

SC PRIVATE LETTER RULING #99-2

TO: XYZ Corporation

SUBJECT: Sale & Lease v. Financing Arrangement  
(Sales Tax)

DATE: August 30, 1999

REFERENCE: S. C. Code Ann. Section 12-36-910(A) (Supp. 1998)  
S. C. Code Ann. Section 12-36-100 (Supp. 1998)  
S. C. Code Ann. Section 12-36-110 (Supp. 1998)

AUTHORITY: S. C. Code Ann. Section 12-4-320 (Supp. 1998)  
SC Revenue Procedure #97-8

SCOPE: A Private Letter Ruling is an official advisory opinion issued by the Department of Revenue to a specific person.

NOTE: A Private Letter Ruling may only be relied upon by the person to whom it is issued and only for the transaction or transactions to which it relates. A Private Letter Ruling has no precedential value.

Question:

In the subject transaction, will XYZ Corporation's Commercial Equipment Financing Division ("XYZ") purchase tangible personal property from a South Carolina customer ("customer") and subsequently lease the property back to that customer, or is the proposed transaction a financing arrangement, therefore, not subject to the sales tax?

Conclusion:

In the Department's opinion, whether a sale followed by a leaseback is subject to sales tax depends upon the substance of the transaction. If the leaseback is a true lease, i.e. a lease for income tax purposes, it is subject to sales tax. If the sale and leaseback is in substance a financing arrangement, i.e. a loan for income tax purposes, it is not subject to sales tax.

The Department concludes that the proposed transaction between XYZ and Customer is a financing arrangement for income tax purposes and is, therefore, not subject to the sales tax.

Facts:

XYZ's Customer currently owns tangible personal property in South Carolina that is used in the Customer's business. Customer claims depreciation for financial reporting and for federal and

state income tax purposes. Customer paid all applicable sales or use tax on the acquisition of the property.

The Customer desires to obtain money using the property as security, but does not want to incur indebtedness that will affect its balance sheet for financial reporting purposes. XYZ desires to advance the money to the Customer and require an appropriate security interest in the property. To achieve these business purposes, the Customer and XYZ will do the following:

1. Customer will transfer title to the property to XYZ via a bill of sale and XYZ will transfer money to Customer equal to the property's fair market value.
2. Immediately after transfer of title to XYZ, and without Customer surrendering possession of the property, XYZ will "lease" the property back to Customer.
3. Payments due under the "lease" will correspond to a principal and interest amortization table for a loan of an amount equal to the cash transferred to Customer from XYZ at the rate of interest.
4. At the expiration of the "lease" term, Customer may either (1) extend the term of the agreement for increments of one year to a maximum of 5 years; (2) "purchase" the property back from XYZ for a predetermined fixed amount, which will return to XYZ in the form of a purchase price an amount equal to the unamortized portion of its original advance to the Customer; or, (3) decline to "purchase" the property and surrender it to XYZ, in which case the property will be sold to a third party. If the property is sold for more than the amount stipulated in the "lease," XYZ will receive only the lease option price and Customer will receive the additional amount. If the property is sold for less than the lease option price, XYZ will receive the proceeds and Customer will pay some (but not all) of the difference to XYZ.
5. In the event of a voluntary or involuntary termination of the "lease" term, Customer must pay XYZ any accrued and unpaid "rent," late charges and interest, plus the termination value (unpaid principal) under the "lease," which is established according to the amortization schedule noted in 3 above.
6. Under the terms of the "lease," Customer bears all risk of loss with respect to the property and is liable for all maintenance, insurance, and taxes due on the property.
7. For federal income tax purposes, Customer and XYZ must and will treat these transactions as a loan from XYZ to Customer secured by the property. Customer will continue to take depreciation deductions on the same basis as before these transactions and will treat a portion of the payments under the "lease" as interest, in accordance with the amortization schedule. XYZ will treat the lease payments as part interest income and part principal repayment in accordance with the amortization schedule. The Internal Revenue Service has informed XYZ that, for federal income tax purposes, the transaction in question is a loan.

XYZ has asked if the sales tax is due on the described transaction.

Discussion:

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

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:

...any transfer, exchange, or barter, conditional or otherwise, of tangible personal property for a consideration including:

- (1) any 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, for purposes of the sales tax, a “sale” takes place when there is a transfer of tangible personal property for a consideration. Transfer of the property can occur in different ways, including transfer of title to or possession of the property.

We first consider whether possession of the property in question transfers to XYZ.

An examination of the facts reveals that possession does not transfer. The Customer currently has possession of the property and will retain possession of the property. As support for this position, fact number two above states “without Customer ever surrendering possession of the property, XYZ will lease the Property back to Customer.” Further, the Master Lease Agreement provides that “Customer is and will remain in possession of the Property at all times before and during the lease term.”

Based on facts number one and two above, title will transfer to XYZ. However, because Customer will retain all indicia of ownership (i.e., risk of loss and responsibility for the equipment’s maintenance, insurance, and taxes), transfer of the property to XYZ will not occur. “[T]ransfer of title” is used in Section 12-36-100(4) as an example of a “transfer, exchange, or barter” of tangible personal property. In the opinion of the Department, it is not intended to convert the giving of a security interest into a “sale.” As stated above, there must be a transfer of tangible personal property for there to be a sale for sales and use tax purposes. The mere transfer of title as an

of title as an indication of a debtor-creditor relationship does not constitute a “sale” as contemplated under the sales and use tax laws. There must be a transfer of the ownership rights in the property. In this instance, there is no transfer of ownership rights to XYZ.

The proposed transaction is not unlike someone surrendering the title to their vehicle to a financial institution as evidence that the vehicle is collateral on a loan. While the financial institution may have possession of the title, the institution does not take ownership of the vehicle. The borrower retains ownership and is still responsible for insurance, maintenance, taxes, etc. on the vehicle.

The Alabama Department of Revenue, in Revenue Ruling No. 95-007, addressed this issue. The facts in that ruling are substantially the same as those presented in this document. In ruling that the transaction in question was a financing arrangement, the Alabama Department of Revenue reasoned:

Based upon the particular facts of this case, the contemplated transactions between Corporation “A” and its Customers do not qualify as a sale under Ala. Code Section 40-23-1 (1993 Replacement Volume), as there is no true transfer of ownership of the property.....At all times, the Customer owns and controls the possession of the Property subject only to Corporation “A’s” security interest in the property. The substance of these transactions is that of a non-taxable financing arrangement or loan, and there is no sales, use or lease tax applicable.

Alabama used the same above reasoning concerning transfer of title in Revenue Rulings No. 97-013 and 98-008.

Likewise, in Cedars-Sinai Medical Center v. State Board of Equalization [California], 208 Cal.Rptr. 837 (1984), the Court of Appeal, Second District, Division 7, California, dealt with the issue of transfer of title for use tax purposes.

In ruling that certain transactions between Cedars-Sinai were financing arrangements, as opposed to sales of tangible personal property, the court reasoned:

For taxation purposes ‘sale’ includes ‘[a]ny transfer of title or possession.....in any manner or by any means whatsoever, of tangible personal property for a consideration.’ (Rev. & Tax. Code, Section 6006, subd. (a).)....Plaintiff [Cedars-Sinai] entered into the agreements with the leasing companies in order to obtain alternative financing of the equipment. That such was the object of the agreements, and the mutual intention of the companies, is shown by reasonable inference....that the companies....had no use for the equipment and were not interested in purchasing it from plaintiff. Indeed, following execution of the agreements, the equipment remained at plaintiff’s facility and was used by plaintiff there, just as it had been used after plaintiff purchased it from the vendors. Under the lease agreements between plaintiff and the companies plaintiff was responsible for payment of all license fees, assessments, and property, sales, use and other taxes imposed....upon any of the equipment. Plaintiff assumed all risk of loss and liability in the operation, maintenance and storage of the equipment, and for damages for injury or death to persons or property

death to persons or property arising therefrom. Plaintiff was required to keep the equipment insured against all risks of loss or damage as are customarily insured against by companies owning equipment of similar character and engaged in a business similar to that engaged in by plaintiff. The foregoing circumstances and provisions are inconsistent with a 'sale' of the equipment by plaintiff to the leasing companies and indicate that despite plaintiff's formal transfer of title to companies, plaintiff remained owner of the equipment. (Emphasis added.)

Based on the facts presented and the above discussion, the proposed transaction between XYZ and Customer will not be subject to the sales tax. There is neither a transfer of possession nor a transfer of ownership between the two parties.

The transaction in question is merely a financing arrangement between XYZ and Customer, to which the sales and use taxes do not apply. The question of sale and leaseback versus a financing arrangement has been addressed by the department before in SC Private Letter Ruling #90-13. The conclusions in this instance are consistent with that ruling.

Further, it is an accepted rule of statutory construction that administrative interpretations of statutes by the agency charged with their administration and not expressly changed by the legislative body are entitled to great weight. Marchant v. Hamilton, 279 S.C. 497, 309 S.E.2d 781(1983). When as in this case, the construction or administrative interpretation of a statute has been applied for a number of years and has not been changed by the legislature, there is created a strong presumption that such interpretation or construction is correct. Ryder Truck Lines, Inc. v. South Carolina Tax Commission, 248 S.C. 148, 149 S.E.2d 435 (1966); Etiwan Fertilizer Company v. South Carolina Tax Commission, 217 S.C. 354, 60 S.E.2d 682 (1950). See Statutes Key Nos. 219(3) & 223.5(2).

Based on the above, the transaction in question is a financing arrangement and is, therefore, not subject to the South Carolina sales tax.