

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

335.0680

In the Matter of the petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
)
Petitioner)

The above-entitled matter came on regularly for hearing on February 28, 1985, in
--- California, before H. L. Cohen, Hearing Officer.

Appearing for Petitioner: --- --- ---
--- --- ---

Appearing for the Board: --- --- ---
--- --- ---
Auditor
--- District

Protested Items

The protested tax liability for the period January 1, 1983, through September 30,
1983 is measured by:

<u>Item</u>	<u>State, Local and County</u>	<u>Transit District</u>
A. Purchase price of two aircraft subject to use tax	\$1,500,000	\$750,000
B. Credit for lease receipts reported	- 102,258	-102,258
Totals	\$1,397,742	\$647,742

Contention

Petitioner contends that election to pay tax on fair rental value was made timely, therefore tax is not due on the purchase price of the aircraft.

Summary

Petitioner is a wholly owned subsidiary of --- --- --- Petitioner purchased two aircraft ex-tax for the purpose of leasing them. The lease for one aircraft was signed March 7, 1983, with the first lease payment due March 7, 1983. Tax on fair rental value (lease amount) was first reported on petitioner's return for the second quarter of 1983. The lease for the other aircraft was signed May 6, 1983, with first lease payment due on that date. Tax on fair rental value (lease amount) was first reported on petitioner's return for the third quarter of 1983.

The auditor concluded that petitioner had failed to make a timely election to pay tax on fair rental value for both aircraft. Tax was asserted on the cost of the two aircraft with credit allowed for the tax previously paid on fair rental value.

Petitioner states that the first lease payment for the first aircraft was received April 22, 1983, and that the first lease payment for the second aircraft was received August 8, 1983. Tax on fair rental value was therefore reported on the returns for the period in which lease payments were first received. Petitioner contends that by reporting and paying tax on the period in which lease payments were received, a timely election was made to pay tax on fair rental value rather than cost.

Petitioner contends that since the leases were both signed before July 3, 1983, the version of Regulation 1661 in effect prior to that date is controlling. Petitioner interprets the regulation as requiring tax to be paid when the first rental payment is received. If no payment is received, no tax is due. Therefore, no tax can be reported in that period and the election must be deferred until tax is due.

Analysis and Conclusions

Section 6006 of the Revenue and Taxation Code defines "sale" to include most leases, however, subdivision (g)(4) of the statute excludes leases of mobile transportation equipment from the definition of "sale". Section 6023 defines "mobile transportation equipment" to include aircraft. Leases of mobile transportation equipment are therefore, for purposes of the Sales and Use Tax Law, uses by the lessor rather than sales by the lessor.

This distinction has important tax consequences. Under Section 64C1, the applicable tax under leases that are sales as to the lessor is a use tax on the lessee for the possession and use of the property in this state by the lessee. The lessor is required to collect the tax from the lessee, but the lessee is responsible for payment of the tax. Under leases which are not sales, the applicable tax is a use tax on the lessor for the use made by way of lease. That is the act of leasing is itself a taxable use. The tax is not the

responsibility of the lessee. Persons who buy property for use are not usually legally permitted to issue resale certificates for the property.

Section 6094 provides that if a purchaser who gives a resale certificate makes any use of the property other than retention, demonstration or display while holding it for sale in the regular course of business the use shall be taxable to the purchaser as of the time the property is first used by him, and with certain exceptions the tax shall be based on the sales price of the property. The exception which is pertinent here is contained in subdivision (d) of the statute. That subdivision provides that if the property is mobile transportation equipment, and the use is limited to leasing the equipment, the purchaser may elect to pay his use tax measured by fair rental value. The election must be made on or before the due date of a return for the period in which the equipment is first leased. The election must be made by reporting tax measured by the fair rental value on the return for that period.

Under the statute, the tax is a tax on the lessor based on fair rental value, not rental receipts. The election must be made when the first leasing use occurs, not when rental payments are received. There is thus no support in the statute for petitioner's contention that the election may be made when the first rental payments are received.

Petitioner's reliance on subdivision (e) (2) of Sales and Use Tax Regulation 1661 is misplaced. In the version of the regulation in effect when the aircraft were purchased and leased there is a sentence:

"Fair rental value will normally be regarded as the amount received from the lessee."

That is merely a definition of "fair rental value", which is the amount upon which the tax is based. It has no relation to when the election must be made or to the actual receipt of rental payments. Petitioner made a use of the aircraft when the leases were entered into. Even if the lessees totally defaulted on lease payments, petitioner would still be liable for tax on fair rental value.

Recommendation

Redetermine without adjustment.

H.L. Cohen, Hearing Officer

5/8/85
Date