

M e m o r a n d u m**330.1873**

To: Mr. Jack E. Warner
Out-of-State District Principal Auditor

February 27, 1990

From: David H. Levine
Tax Counsel

Subject: W--- Credit Corporation
SZ --- XX-XXXXXX

This is in response to your memorandum dated January 24, 1990. You believe that W--- Credit Corporation has assumed the position of the original lessor through a lease assignment and is responsible for reporting the taxable lease receipts. You note that the lessee, M--- L--- Corporation, apparently paid tax on its purchase price at the time of its purchases in November and December 1984. The lease assigned to W--- was entered into by M--- with B--- Leasing Corporation several months later on May 13, 1985. You state that there appears to have been intervening use of the equipment by M--- prior to the lease with B---. That is, M--- was the original purchaser of the equipment and, I assume, sold the equipment to B--- and leased it back. B--- then assigned the lease to W---. You ask whether we agree that W--- must report as taxable the rentals payable by M---.

Had M--- not used the equipment prior to its sale to B---, we would regard M--- as having purchased the property for resale. This means that M--- would be entitled to a tax-paid purchases resold deduction with regard to the taxes it paid when purchasing the equipment. This would also mean that B--- would be regarded as having purchased the equipment for resale and the applicable tax would be either sales tax owed by B--- measured by the sales price (if the "lease" was actually a sale at inception) or use tax measured by rentals payable owed by M--- to be collected and paid to the state by the lessor. The remainder of this opinion is based on the assumption that M--- did, in fact, use the equipment prior to the transactions analyzed herein.

We have been supplied a number of documents: Security and Pledge agreement between M--- and B---, with a rider; an Assignment and Pledge by B--- to W---; an Amendment to Master Agreement of Terms and Conditions for Lease between M--- and B---; a Promissory Note from B--- to W---; and a Security Agreement between B--- and W---. The Security and Pledge Agreement refers to a Master Agreement of Terms and Conditions of Lease dated May 13, 1985.

Although we have a copy of an amendment to that agreement, we do not have a copy of the agreement, and that agreement is the most important document with respect to our analysis.

If the transaction between M--- and B--- were a financing transaction within the meaning of subdivision (a)(3)(A) of Regulation 1660, neither the sale nor the leaseback would be regarded as a sale for purposes of sales and use tax and no tax would apply to the financing transaction. (Subdivision (a)(3)(B) of Regulation 1660 does not apply since, at the time of the agreement, M--- had no further liability to the equipment vendor on the original purchase price as confirmed by Section 8 of the Security and Pledge Agreement.) If the transaction between B--- and M--- were a financing transaction, then the assignment of the lease portion to W--- would not constitute a sale but rather would constitute a transfer of part of the financing transaction. No tax would apply to such transfer.

In order for the transaction between B--- and M--- to be regarded as a financing transaction: the lease to M--- must be regarded as a sale at inception; B--- must not claim and deduction, credit, or exemption with respect to the property for federal or state income tax purposes; and the amount which would have been attributable to interest, had the transaction been structured originally as a financing transaction, must not be usurious under California law. In a letter dated July 31, 1989, W--- states that it did not depreciate the equipment or take any tax benefits which might have accrued from the transaction. However, we have no such information regarding B---, the original lessor. To conclude that the sale and leaseback between M--- and B--- was a financing transaction, we would need confirmation that B--- took no income tax benefits as an owner of the property and that the interest would not be usurious under California law. We would also need to review the actual sale and lease documents between B--- and M--- to ascertain whether the lease was a sale at inception, qualifying the transaction as a financing transaction.

Unless and until we receive the information discussed above, we must regard the transaction between B--- and M--- as a sale and leaseback. The remainder of this opinion assumes that the transaction does not qualify as a financing transaction.

If the "lease" from B--- to M--- is actually a sale at inception under subdivision (a)(2) of Regulation 1660, B--- owes sales tax on that sale measured in accordance with subdivision (a) of Regulation 1641. B--- would be regarded as holding merely a security interest in the "leased" property. This means that the assignment of that security interest to W--- would not be subject to tax because it was not a sale of tangible personal property under the Sales and Use Tax Law but rather a transfer of a security interest. If the lease is not a sale at inception, this means that use tax applies to the rentals payable since, apparently, no timely election was made to pay tax measured by purchase price.

If tax is due on rentals payable, we must determine whether B--- or W--- is the party responsible for collecting and paying that tax to the state. The Assignment and Pledge by Secured Party dated May 13, 1985 by B--- assigns and pledges to W--- all right, title, and interest

of B--- in the subject equipment. Section 1 of the Security Agreement dated May 13, 1985 between W--- and B--- also grants W--- a security interest in and lien on all of B---'s right title, and interest in the subject equipment. Further, the Security Agreement specifies that the assignment is a non-recourse assignment and that W--- has made non-recourse loans to B---. Under subdivision (c)(9)(D), the original lessor remains responsible for collecting and paying the tax when the lessor merely assigns a right and creates a security interest. Under subdivision (c)(9)(C) of Regulation 1660, the assignee assumes the position of a lessor when the original lessor assigns the lease contract with a transfer of right, title, and interest for security purposes. This is what happened here. Further, we note that under subdivision (c)(9)(D), the assignee has no recourse against the assignor and is regarded as assuming the position of a lessor (in effect, under this provision the original lessor sells the property to the assignee outright). In the situation here, W--- has no recourse against B---. Although we conclude that the transaction comes within subdivision (c)(9)(C), we also conclude that it is closer to subdivision (c)(9)(D) than it is to subdivision (c)(9)(B) because W--- has no recourse against B---. That is, the only valid argument in our opinion is whether the assignment comes within subdivision (c)(9)(C) or (c)(9)(D). In either event, W--- assumes the position of a lessor.

In summary, if we are not provided any further documentation or information, we agree that W--- has assumed the position of a lessor through the lease assignment and is responsible for reporting as taxable the rentals payable. If W--- provides documentation and information showing that the transaction between B--- and M--- was a financing transaction, then W--- would have no sales or use tax liability with respect to the transaction. If W--- cannot show that it was a financing transaction but can show that the lease from B--- to M--- was actually a sale at inception and occurred before the assignment to W---, then B--- would have sales tax liability and W--- would have no tax liability with respect to this transaction.

If you have further questions, or if you obtain further documentation that you would like us to review, feel free to write again.

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