STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Claim for Refund Under the Sales and Use Tax Law of: LOCKHEED MARTIN GOVERNMENT SERVICES, INC. Claimant	Account Number: SC OHB 30-685390 Case ID 300158 Philadelphia, PA

Type of Business: Provider of information and technology services

Audit Period: 01/01/01 – 12/31/03

Item	Cost of Equipment
Use tax paid on purchases of equipment for lease	$6,393,911

Claimant filed a claim for refund of use tax it had paid with respect to the cost of equipment it purchased and then leased to the United States Government.

UNRESOLVED ISSUE

Issue 1: Whether claimant's transfers of computer hardware, software, and office equipment to the United States Government were exempt leases of the items transferred, thus entitling claimant to a refund of use tax paid on the cost of the equipment. We find there is no basis for refund.

Claimant paid use tax with respect to purchases of certain computer hardware, software, telephones, fax machines, and other office equipment which it leased to NASA, that is, to the United States. Claimant initially treated the contract as a service agreement, and it paid use tax on its purchases from out-of-state vendors. The tax-paid equipment was then transferred to NASA for use by its employees. Claimant later concluded that the equipment transfers to NASA were exempt leases to the United States, and it filed a claim for refund of the use tax it believed it paid in error.

The Sales and Use Tax Department (Department) found that the equipment transfers were incidental transfers of tangible personal property under a service contract and that the claimant was the consumer of the equipment. As such, the Department concluded that claimant had properly paid use tax on its consumption of the equipment, and thus denied the claim for refund. Claimant contends that

the equipment was either sold or leased to the United States; if regarded as a lease, then claimant asserts the equipment was *not* leased in substantially the same form as acquired.

We conclude that the true object of claimant's contract with NASA was the procurement of the equipment, and thus the equipment was not transferred to the United States incidental to a service agreement. However, we reject claimant's argument that the transfers of equipment were outright sales because that would be contrary to the specific wording of the contract. Rather, we found that claimant leased the equipment to the United States. A lessor's timely payment of sales tax reimbursement or use tax with respect to tangible personal property that is leased in substantially the same form as acquired is an *irrevocable* election to pay tax on cost rather than on rentals payable (i.e., an irrevocable election to be the consumer of the leased property). Thus, a lease of property in substantially the same form as acquired by a lessor who has timely paid sales tax reimbursement or use tax on the cost of property is not a sale within the meaning of the Sales and Use Tax Law. On the other hand, under the Revenue and Taxation Code, where leased property is *not* leased in substantially the same form as acquired by the lessor, the lease is a continuing sale and purchase, with the lessor's purchase of that property for lease having been for resale, even if the lessor had timely paid sales tax reimbursement or use tax on cost. Accordingly, in the D&R, we recommended a reaudit based on our conclusion that no refund is warranted where the property was leased to the United States in substantially the same form as acquired, and that a refund *of use tax* (but not sales tax reimbursement) would be warranted to the extent that claimant established that the property had been leased to the United States *not* in substantially the same form as acquired.

Upon reaudit, the Department concluded that claimant had failed to show that any of the property at issue was not leased in substantially the same form as acquired and that there was no overpayment of tax. Regarding whether claimant paid sales tax reimbursement or use tax to GMR the Department found that GMR is an out-or-state retailer which reports both sales tax and use tax. Based on examination of the invoices alone, the Department could not determine whether the amounts paid by claimant were sales tax reimbursement or use tax.

Claimant thereafter requested a second appeals conference to consider whether the property was leased in substantially the same for as acquired or not, and we granted that request. Claimant

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argues that 94.4 percent of the property was not leased to NASA in substantially the same form as acquired. Claimant states that it was leasing computer systems, which the contract refers to as "seats," and that claimant was responsible for assembling the various components comprising the system (such as the personal computer, software, monitor, keyboard, mouse, printer, and scanner) into the computer seats. Claimant apparently views the seat as the single item being leased, and based on that view asserts that the equipment was not leased in substantially the same form as acquired. Claimant's argument at the time we issued the D&R was that the amounts it paid in connection with purchases from Government Micro Resources, Inc. (GMR) were sales tax reimbursement that should be refunded directly to claimant. We find in the D&R that there is no legal basis under which claimant could receive a direct refund of such sales tax reimbursement it paid to GMR from the Board. Thereafter, claimant stated that all the amounts for which it seeks a refund were use tax, including the amounts paid to GMR.

The premise of claimant's argument is that the seat is a single item or property, connected by cables. However, as we explained in the Supplemental D&R, claimant itself concedes that the cabling, that is, the very means of connecting the computer, monitor, keyboard, scanner, etc. into such single "seat," was leased in substantially the same form as acquired, and we find this concession (which we would find is the case in any event) is fatal to claimant's argument. Furthermore, the seat was not a single item of equipment. We find that connecting discretely identifiable equipment, which here were themselves mostly leased in exactly the same form as acquired, by way of cabling does not result in the creation of a single item of equipment that is not leased in substantially the same form as acquired.

Regarding the computers, we note that claimant received actual computer systems that functioned as computer systems upon claimant's receipt of them, and none of the changes it made could be regarded as substantial. Further, the additional software claimant added did not transform the computers into something other than personal computers and did not result in a substantial change in form. In summary, we find that claimant leased computer hardware and software in substantially the same form as acquired. As such, claimant's payment of use tax on cost represented its irrevocable election to be treated as a consumer of the leased property. Accordingly, we find that claimant did not overpay tax (or tax reimbursement). Although the record is not sufficient to establish whether

petitioner paid sales tax reimbursement or use tax to GMR, based on our finding that claimant made an irrevocable election to be a consumer of the leased property, the character of the payment to GMR is moot. We find that claimant made no overpayment of tax or tax reimbursement, and recommend that the claim for refund be denied.

OTHER DEVELOPMENTS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III