STATE OF CALIFORNIA

BOARD OF EQUALIZATION **395.0075**

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
A--- J---	)	No. SN -- XX XXXXXX-010
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel James E. Mahler on September 24, 19XX, in Culver City, California.

Appearing for Petitioner: C--- L. N---, CPA
Attorney at Law

Appearing for the
Sales and Use Tax Department: Daniel E. Ellsberry
Senior Tax Auditor

Protested Item

The protested tax liability for the period October 1, 1985, through March 31, 1990, is measured by:

Item	State, Local, County & Transit	EQRF
Unreported taxable rental receipts (including reaudit adjustment)	$644,913	$77,847

The determination includes a ten percent penalty in the amount of $4,146 ($4,211.39 after reaudit adjustment) for failure to file returns.

Petitioner's Contentions

1. The lease of equipment is not subject to tax under the Sales and Use Tax Law.

2. If Sales and Use Tax Regulation 1595(a) were construed to mean that the lease is taxable, the regulation would conflict with the statute and thus be void.

3. Relief from the penalty for failure to file returns should be allowed.

Summary

On or about November 20, 1985, petitioner contracted to lease certain equipment to M--- L---, Inc. (later called P--- I---, Inc., hereinafter "ML"). Appendix A of the lease agreement listed 22 pieces of equipment subject to the lease, with a total "cost" of $395,863. The equipment included a gluing machine, drills, sanders, a saw, a forklift and other items intended for use in manufacturing furniture. The principal issue is whether tax applies to petitioner's lease receipts.

The lease price was not clearly set out in the agreement. Section 3 stated that ML would pay rent of $12,000 "on the ____ day of each ____" for a term of 50 months, but the blanks were not filled in. ML also agreed to pay any taxes which might be assessed on the equipment. The agreement did not specify who would be responsible for insuring or maintaining the equipment, but did provide that ML had a "right" to add to the value of the equipment by making repairs.

Petitioner advised the audit staff that his lease receipts totalled $644,915 for the period October 1, 1985, through March 31, 1990, and the staff accepted this figure as correct. Petitioner's figure was broken down by years, but not by quarters. The yearly receipts varied greatly. For example, petitioner received $248,837 in 1987, $144,365 in 1988 and $163,052 in 1989. No explanation for these fluctuations has been offered, but they may reflect additions to or deletions from the number of items being leased.

According to petitioner, he originally purchased the equipment for use in manufacturing furniture in South Africa. (The audit staff found that the purchases were ex-tax, and petitioner does not dispute this finding.) Petitioner emigrated to California and brought the equipment with him in 1984. He stored the equipment in this state for about a year while he looked for an opportunity to open another furniture-manufacturing business, and ultimately set up ML to conduct the business. On the advice of an accountant, he decided to minimize his income taxes by retaining ownership of the equipment and leasing it to ML, rather than contributing it to the corporation. (For federal income tax purposes, petitioner has reported the lease receipts on Schedule E of his returns as supplemental income, and has claimed depreciation deductions, but we do not know whether he has also claimed other business expense deductions such as maintenance and insurance.)

Analysis and Conclusions

Subdivision (a)(1) of Sales and Use Tax Regulation 1595 provides, in the third paragraph:

> "Tax does not apply to a sale of property held or used in the course of an activity not requiring the holding of a seller's permit unless the sale is one of a series of sales sufficient in number, scope and character to constitute an activity for which the seller is required to hold a seller's permit or would be reburied to hold a seller's permit if the activity were conducted in this state. If tangible personal property is leased under a lease which is a 'sale' as defined in Section 6006 or a 'purchase' as defined in Section 6010, tax applies to the lease as provided in Regulation 1660. The lessor is making a 'continuing sale' which is not an 'occasional sale'." (Emphasis added.)

The parties agree that petitioner's lease to ML was both a "sale" and a "purchase" as defined in the statutes cited in the regulation. In the staff's view, the lease is therefore subject to tax under the express terms of the regulation.

Petitioner attacks the staff's position on two fronts. He contends, first, that the regulation does not apply to him, and second, that the regulation would be void if it were construed as applying to him. Petitioner's arguments on these points are set out in detail in his representative's letter dated October 2, 1992, which we have attached hereto as an exhibit.

Briefly summarized, petitioner's first argument runs as follows. Sales and use taxes apply only when property is sold by a "retailer". (Rev. & Tax. Code §§ 6051 and 6201.) With certain exceptions not relevant here, a vendor is not a "retailer" unless he or she is also a "seller" or a "person engaged in the business of making sales [at retail]." (Rev. & Tax. Code § 6015, subds. (a)(1) and (a)(2).) Similarly, "seller" means a person "engaged in the business of selling" taxable property. (Rev. & Tax. Code § 6014.) "[T]he term `business' requires that the seller engage in more than one isolated sale." (Market Street Railway Co. v. State Bd. of Equalization, 137 Cal.App.2d 87 at 95.) A lease of the type in question is a "sale". (Rev. & Tax. Code § 6006, subd. (g).) Petitioner concludes that a person who makes a single lease is not "engaged in the business" of selling, and thus is not a "seller" or "retailer", so tax does not apply.

The second argument, again briefly summarized, is based on Revenue and Taxation Code section 6367, which authorizes an exemption for "occasional sales". Subdivision (a) of section 6006.5 defines that term to mean a sale of tangible personal property not held or used by a "seller" in the course of activities requiring a seller's permit. Using the same chain of reasoning just described, petitioner argues that he was not a "seller" because he was not "engaged in

business". Therefore, he concludes that he must qualify for the occasional sales exemption under the statute and, if the regulation is to the contrary, the regulation must be void.

While petitioner's two contentions are analytically separate, they both boil down to the same question. Is a person who makes a single lease (of a type which qualifies as a "sale" and a "purchase") engaged in "business" as a seller?

The term "business" is broadly defined in Revenue and Taxation Code Section 6013 to include "any activity engaged in by any person ... with the object of gain, benefit, or advantage, either direct or indirect." This definition is consistent with the income tax rule that an activity for profit is a trade or business. (See RIA, United States Tax Reporter, Vol. 4, ¶¶ 1624.002 *et seq*.; Mertens Law of Federal Taxation, Vol. 7, §§ 28.49 *et seq*.) As petitioner correctly notes, despite the broad statutory definition, the California courts have held that a single sale by way of title transfer is generally not a business for sales and use tax purposes. However, no California case has decided the precise question before us here, that is, whether a single lease is a business.

The issue has been litigated in other states. The courts of Alabama and Arizona have concluded that a single lease is not a business activity. (State of Alabama v. GM&O Land Co., 275 So.2^{d} 687; Arizona, et al. v. Selby, 544 P.2^{d} 717.) Ohio and New Jersey, on the other hand, have held that a single lease is a business. (Hayes-Albion Corp. v. Kosydar, Oh. Bd. Tx. App., May 21, 1975; New Jersey State Tax News, April-May 1974 [2 CCH N.J. Tx. Rptr. ¶60-590.70].)

The issue has also been litigated under the federal income tax law. As in California, the federal courts do not view a single sale by way of title transfer as a business. (See Guggenheimer v. Commissioner, 209 F.2^{d} 362 at 365.) A single lease, however, is classified as a business activity. (Gilford v. Commissioner, 201 F.2^{d} 735; Reiner v. United States, 222 F.2^{d} 770 at 772-773; Alvary v. United States, 302 F.2^{d} 290 at 796; Rosalie W. Post v. Commissioner, 26 T.C. 1055.) Most of these cases deal with leases of real property, but the rule has also been applied to a single lease of equipment for use in manufacturing. (Cooper Tire & Rubber Co. Employees Retirement Fund v. Commissioner, 36 T.C. 96, aff'd. *per curiam*, 306 F.2^{d} 20.) The appellate court in the last cited case explained its holding as follows:

> "We do not think that a trust must necessarily engage in more than one venture in order to be regularly engaged in the business.... Here was a transaction of considerable magnitude involving 21 pieces of equipment and extending over a period of 10 years or even additional periods of time. The trust was required to purchase tire manufacturing machinery, borrow money and execute a chattel mortgage to finance the purchase price. Mere purchase of the machinery did not produce the income. The trust had to lease the machinery, collect the rentals and make monthly payments on the bank note. To us the deal looks more like one to finance the entire purchase price of machinery needed by the tire company rather

> than a conventional investment for the trust. The statute prohibited loans by the trust to the tire company without adequate security...." (306 F.2d at 21, citations omitted.)

Of course, the income tax has different goals and policies than our Sales and Use Tax Law, so federal authorities are not necessarily dispositive. In this case, however, the federal decisions are persuasive. The sales tax, which is complimented by the use tax, is imposed for "the privilege of selling tangible personal property at retail" in this state. (Rev. & Tax. Code § 6051.) A person who makes a single sale by transferring title has arguably not exercised the privilege to an extent sufficient to warrant imposing the tax. In contrast, a lessor exercises the privilege over a period of months or years. A lessor must regularly collect the rent, take steps to maintain and insure the property and account for receipts and expenses. Even a single lease is therefore a significant exercise of the selling privilege and justifies the tax.

Petitioner's arguments are based on the assumption that title transfers and leases must be treated identically because they are both defined as "sales". This assumption ignores the obvious differences between the two types of transactions. As just noted, a title transfer may be an isolated event completed in a short time, while a lease endures for long periods and requires the continuous involvement of the lessor. Further, while profit undoubtedly motivates many title transfers, such sales are sometimes also made simply to dispose of the property. A lease, however, is almost by definition undertaken for profit. While a single sale by title transfer may thus not be a business venture for profit, a single lease is almost invariably so.

Petitioner draws our attention to Richard Betram & Co. v. Green, 132 So.2d 24, a case decided in 1961 by the Florida Court of Appeal under that state's sales tax law. Plaintiff therein was a broker who listed yachts for lease. He collected the rentals and remitted the money (less a commission) to the yacht owners. Tax was asserted against the broker in part because of a regulation which provided that a rental could not qualify for exemption as an occasional sale. In order to support this regulation under Florida law, the taxing authorities argued that a lease was a "sale" only for purposes of imposing the tax, not for purposes of the exemption statutes. The court rejected this distinction and concluded that a lease is a "sale" for all purposes. Thus, the court invalidated the regulation and determined that the broker did not owe tax.

The Florida case is readily distinguishable. First, Florida law appears to differ greatly from our Sales and Use Tax Law in this area. The yacht leases would apparently have been nontaxable under California law for reasons independent of the occasional sales exemption. Second, there is no doubt that petitioner's lease was a "sale" under California law for purposes of both the imposition statutes and the exemption statutes. The problem addressed by the Florida court (inconsistent definitions of the word "sale") is therefore not present here. Third, and most important, the Florida court did not review the question which does concern us here (whether a single lease would be a "business") nor did it express any opinion on that subject. Accordingly, we find the Florida case of no relevance.

To sum up, subdivision (a)(1) of Sales and Use Tax Regulation 1595 reflects a finding by the Board that a single lease is a "business", which requires imposition of the tax and precludes the claimed occasional sales exemption. The Board's finding is supported by the income tax precedents and is consistent with the sales and use tax statutes. Petitioner's arguments to the contrary are without merit.

Petitioner next contends that his particular lease to ML was not a business, even if the general rule would classify most leases as business activity. He points out that the Board generally looks to the "number, scope and character" of an activity to determine whether it requires the holding of a seller's permit. (See Sales & Use Tax. Reg. 1595, subd. (a)(4).) He alleges that his lease to ML bears none of the indicia of "business" as set out in subdivision (c) of Sales and Use Tax Regulation 1599, which provides:

> "**PURCHASE OF COINS AND BULLION AS INVESTMENT**. Purchases of coins and bullion as investments are purchases at retail. It is immaterial that a gain, benefit, or advantage may not be realized until the resale of the coins and bullion. A resale certificate may not be issued for purchases for this purpose.
>
> "A person purporting to hold coins or bullion solely for resale in the regular course of business must be able to prove that he actively engages in business as a seller of coins and bullion. The following are some examples of relevant evidence:
>
> "(1) The number, scope, and character of the person's purchases and sales of coins or bullion.
>
> "(2) Evidence of the person's continuing efforts to advertise and sell coins or bullion.
>
> "(3) Evidence that the person held out to the public that he was engaged in business as a seller of coins or bullion at an identified place of business.
>
> "(4) The manner in which income from transactions in coins or bullion was reported by that person for income tax purposes.
>
> "(5) Whether a local business license was issued to that person to engage in sales of coins or bullion.
>
> "Seller's permits may be held only by persons actively engaging in the business of selling tangible personal property."

We are not impressed with this argument. Regulation 1599 deals with sales and purchases of coins and bullion, that is, with title transfers. While it is true that the factors listed in the regulation have also been applied in cases involving other types of property, the regulation was not drafted with the unique problems of leases in mind, and the factors listed in the regulation are not particularly relevant to leasing businesses. More importantly, the regulation expressly states that the listed factors are "examples of relevant evidence." The regulation does not even remotely suggest that the listed factors are requirements which must be met before an activity can be classified as a business.

We find that petitioner's lease to ML is properly classified as a business. The lease included 22 individual pieces of equipment with a total cost of $395,863. (It is fortuitous that petitioner chose to draft the transaction as a single lease instead of having 22 separate lease agreements.) The lease continued for at least 50 months, perhaps longer. The admitted purpose of the lease was to create income tax savings. Throughout the term of the lease, petitioner had to take actions typical of a business, such as collecting rents, paying expenses, and accounting for profits and losses. The lease generated receipts of $644,915 during the periods at issue, an average of $11,943 per month. In our view, it borders on the frivolous to argue that an activity of such "number, scope and character" was not a business. We find that the tax was properly asserted.

With respect to the penalty, Revenue and Taxation Code Section 6592 provides that the Board may grant relief only if the taxpayer files a statement, signed under penalty of perjury, explaining the reasons for the failure to file returns. Petitioner has not as yet filed the required statement and we are therefore unable to recommend relief. If petitioner wishes to file a statement, signed under penalty of perjury, he should do so within 30 days from the date this Decision and Recommendation is mailed.

Recommendation

Redetermine in accordance with the reaudit dated April 12, 1991.

5/6/93

James E. Mahler, Senior Staff Counsel Date