

370.7121 ECM

Board of Equalization

State of California

## Memorandum

To :

Date: ~~October 27, 1977~~

From : Headquarters - Legal (JEM)

Subject:

Your memo of October 11, 1977, to [redacted], has been referred to the undersigned for reply. We understand that the [redacted] offer various instructional courses to [redacted] school graduates to prepare them for the [redacted] examination. It furnishes written materials to its students in connection with some of these courses. The contract between [redacted] and the student provides that these materials are leased to the student for use only while he is taking the course, and that they must be returned to [redacted] on or before a certain date. Failure to return the materials by the specified date is deemed an election to extend the lease at the rate of \$50 per month.

In our memo to you of March 15, 1975, <sup>not in data base</sup> we concluded that part of [redacted] charge to its students is for instructional services and part is for the lease of materials. On the basis of the available evidence, we also concluded that the measure of tax would be the \$50 per month extended lease rate. You have now sent us copies of the form contracts used by the taxpayer in 1973 and 1974.

After examining the contracts, we remain of the opinion that [redacted] is leasing materials to its students. "Lease" is defined in Section 6006.3 of the Revenue and Taxation Code to include "rental, hire and license", and this definition is broad enough to encompass the sort of arrangement involved here. The fact that [redacted] may destroy the materials after they are returned does not alter this conclusion.

We have also concluded, however, that our previous estimate of the measure of tax was inaccurate. [redacted] 1973 contract offered students an option to lease the materials alone without purchasing any of its instructional services. The price for such a lease was \$190. Furthermore, if the student contracted to lease materials and purchase instructional services, but canceled the contract after possessing the materials for five or more days, the student agreed to be liable for the \$190 "materials only" option. In view of these contract provisions, we now conclude that the measure of tax for each 1973 lease is \$190.

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1974 contract did not offer a "materials only" option. The contract did provide, however, that if the student canceled the contract after possessing the course materials for five days or more, the student would be liable for \$200 as the cost of using the materials. Accordingly, the measure of tax for 1974 leases is \$200 per lease.

argues that the lease prices do not reflect the actual value of the course materials. It points out that its cost for compiling the materials was only about \$12 to \$19 per set. However, the measure of tax for a lease which is a sale is the rentals payable, not the fair market value of the leased property. (See Regulation 1560, subdivision (c)(1).) chose to lease the materials, rather than transfer title, in order to insure that the materials would be returned and destroyed. Moreover, both the 1973 and 1974 contracts specified the portion of the total charge which was attributable to the lease of materials, and these contracts were entered into by the parties in arm's length transactions. For these reasons, although the agreed lease price may have been high, there is no basis for using the cost of the materials as the measure of tax.

JEM:pp

*James E. Mahler*

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U.S. DEPARTMENT OF JUSTICE  
OCT 30 1977