

330.5260

(916) 445-5950

November 27, 1989

Re: _____

This is in response to your letter dated October 18, 1989. In a letter dated October 6, 1989, I responded to your previous letter dated September 21, 1989 in which you asked for an opinion regarding the application of sales and use tax to transactions among _____ (the equipment vendor), _____ and _____ and _____ had entered into a master lease agreement which contemplated execution of subsequent separate lease schedules. Of course, each separate lease schedule was a separate contract even if subject to the master lease.

For the first two lease schedules, _____ purchased the equipment directly from vendors and then leased that equipment to _____. However, when _____ desired to obtain certain equipment sold by _____, _____ purchased the equipment, selling the equipment to _____ and leasing it back under the third lease schedule. _____ had apparently paid sales tax reimbursement (or use tax) to _____. You asked for our opinion as to the application of tax with the obvious hope that we would conclude that the sales tax reimbursement or use tax paid by _____ would satisfy all tax liabilities on the transactions.

We concluded that _____ sold the equipment to _____ who in turn sold the equipment to _____ and leased it back. We noted that some sale and leaseback transactions will be regarded as financing transactions when certain requirements are satisfied. However, you had provided no information that would indicate ~~that~~ any of the requirements were satisfied, and we therefore _____ the transaction on the assumption that the transaction would be regarded as a sale and leaseback under the Sales and Use Tax Law. Nevertheless, we concluded that, if the facts were _____ you described them and _____ had made no use of the equipment _____ that we would regard as functional use prior to the sale of the equipment to _____ would be regarded as

purchasing the equipment for resale to [redacted] and could therefore take a tax-paid purchases resold deduction as described in Regulation 1701. The sale or the leaseback would be subject to sales or use tax under the usual leasing rules. (See Reg. 1.650.)

In your most recent letter, you state:

"First, we are surprised, dismayed and frankly confused by your apparent conclusion, at page 4, that [redacted] purchased the equipment for resale to [redacted]. We do not understand how such a conclusion is possible in light of the history and documentation of this transaction as a lease of equipment owned by

"Your conclusion appears to ignore the fact that the leased equipment and lease schedule for this transaction is the third of three lease schedules all governed by a master lease entered into two years ago.

"I am at a loss to understand how the Board of Equalization can ignore the historic substance of an ongoing lease relationship between these parties, and apparently narrowly focus on the third lease transaction as though it were entirely separate and unrelated to this existing course of dealing.

"We believe it is unfair and completely inappropriate to isolate the most recent lease transaction and treat of [redacted] it without reference to the master lease by which it is governed."

As mentioned above, the transaction was structured so that the third lease schedule, which included the terms of the master lease, was a separate contractual arrangement from the first two lease schedules. Furthermore, regardless of the terms of the lease, the transaction between [redacted] and [redacted] was clearly a sale from [redacted] to [redacted] without regard to the manner in which [redacted] and [redacted] had originally contemplated that equipment would be acquired. That is, even if contrary to the specific terms of the master lease (which [redacted] was a party to), [redacted] actually purchased the equipment from [redacted] and we therefore regard [redacted] as having purchased the equipment from [redacted].

In your previous letter you argued that Civil Code Section 3440.1(k) and Commercial Code Section 10308 were relevant and supported your position. In your most recent letter you state:

"I urge you to read Civil Code §3440.1(k) and Commercial Code §10308, if you are not already familiar with these provisions. These Code sections were enacted and adopted to cover just such a situation as this where a bona fide good faith lease transaction was required by practical necessity to be structured in such a way that on its surface it appears to resemble a sale and leaseback when it emphatically is not."

Because of the conclusions made in my previous letter, I did not feel it necessary to point out that these provisions are totally irrelevant to the application of sales and use tax. The Uniform Fraudulent Transfer Act (Civ. Code § 3439 et seq.) provides protection to creditors against fraudulent transfers. Its provisions do not determine when a sale occurs for purposes of sales and use tax. (The primary provisions for the analysis of when a sale occurs are contained in the second chapter of the Uniform Commercial Code - Sales. (See Cal. UCC 2101 et seq.)) Contrary to your interpretation of the provisions you cite, these provisions mean that a sale and leaseback such as between [redacted] and [redacted] cannot be treated as a fraudulent transfer by creditors under the Uniform Fraudulent Transfer Act, but will instead be treated as a bona fide sale and leaseback. That is, these provisions in no way permit [redacted] and [redacted] to disregard the true character of the sale from [redacted] to [redacted]. Another reason I did not discuss this argument is that I would have had to point out that the provisions you cite, subdivision (k) of Civil Code Section 3440.1 and Commercial Code Section 10308, were added by statute in 1988 and do not become operative until January 1, 1990.

Your most recent letter also states:

"The facts in this case simply do not warrant your conclusion that [redacted] purchased the equipment from [redacted] for sale or at retail. [redacted] purchased the equipment temporarily for [redacted] account so that the lease could be consummated when all the equipment was delivered. It is as simple as that. To ignore the underlying facts and purposes of this lease is to slavishly adhere

to form over substance. Revenue and Taxation Code §6007 cannot be so broadly construed to support your conclusion that this was a retail sale. Clearly, what is intended ultimately is that [redacted] would make functional use of the property (once fully installed) as a lessee. [redacted] did not purchase this property for the purpose of reselling it, but rather of using it once the entire lease transaction could be fully documented and consummated. It is absolutely clear and undeniable here that [redacted] is not in the business of selling equipment of this kind, especially equipment that it is leasing and that does not belong to it."

Whether or not [redacted] purchased the equipment "temporarily" for [redacted] account does not alter the fact that it was [redacted] that made the purchase and that title was passed from [redacted] to [redacted]. This is a sale from [redacted] to [redacted] regardless of the length of time [redacted] intends to retain ownership. As mentioned in my previous letter, it is possible for a person such as [redacted] to act as the agent of another, such as [redacted] in which case the principal would be regarded as making the purchase and not the agent. However, this agency status cannot be "understood" but must be explicit and satisfy the specific requirements mentioned in my previous letter. [redacted] did not act as an agent for [redacted] but rather purchased the equipment for its own account.

In the portions of your letter quoted above, you acknowledge that I concluded that [redacted] purchased the equipment from [redacted] for resale or at retail. You then proceed to argue that Revenue and Taxation Code Section 6007 cannot be construed to support my conclusion that this was a retail sale. As you had just acknowledged, this was not my conclusion. Rather, my conclusion was that the sale was to [redacted] and that [redacted] therefore either purchased the property for its own use, at retail, or purchased the property for resale. Of course, sales tax does not apply when property is purchased for resale in the regular course of business. (Rev. & Tax. Code §§ 6007, 6051.)

In summary, I am surprised and confused by your most recent letter. If the facts are as stated in your September 21, 1989 letter, sales tax would apply to [redacted] sale to [redacted] or to [redacted] lease to [redacted], but [redacted] would be entitled to a tax-paid purchases resold deduction with respect to the sales tax reimbursement or use tax it paid on its purchase of the equipment.

result to . . . If, after a careful reading of this and my previous letter, you remain confused, feel free to contact me again.

Sincerely,



David H. Levine
Tax Counsel

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bc: Out-of-State District Administrator
Santa Ana District Administrator