



SC PRIVATE LETTER RULING #90-13

TO: ABC Company

SUBJECT: Sale/Leaseback - Financing Arrangement
(Sales Tax)

TAX ANALYST: Sally Major

REFERENCES: S.C. Code Ann. Section 12-36-910(A) (Enacted June, 1990)
S.C. Code Ann. Section 12-35-1310(A) (Enacted June, 1990)
S.C. Code Ann. Section 12-36-110 (Enacted June, 1990)
S.C. Code Ann. Section 12-36-120 (Enacted June, 1990)
S.C. Code Ann. Section 12-36-100 (Enacted June, 1990)

AUTHORITY: S.C. Code Ann. Section 12-3-170 (1976)
SC Revenue Procedure #87-3

SCOPE: A Private Letter Ruling is a temporary document issued to a taxpayer, upon request, and it applies only to the specific facts or circumstances related in the request.

Private Letter Rulings have no precedential value and are not intended for distribution.

Question:

Is the transfer of equipment under the agreement in question from ABC Company to Corporation C, or the subsequent "lease" from Corporation C to ABC Company, subject to sales and use tax?

Facts:

ABC Company purchased tangible personal property from several vendors. At the time of the purchase, ABC Company paid sales tax on the purchase price. Subsequently, ABC Company entered into a lease agreement with another company (Corporation C) whereby ABC Company "sold" the property to Corporation C and then "leased" the property back from Corporation C.

The agreement, entitled "Lease Agreement B" and dated as of September 28, 1989, contains the following provisions:

1. ABC Company retains legal title to the property. (Section 4)
2. The lease is a net lease; therefore, ABC Company bears all expenses associated with the property. (Section 5)
3. ABC Company must sell the property to be released from the lease (even at the end of the initial term) and can receive some of the proceeds from the sale in certain circumstances. (Section 12)
4. The lease allows ABC Company to purchase the property for the "Adjusted Acquisition Cost" or its fair market value, whichever is greater. (Section 13)
5. ABC Company bears the burden of loss of the equipment. (Section 15)
6. ABC Company is treated as the owner of the property for income tax, as well as sales and use tax purposes. (Section 21)

According to ABC Company, the lease is being treated as an operating lease for financial statement purposes and a capital lease for federal income tax purposes. Corporation C is a leasing company and would not be interested in the equipment except for leasing purposes.

Under a capital lease for income tax purposes, the lessee treats the leased item as property owned by the lessee. The property is recorded as an asset of the lessee and depreciation is deducted rather than the lease payments. An operating lease is treated as a true lease with the lessee deducting the lease payments.

Discussion:

Code Section 12-36-910(A) imposes a sales tax "upon every person engaged or continuing within this State in the business of selling tangible personal property at retail."

Code Section 12-36-1310(A) imposes a use tax "on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, ..., regardless of whether the retailer is or is not engaged in business in this State."

The term "sale at retail" is defined in Code Section 12-36-110, in part, as, "...all sales of tangible personal property except those defined as wholesale sales." A wholesale sale is defined in Code Section 12-36-120, in part, as "a sale of tangible personal property to licensed retail merchants, jobbers, dealers or other wholesalers for resale, and do not include sales to users or consumers."

Under Code Section 12-36-100 the term "sale" is defined as follows:

'Sale' and 'purchase' mean any transfer, exchange, or barter, conditional or otherwise, of tangible personal property for a consideration including:

- (1) a transaction in which possession of tangible personal property is transferred but the seller retains title as security for payment, including installment and credit sales;

- (2) a rental, lease, or other form of agreement;
- (3) a license to use or consume; and
- (4) a transfer of title or possession, or both.

In summary, a sale occurs with the transfer of title, possession, or title and possession of tangible personal property for a consideration.

In the fact situation presented, ABC Company retains legal title to the property (Section 4 of the agreement), as well as the benefits and burdens of ownership since it bears the burden of loss and all expenses associated with the property. Additionally, possession of the property never transfers. ABC Company possessed the property both before and after the transaction with Corporation C. Therefore, neither legal title nor possession is transferred in the transaction in question.

Furthermore, for both financial accounting and income tax purposes, the Accounting Standards Board and the Internal Revenue Service have recognized that some leases are in substance financing arrangements rather than true leases.

At least two state courts have recognized that a sale-leaseback transaction may be a financing technique rather than a true sale and lease. Footpress Corporation v. Strickland, 251 S.E.2d 278 (Ga. 1978), Cedars-Sinai Medical Center v. State Board of Equalization, 208 Cal. Rptr. 837, 162 Cal. App. 3d 1182 (1984). Additionally, a number of states have recognized that a lease is sometimes a financing technique rather than an actual lease. In those situations, the states have generally taken the position that sales tax is imposed on the initial purchase price rather than on the lease payments. American Bar Association Sales and Use Tax Handbook, paragraphs 1-502 (California), 12-502 (Hawaii), 13-502 (Idaho), 15-502.3 (Indiana), 16-502 (Iowa), 19-502 (Louisiana), 20-502 (Maine), 24-502.05 (Minnesota), 32-502 (New Mexico), 33-502 (New York).

The facts in Cedars-Sinai Medical Center v. State Board of Equalization, *supra*, are similar to the ABC Company situation. In Cedars-Sinai Medical Center, the Medical Center entered into lease arrangements in order to obtain alternative financing of hospital equipment. The California Court of Appeals found that the transaction was a financing arrangement rather than a sale transaction and, therefore, not subject to sales tax.

The Medical Center purchased a substantial amount of equipment on which it paid sales tax and then used the equipment at the medical center. Later the Medical Center determined that it did not have sufficient funds for an expansion of building and equipment. In order to obtain alternative financing, the Medical Center entered into an arrangement with several leasing companies whereby the Medical Center sold hospital equipment to the leasing companies and then leased the equipment for continued use in the Medical Center.

The California definition of sale is virtually identical to the South Carolina definition. "For taxation purposes 'sale' includes '[a]ny transfer of title or possession ... in any manner by any means whatsoever, of tangible personal property for consideration." Cedars-Sinai Medical Center, *supra*.

The California State Board of Equalization contended that there were two transactions subject to tax: one by the vendor to the Medical Center and a second by the leasing company leasing the equipment back to the Medical Center. (The sale by the Medical Center to the leasing company was considered a nontaxable wholesale sale.)

The California Court of Appeals held that the transaction between the Medical Center and the leasing company was not a sale, but rather a financing transaction. In reaching its conclusion the Court looked at the following factors:

1. The leasing companies that purchased the equipment had no use for the equipment and were not interested in purchasing the equipment.
2. The Medical Center was responsible for the payment of all license fees, assessments, and property, sales, use and other taxes imposed by any governmental entity.
3. The Medical Center assumed all risk of loss and liability associated with the equipment and for damages for injury or death to persons or property from the use of the property.
4. The Medical Center was required to insure the equipment against all risks of loss or damage.
5. The intention of the parties was that the transaction was a financing transaction rather than a sale transaction.

Since the transaction was merely a financing technique, the Court held that no sales or use tax was due on the leasing transaction.

Conclusion:

The transfer of equipment from ABC Company to Corporation C, and the subsequent lease from Corporation C to ABC Company, are not subject to sales and use tax, as the agreement in question is merely a financing arrangement rather than an actual lease.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/S. Hunter Howard Jr.

S. Hunter Howard, Jr., Chairman

s/A. Crawford Clarkson Jr.

A. Crawford Clarkson, Jr., Commissioner

s/T. R. McConnell

T. R. McConnell, Commissioner

Columbia, South Carolina
October 3, 1990