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M e m o r a n d u m

To : Acting Supervisor
Audit Determination & Refund Section, MIC:39

Date: May 11, 2006

From: Denise L. Riley, Tax Counsel
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Subject: U---, Inc.
SR -- XXX-XXXXXX

This memorandum responds to Robert Buntjer's memorandum to Acting Assistant Chief Counsel Selvi Stanislaus, dated December 23, 2005. In relevant part, Mr. Buntjer's memorandum states:

Attached is a district recommendation to deny a claim for refund filed by the above claimant for tax [reimbursement] paid on parts used for repairs on Mobile Transportation Equipment (MTE). The claim was generated based on advice provided by Legal in a letter [by Tax Counsel IV John Abbott] dated September 30, 2003. It appears that based on Section 6901, no action should be taken on the claim since claimant is the purchaser of the parts and paid sales tax [reimbursement] on the transactions. However, the district requested that Legal be asked to review the advice provided and possibly rescind the opinion.

DISCUSSION:

We have reviewed the documents that you provided along with the relevant statutory provisions and regulations. As explained below, based upon our review of the law and facts underlying the claim, we concur that the purchase of parts in California for repair of the MTE that U---, Inc. (U---) leased to X--- G--- S---, Inc. and any other lessees (collectively, X---) constitutes a sales tax transaction, not a use tax transaction. Accordingly, U--- is not a proper claimant.

U--- leases tractors and trailers (Equipment) to X---. The terms of the lease provide that U--- is to maintain, repair or alter the Equipment and that U--- "shall be responsible for purchasing all repair parts and maintenance items for resale to Lessee." (Master Equipment Lease Agreement, ¶6.) However, under the definition of MTE, "mobile transportation equipment" includes equipment, such as truck tractors and truck trailers, *and* any tangible personal property which is or *becomes* a component part of such equipment, such as the parts being purchased by U--- for the leased Equipment. (Rev. & Tax. Code, § 6023.)

In addition, California Code of Regulations, title 18, section (Regulation or Reg.) 1661, subdivision (b)(1), provides that “with respect to leases of mobile transportation equipment, the sale to the lessor is the retail sale and the lessor is the consumer of the equipment.” As such, U-- is the consumer of the MTE and the consumer of any parts used to maintain or repair the MTE. In other words, U--- is not the retailer of the parts to its lessee. Rather, U--- is purchasing the parts for its own use in connection with the lease. Thus, notwithstanding how the transaction is characterized in the relevant lease agreements, the purchase of the parts by U--- is not a purchase for resale under California law.

Moreover, because U--- is the consumer of the parts, and not the retailer, it has no standing to request a refund of the tax reimbursement that U--- may have paid to California retailers. The general rule prohibits suits or claims for refund by anyone other than the taxpayer, here the retailers. (See Rev. & Tax. Code, § 6901.5.)

Additionally, we concur that U--- may not purchase parts ex tax based upon the alleged mandatory maintenance contracts it has with its lessees. Because U--- has apparently owned and leased the MTE out of state for more than a year before bringing the MTE into California, U--- did not purchase the MTE for California use. (See Reg. 1620, subd. (b).) Therefore, U--- would not be liable for California use tax with respect to its purchase and use of the MTE. Accordingly, based on the presented facts, U--- could never have made an election to pay use tax on the fair rental value of the MTE in California.¹

In this regard, Annotation 335.0010 states, in relevant part:

A lessor of mobile transportation equipment who has properly elected to measure his use tax liability by “fair rental value” may properly purchase the repair parts he places on such equipment ex[]tax for resale.^[2] (Business Taxes Law Guide, vol. 2, Annotation 335.0010 (7/25/73) [emphasis added]; see also Rev. & Tax. Code §§ 6092.1, 6094, subd. (d), 6243.1, 6244, subd. (d).)

¹ Obviously, if the facts differ and U--- purchased the MTE for use in California and timely elected to pay use tax based on the fair rental value of the MTE, then the opinion expressed herein would be different. Additionally, it should be noted that the application of tax depends on the actual facts, not on factual assumptions.

^[2]For the limited purpose of allowing lessors of MTE the option of reporting use liabilities based on fair rental value, such lessors are permitted to issue resale certificates to purchase MTE (inclusive of component parts of MTE, like repair parts) on an ex-tax basis. (See Rev. & Tax. Code, §§ 6092.1, 6243.1.) However, this legislative grace does not convert such transactions to sales for resale in fact. As explained above, under California law, the lessor is always the consumer of the MTE and the parts that are incorporated into the MTE.

The relevant back-up legal memorandum for Annotation 335.0010 emphasizes that this procedure of making a valid, timely election to report use tax liability based upon fair rental value for the lease of MTE *must* be followed *before* a taxpayer is allowed to purchase parts for the leased MTE ex tax. (See memorandum of Glenn L. Rigby to Robert Nunes of 7/25/73, attached hereto for your reference, which states “If this procedure is followed [i.e. the timely election to report use tax on the purchase and use of MTE measured by the fair rental value], the replacement and maintenance parts can be purchased ex tax.” [Emphasis added].)

In conclusion, we affirm that Annotation 335.0010 is only applicable with respect to mandatory maintenance agreements where the lessor of MTE has made a timely, valid election to pay tax on fair rental value. If such an election cannot be made because, as with U---, the MTE was not purchased for use in California, then Annotation 335.0010 is inapplicable. In this case, because U--- never timely elected to pay use tax on fair rental value in California, it is not qualified to purchase the subject parts in California ex tax, nor may it claim a refund for tax reimbursement it paid, if any, to the retailers.

Finally, because John Abbott’s September 30, 2003, letter misapplies the rule of Annotation 335.0010 and failed to analyze an additional sublease issue presented by the facts associated with that letter, we are rescinding Mr. Abbott’s letter.

I hope the above answers your questions. If you have any further questions, please do not hesitate to contact me.

DLR:ds

Attached: Back-up memorandum to Annotation 335.0010

cc: Mr. Jeff McGuire (MIC:92)
Mr. Joe Young (MIC:49)
Mr. Brian Manuel (MIC: 39)
Mr. Robert Wils (MIC: 39)
Mr. Steve Sisti (MIC: 39)
Out-of-State District Administrator (OH)