

Cite as Det. No. 90-162, 12 WTD 291 (1990).

BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In The Matter of the Petition)	<u>D</u> <u>E</u> <u>T</u> <u>E</u> <u>R</u> <u>M</u> <u>I</u> <u>N</u> <u>A</u> <u>T</u> <u>I</u> <u>O</u> <u>N</u>
For Correction of Assessment)	
of)	No. 90-162
)	
. . .)	Registration No. . . .
)	. . . /Audit No. . . .
)	

[1] RULE 211: RETAIL SALES TAX -- B&O TAX -- PURCHASE OF LEASE PAYMENTS -- TAX LIABILITY OF LESSOR. In the unique factual situation, when a purchaser acquires a lessor's right to receive payments on a lease and sufficient "right, title and interest" in the lease, the purchaser becomes a "sublessor" of the lessor's interest, and stands in the shoes of the lessor, and is liable for retailing B&O tax and retail sales tax on the leases. Lessor is liable for wholesaling B&O tax on the amount received from the purchaser. Partial accord: Det. 88-33, 5 WTD 83 (1988).

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

TAXPAYER REPRESENTED BY: . . .

DATE OF CONFERENCE: . . .

NATURE OF ACTION:

Taxpayer protests the assessment of retailing B&O tax and retail sales tax on leases it sold to a third party.

FACTS AND ISSUES:

Hesselholt, A.L.J. -- Taxpayer is an affiliate of a Washington financial group. It leases tangible personal property to various businesses. Its books and records were audited for the period . . . , 1985 through . . . , 1988. An assessment was issued in the amount of \$ Taxpayer protested that part of the

assessment imposing retailing business and occupation tax and retail sales tax on leases previously sold to a third party.

Taxpayer explains that prior to the audit period it owned a number of personal property leases. Some were obtained by purchase and others were obtained by entering into leases as the lessor. Washington sales tax was computed as part of the lessees' periodic payments and was stated in the lease documents. The taxpayer collected and remitted the retail sales tax and paid retailing B&O tax on the payments it collected.

In [1985] the taxpayer sold the leases to [Purchaser] corporation for a lump sum. Upon sale of the leases, the contracts were transferred to Purchaser and the payments were remitted by the lessees to Purchaser. The lease was physically transferred to Purchaser and, according to taxpayer, the only right it retained was a portion of any residual value of the underlying property after the lease period was finished.

The Audit Division assessed retailing B&O tax and retail sales tax on the payments that would have been due after the date of the sale. The Detail of Differences explains the Divisions reasoning as follows:

You entered into a "Rent Purchase Agreement" with [Purchaser] . . . a corporation, [in 1985], whereby you sold your rights to receive rent payments on certain leases of tangible personal property. For the sale of your rights to receive rent payments, you granted [Purchaser] a security interest in these properties while retaining title as lessor, with the rights to receive all residual payments at the expiration of the leases. For the sale of the rent payments, you received \$. . . prior to [1985]. The receipt of these monies was not reported. After the receipt of monies, you ceased reporting the leases, evidently assuming that [Purchaser] would report the rent payments it was receiving.

This schedule lists all Washington leases of tangible personal property that were contained in your "Rent Purchase Agreement" with [Purchaser] for the following reasons: First, the agreement does not indicate that a "sale" was made as outlined in RCW 82.04.040; there was no transfer of ownership or title to the properties. The transaction appears to represent the borrowing of monies, using a contract to receive future rent payments (rent receivables) as collateral. Second, the agreement does not address the issue of the retail sales taxes due on lease payments. On the Washington

leases, the sales tax was computed at inception on all leases as was to be part of the lessee's monthly payments. The Washington lessees obviously made monthly payments as they contracted with you, to include retail sales taxes. You the actual lessor have not reported any of the lease payments during the audit period. It is unknown whether [Purchaser] has reported the lease payments addressed in this schedule.

This schedule also includes the residual amounts on the [Purchaser] leases, since by the "Rent Purchase Agreement" you did not transfer ownership, but retained titles and the rights to receive all residual amounts due.

The contract itself provides, in relevant part:

. . . Lessor desires to sell to Purchaser and Purchaser desires to purchase from Lessor certain rent payments under the Leases specified on Exhibit A hereto (the "Rent"). Lessor will grant a security interest in the Leases, the Guaranties and the Equipment to Purchaser to secure performance of Lessor's obligations under this Agreement and the Leases.

SECTION 1. AGREEMENT TO PURCHASE. Lessor agrees to sell to Purchaser and Purchaser agrees to purchase from Lessor the Rent [in 1985] (the "Closing Date"). Subject to the conditions of this Agreement, Purchaser agrees to pay to Lessor on the Closing an amount equal to \$. . . (the "Purchase Price") for the Rent. Only the Rent is purchased hereby; Lessor retains any ownership interest it has in the Equipment, including residuals.

* * *

(d) Absence of Liens. Lessor has either good and marketable title to or a perfected first priority security interest in the Equipment, and Lessor has good and marketable title to the Rent, the Leases and the Guaranties, free and clear of all Liens of others except for any security interest to be satisfied on the Closing Date and specified on Exhibit B hereto. . . On the Closing Date and upon filing required U.C.C. financing statements, Purchaser will have a fully enforceable, first and only perfected security interest in the collateral except for the Rent, which Purchaser will own free and clear of all Liens.

* * *

[SECTION 3] (c) Concerning Leases. Lessor agrees not to amend, modify, rescind, cancel, discharge, terminate or accept surrender of any Lease or any Guaranty or any provision thereof or give any waiver or consent hereunder or extend the time of payment for payments due thereunder. Lessor shall duly and completely pay, perform and discharge all of its obligations as Lessor under each Lease and remain liable thereunder. If Lessor obtains notice or knowledge of the occurrence of any Lease Default, or any Potential Default under any Lease, Lessor will notify Purchaser immediately of such event, and, upon request of Purchaser, Lessor will enforce all of its rights as Lessor under the Lease. .

. .

(d) Further Documentation. . . . Lessor will execute and deliver to each Lessee prior to or promptly after the Closing Date a Notice of Assignment substantially in the form of Exhibit D attached hereto. Lessor will obtain from each Lessee, and deliver to Purchaser, prior to or promptly after the Closing Date, a certificate of insurance evidencing the insurance coverage required under the related Lease and showing Purchaser as a loss payee.

* * *

SECTION 4. GRANT OF SECURITY INTEREST.

(a) As security for the performance of its obligations under this Agreement, Lessor hereby assigns to Purchaser the following: (i) all of Lessor's right title and interest in the Equipment and all Alterations and all appliances, parts, instruments, appurtenances, accessories, furnishings and other equipment which may be incorporated or installed in or attached to the Equipment; (ii) all of Lessor's right, title, possession and interest in each Lease and all amounts payable to Lessor thereunder and other monies due or to become due to Lessor thereunder or which are attributable to the Equipment, and any related Guaranty (excluding amounts payable to Lessor pursuant to any lease with respect to any general or transaction indemnity, any indemnity for loss of federal or state income tax benefits, or any indemnity for sales, use, personal property or similar taxes imposed by any federal, state or local government or taxing authority to the extent such taxes have been paid by Lessor or a Lien has been placed against Lessor's assets generally or a judgment has been entered against Lessor for payment thereof); and (III) all proceeds of (i) and

(ii) above. All of the property described in this subsection (a) is collectively called the "Collateral."

* * *

SECTION 8. LIMITATION OF LIABILITY.

(a) Except as otherwise provided herein, Lessor shall not be personally liable to Purchaser with respect to Rent due under any Lease. Lessor's liability to Purchaser for Rent and for other amounts due under this Agreement shall be limited to the Collateral and the income and proceeds of the Collateral. . . .

* * *

SECTION 12. COLLECTION OF RENT. Purchaser shall invoice Lessees for and collect all Rent. Provided that no Event of Default shall have occurred and be continuing, when all Rent with respect to a Lease has been received by Purchaser, Purchaser will promptly release its security interest in the related Collateral.

Taxpayer argues that

Although the lessor normally is the initial owner of a lease interest, a lease interest may be transferable much like an evidence of indebtedness. A lease constitutes a legal, binding agreement and obligation of a lessee. Equipment for lease and a lease interest are two distinct assets separately accounted for. As such, the holder of a lease interest is entitled to rent payments. The ownership of property by itself does not entitle an owner to receive rent payments.

DISCUSSION:

RCW 82.04.050 (4) provides that the term "retail sale" includes the renting of tangible personal property to consumers. That provision is administered by WAC 458-20-211 (Rule 211). The rule provides that the lessor is to collect the retail sales tax on the lease payments as they fall due and remit the same to the state. The lessor is liable for B&O tax under the retailing classification on the lease payments as well.

The Audit Division concluded that since taxpayer sold only its right to payment (rent) under the lease, and not the actual property, that no sale of the leases had occurred and taxpayer was liable for retail sales tax and retailing B&O tax on the payments as they fell due.

[1] The Washington Supreme Court has held that retail sales tax is due as rental payments fall due on leases of tangible personal property, because "each rental payment relates to a period of possession. . . [a] lease if viewed in this light is not a single transaction (or sale) but a contract for a series of transactions--the exchange of rental payments for continued enjoyment of possession." Gandy v. Washington, 57 Wn.2d 690, 695 (1961). By rule, the Department has provided that retail sales tax is due at the time the monthly payment is due. WAC 458-20-197, WAC 458-20-211 (Rules 197 and 211). This authority is granted to the Department in RCW 82.08.090. Under WAC 458-20-103 (Rule 103), for purposes of a lease, a sale takes place when the property is used in Washington by the lessee.

In Det. 88-33, 5 WTD 83 (1988), a Lessor had retained its obligations under the "trust indentures [and] trust agreements," but taxpayer had otherwise received all "right, title and interest" in the leases. The taxpayer was an organization created to service the leases and collect the lease payments. It monitored lease payments and made sure that the lessees made their payments on a timely basis. The Department found that the taxpayer, which was actually receiving the lease payments, was responsible for remitting the retail sales tax and for retailing B&O tax on the lease payments "under its control;" the lessor that retained some leases in its own name so as to allow it to qualify for investment tax credit was liable for B&O tax on those leases. Lease payments were made to the entities as the payments fell due; the lessor did not receive a lump-sum payment from the taxpayer for the leases.

In this case, the taxpayer/lessor received a lump-sum payment for its right to receive the lease payments from the Purchaser. Once the payment was received, taxpayer no longer had any right to the actual lease payments as they were made. The purchaser apparently actually paid B&O tax and retail sales tax on the lease payments as it received them; taxpayer apparently paid no tax on the transfer at all. Purchaser evidently considered itself to have "stepped into the shoes" of the taxpayer as regards the leases. Purchaser did receive sufficient "right, title and interest" in the property to become entitled to the rent payments. It was similar to the lessor because it was entitled to the rent payments for the use of the property, and was given a security interest in the property necessary to protect its interest. In this unique situation, we believe that taxpayer "subleased" its leases from itself to Purchaser. Purchaser then became the Lessor, and made the retail sale from itself to the actual lessee. Taxpayer should have paid wholesaling B&O tax on its receipts for the leases; Purchaser was liable for (and apparently did pay) retailing B&O tax and retail sales tax on the lease payments as they fell due. The Audit Division was incorrect when it asserted the retailing B&O tax and

retail sales tax against taxpayer for lease payments which were payable after the effective date of the sublease. The wholesaling tax was due on the total consideration received by the taxpayer from the purchaser, but the Department is now precluded from now asserting this tax since the statute of limitations has run.

DECISION AND DISPOSITION:

Taxpayer's petition is granted.

DATED this 13th day of April 1990.