

330,3177

Leases

DJH

Certain maintenance
and management
has not subject
to tax.

(916) 445-2641

July 15, 1977

1017

This is in response to your letter of May 2, 1977, as supplemented by your letter of June 20. You have inquired as to whether sales or use tax is properly applicable to certain payments made by you to the _____, under a certain "Budgeted Maintenance and Control Agreement" dated January 1, 1974.

As reflected in the documentation which accompanied your letter of June 20 _____ s leased certain motor vehicles from _____.

1. The "Maintenance and Replacement" paragraph of the Motor Vehicles Fleet Lease Agreement, dated January 1, 1974, provides as follows:

"Lessee shall, at all times, at its own expense, cause the leased motor vehicles to be maintained in good working condition and appearance, and lessor shall have no responsibility therefore, or for any damages sustained by the lessee, or others in privity with him, by virtue of any mechanical or operational failure of the leased motor vehicle during the term of the lease. Lessee agrees that all maintenance and replacement expense, including repairs, gasoline, oil, grease, tires, tubes, storage, parking, tolls, adjustments and other services shall be solely at the expense of the lessee, it being the intent herein that the lessor shall not be responsible for any charges or claims in connection with the operation of the leased vehicle. If any Vehicle is lost, stolen, destroyed or damaged beyond repair, or if Lessee determines that the condition of any Vehicle makes its continued maintenance and repair imprudent, Lessee shall notify Lessor. If the Vehicle or any wreckage of the Vehicle is available, Lessee shall hold it for disposal by Lessor. Upon receiving the notice from Lessee, Lessor, as soon as practicable, shall

TPP

July 21, 1977

cause the Vehicle to be sold in the manner provided in Paragraph 5. Upon the sale, Lessee shall pay additional rent or receive a refund as provided in Paragraph 5."

The Fleet Lease Agreement is not reflective, however, of the entire relationship between _____ and _____ with respect to maintenance of the leased vehicles. You have indicated that the majority of the vehicles being leased are part of an optional maintenance cost reporting program. In those instances where you have elected to receive monthly cost reports, you pay, in addition to the basic monthly rental charge under the Fleet Lease Agreement, a \$20 maintenance reserve deposit per vehicle and a \$2 per month management fee per vehicle.

You indicate that the \$2 monthly fee represents a current and unrecoverable expense for _____. The \$20 monthly payment represents an asset on your books and a liability on the books of the lessor. You state that "When it becomes necessary to repair one of these vehicles the custodian issues the garage a _____ purchase order. The garage bills _____ who, in turn, pays the bill and reduces our deposit account by a like amount." You state that should the garage bill exceed the balance in the account, _____ will request an additional payment from you for the difference. At the expiration of the lease, any unused deposit balance will be returned to you by _____. Likewise, should the deposit account reflect a negative balance, you would issue a check to _____ in that amount.

From the beginning of your lease arrangement with _____ it has included the aforementioned \$22 in its tax base.

We find that the relationship between _____ and _____ as established by the "Budget Maintenance and Control Agreement," is somewhat different from the way in which you describe it in your letter to us. The Maintenance Agreement states in the second paragraph that "Lessee's obligations in regard to the maintenance of Vehicles under its Fleet Lease are in no way modified by this Agreement. . . . This Agreement is entirely separate from the Fleet Lease and does not incorporate, limit, or modify any provision of the Fleet Lease or any obligation of Lessee under the Fleet Lease."

Section 2 of the Maintenance Agreement provides that whenever maintenance or repair is performed on a Vehicle, Lessee shall either:

"(a) pursuant to Section 10, cause an original invoice and a Service Control Card to be sent to Lessee in care of Lessor, by the service station or garage performing the maintenance or repair, for payment by Lessor from the maintenance account; or

July 21, 1977

"(b) pursuant to Section 11, pay the amount of the invoice directly to the service station or garage performing the maintenance or repair, and request reimbursement by Lessor from the maintenance account."

Section 4 of the Maintenance Agreement provides as follows:

"On the Date of this Agreement, Lessor shall establish, for accounting purposes only, a single maintenance account with respect to Lessee ('the maintenance account'). Lessor shall credit to the maintenance account each initial maintenance payment or monthly maintenance payment pursuant to Section 5 and each additional maintenance payment pursuant to Section 6. Lessor shall charge to the maintenance account the amount of each invoice paid by Lessor pursuant to Section 10 or Section 11. Within thirty (30) days after each anniversary of the Date of this Agreement, Lessor shall refund to Lessee an amount equal to any balance remaining in the maintenance account on the anniversary with respect to each Vehicle for which the maintenance term ended during the contract year under this Agreement immediately preceding the anniversary. Lessor shall charge the amount refunded to the maintenance account with respect to such Vehicles. Within thirty (30) days after the term of this Agreement ends, Lessor shall refund to Lessee an amount equal to any balance remaining in the maintenance account. Each initial maintenance payment, monthly maintenance payment, and additional maintenance payment shall be the sole property of Lessor, may be commingled by Lessor with its other funds, and may be used by Lessor for general purposes. Lessor shall not hold any initial maintenance payment, monthly maintenance payment, or additional maintenance payment as security for any Vehicle leased under the Fleet Lease; for the payment of rent, additional rent, or any other charge under this Agreement or the Fleet Lease; or for the performance of the terms of this Agreement or the Fleet Lease. Lessor shall not be required to pay any interest to Lessee because of any balance in the maintenance account."

Section 10 of the Maintenance Agreement provides, in part, as follows:

"For each maintenance or repair performed during the maintenance term of a Vehicle, unless the cost of the maintenance

July 21, 1977

or repair is paid by the operator of the Vehicle directly to the service station, the operator shall cause the service station to mail to Lessee in care of Lessor, within ten (10) days after the maintenance or repair is performed:

"(i) an original, complete, and itemized invoice, signed by Lessee and the service station, for payment by Lessor on behalf of Lessee from the maintenance account;

"(ii) a Service Control Card for the maintenance or repair, with all items completed and signed by both the operator and the service station."

Section 10 also provides that "Lessor's obligation to pay the invoice is solely for the benefit of Lessee. The service station shall not have any rights against Lessor under this Agreement, whether as third-party beneficiary or otherwise."

We are of the opinion that neither the maintenance payments (initial, monthly and additional) nor the management fees are subject to tax. The Maintenance Agreement is not in conflict with the Fleet Lease Agreement.

has undertaken to maintain the vehicles.
contracts for maintenance directly with local service stations, and, consequently, is legally responsible to the servicing organizations for payment for work done.

The maintenance payments and management fees paid under the optional Maintenance Agreement are not payments made to in reimbursement for expenses incurred by under the Fleet Lease Agreement. Such payments do not constitute taxable lease receipts under the California Sales and Use Tax Law.

Very truly yours,

Gary J. Jugum
Tax Counsel

j:alicetilton