

**M e m o r a n d u m****330.3165**

To: San Diego – District Principal Auditor (WLW)

November 20, 1968

From: Tax Counsel (TPP:LAA) – Headquarters

Subject: Subleasing

Your memorandum of November 7, 1968, asked for clarification of the taxation of subleases. The hypothetical question you present involves a manufacturer, A, who leases equipment to B leasing company who subleases to C, the consumer. No tax has been paid to the state in connection with any of these transactions. All parties are located in California.

We recently analyzed these relationships in response to a similar question. We concluded that the prime lessor (here, A) has “prime responsibility” in the sense you use the term, for any tax due on the lease, i.e., he should be looked to first for payment to the state. If tax is uncollectible from him, the next person in the chain should be looked to and so on to the ultimate lessee, provided resale certificates have not been presented. Acceptance of a resale certificate in good faith from a person engaged in the business of selling (or leasing) tangible personal property and who holds a seller’s permit, relieves the seller from the duty of collecting use tax (see §§ 6241, 6242).

The tax on rentals is a use tax imposed by section 6202 on the person storing, using, or otherwise consuming the property. Technically, the prime legal responsibility is on the consumer and he must pay the tax to the retailer under this section and the case of Brandtjan & Kluse v. Fincher, 44 Cal.App.2d 939. However, section 9203 and ruling 74 require the retailer (lessor) to collect the tax from the lessee at the time amounts are paid by the lessee under the lease. Section 6241 provides further that it shall be presumed that tangible personal property sold for delivery in this state is sold for storage, use, or other consumption in this state (i.e., that tax is due and must be collected by the retailer) until the contrary is established. The burden of proof is on the retailer unless he accepted a resale certificate pursuant to section 6242. From this we conclude that the “Primary Liability” for the tax due is on the prime lessor, in this case A. He must collect the amount of tax due or prove he sold it for resale. If he fails to collect it, he is still liable to the state and must pay the tax due from his own funds. Bank of America v. State Board of Equalization, 209 Cal.App.2d 780.

At the same time, the purchaser-lessee remains liable for the tax imposed on him by section 6202 until he can show that: (1) tax has been paid to the holder of a valid seller's permit or Certificate of Registration – Use Tax through presentation of the receipt required by ruling 76 [see § 6202, ruling 70(c)(3)J; or, (2) tax has been paid on the rental receipts of the prime lessor or other prior sublessor [§ 6006(g)(5) and ruling 70(c)(2)(G); or, (3) a basis for exemption otherwise exists. Thus, the prime lessee would be looked to next for the tax in my opinion, and from there, applying the same tests, to subsequent lessees.

The upshot of this is that you can assess a deficiency against whomever in the chain you audit first. The burden is then upon them to establish the contrary; and if they do so, you can proceed from there.

In your hypothetical question No. 1, you add the conditions that B has refused to issue a resale certificate to A contending he does not intend to buy anything for resale, but that you have an overview allowing you to see all elements of the chain. When A leased to B, and B stated his intention not to sublease, the correct procedure was for A to collect tax from B and remit it to the state.

However, once the sublease is established A is relieved from his responsibility to collect and remit tax on the transaction. The tax is then due from B, or if we cannot collect from B, from C. We have held, however, that if A chooses to have the tax assessed against him, he may pay it and relieve his lessee, the sublessor, from the duty of collecting tax on the sublease.

If B is audited first under your hypothetical facts, tax can be assessed against him measured by the rental receipts from the sublease to C. B would have a cause of action against C for the amount paid under the rule of the Brandtjan case, supra.

If C is audited first, tax measured by his rental payments can be assessed against him under section 6202.

LAA:ph