

M e m o r a n d u m**465.0110**

To: Mr. Mike Kitchen
Audit Refunds

Date: December 26, 1990

From: David H. Levine
Senior Tax Counsel

Subject: A--- A---
S- -- XX-XXXXXX

A--- A--- (taxpayer) has filed a claim for refund for taxes it reported by fair rental value with respect to its lease of an aircraft. Taxpayer's purchase and lease of the subject aircraft was one in a series of complicated transactions. These transactions are set forth in simplified form below.

F--- Corporation owned the aircraft. On August 26, 1985, F--- sold the aircraft to taxpayer who then leased the aircraft back to F---. On October 31, 1985, taxpayer sold the aircraft, subject to lease to F---, to I--- Corporation. On that same day, I--- sold the aircraft, subject to lease, to E--- Company.

It appears that the only tax voluntarily paid with respect to this series of transactions were payments made by taxpayer on February 20, 1987, May 4, 1987, and July 31, 1987 in a total amount of \$103,429.92. This was apparently use tax measured by six percent of the \$574,610.00 rental amount payable for each of three six-month periods and is the amount for which taxpayer has filed a claim for refund. The basis of the claim for refund is that use tax measured by purchase price was assessed against E---. A portion of that assessment is represented by a Notice of Determination issued to E--- on January 29, 1987, prior to any payment of tax with respect to these transactions. E--- paid the amount of that assessment and thereafter filed a claim for refund. An additional Notice of Determination was issued to increase the measure of tax, and E--- filed a petition for redetermination of that assessment. The claim for refund and the petition for redetermination were denied based upon a sale having occurred from taxpayer to E--- and E---'s failure to make a timely election to report tax measured by fair rental value with respect to its lease of the aircraft.

You state that taxpayer contends that the purchase of the aircraft in August was a purchase for resale and that the eventual sale to E--- was a simultaneous transaction. Taxpayer further contends that the payments made by it were, in effect, on behalf of E--- in order to relieve E--- from liability for tax measured by purchase price and allow E--- to pay tax measured by fair rental value. (I assume that these contentions are derived from your oral discussions with taxpayer and its representatives since I have seen no such contentions from taxpayer in writing.)

The staff contends that taxpayer's purchase of the aircraft in August 1985 was a retail purchase subject to use tax since the seller was not an aircraft dealer. Taxpayer consumed the aircraft by leasing it to F---, but did not make a timely election to report tax measured by fair rental value. The board, however, is no barred by the statute of limitations from issuing a determination for use tax measured by purchase price. Nevertheless, staff believes that the voluntary payments made by taxpayer may be retained and applied towards the unsatisfied liability pursuant to the case of Owens Corning Fiberglass Corp. v. State Board of Equalization (1974) 39 Cal.App.3d 532. the plaintiff in that case sought a refund of amounts it paid during periods for which the board had the right to issue deficiency assessments, but the board did not get around to issuing the applicable deficiency assessments until after the statute of limitations barred the issuance of those assessments. The court upheld the board's denial of plaintiff's claim for refund since at the time of the payment the amount of tax due exceeded the amount actually paid.

Based upon the fact you have set forth and the facts set forth in the hearing officer's decision and recommendation on E---'s claim for refund, we agree that taxpayer's claim for refund comes within the rule set forth in Owens Corning. Taxpayer's purchase of the aircraft was complete in August 1985. That purchase was at retail since taxpayer did not resell the aircraft prior to use but rather consumed the aircraft by leasing it back to F---. Tax should have been reported measured by purchase price with taxpayer's return for the third quarter of 1985 unless taxpayer made an election with its timely return for that quarter to pay tax measured by fair rental value. Taxpayer paid tax on neither purchase price nor fair rental value with its return for the third quarter 1985. Although taxpayer believes that the tax with respect to the subject transaction was paid by E---, taxpayer is mistaken since E--- paid tax with respect to its own retail purchase of the aircraft.

Tax was properly assessed and collected from E--- with respect to its retail purchase of the aircraft. Taxpayer did not purchase the aircraft for resale to E--- prior to its own use since it sued the aircraft (by leasing it to F---) prior to that sale. Since taxpayer failed to make a timely election to report tax measured by fair rental value, tax was due measured by its purchase price of the aircraft. Taxpayer voluntarily paid tax with respect to its retail purchase of that aircraft, although it mistakenly did so measured by fair rental value. The tax it paid measured by fair rental value was paid during the period which the board could have issued a deficiency assessment against taxpayer, and the amount of the tax paid was less than the amount of tax actually due. Although we can no longer issue an assessment to collect the tax remaining due, we believe that we may retain the amount voluntarily paid by taxpayer toward its tax liability.