April 1, 1985

Ken McManigal

February 1, 1985, Letter from Imperial County

This is in response to your request that we review the letter and attached documents pertaining to [redacted] Inc.'s Equipment Rental Agreement (Agreement) with [redacted] and advise as to whether the drilling rig and items of related equipment (equipment) which was the subject of that Agreement was eligible for the inventory exemption on March 1, 1983. As hereinafter indicated, we do not believe that it was.

Briefly, the equipment was moved from Kern County to Imperial County on November 11, 1982, the Agreement was executed by [redacted] and by [redacted] on December 1, 1982, the equipment was set up at the site prior to March 1, 1983, and on the basis of a November, 1982 Security Service Agreement between [redacted] and [redacted] Inc. and a December, 1983 billing by [redacted] to [redacted] for work done on the site in December, 1983 it is contended that the equipment remained in [redacted]'s inventory, held for sale or lease, until used by [redacted] in December, 1983.

Property Tax Rule 133 (b) provides that property eligible for the exemption does not include:

> "(1) Property of any description in the hands of a vendee, lessee or other recipient on the lien date which has been purchased, leased, rented, or borrowed primarily for use by the vendee, lessee, or other recipient of the property rather than for sale or lease or for physical incorporation into a product which is to be sold or leased.
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> ***
>
> "(3) Property actually leased or rented on the lien date.
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> ***"

As you have noted, the Agreement pertains to the equipment as of December 1, 1982. There is nothing therein to indicate that the Agreement was not effective on its execution or was to become effective at a later date. While the rent provisions (Agreement, Paragraph 2) appear to be based on a daily rate for normal operations and a daily rate for "fishing" operations, the fact that payment for the equipment is based upon actual operations/use rather than a period or periods without regard to use should not be determinative as to when the Agreement became effective.

The December 12, 1984, letter from [redacted] [redacted] states, in part:

> "You will note that the equipment rental agreement in no way covers a fixed period of time and only sets forth the use of the equipment and the amount to be charged. The date of the agreement is merely the first date the equipment was available to be rented by [redacted] Services…The actual rental of Rig #6 by [redacted] did not occur until December 28, 1983…."

It is true that the Agreement does not cover a fixed period of time, but not all leases are for fixed periods. The agreement also, however, does not state that the date thereof is the first date the equipment is available to be rented; or that even though it was executed by both parties, to [redacted] was contingent upon its

not being sold or leased to someone else at the time [redacted] desired to use the equipment; or that even though it was executed by both parties, that [redacted] could thereafter sell or lease the equipment to someone other than [redacted] without incurring any liability to [redacted] as a result thereof.

It would seem that if, as [redacted] contend, the Agreement was not a lease, the Agreement would have been written differently, stated that it was not a lease and if and when it would become one, provided that the rental of the equipment was subject to availability, and provided for a hold-harmless provision in favor of [redacted] in the event that [redacted] later needed the equipment but [redacted] did not have it available. Absent such language and provisions, and given the language and provisions of the Agreement, it seems clear that the equipment was subject to the Agreement as of December 1, 1982, and March 1, 1983 (Rule 133(b)(3)). As property leased on March 1, 1983, the equipment could not have been held for sale or lease on that date.

As indicated, in addition to Rule 133(b)(3), Rule 133(b)(1) precludes the eligibility of property in the hands of a vendee, lessee, or other recipient on the lien date which has been purchases, leased, rented or borrowed primarily for use by the vendee, lessee or other recipient for the exemption. We have interpreted this exclusion to mean that a vendee, lessee or other recipient must have possession and control of the property and be capable of putting it to the use for which it was designed (December 1, 1971, letter from Delaney to [redacted].

In this regard, the December 12, 1984 letter from [redacted] states:

> "…the enclosed agreement [redacted] had with [redacted] [redacted] shows a start date of November 10, 1982, with [redacted] continuing through December 27, 1983… The actual rental of Rig #6 by [redacted] did not occur until December 28, 1983…."

Regarding the Agreement as a lease, as we have done, by virtue of the Agreement [redacted] became entitled to possession and control of the equipment and to the right to use with in accordance with the provisions set forth therein. Thus, if [redacted] has possession and control of the equipment and was capable of putting it to use as of March 1, 193, Rule 133(b)(1) also might be applicable. Additionally, it is arguable that if the equipment was capable of being put to use by [redacted] as of March 1, 1983, which apparently it was, Rule 133 (b)(1) would be applicable even if [redacted] had not taken actual possession and control of the equipment, since under the provisions of the Agreement, [redacted] had the right to possession and control of the equipment at any time after December 1, 1982. In other words, [redacted] had constructive possession and control of the equipment, if not actual possession and control thereof.

As to [redacted] contracting for guard service for the equipment, we do not consider this determinative. Initially, as the owner of the equipment (Agreement, Paragraph 10), [redacted] could take whatever steps it desired to protect it, including the hiring of a guard. Such would not interfere with [redacted]'s possession and control of the equipment in accordance with provisions of the Agreement, however. In addition, the [redacted] Temporary Service Authorization has a starting date of 11-10-82 and an ending date of 1983, presumably, January 1983, not December 1983, although it is possible that it could have been extended thereafter. Whatever the case, such would not interfere with [redacted]'s possession and control, etc.

We are returning the letter and attached documents herewith.

In the future, please route inquiries through Verne Walton to Richard Ochsner as we are attempting to centralize incoming inquiries in order to better ascertain existing workload and assignments.

JKM:fr

Attachments

cc: Mr. Gordon P. Adelman
Mr. Robert H. Gustafson
Mr. Verne Walton
Legal Section

December 1, 1971

[redacted]

Gentlemen:

This is in response to your recent request that we issue a letter ruling concerning the application of the inventory exemption to the following factual situation:

> Usually the equipment is assembled in a single location at an [redacted] plant or warehouse until the particular configuration is complete and ready for installation. At that time it is delivered to the customer's premises and installed. Only after it is installed and placed in operation does the customer commence to make payments under the lease or use the equipment. Occasionally the [redacted] equipment being assembled for a particular configuration is stored on the customers premises until the configuration to be installed is complete. The privilege of storing the uninstalled equipment at the customer's premises in those instances where that is done is a gratuitous concession by the customer to [redacted] a customer may refuse with complete impunity a request of [redacted] to permit such storage. The storage time is indeterminate and may extend to several months. While at the customer's location in such an uninstalled status, the customer has no control, responsibility or authority with respect to the equipment. He may not use or attempt to use it, he bears no risk of its loss, and he neither makes nor accrues lease payments during such period. It is not at that time in any sense leased equipment. The equipment is in precisely the same legal relationship with to both [redacted] and its customer as it is in those cases where the configuration is being assembled in a public warehouse or at [redacted] facilities until complete; it is subject to the complete control of [redacted] just as it would be if stored in a warehouse.

On the basis of the above factual statement it is our opinion that the inventory exemption from property taxes would apply to the equipment that has not as yet been placed in the control of the intended lessee even though some of a particular installation may have been delivered to his premises. We view the exclusion contained in paragraph (b) of Rule 133 (California Administrative Code) as excluding from business inventories that property which is "…in the hands of a vendee, lessee or recipient…" to mean that such recipient must have possession and control of the property and be capable of putting it to the use for which it was designed. We trust that this statement is sufficient for your needs. If we can be of further assistance, please feel free to contact us at any time.

Very Truly Yours,

J.J. Delaney
Assistant Chief Counsel

JJD:fb