



STATE BOARD OF EQUALIZATION

April 30, 1996

Dear

This is in response to the undated letter you sent to our ---, District Office regarding the application of tax to the lease of a vessel. Your inquiry, which was forwarded to the Legal Division for response, was received by the Legal Division on February 16, 1996. You state:

"I hold a California resale certificate and I am in the business of acquiring, repairing and selling boats.

"I obtained a lease with an option to buy (after a two year period) on a 1976 model, 51 foot sailboat. The lease was obtained from the --- ---. As I was planning on exercising the option after the two year period and reselling the boat I have not paid tax on any of the lease payments made to date.

"I have recently decided not to exercise the option. For the consideration of \$55,630.00 I have agreed to have my lease with the --- canceled so that another party may obtain the lease on the boat including the option to buy at the end of the two year period.

"My original lease with the --- required me to pay \$11,000.00 in cash plus \$4,750.00 in future lease payments.

"The new lease between the --- and the party referred to above requires lease payments totaling \$4,120.00."

You provided copies of the undated "--- --- Lease/Option to Purchase Agreement" in which the --- --- acknowledges what it refers to as the assignment of your lease to --- and --- in which the --- executes a new lease directly between it and the --- and in which the --- releases you from "any and all obligation, present and/or future with regard to said lease."

Although the agreement you have enclosed with your letter characterizes the agreement between you and the --- as an assignment of a lease, it is my understanding from the information you have provided that the agreement is actually for a sublease, rather than an assignment. Since the sailboat measures 51 feet in length, it is included in the definition of Mobile Transportation Equipment (MTE) provided in Revenue and Taxation Code section 6023. (See Reg. 1661(copy enclosed); Business Taxes Law Guide Annotations 335.0050 (1/31/73), 335.0075 (2/21/73).) Therefore, the rules applicable to leases of MTE apply.

It is not entirely clear whether the transaction between you and --- designated as a lease constitutes a true lease, or instead constitutes a sale at inception. (See Reg. 1660(a)(2)(A).) If the

transaction is a sale at inception, then tax was due at the time possession of the property was transferred to you, measured by the full contract price, unless --- has kept adequate and complete records to show separately the sales price of the sailboat, and the insurance, interest, finance, and carrying charges made in the contract. (Reg. 164Ha.) If --- has kept such records, the insurance, interest, finance, and carrying charges may be excluded from the computation of the tax. (Id.) For the remainder of this opinion, we assume that the transaction between you and --- is not a sale at inception, but is instead a true lease.

A lease of MTE is never a sale. (Rev. & Tax. Code § 6006(g)(4).) Rather, the sale of MTE to a person who will lease it is a retail sale, and the sale to the lessor, or the use by the lessor (by leasing), is subject to sales or use tax. (Rev. & Tax. Code §§ 6051, 6201.) If, however, the use of the MTE will be limited to leasing and the lessor makes a timely election to do so, the lessor may pay his or her tax liability measured by the fair rental value of the MTE, which means the amount of rentals required by the lease. (Reg. 1661(e)(2)(A).) When the lessor elects to pay tax measured by fair rental value, the election is irrevocable and the lessor must continue to report tax on that basis whether the MTE is inside or outside California. (Rev. & Tax. Code §§ 6094(d), 6244(d).) Where the lessor does not make such a timely election, the lessor owes tax on the purchase price of the MTE.

Thus, in the situation about which you inquire, the retail sale was the sale of the sailboat to ---, and --- is the consumer of MTE it leases. Based on the facts you have provided, it appears that --- did not make a timely election to pay tax measured by fair rental value. This means that --- owes sales tax reimbursement or use tax on the purchase price of the MTE. You do not state whether or not --- has already paid the tax reimbursement or use tax.

Without regard to whether --- has already paid the tax it owes on its purchase of the sailboat, since the lease to you is not a sale or use by you for purposes of the Sales and Use Tax Law, you are not liable for tax on your lease or or --- sublease of the sailboat. Please note, however, that the sale to the --- when they exercise their option to purchase the sailboat will be subject to tax, measured by the sale price of the option.

If you have further questions, please feel free to write again.

Sincerely,

Kelly W. Ching
Staff Counsel

KWC:cl

Enclosure (Reg. 1661)

cc: --- District Administrator

Mr. Robert Reichmuth, --- District Office

Ms. Oveta Riffle, Supervisor (Consumer Use Tax Section - MIC:37)

Ms. Louise Null (Consumer Use Tax Section - MIC:37)