a credit might be available to a lessee for tax imposed by a lease state (either up-front or on a periodic basis) upon the lease receipts or proceeds, no credit is available to the lessee for tax imposed on the sale to or use of the property by the lessor.⁷ (See Reg. 1660, subd. (c)(8).)

3. Additional Requirements to Claim a Section 6406 Credit

Although the out-of-state tax liability may have been on the lessee, the lessor, or on both the lessor and lessee jointly and/or severally, in order to claim a credit the lessee must show that: (1) tax was actually imposed on the lease transaction at issue between the lessor and the lessee and (2) the lessee directly paid the amount for which credit is claimed to the lease state or paid to the lessor an agreed upon and separately stated and invoiced amount pursuant to the lease contract for that tax or tax reimbursement. (See Rev. & Tax. Code, § 6406.) For example, if a lessor pays a six percent sales or use tax to a lease state upon the \$10,000 purchase of a vehicle and the lease state does not tax the proceeds from the subsequent lease of the vehicle, the lessee’s lease payment cannot include creditable “tax” or “tax reimbursement” because the lease receipts are not subject to tax and the lessee was not a party to any taxable transaction. (See Reg. 1660, subd. (c)(8).) In addition, we would reach the same conclusion, even if the lessor shifted the economic burden of the tax to the lessee by increasing the amount of the periodic or up-front payments due from the lessee by the \$600 in tax the lessor paid to the lease state on the purchase or registration of the vehicle. Furthermore, if otherwise creditable tax or tax reimbursement were paid to the lessor, the lessee cannot claim a Section 6406 credit unless the lessor actually paid the tax to the lease state or the lessee received and retained a receipt for the tax from the lessor as explained under Regulation 1686. (Reg. 1660, subd. (c)(1); see Reg. 1686, subd. (a).)

II. Applying the Section 6406 Credit to Common Lease Transactions

As discussed, the lessee may be able to claim a Section 6406 credit if the lessee paid tax or reimbursement for tax that was imposed on the lease transaction by the lease state. (See Rev. & Tax. Code, § 6406.) Examples of creditable transactions may include transactions where the lease state imposed a tax on the lease transaction on an up-front basis or on a periodic basis.

1. Up-Front Leases

An up-front lease is a lease transaction subject to a sales or a use tax measured by the total dollar amount of the payments due under the lease and payable at lease inception. For up-front leases, the lessee may be able to take a Section 6406 credit to the extent that the lessee already paid: (1) tax directly to the lease state or a separately stated and identified amount of “tax” or “tax reimbursement” to the lessor and (2)

⁷ The fact that the out-of-state tax is due at lease execution or when property is titled or registered by the lessor does not mean that the lease transactions (e.g., the lease receipts or lease proceeds) are subject to an up-front tax.

the lease state was the first state to impose a retail sales or use tax on the transaction at issue. (Rev. & Tax. Code, § 6406.) The creditable amount for each period is the tax that would have been due in the lease state if the tax were collected on a periodic basis; thus the maximum credit allocable to each period is generally the total tax imposed up-front divided by the number of lease payments required under the lease. (See *Ibid.*) As discussed, no credit is available for tax paid for and/or allocable to a period prior to the storage, use, or other consumption of the property in this state that subjected the lease receipts to California use tax. (See *Ibid.*)

2. Periodic Leases

The Section 6406 credit against California use tax may also be available if the lease state taxed the lease transaction on a periodic basis. (See *Yamaha Corp. of Am. v. State Bd. of Equalization* (1999) 73 Cal. App. 4th 338, 368 [suggests a Section 6406 credit is available in instances where a transaction is subject to double taxation].) A periodic lease is a lease subject to tax measured by the rentals payable. (See Reg. 1660, subd. (c)(1).) The Section 6406 credit is available to the lessee when the lease state and California are both imposing a tax on the same lease payment if: (1) the lessee directly paid the tax to the lease state or the lessee directly paid a separately stated and identified amount of “tax” or “tax reimbursement” to the lessor, (2) for a lease payment covering a period that the vehicle was physically present and subject to tax in California, and (3) the lease state was the first state to impose a retail sales or use tax on the transaction at issue. (See Rev. & Tax. Code, § 6406; see also, Multistate Tax Compact, Art. V, subd. (1).) Again, the lessee does not receive credit for tax paid to another state if it was paid for or allocable to “a period prior to the storage, use, or other consumption of the property in this state” that subjected the lease receipts to California use tax. (Rev. & Tax. Code, § 6406.)

III. Tax or Reimbursement for Tax Imposed by Other States

Your letter indicates that you believe some of taxpayer’s transactions may involve up-front leases as described above. You request advice describing the circumstances, if any, under which amounts itemized as “tax” or “tax reimbursement” and paid by a lessee pursuant to a lease contract in certain jurisdictions would be creditable for purposes of Section 6406. The jurisdictions are: (1) Arkansas, (2) Illinois, (3) Iowa, (4) Maine, (5) Maryland, (6) North Dakota, (7) New Jersey, (8) New York, (9) Oklahoma, (10) South Dakota, (11) Texas, (12) Vermont, and (13) Virginia.

You state that the leased property was brought into California after lease inception, but you do not provide any facts describing any individual transaction. Please note that even if it is determined that a Section 6406 credit is available for a transaction, the credit will be proportionately disallowed with respect to any amount of out-of-state tax imposed on, paid for, or allocable to a lease period prior to the storage, use, or other consumption of the property in this state that subjected the lease receipts to tax in California. (See Rev. & Tax. Code, § 6406). As no facts were provided, and because it would not be feasible for the Board’s Legal Department to provide advice based on the facts of every individual transaction, the actual facts (and amount of credit allowable based on those facts) will be determined at the time of the audit.

1. Arkansas

We researched Arkansas Sales and Use Tax Law as it applies to leases or rentals of motor vehicles for periods of 30 days or longer to a single lessee. As relevant to your inquiry, our understanding is that at the time a lessor registers a vehicle with the State of Arkansas the lessor must irrevocably elect either (1) to pay sales or use tax on the purchase price of the vehicle and the subsequent lease transaction(s) are not subject to tax or (2) treat the sale to the lessor as an exempt sale for resale. (See Ark Code Ann., §§ 26-52-

101 et. seq. [sales tax], 26-53-101 et seq. [use tax], 26-63-304 [long term rental vehicle tax]; Ark. Regs. GR-20, subd. (D).) If the latter is elected, the lease payments required under the lease transaction(s) are subject to a sales tax and long term rental vehicle tax as they become due. (Ark. Regs. GR-20, subd. (D)(3)(a).) If the lease transaction is taxed on a periodic basis, the liability to pay the tax is on the lessor regardless of whether or not the lessee timely makes any of the payments required under the lease. (Ark. Regs. GR-20, subd. (D)(3)(a),(b).)

Application of California's Section 6406 Credit

Your letter states that taxpayer opted to pay the sales or use tax based on purchase price at the time that taxpayer registered the motor vehicles and for this reason the lease transaction(s) are not subject to tax under Arkansas' Sales and Use Tax Law. Thus, under these facts, the lessee was not a party to the taxable transaction between the lessor and the automobile seller. (See Reg. 1660, subd. (c)(8).) Further, the lessee could not have paid any amount of "tax or reimbursement therefore" that was imposed on the lease transaction because the lease receipts were not subject to tax in Arkansas. It is irrelevant that the lessee bore the economic burden of the tax. The lessee is not entitled to a Section 6406 credit because the lessee was not a party to any taxable transaction.

2. Illinois

As relevant to your inquiry, our understanding of Illinois law is that a lessor of an automobile, who rents or leases the use of an automobile for a term of one year or more, is subject to use tax on their purchase price of the automobile. (Ill. Admin. Code, tit. 86, § 130.2010, subd. (b).) The lessor is not considered a retailer of the leased property; instead they are a "user" of the property and generally must pay use tax on the purchase price even if the lease will be made to an exempt entity. (Ill. Admin. Code, tit. 86, §§ 130.2010, subd. (b), 150.305, subd. (e).) Regarding the subsequent lease transaction, tax does not apply to the rental payments made by the lessee to the lessor. (Ill. Admin. Code, tit. 86, § 150.305, subd. (e).)

Application of California's Section 6406 Credit

No credit is available to the lessee because the lease receipts were not subject to tax and the lessee was not a party to any taxable transaction.

3. Iowa

Effective July 1, 2008, Iowa amended their Sales and Use Tax law. (See 2008 Ia. ALS 1113.) Your letter only requests advice with respect to leases entered into prior to July 1, 2008. Prior to that date, Iowa imposed a Motor Vehicle Lease Tax on leases of vehicles for a period of 12 months or longer as follows: (1) the purchase of a vehicle to be used for leasing purposes was exempt from tax and (2) instead the total amount of the lease payments due under the lease were subject to a 5 percent use tax due at the lease inception. (Iowa Code § 423.27, subds. (1), (2). [repeal effective 7/1/08].) The liability is imposed on the lessor, who may collect reimbursement from the lessee if the lease contract so provides. (*Ibid.*) Therefore, pre-July 1, 2008, lease transactions were subject to tax in Iowa.

Application of California's Section 6406 Credit

The lease described above is an up-front lease because the tax was imposed on the lease transaction at lease inception based on total payments due under the lease. Unlike in Arkansas, leases in Iowa are

subject to tax. The lessee was a party to the lease transaction, therefore the lessee might have paid an amount of “tax or reimbursement therefore” that was previously imposed on the lease transaction by a state other than California. It is irrelevant whether the lessor, the lessee, or both the lessor and lessee are jointly or individually liable for payment of the tax to the state. (See Rev. & Tax. Code, § 6406.) Provided the additional requirements for claiming a Section 6406 credit are met (as explained above), the lessee may be able to take a Section 6406 credit for tax or reimbursement for tax that Iowa imposed on a pre-July 1, 2008, lease transaction to the extent the payment is allocable to periods that the property was stored, used or consumed in California. (See *Ibid.*)

4. Maine

Our understanding of Maine Sales and Use Tax law is that: (1) sales tax does not apply to automobiles sold to a person engaged in the business of renting or leasing automobiles if purchased for rental or lease for any length of time, and (2) the subsequent lease or rental is subject to a 5 percent tax due at lease inception and measured by the total amount of payments due under the lease (including any amount for which credit was given such as a down payment or trade-in allowance). (Me. Rev. Stat. Ann. §§ 1752, subds. (11)(B)(3), (5), 1811.) The tax is the liability of the person that negotiates the lease transaction. (Me. Rev. Stat. Ann. § 1811.) Therefore, Maine imposes a 5 percent up-front tax on lease transactions.

Application of California’s Section 6406 Credit

A Section 6406 credit might be available to the lessee for leases in Maine subject to tax an up-front tax due at lease inception. The analysis is the same as it was for Iowa.

5. Maryland

Maryland does not impose tax on a lease of a motor vehicle for periods of one year or longer. (Md. Code Ann. Tax-Gen. § 11-221, subd. (a)(5).) Although the lease transaction is not subject to tax, the lessor would have previously paid an excise tax when they registered and received a certificate of title for the motor vehicle from the state of Maryland. (Md. Code Ann. Tax-Gen. § 13-809, subd. (b)(1).) The excise tax is based on the fair market value of the vehicle as defined under Maryland law. (See Md. Code Ann. Tax-Gen. §13-809, subds. (a), (c).) Therefore, leases in Maryland are not subject to tax.

Application of California’s Section 6406 Credit

No credit is available to the lessee because the lease receipts were not subject to tax in Maryland and the lessee was not a party to any taxable transaction. The analysis is the same as it was for Arkansas.

6. North Dakota

Our understanding of North Dakota law is that North Dakota imposes an excise tax on the lease of a motor vehicle weighing less than 10,000 pounds that is leased for a lease term of 1 year or more. (N.D. Admin. Code § 81-05.1-01-02, subd. (2).) All vehicles titled for leasing purposes are subject to the excise tax.⁸ (N.D. Admin. Code § 81-05.1-01-04, subd. (1).) The tax is the liability of the lessor and must be paid in full by the first payment due under a lease. (N.D. Cent. Code § 57-40.3-02.1, subd. (1).) The tax is based on “the total consideration of the lease at the time the lease is initiated,” but certain additional charges made

⁸ See North Dakota Office of State Tax Commissioner Guideline 22071, available at: “<http://www.nd.gov/tax/salesanduse/pubs/guide/gl-22071.pdf>.”

after the inception of the lease are also subject to this tax. (N.D. Admin. § Code 81-05.1-01-04, subd. (1).) Therefore, certain leases of motor vehicles in North Dakota are subject to an up-front excise tax measured by rental receipts required under the lease.

Application of California's Section 6406 Credit

A Section 6406 credit may be available to a lessee for lease transactions in North Dakota that were subject to an up-front tax as described. The analysis is the same as it was for Iowa.

7. New Jersey

Prior to October 1, 2005, New Jersey imposed tax on certain transactions if the property (including automobiles) was sold or would be leased for a period of more than 28 days. (N.J. Stat. § 54:32B-2, subd. (bb) [Repealed eff. 10-1-05]; see N.J. Admin. Code 18:24-1.4, subd. (p) [Repealed eff. 12-1-08].)⁹ Tax was due at the time of the sale or lease execution, and in the latter case the lessor had the option to elect (1) to pay tax on the lessor's purchase price or (2) to pay tax based on the total lease payments due under that lease. (See *Ibid.*) If the second option is chosen, the tax applies to the current lease and all subsequent leases involving the property. (See *Ibid.*) After October 1, 2005, all leases for terms exceeding 6 months are subject to tax based on the Streamlined Sales and Use Tax Law which basically eliminates the option to pay tax on purchase price and provides a different formula to calculate the taxable amount of the total lease payments due under the lease. (See § N.J.S.A. 54:32B-7(d).)¹⁰ Therefore the lease receipts from all lease transactions entered into after October 1, 2005, and some lease transactions entered into prior to this date, are subject to an up-front tax in New Jersey.

Application of California's Section 6406 Credit

Your letter indicates that taxpayer elected in all instances to pay tax up-front measured by the lease receipts due under the lease instead of on the purchase price of the property. A Section 6406 credit may be available to a lessee for lease transactions in New Jersey that were subject to an up-front tax as described. The analysis is the same as it was for Iowa.

8. New York

The sale of tangible personal property in New York to a lessor for long term leasing purposes is an exempt sale for resale. (N.Y. CLS Tax § 1101, subd. (b); 20 NYCRR § 526.7(a)(2); see 20 NYCRR § 527.15, subd. (c).) With respect to the subsequent lease transaction, as discussed in our June 28, 2008, memorandum, New York imposes an up-front tax on leases of certain motor vehicles for a term of one year or longer based on total rentals to be paid under the lease and is due at lease inception. (N.Y. CLS Tax § 1111, subd. (i)(A); 20 NYCRR § 527.15, subd. (c).)

Application of California's Section 6406 Credit

A Section 6406 credit may be available to a lessee for lease transactions in New York that were subject to an up-front tax as described. The analysis is the same as it was for Iowa.

⁹ See New Jersey Sales and Use Tax Guide for Automobile Dealers: <http://www.state.nj.us/treasury/taxation/pdf/njcar.pdf>

¹⁰ See "Summary of Changes in Tax Base for Motor Vehicle Lease Transactions under the Streamlined Sales and Use Tax Law (Effective 10-01-05)" available at: <http://www.state.nj.us/treasury/taxation/mvleasetrans.shtml>

9. Oklahoma

First, with respect to the sale of a motor vehicle, an excise tax under the Oklahoma Vessel and Motor Excise Tax Act applies based on the value of the vehicle at the time the vehicle is registered in the state (e.g., anytime title transfers) and the excise tax is imposed in lieu of a sales or use tax on the sale of a motor vehicle. (Okla. Stat. 68 §§ 4103, subd. (A), 4107; see Okla. Stat. 68 §§ 2103, subds. (A)(1), (3), 2104 [defining “value” of vehicle].)

Second, with respect to a “lease” of a motor vehicle, Oklahoma’s Sales and Use Tax Code imposes a tax in addition to the Motor Vehicle Excise Tax when there is only a transfer of possession of the motor vehicles. (Peterson v. Oklahoma Tax Commission (Okla. 1964) 1964 OK 78.) The tax is imposed on the gross receipts or gross proceeds from a lease of tangible personal property.¹¹ (Okla. Stat. 68 § 1354, subd. (A)(18) & Okla. Admin. Code § 710:65-1-11, subd. (a) [Eff. 11-1-07.];) In Oklahoma a lease or rental “means any transfer of possession or control of tangible personal property for a fixed or indeterminate term for a consideration.” (Okla. Admin. Code § 710:65-1-2.) The term “lease or rental” also includes “agreements covering motor vehicles and trailers where the amount of consideration may be increased or decreased by reference to the amount realized upon sale or disposition of the property as defined by 26 U.S.C. § 7701(h)(1).” (Okla. Admin. Code § 710:65-1-2.)¹² The terms gross receipts and gross proceeds refer to “the total amount of consideration, including cash, credit, property and services, for which personal property or services are sold, leased or rented, valued in money, whether received in money or otherwise.” (Okla. Admin. Code § 710:65-1-9.)

Therefore we understand that there are two levels of tax in Oklahoma; the first tax is imposed when the lessor registers a vehicle and the second tax is imposed on the gross receipts or gross proceeds from leasing the vehicle. (See 68 Okl. St. § 2103; Okla. Admin. Code §§ 710:65-18-3, 710:65-1-11, subd. (j).)

Application of California’s Section 6406 Credit

No Section 6406 credit is available to a lessee with respect to the excise tax paid by the lessor when a vehicle is registered in Oklahoma because the excise tax is not imposed on the gross receipts or gross proceeds from the lessee’s lease. However, a Section 6406 credit might be proportionately available to a lessee who paid tax or tax reimbursement for Oklahoma sales or use tax imposed on the gross receipts or gross proceeds from the lessee’s lease of a vehicle to the extent that both Oklahoma and California imposed tax on the same lease payments for the same lease periods.

10. South Dakota

Our understanding is that South Dakota imposes a motor vehicle excise tax when a motor vehicle is purchased for use in South Dakota. (S.D. Codified Laws § 32-5B-1.) A purchase for use includes a lease of a motor vehicle for use in South Dakota for a period exceeding 28 days. (S.D. Codified Laws § 32-5B-1.1.) The excise tax is imposed at the time the vehicle is titled for leasing purposes and the lessee must be listed on title. (*Ibid.*) The measure of tax is the “total consideration whether received in money or otherwise” for

¹¹ The definition of “gross proceeds” was amended effective November 1, 2007. (See Okla. Stat. 68 § 1354, subd. (A)(17) [prior to 11-1-07].)

¹² We note that if the lessee subsequently purchases the leased vehicle, the lessee’s purchase is exempt from the Oklahoma Vessel and Motor Excise Tax if an excise tax “was paid at the time of the initial lease or lease-purchase agreement.” (Okla. Stat. 68 § 2105, subd. (14).)

the lease, and generally the “[t]otal consideration is all lease payments including cash, rebates, the net trade-in, extended warranties. . . .”¹³ (S.D. Codified Laws § 32-5B-4, subd. (7).) Therefore, the lease transactions described above are subject to tax in South Dakota.

Application of California’s Section 6406 Credit

A Section 6406 credit may be available to a lessee for lease transactions in South Dakota that were subject to an up-front tax as described above that was based on the total amount required to be paid by the lessee during the lease period. The analysis is the same as it was for Iowa.

11. Texas

With respect to leases of motor vehicles for periods exceeding 180 days, the: “Lease payments are not taxed in Texas. The lessor pays 6.25 percent motor vehicle sales tax when the [leased] vehicle is purchased and titled in Texas.” (Texas Comptroller of Public Accounts, Publication 96-116 (Rev. March 2009), p. 5.)¹⁴ Furthermore, the “6.25 percent sales tax is imposed on the retail sales price (less trade-in allowances) [to the lessor] of [leased] motor vehicles sold in Texas.” (Id at p. 1.) Therefore, we understand that taxpayer’s leases are not subject to tax in Texas. (See Tex. Tax Code Ann. § 152.021, subd. (a); Tex. Admin. Code § 3.70, subd. (a); Tex. Admin. Code § 3.70, subd. (a).)

Application of California’s Section 6406 Credit

No credit is available to the lessee because the lessee was not a party to a taxable transaction. The analysis is the same as it was for Arkansas.

12. Vermont

Our understanding of Vermont Sales and Use Tax Law is that a 6 percent tax applies to purchases of motor vehicles and that the definition of a “purchase” includes “leases.” (Vt. Stat. Ann. §§ 8902, subd. (3), 8903, subds. (a), (b), (d) [short term rentals].) The measure of tax for lease transactions involving motor vehicles is based on the lessee’s “taxable cost,” which includes the amount computed by subtracting the “lease end value” of the motor vehicle from the “original acquisition cost” of the motor vehicle. (Vt. Stat. Ann. §§ 8902, subds. (4), (5), 8903, subd. (a)(2).) Therefore, leases in Vermont are subject to tax.

Application of California’s Section 6406 Credit

A Section 6406 credit may be available to a lessee for lease transactions in Vermont that were subject to an up-front tax as described above. The analysis is the same as it was for Iowa.

13. Virginia

It is our understanding that in Virginia “sales, leases, and rentals of motor vehicles” are not subject to the retail sales and use tax if they are subject to the Department of Motor Vehicles sales and use tax (DMV Tax) and the DMV Tax has been paid. (Va. Admin. Code § 10-210-990, subd. (A).) The DMV Tax applies to: (1) four percent of the gross proceeds from leases or rentals of motor vehicles for a period of less than 1 year and (2) three percent of the sales price on the sale of a motor vehicle (Va. Code. Ann. §§ 58.1-2401 [definition of “rental”], 58.1-2402, subd. (A); Va. Admin. Code 24 § 20-100-10.) Long term vehicle

¹³ I assume that the total amount due under the leases in question is determinable at the time of lease execution.

¹⁴ Publication 96-116 is available at: http://www.window.state.tx.us/taxinfo/taxpubs/tx96_116.html.

leases are also subject to a sales and use tax of 4 percent of the “gross proceeds.”¹⁵ (Va. Code. Ann. § 58.1-603, subd. (2).) The gross proceeds are defined as the total amount received for the lease of tangible personal property pursuant to an established business of the lessor and the tax is due up-front at lease inception. (Va. Code Ann. § 58.1-602.) Therefore, all leases (long or short term) are subject to tax in Virginia based on four percent of the total amount paid or payable under the lease term.

Application of California’s Section 6406 Credit

Based on our understanding that the Virginia tax applies to lease transactions and is based on the total consideration paid or payable under a vehicle lease, a Section 6406 credit may be available to a lessee. The analysis is the same as it was for Iowa.

Sincerely,

Andrew J. Kwee
Tax Counsel

AJK/ef

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cc: Out-of-State District Administrator (MIC:OH)
Ms. Barbara Bolda, Supervising Tax Auditor (MIC:OHA)
Mr. Kevin Johnson (MIC:38)
Mr. Steve Ryan (MIC:87)
Mr. Robert Thomas (MIC:85)
Mr. David Levine (MIC:85)

¹⁵ See Page 25 of 53 from: “Virginia’s General Fund Taxes,” available at: <http://dls.state.va.us/groups/taxcode/overview.pdf>