M e m o r a n d u m

330.5270

To: San Bernardino - Auditing (BM) Date: November 28, 1966

From: Tax Counsel (EHS:CLR) - Headquarters

Subject:

I have examined the copies of the various documents from you in the transactions of the above captioned matter including the memorandum of auditor W. B. Flynn dated July 29, 1966.

We understand the taxpayer engages in the following type of transaction:

"X," an owner of a business, sells all or a portion of its assets to taxpayer who leases it back to X. The assets include property such as carpets and wall panels affixed to the real property as well as furniture and other property. Although it is not stated in the "Security Agreement," Mr. --- was informed that title to the assets automatically passes to X when the amount due taxpayer per the "Security Agreement" is paid.

The initial problem to be solved in determining the taxability of transactions is whether or not title to the property passed to the taxpayer or whether he merely received a security interest. Although there is some question as to what interest taxpayer received, we are of the opinion that the following factors support our position that taxpayer became the owner of the property:

1. The Assignment of Lease between taxpayer and Union Bank provides "Lessor hereby represents and warrants to Bank that it is the lawful owner of the property ...."

2. The Agreement to Furnish Insurance, entered into between X and taxpayer, provides X as lessee would provide the insurance. If taxpayer did not become the owner of the property, he would have nothing to lease back to X.

3. If taxpayer was not the owner of the property, the transaction would be considered a financing arrangement and not a sale. If this were the case, the taxpayer would be engaged in the business of a Personal Property Broker (§ 23009 of the Financial Code), and as such, would

be required under § 22200 of the code to obtain a license from the Corporation Commissioner. Without the license, taxpayer would be guilty of a misdemeanor under § 22653 of the code. We have checked with the commissioner's office and were informed taxpayer does not have a Personal Property Broker's license. Since it is presumed that a person does not intentionally engage in an illegal activity, we are of the opinion that, absent clear and convincing evidence to the contrary, the taxpayer must be considered to have received title to the property.

Assuming that title to the property initially passed to the taxpayer, we are then faced with the question of the application of tax to the lease back to X. We understand that if all required payments were made, title to the property will ultimately reside in X. Under such circumstances, the transaction would be considered taxable, either as a lease in lieu of sale or as a conditional sale contract. For our purposes, it makes no difference which characterization we use. However, the amount of tax due from taxpayer will depend on which of the following circumstances are applicable:

1. If taxpayer purchased the property tax paid, the tax due form taxpayer would be computed on the difference between his cost and the total amount of the lease or conditional sales contract, less interest. The amount of interest allowed would be the amount appearing on the promissory note or notes executed by X in favor of taxpayer per the terms of the "Security Agreement" under the heading "Debts." Since we do not have a copy of these notes, we are unable to tell what the interest rate is.

2. If taxpayer purchased the property ex tax, the tax due would be computed on the total amount of the lease or conditional sales contract, less interest.

Sales of readily removable items that are not an integral part of the premises are treated as sales of tangible personal property and subject to sales tax. In determining what items are an integral part of the premises, it is proper to be guided by the distinction made in ruling 11 between "materials" and "fixtures." However, this guideline is ordinarily used only when there is no expression of the parties to the contrary. Such an expression is found in paragraph IV of the "Security Agreement" which provides that all assets are to remain personal property even though they are affixed to the real property. Accordingly, we are of the opinion that these assets that are reasonably capable of being considered personal property should be considered as such for sales tax purposes.

CLR:md

cc: Santa Ana - Subdistrict Administrator