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**STATE BOARD OF EQUALIZATION**

January 3, 1996

This responds to your letter dated October 9, 1995 concerning repossessed leased vehicles. You write that --- --- leases vehicles under lease contracts. You enclose a copy of a sample contract. You state that --- receives monthly lease payments on the vehicles and pays tax on the lease payments upon their receipt. You ask several questions concerning funds from the disposition of a repossessed vehicle and funds from a security deposit, and describe hypothetical situations as follows:

"For these questions, I would like to make the following assumptions about the amounts owed and condition of the car on date of repossession:

Past due 2 lease payments:	Base Payment	\$800.00
	Sales Tax	66.00
Past due 2 late fees:	Late Fees	40.00
Past Due Bounced Check Fees: Bncd Ck Fees		15.00
Owes Repossession Fees:	Repo. Fees	300.00
Termination Fee Per Contract:	Term Fee	350.00
	Tax on Term Fee	28.88

The vehicle has \$750 of collision damage.

The vehicle has 1000 more miles than agreed to:

Mileage Fee:	150.00
Tax on Miles Fee:	12.38"

## Question 1

You ask us to assume that there is no security deposit, and that --- sells the repossessed vehicle to another automobile dealership for \$10,000. You also ask us to assume that it is a sale for resale for which --- receives a valid resale certificate. You ask whether the entire \$10,000 is considered to be "for resale" and, thus, not subject to sales tax.

Response: For the privilege of selling tangible personal property at retail in this state, a tax is imposed upon the gross receipts of a retailer from such sales. (Rev. & Tax. Code § 6051.) A sale includes any transfer of title of tangible personal property for a consideration. (Rev. & Tax. Code § 6006(a).) A retail sale means a sale for any purpose other than resale in the regular course of business. (Rev. & Tax. Code § 6007.) A sale for resale is not subject to tax. (Reg. 1668.) In making a sale for resale, if the seller of tangible personal property in good faith accepts a timely resale certificate in proper form from the purchaser, the sale is nontaxable. (Rev. & Tax. Code §§ 6091, 6092; Reg. 1668.) Thus, if --- sells a repossessed automobile to another dealership for resale, that sale is not subject to tax as long as --- in good faith takes a timely resale certificate in proper form from the purchasing dealership.

## Question 2

You ask us to assume that there is a \$1,000 security deposit which --- holds on the hypothetical account. Your question concerns the allocation of the security deposit funds upon the lessee's default. You ask:

"A. Is there a required order for the allocation of the security deposit?"

"1. Can we first consider that the Security Deposit was reimbursing us for out of pocket costs, such as Repossession Fees, or other contractual amounts such as late fees, etc.

"2. Can we first apply it to damage on the car.

"3. Or are we required to first apply the security deposit to past due lease payments and the corresponding tax and/or the excess mileage fee and tax?"

Response: There are no provisions in the Sales and Use Tax Law concerning the order in which funds from a security deposit must be applied upon default. Assuming that there is no other statutory or case law specifying an order, and that the lease contract itself does not specify an order, --- may apply the security deposit funds as it deems appropriate.

Please note, however, that if --- applies any of the security deposit funds to satisfy charges which are taxable under the Sales and Use Tax law, --- is liable for payment of the tax. For example, in the hypothetical, if --- applies \$700 of the security deposit to the late lease payments, the \$700 is considered lease payments which are subject to tax.

## Question 3

You ask,

"[I]f we file an insurance claim for the damage and are paid \$500 (\$700 less \$250 deductible) by the insurance company and there is a \$250 security deposit:

"A. Can we apply the insurance payment to damage (non-taxable), and the security deposit to the deductible that was not covered by the insurance company (thus also non-taxable)?

"B. Or is there another required order for allocating the money?"

Response: The sample contract provides that in the event of a casualty loss to the vehicle, the lessee is obligated to pay any difference between the proceeds of the lessee's insurance and the total amount of the lessee's obligations under the lease (which includes any damage to the vehicle during the lease term and before the vehicle is returned to the lessor). ("Closed End Vehicle Lease Agreement", Items 7. & 20.) Based upon this, it is our opinion that the amount of the deductible is part of the lessee's obligation under the lease. If the lessee does not pay that amount to the insurer, and the insurer withholds the amount of the deductible from the proceeds which it remits to ---, the lessee has an indebtedness to the lessor, --- for the amount of the deductible. The order in which the security deposit funds may be applied to a lessee's indebtedness to --- is discussed in our response to Question 2, above.

I hope this information is of assistance. Please write again if we may answer further questions.

Sincerely,

Sharon Jarvis  
Staff Counsel

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District Administrator