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August 14, 1969

It will Not relate to prof liability. See Annot. 330.2793

Attention:

Gentlemen:

Re:

Your letter of June 11, 1969, addressed to our Van Nuys office has been referred to this office for reply. Your letter poses a question on a matter of relieving your organizations from the necessity of charging use tax on rental of equipment to your customers.

We understand that [redacted] (hereinafter referred to as "taxpayer") is owned, solely, by [redacted] Taxpayer manufactures mechanical equipment. Taxpayer sells some of this equipment to [redacted] at cost of manufacture. [redacted] pays sales tax reimbursement to taxpayer on the purchase of this equipment. [redacted] individual and owner of the equipment on which sales tax has been paid, leases this equipment to taxpayer ex tax and not under a resale certificate. Taxpayer then rents this equipment to users without having to collect use tax. You ask if this plan will relieve taxpayer of tax liabilities in connection with the rental of this equipment.

In our opinion this plan will relieve taxpayer of the obligations to collect use tax but will subject taxpayer to penalties for tax evasion. Tax which would otherwise be due on a bona fide transaction will be lost on the equipment which taxpayer sells to [redacted], to the extent that the selling price of the equipment is below its fair market value. While taxpayer could accomplish its goal by taking the steps outlined above if the sale and leaseback transactions were at arms length, since the selling price of the equipment is artificially low, we would regard the plan as an attempt to evade the tax.

Taxpayer would be required to collect tax on leases of the equipment which it manufactures if it directly leased the equipment because the equipment would not be leased in substantially the same form as it was acquired. (The property was acquired as raw materials and leased as fabricated equipment.) If taxpayer sold this equipment in an arms-length transaction, the selling

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price of the equipment would be the rough equivalent of the discounted value of the rentals to be paid over the life of the equipment. Thus, economically, the measure of tax would be at least theoretically the same whether the property was leased or sold. If, however, taxpayer were allowed to pay tax as measured by the cost of the equipment only or some other artificially low "sales price" such as \$10 per unit or \$1 per unit, taxpayer would in effect be manipulating its measure of tax liability. We are not saying that taxpayer cannot sell his equipment at cost or below cost or at any other price which it may choose. We are saying that in its totality the plan proposed is, in our opinion, a tax evasion scheme.

We are sure that taxpayer has not done or did not intend to do anything illegal, and we are confident that taxpayer's only concern has been with relieving itself of the inconvenience of collecting tax from its customers. If you have further inquiries on this matter or if you would like a fuller explanation of our position, please feel free to write directly to this office.

Very truly yours,

Gary J. Jugum
Assistant Tax Counsel

GJJ:ab

bc: Los Angeles District - Dist. Admn.
Van Nuys - Subdistrict Administrator