

770. 3448

Auditing (WFP:RO) - San Francisco

March 12, 1971

Tax Counsel (GJJ) - Headquarters

~~_____~~
San Francisco

This is in response to your memorandum of February 3, 1971.

We understand that taxpayer is the lessor of equipment. Pursuant to taxpayer's "Lease Agreement for Equipment" taxpayer's lessee customers agree that:

"Customer shall enter into and maintain in force a standard Maintenance Agreement covering at least prime shift maintenance of the machines. Customer will cause to keep the machines in good working order in accordance with the provisions of such Maintenance Agreement and to make all necessary adjustments and repairs to the machines, and Customer shall allow access to the machines for such purposes. _____ is hereby authorized to accept the directions of Customer with respect to such maintenance, adjustments and repairs. Upon termination of this Agreement or any Machine Schedule subject hereto for any reason, Customer shall return the machines to _____ in good condition and repair, with all engineering changes prescribed by _____ prior to the date of termination incorporated therein, reasonable wear and tear only excepted.

"Charges for the Maintenance Agreement and all other maintenance and service charges, including installation and dismantling, shall be borne by Customer, and Customer agrees promptly to reimburse _____ for any amount thereof paid by _____"

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In our letter of June 26, 1970, in regard to _____ we referred, at page 3, to a "net lease" agreement used by taxpayer _____ where _____ appointed its lessee customer "as its agent to obtain maintenance service from _____." We concluded that under this type of agreement the lessor is the principal in supplying the maintenance service. That is, we concluded that under this type of agreement the lessor is required to maintain the equipment. We thus came to the ultimate conclusion that charges for such services were includable in the measure of tax with respect to the rentals of the computer equipment. In effect, we were applying CTS Anno. 1536.50 to which you have referred.

You have been lead to ask, upon considering this letter in regard to _____

Would the tax application differ if no principal agent relationship exists?

We think that where, as in the _____ agreement, the lessor does not designate the lessee as its agent in securing maintenance service, the obligation to maintain the equipment is the obligation of the lessee, not the lessor, and that maintenance charges are not includable in the measure of the tax.

In regard to the _____ agreement you specifically ask:

What is the tax application if (a) lessee pays directly to _____? (b) lessee reimburses lessor for latter's payment to _____?

As we have already indicated, under the _____ agreement the obligation to maintain is, at least on the face of the agreement, the obligation of the lessee. Presumably the customer would make payments directly to _____. Such payments would not be subject to tax. If payment is made directly to _____, for remittance to _____ the payment would still remain not subject to the tax. If the customer is in fact reimbursing _____ for _____ cost under the maintenance agreement, these facts would tend to indicate a "net lease" agreement of the type discussed in _____ and we would be required to reconsider the question as to whose obligation it is to maintain the equipment.

As you have no doubt gathered already, the last sentence of CTS Anno. 1536.50 is still applicable. In _____ we were attempting to make the initial determination--whose obligation was it to maintain the equipment?

It is our opinion that the fact that the agreement specifies a named maintenance company is immaterial to the _____

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application of the tax, assuming that the obligation to secure the maintenance service is the obligation of the lessee. If some master agreement were shown between the lessor, here and the maintenance company, here, under which the lessor agreed to require its lessees to secure maintenance contracts with the maintenance company, we would have to reconsider this question.

GJJ/ab
cc: Mr. R. J. Hyman

This opinion relates only to whether the maintenance charges are part of the taxable rentals. When they are not taxable, they must therefore be examined to determine whether they are part of the taxable rentals. Reg 1546 - i.e., if the lessor enters into an optional maintenance agreement that charges for maintenance, that charge isn't taxable if the company providing the parts furnished. If the lessee has equipment repaired on a repair or parts basis, it is the consumer's responsibility. If the consumer's equipment is repaired on a separate basis, it applies to the charges for those parts.

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