



## Summary

Petitioner was a partnership of two or three individuals formed in 1979, in Michigan, for the purpose of leasing business computers. Most of its business was conducted outside California, but it did lease two computer systems to --- --- --- for use by that company at its offices in-San Francisco.

The first lease to ---began in 1982. The computer was a DEC Ultimate 2000 which petitioner had previously leased to a company in New Jersey. Upon termination of the New Jersey lease, petitioner sold the equipment to --- --- --- and immediately leased it back. About the same time, petitioner leased the system to

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The file includes no documentary evidence regarding petitioner's original purchase of the equipment, the lease to the New Jersey company or the sale to --- nor is petitioner's lease to --- in the file.

However, petitioner has presented a copy of the leaseback agreement with --- The agreement provides that petitioner will pay a lump-sum price per month for the lease of the equipment. There is a space on the form to show any tax which might be included in the monthly payment, but no amount is entered in that space. Section 5 of the agreement states:

"No title or right in said equipment shall pass to lessee.... Upon termination of the lease period, lessee will immediately crate, insure and ship the equipment to whatever destination lessor shall direct...."

The second transaction is a lease of a Honeywell Ultimate Computer System to --- beginning in May 1984. (We understand that this system was intended as a replacement for the DEC Ultimate previously leased to ---) Petitioner purchased the --- from --- and in order to finance the purchase, petitioner sold the equipment to --- and immediately leased it back.

--- invoice to petitioner is dated May 8, 1984. It charges \$155,000 for equipment, plus "sales tax" of \$6,200, for a total of \$161,200. We note that tax of \$6,200 is equal to four percent of the charge for the property.

Petitioner's invoice to --- also charged \$155,000 for the property (\$145,300 for the computer and \$9,700 for a printer) plus "Michigan sales tax" of \$6,200. Petitioner has presented evidence indicating that --- paid the entire \$161,200 directly to --- in satisfaction of petitioner's liability to ---.

The leaseback agreement between --- and petitioner is on a slightly different form than the one discussed above. It does not include a space to show the amount of any tax which might be included in the monthly price, but does include a statement that the monthly price is "including sales/use tax, if applicable". There is no --- evidence to show whether --- believed that tax was applicable to this transaction or to show that the parties in fact intended the monthly price to include any tax or tax reimbursement. Section 6 of this leaseback form is identical to Section 5 on the old form quoted above.

Petitioner did not file California sales and use tax returns and did not report any California tax with respect to the leases to ---. An audit concluded that the lease receipts are taxable and the determination in question was thereupon issued against petitioner.

### Analysis and Conclusions

1. Petitioner sold the Honeywell Computer System to --- and leased it back. The leaseback was a true lease and not a sale at inception because GFG retained title in the equipment at the end of the lease term. (See subdivision (a) of Sales and Use Tax Regulation 1660.) Petitioner then leased the equipment to----. Petitioner contends that it cannot be held liable for any tax on the lease to --- on the ground that --- and not petitioner was the "owner" of the equipment.

However, Revenue and Taxation Code Sections 6006.1 and 6010.1 define the terms "continuing sale" and "continuing purchase", respectively, as follows:

"The granting of possession of tangible personal property by a lessor to a lessee, or to another person at the direction of the lessee, is a continuing sale [purchase] in this state by the lessor for the duration of the lease as respects any period or time the leased property is situated in this state, irrespective of the time or place of delivery of the property to the lessee or such other person." (Emphasis added.)

Under these statutes, the lessor is the seller and is thus the person responsible for any tax.<sup>1</sup> Nothing in either statute conditions the lessor's responsibility for tax on holding legal title to the leased property. Petitioner leased a computer system to --- and is therefore the seller responsible for any applicable tax, regardless of whether petitioner was the "owner" of the property.

2. Lease receipts are subject to sales or use tax only if the lease is a "sale" or "purchase". Revenue and Taxation Code Sections 6006(g) and 6010(e) provide that leases of tangible personal property for a consideration are "sales" and "purchases", respectively, with certain exceptions. One of the exceptions is for tangible personal property acquired tax-paid and leased in substantially the same form as acquired.

Subdivision (c)(2) of Sales and Use Tax Regulation 1660 provides that where a lessor purchases property without paying tax or tax reimbursement, and wishes to pay tax on the purchase price in order to avoid tax on lease receipts, the tax on the purchase price "must be reported and paid timely with the return of the lessor for the period during which the property is first placed in rental service." This rule has been upheld by the California Court of Appeals. (Action Trailer Sales, Inc. v. State Board of Equalization, 54 Cal.App.3d 125.)

Petitioner contends that it paid Michigan tax or tax reimbursement with respect to both computer systems leased to ---. Accordingly, petitioner argues that the leases to --- were not taxable "sales" or "purchases". Petitioner admits that it did not file California returns electing to pay tax on cost rather than on lease receipts. However, petitioner believes it should be relieved of the requirement for filing such returns on the ground that it was a small out-of-state company unfamiliar with California law.

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<sup>1</sup> Depending on the circumstances, the lessor may be directly liable for sales tax or may have a duty to collect use tax from the lessee. See subdivision (c) (1) of Sales and Use Tax Regulation 1660

With respect to the lease of the Honeywell Ultimate System, it appears that Michigan tax or tax reimbursement was in fact paid on the acquisition of the equipment. The problem is that the tax was paid at the rate of four percent, which is less than the applicable California tax. On this point, subdivision (c) (8) of Sales and Use Tax Regulation 1660 provides:

"A lessor who leases property in substantially the same form as acquired and who has paid a retail sales or use tax, or reimbursement therefor, 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 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 by this state. If the out-of-state tax equals or exceeds the tax imposed on him 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. If the lessee is not subject to use tax and the lessor does not make a timely election to pay tax measured by his purchase price, he may not credit the amount of the out-of-state tax against the tax due on the rental receipts because the tax due is a sales tax rather than a use tax.

"A credit otherwise permitted by the foregoing provisions shall not be allowed against taxes which are measured by periodic payments made under a lease, to the extent that taxes imposed by any other state, political subdivision or the District of Columbia were also measured by periodic payments made under a lease prior to the lease of the property in this state." (Emphasis added.)

Since the amount of Michigan tax or tax reimbursement was less than the applicable California tax, petitioner had two options when it placed the equipment into rental service in California: it could file a return reporting California tax on the purchase price, less a credit for the Michigan tax or tax reimbursement actually paid; or it could collect and report tax on the rental receipts. Since petitioner failed to file a timely return reporting tax on the purchase price, petitioner no longer has an option. Tax is due on the rental receipts without credit or deduction for the Michigan tax or tax reimbursement.

This rule applies equally to all taxpayers engaged in the business of leasing tangible personal property in California. We cannot make an exception for petitioner merely because petitioner was a small company doing business primarily outside the state. When petitioner began doing business in California by leasing tangible personal property here, it incurred an obligation to discover and comply with all applicable California laws. Petitioner failed to do so, and we see no reason why this failure should entitle petitioner to special treatment not available to other taxpayers.

With respect to the DEC Ultimate System, there is no evidence whatsoever to indicate that petitioner paid Michigan tax or tax reimbursement upon acquisition of the property. If Michigan tax or tax reimbursement was paid, it was presumably at the rate of four percent, and what we

have just said regarding the Honeywell System applies with equal force. Petitioner failed to make a timely election to report California tax on the purchase price and the lease receipts are therefore subject to tax.

3. Petitioner has filed a statement under penalty of perjury explaining the reasons California returns were not filed. The statement meets the requirements of Revenue and Taxation Code Section 6592 and we therefore recommend that relief from the penalty for failure to file returns be granted.

Recommendation

Redetermine without adjustment to the tax, deleting the failure-to-file penalty.

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James E. Mahler, Hearing Officer

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6/12/89  
Date