

**M e m o r a n d u m****330.3655**

To: Mr. J. W. Cornelius  
Supervisor, Petition Section

From: David H. Levine  
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Subject: W. H--- & Co.  
SR --- XX-XXXXXX-020

This is in response to your memorandum dated March 8, 1991 regarding a Decision and Recommendation issued in this case.

W. H--- & Co. was a lessee of computer equipment in California. The lessor apparently did not purchase that equipment for use in California and had paid sales tax with respect to that equipment to another state. No tax was reported on the lease receipts, and upon audit use tax measured by rentals payable was assessed against H---.

The lessor had paid four percent non California sales tax on one computer and six percent non California sales tax on the other two. H--- asserted that it was entitled to a credit for these taxes paid by the lessor. The hearing officer properly dismissed this argument since Revenue and Taxation Code section 6406 allows a credit only to the person who actually paid the out-of-state tax, the lessor, and not to the person who owes the California tax, the lessee. Although not granting the relief requested by the taxpayer, the hearing officer granted other relief, which was even more favorable to the taxpayer than requested.

Subdivision (c)(8) of Regulation 1660 provides that a person who purchases property for lease in California in substantially the same form as acquired will be deemed to have made a timely election to pay tax on purchase price if the lessor had paid an out-of-state tax equal to or greater than the "tax imposed on him by this state." The hearing officer concluded that the reference in this provision to tax imposed by this state is only to the 4  $\frac{3}{4}$  percent tax imposed directly under Revenue and Taxation Code section 6051. The hearing officer therefore concluded that the lessor had paid tax on purchase price with respect to the two computers for which the lessor had paid out-of-state tax above 4  $\frac{3}{4}$  percent but below the applicable California combined rate. The hearing officer has reached a clearly incorrect conclusion.

Prior to reaching the question which has arisen because of the hearing report, I note that there are facts which are not specified in the file which may render the conclusion at issue irrelevant to the resolution of this matter. That is, it is not entirely clear how long the computers were used outside California prior to their entry into this state. The computers were first leased outside California between November 1970 and April 1980. The rental payments at issue in this case commenced for February 1984. It is not clear whether the subject computers entered California prior to February 1984. If not, this fact resolves the matter as discussed below.

Generally, a lease of tangible personal property in California is a continuing sale by the lessor to the lessee. (Rev. & Tax. Code section 6006(g), 6006.1, Reg. 1660(b).) However, if the lessor leases the property in substantially the same form as acquired, the lessor may choose to treat himself as the consumer of that property by paying California sales tax reimbursement or by timely paying the full amount of California use tax measured by purchase price. When the lessor makes this election, the lessor is the consumer of the property and the lease does not constitute a sale under the California Sales and Use Tax law. (Rev. & Tax. Codes section 6006(g)(5), Reg. 1660(c)(2).)

Generally, a person purchasing property outside California who brings the property into California within ninety days is regarded as having purchased that property for use in California and will owe use tax measured by purchase price unless purchasing the property in an exempt transaction or for resale. (Reg. 1620(b)(3).) If that person will be leasing the property in substantially the same form as acquired, his timely payment of the full amount of use tax measured by purchase price will mean that the lease is not a sale and is not subject to use tax. Since that lessor would be making an election to pay his own use tax liability, he would be entitled to the credit provided by Revenue and Taxation Code section 6406 if he had paid tax or tax reimbursement to any other state. This is the context of the credit provision set forth in subdivision (c)(8) of Regulation 1660. We have consistently allowed a lessor who purchased property for use in California and paid a tax to another state at a rate below the applicable combined California rate to make a timely election to, in effect, pay the difference between the rates and lease the property tax paid by reporting the full California combined tax and taking an offsetting credit for the out-of-state tax.

A person who acquires property in a transaction not subject to sales or use tax may, of course, consume the property in California without paying sales or use tax. Unless provided otherwise by statute, that person's lease of the property in California will be subject to use tax because the lessor will not hold the property tax paid and will thus be regarded as selling the property when leasing it. There are two circumstances when this is not the case. One is if the lessor has retained his transferor's tax paid status. (See Rev. & Tax. Code section 6006(g)(5).) The other circumstance is authorized by Revenue and Taxation Code section 6094.1. Under that provision, a person who acquires property in a tax free occasional sale may elect to pay use tax measured by purchase price in order to lease the property tax free even though that person would not actually own any use tax on his own consumption of the property.

When a person purchases property outside California and functionally uses it outside California for over ninety days prior to its entry into the state, that person is not regarded as purchasing the property for use in California and he owes no use tax on his consumption of the property in this state. (Reg. 1620(b)(3).) There is no statute such as section 6094.1 that would authorize that person to pay use tax measured by purchase price in order to avoid the requirement of collecting use tax measured by rentals payable on his leases of that property. Therefore, whenever a person who leases in California tangible personal property that had not been purchased for use in California, those leases are continuing sales and are subject to use tax measured by rentals payable. As properly concluded in the hearing report, the credit provisions of section 6406 do not apply because the person paying any taxes to another state, the lessor, is not the person who owes the tax to California on the rentals, the lessee. This is a long-standing interpretation of the Board and is set forth in Business Taxes Law Guide Annotation 330.2990 (4/28/75, 11/26/71).

As mentioned above, the subject computers were first leased outside California in late 1979 and early 1980 but the amounts at issue here are rentals paid beginning for the period February 1984. These facts indicate that it is highly unlikely that the subject computers were brought into this state prior to being functionally used outside California for more than ninety days. If this is true, the lessor could have used the computers itself inside California without paying any use tax and, since there is no statutory authorization to do so, could not elect to pay tax measured by rentals payable, and there is no credit against the lessee's liability for those taxes for any tax or tax reimbursement paid by the lessor to any other state. The hearing report does not address this issue nor does it mention the annotation. The hearing report is defective based on the failure to rule out this possibility. The remainder of this opinion is based upon the unlikely assumption that the subject computers were, in fact, purchased for use in California as evidenced by their having been brought into California within ninety days of the lessor's purchase of them (that is, by February 1980 and July 1980, respectively).

You note that you can find no opinions supporting using the combined rate when applying the relevant provision of subdivision (c)(8) of Regulation 1660. The reason you have been unable to do so is because this interpretation is sufficiently farfetched that it has not occurred to anyone that it is worthwhile making this argument. Rather, for twenty years, without deviation, the interpretation of the Board of this provision in its own regulation is that the "tax imposed on him by this state" means that entire applicable combined sales and use tax rate.

The Uniform Local Sales and Use Tax Law requires cities and counties adopting sales and use tax ordinances under its provisions to include provisions, as relevant here, identical to those contained in the Sales and Use Tax Law, Revenue and Taxation Code section 6001 et seq., as well as the provision that all amendments to that law become a part of the city or county ordinance. (Rev. & Tax. Code section 7202, 7202.6, 7203.) Similar provisions are required for an agency adopting a transactions and use tax ordinance. (Rev. & Tax. Code section 7261, 7262.)

In other words, a lease of tangible personal property in California is a continuing sale for purposes of the local sales tax and the transactions tax unless that property is leased in substantially the same form as acquired and the lessor had paid local sales tax reimbursement and transactions tax reimbursement or timely paid local use tax and transactions (use) tax measured by the lessor's purchase price of the leased property. The Board has no authority to disregard these provisions by adoption of a regulatory provision. If the subject provision actually meant what the hearing officer believes it does, that would lead to the result set forth in the following paragraph.

A person purchases property for use in California and pays tax to another state at a rate of at least  $4\frac{3}{4}$  percent but less than 6 percent. The lessor makes no payments of tax to California. When that person leases the property in California, the lease would not be a sale for purposes of the use tax imposed by section 6203 but would nevertheless be a continuing sale for purposes of the local sales and transaction taxes. In other words, the rentals would be subject to a tax of  $1\frac{1}{4}$  percent plus the applicable transactions tax rate, multiplied by the rentals payable. If we were to conclude otherwise and hold that the lease was not a sale for any of the three applicable sale taxes by virtue of payment of sufficient out-of-state tax to cover the  $4\frac{3}{4}$  percent tax rate, then it is quite clear that the effected city, county, and transit district would have standing to force the Board to collect the appropriate local sales and transaction taxes applicable to the leases which constitute continuing sales for purposes of those taxes. (City of Gilroy v. State Board of Equalization (1989) 212 Cal.App. 3d 589.)

The following is another example of the practical implications of the conclusion in the hearing report. A person who will be leasing property in California finds that he can obtain the property in California or may obtain it in a state with a 5 percent tax rate. Knowing of the rule in the hearing report and wishing to save tax money, that person purchases the property in the other state and brings it into California for leasing purposes. Under the rules set forth in the hearing report, that person may now lease the property tax free, putting the California businesses selling that property at a distinct disadvantage versus a seller outside California. Of course, as all of us at the Board well know, the whole reason that the use tax was adopted back in 1935 was to prevent just this type of discrimination against sellers in our own state.

There can be no denying that, with 20-20 hindsight, it is difficult to argue that the choice of the words "imposed on him by this state" are not the words that we would choose today for this provision. However, this provision has always been interpreted, from the day of its adoption, to mean the sales or use taxes imposed as specified in the sales tax laws adopted by this state and administered by this Board. All the taxes at issue now, the taxes imposed under ordinances adopted under the authority of the Uniform Local Sales and Use Tax Law or the Transactions and Use Tax Law, come within this long-standing interpretation. Any other interpretation not only yields absolutely ridiculous results but is also subject to attack by the courts. When that happened, there would be two possibilities: we would be required to apply our long-standing current interpretation; or we would have to bifurcate the taxability, treating the

lease as no sale for the tax imposed by section 6201 but a continuing sale for the local sales and transaction taxes.

The Board's regulation should be interpreted in a reasonable manner to further the purposes of the combined state, local, and district tax laws – at least by the Board's own employees.

DHL:c/0197F

cc: Mr. E. L. Sorensen, Jr.  
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