M e m o r a n d u m

570.1460

To: San Francisco – Auditing (LC/CFL) Date: July 29, 1964

From: Tax Counsel (PM)

Subject: "X"

In memo dated April 13, you ask our opinion on whether there is an unsatisfied tax liability under the circumstances described below:

"X" and "Y" each purchased 500 refrigeration cars for $XX,000,000 from "Z" of Washington. The cars were delivered to "X", care of "A" at the Black River, Washington, junction, where they were presumably started out on the "B" system at the instructions of "A". Delivery was from May to September 196X.

You have been informed that in order to avail themselves of a federal income tax advantage, the purchasers leased the cars to "A", which is jointly owned by them. "A", in turn, charged the various railroads using the cars a daily rental. The temporary lease attached to your memo states that the cars are leased to "A" "for use upon the lines of railroad constituting "Y" and "X", and upon connecting and other railroads in the usual interchange of traffic.

It is our opinion that the purchaser-lessors would be liable for use tax on the purchase price of any refrigeration cars physically used by the lessee or its sublessees in this state, provided such cars received their initial use here or received substantial use here following initial use elsewhere. Liability would not, of course, extend to any cars purchased for use in interstate commerce, placed in use in interstate commerce prior to entry into this state, and thereafter used continuously in interstate commerce. Only yesterday, at a conference with representatives of the Attorney General's office, it was concluded that this principle applies to a case in which a lessor leases the property to a lessee who takes delivery at an out-of-state point and thereafter uses the property in this state exclusively in interstate commerce. both inside and outside Cal (see Reg 1620). DHL 5/17/97.

The Union Oil Co., case held, as you know, that a lessor makes a "use" of property within the meaning of section 6009 when he leases it. This use occurs in California when the leased property is physically used here by a lessee. In other words, the lessor is deemed to be making a use of the property in this state because he derives rental income from the lessee's use here.

We do not believe this principle is altered by the fact that the physical use of the property is made by a sublessee. It does not appear that physical use by the lessee should be any more a prerequisite of tax liability than physical use by the lessor, as long as the property is purchased with the knowledge or intent that it will be physically used in this state and it is actually so used. In both instances, the lessor derives rental income from the use made by the lessee. Whether the lessee makes a physical use of the property or a nonphysical use would not appear to be material. If the property is physically usd in California by a sublessee, the use made by the lessee, and hence the use made by the lessor, occurs in this state.

PM:cr [1b]