

330,3796

Memorandum

To : Audit Review and Refunds (BSI)

Date : September 9, 1985

From : Gary J. Jugum

Subject :

This is in response to your memorandum of July 25, 1985. You have requested that we review the transaction described in Mr. Bob Imig's memorandum to the Principal Tax Auditor dated June 13, 1985.

We understand that taxpayer purchased, tax-paid, \$2,166,000 worth of materials to fabricate and build a canning machine. Upon completion of the manufacture of the machine and prior to any use, taxpayer sold the machine to [redacted]. The contract price was \$4,895,339. [redacted] immediately leased the machine back to taxpayer for approximately \$50,000 per month. The lease agreement provides that the lessee has the option to purchase the equipment for fair market value at the end of the eight-year lease term.

Taxpayer reported the total contract price as a taxable sale and took a tax-paid purchases resold deduction for materials incorporated into the machine. [redacted] paid taxpayer the exact contract price. There was no separate statement of sales tax reimbursement, nor is there evidence that the contract price included sales tax reimbursement. [redacted] then invoiced taxpayer for the lease amount, plus tax. [redacted] has collected tax from taxpayer measured by the lease amount and has remitted this amount to this agency.

Tax has thus been paid both upon the sale of the equipment from taxpayer to [redacted] and upon the continuing lease of the property by [redacted] to taxpayer. Taxpayer has now filed a claim for refund with respect to tax paid by it upon the sale transaction. The question is, is this tax subject to refund?

First, there is no basis for ignoring the sale and leaseback transaction for sales and use tax purposes. It is our position that all sales and leaseback transactions should be taxed in accordance with their form unless it is clearly established that the transactions are financing transactions only, in accordance with Cedars-Sinai Medical Center v. State Board of Equalization 162 Cal.App.3d 1182 (1984). Our analysis of that decision is attached for your review.

Second, the amount of tax in question is subject to refund only if taxpayer's sale of the equipment can be established to be a sale for resale. Taxpayer did not take a resale certificate. Taxpayer's position is that the facts themselves document the sale as a sale for resale.

Relevant here is the language of Revenue and Taxation Code section 6006(g)(5) which provides that "sale" includes any lease of tangible personal property for a consideration except the lease of tangible personal property leased in substantially the same form as acquired by the lessor "as to which the lessor . . . has paid sales tax reimbursement or has paid use tax measured by the purchase price of the property."

The question is, if the lessor had not collected use tax measured by the lease price from the lessee in this case, would we have assessed the tax on the lease transaction notwithstanding the fact that taxpayer had paid sales tax? It would appear that the lease transaction would be subject to tax notwithstanding the fact that taxpayer paid sales tax on the transaction. It is crystal clear that the lessor did not pay "use tax measured by the purchase price of the property." There is no showing that the lessor paid sales tax reimbursement since there was no separate statement of sales tax, since there is no showing that the property was purchased on a tax included basis, and since taxpayer paid tax on the entire contract price. It is significant that the language of 6006(g)(5) was changed effective September 26, 1980, to delete the concept that property is tax-paid in the hands of the lessor only if the vendor has in fact paid sales tax on the sale to the lessor. Section 6006 has always been interpreted to allow a tax-paid status if the lessor has paid sales tax reimbursement, without regard to the fact that the vendor may not have paid sales tax to the state. This

interpretation protects the lessor from the defaulting vendor. To be consistent, the lessor should not be required to forfeit its option to resell the property in a taxable lease transaction merely because the vendor may unilaterally have chosen to pay sales tax without collecting sales tax reimbursement from the lessor.

It is the lessor who is given the opportunity under the law to place the rental property in a tax-paid status by paying sales tax reimbursement to the vendor or by paying use tax. The lessor is not bound by the unilateral action of the vendor who may report sales on the transaction without collecting reimbursement from the lessor. In the case before us, it follows that the lessor's leasing of the equipment was a retail sale notwithstanding the payment made by the taxpayer. Taxpayer is entitled to a refund of the tax which it paid. Taxpayer has no obligation to pay this amount over to the lessor. The lease transaction remains taxable.

GJJ:sr

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