

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

*In the Matter of the Petition of RANDOLPH COMPUTER CORP. for Redetermination
of Sales and Use Tax*

Appearances:

For Petitioner: George D. Brodigan
Attorney at Law
John Winters
Vice President

For Staff: Robert H. Anderson
Tax Counsel

OPINION

This petition is for redetermination of sales and use tax in the amount of \$29,683.63 for the period February 1, 1966 to December 31, 1969.

Randolph Computer Corporation (RCC) is a lessor of automatic data processing equipment manufactured by International Business Machines Corporation (IBM). Petitioner's lease receipts are subject to tax under the Sales and Use Tax Law. The issue presented is whether certain amounts paid by petitioner's lessees for maintenance of the leased equipment are includable in the measure of tax.

Petitioner ordinarily gives its lessees an option of entering into either a "net" lease or a "gross" lease. The terms of the "net" lease agreement with respect to maintenance are as follows:

"Customer shall enter into and maintain in force with IBM or such other company as RCC shall designate (subject to customer's consent) or approve in writing at any time during the term of each Schedule subject hereto, a maintenance agreement covering the machines thereunder. Customer will use its best efforts to cause the machines subject to each Schedule to be kept in good working order in accordance with the provisions of the maintenance agreement in effect during the respective term thereof. Subject to United States security regulations, Customer agrees to make the machines available for maintenance in accordance with the provisions of the applicable maintenance agreement. Customer shall provide satisfactory evidence to RCC that Customer has entered into and is continuing to maintain in full force and effect said maintenance agreement at its sole cost and expense, all in accordance with the provisions of this Section.

“Customer shall pay, at its own expense, all maintenance and service charges whether such charges are incurred under the applicable maintenance agreement or otherwise, and in addition will pay expenses, if any, of customer engineers in connection with maintenance and repair services, provided however, that Customer’s liability therefor shall not exceed IBM’s charges for such services as in effect from time to time.”

The terms of the “gross” lease agreement with respect to maintenance are as follows:

“RCC shall enter into and maintain in force a maintenance agreement covering the machines. Customer will use its best efforts to cause the machines to be kept in good working order in accordance with the provision of the applicable maintenance agreement in effect during the term of each Schedule subject hereto. Subject to United States security regulations, Customer agrees to make the machines available for maintenance in accordance with the provisions of the maintenance agreement.

“RCC’s liability for payment of charges under any maintenance agreement in force pursuant to this Agreement shall be limited to the minimum monthly maintenance charge or the amount indicated on the applicable Schedule, whichever is lower. Customer shall pay, at its expense, all maintenance and service charges in excess of RCC’s liability therefor, whether such charges are incurred under the maintenance agreement or otherwise, and in addition will pay expenses, if any, of customer engineers in connection with maintenance and repair services, provided however, that the amount Customer is required to pay shall not exceed IBM’s charges for such services as in effect from time to time.”

Petitioner entered into a special lease agreement with one customer, Lockheed Aircraft Corporation, which contained provisions regarding maintenance that were different from either of the above-quoted agreements. These provisions were as follows:

“RCC agrees to appoint the Customer as its agent to obtain maintenance service from IBM for machines covered by this Agreement. The Customer agrees to include the leased machines either within the coverage of its basic maintenance agreement for purchased machines with IBM or within the coverage of IBM’s standard commercial maintenance contract. Upon receipt of evidence of payment by Customer, RCC shall reimburse the Customer (in the form of a credit against monthly rental charges) for an amount equal to IBM’s January 1, 1967 minimum monthly maintenance charges for the machines. The Customer shall pay all other service charges. In the event the machines covered by this Agreement are removed from the State of California, upon mutual agreement of Customer and RCC, RCC shall enter into and maintain in force an IBM Maintenance Agreement covering the machines in lieu of the Customer obtaining maintenance services as described above, provided however, in the event RCC shall do so, (i) RCC shall

pay no more for maintenance of the machines than the IBM April 1, 1967 minimum monthly maintenance charges therefor, and (ii) RCC's obligation to reimburse Customer for minimum monthly maintenance charges as aforesaid shall terminate."

The lease agreement between petitioner and Lockheed pertained to IBM equipment already located on Lockheed's premises and maintained by IBM which equipment had been owned by IBM, but which petitioner was in the process of purchasing from IBM. Petitioner states that what Lockheed actually wanted was a "net" lease, but that since most of petitioner's leases were at that time "gross" leases, it billed Lockheed the same as it would have under a "gross" lease. Petitioner explains that Lockheed was appointed as petitioner's agent in order to protect petitioner's ownership interest in the equipment.

Petitioner has collected from its customers and paid tax measured by the "minimum monthly maintenance" charges under its "gross" leases, but has not collected or paid tax measured by the "excess" maintenance charges under those leases, nor has it collected or paid tax with respect to any of the maintenance charges under its "net" leases or its lease with Lockheed. The determination here in question asserts tax measured by the "excess" maintenance charges under the "gross" leases and all maintenance charges under the Lockheed lease.

Sales and Use Tax Regulation 1502(k) (18 Cal. Admin. Code § 1502(k)) directly relates to the question of whether the maintenance charges are includable in the measure of tax. It provides as follows:

"Where services, such as . . . maintenance services, are provided to those who purchase automatic data processing and related equipment, on a mandatory basis as an inseparable part of the sale or taxable lease of the equipment, charges for the furnishing of the services are includable in the measure of tax from the sale or lease of the equipment whether the charges are separately stated or not. Where the purchaser or lessee has the option to acquire the equipment either with or without the services, charges for the services may be excluded from the measure of tax from the sale of the equipment."

Under the facts of petitioner's case, the lessees other than Lockheed had the option of acquiring the equipment either with or without maintenance services provided directly or indirectly by petitioner, i.e., they had the choice of entering into a "net" lease, under which they would pay a third party for maintenance services, or a "gross" lease, under which they would pay petitioner for maintenance services provided by a third party with whom petitioner contracted. Pursuant to the regulation, accordingly, none of the maintenance charges under either a "net" lease or a "gross" lease with lessees other than Lockheed are includable in the measure of tax.

The Lockheed lease is less readily classified because of its peculiar provisions and the unusual circumstances surrounding it. Petitioner's own explanation, however, indicates that while Lockheed wanted a "net" lease, petitioner took it upon itself to prescribe a "gross" lease, under which Lockheed acted as petitioner's agent in providing maintenance services. Accepting petitioner's explanation of why this was done, the fact remains that the agreement was cast as it was for petitioner's own purposes. The evidence does not support a finding that Lockheed was given an option to contract for the maintenance services on its own behalf with a third party. We conclude that the maintenance services under the Lockheed lease were provided by petitioner, as the principal, on a mandatory basis as an inseparable part of the taxable lease of the equipment, and that Lockheed did not have the option to acquire the equipment otherwise. Therefore, the maintenance charges under that lease were includable in the measure of tax.

The maintenance charges under those leases other than the Lockheed lease are to be deleted from the measure of tax. The deletion, however, is not to include maintenance charges under "gross" leases as to which petitioner has collected tax from its lessees. Pursuant to Section 6902 of the Revenue and Taxation Code petitioner may, within six months after this determination becomes final, file a claim for refund of tax paid with respect to maintenance charges under "gross" leases, other than the Lockheed lease. The granting of such claim will depend upon satisfactory assurance that the amount of the tax will be returned to the lessees from whom petitioner collected it.

Done at Sacramento, California, this 3rd day of January 1974.

George R. Reilly, Chairman
John W. Lynch, Member
William M. Bennett, Member
Richard Nevins, Member

Attested by: W. W. Dunlop, Executive Secretary