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Executive Director

October 14, 1998

**Re: Personal property tax liability of tax exempt lessee entities**

Dear Ms. :

This is in reply to your letter of August 26, 1998 addressed to former Deputy Director James Speed in which you pose several questions about the property tax liability of tax exempt entities, such as governmental organizations, which lease personal property from your company, the Trust leasing company. Provided below are responses to those of your specific questions concerning exemption for personal property other than licensed vehicles. Licensed vehicles are subject to a vehicle license fee assessed in lieu of the personal property tax, and the questions thereon have been referred to the state Department of Motor Vehicles which administers the vehicle license fee.

**1. Are lessees that are normally tax exempt (e.g. - government clients) exempt from personal property taxes?**

All real property and all tangible personal property located in California is taxable unless specifically exempted by the California Constitution or made immune from taxation by federal law. Section 1 of Article XIII of the California Constitution provides, in part, that

Unless otherwise provided by this Constitution or the laws of the United States  
(a) All property is taxable and shall be assessed at the same percentage of fair market value. . . .

Personal property owned by the federal government or a federal instrumentality is immune from state and local property taxation unless Congress has consented to taxation. Similarly, federal government entities are not liable for state and local property taxes imposed on personal property which they may lease.

However, the fact that property is leased by a tax exempt entity does not exempt the property itself from state or local property taxes. Personal property owned by a private taxable entity and leased by the federal government is taxable to the non-exempt lessor. Pursuant to Section 405 of the Revenue and Taxation Code, property on the unsecured roll may be assessed to both the lessor and lessee, which section provides in part

- (a) Annually, the assessor shall assess all the taxable property in his county, except state-assessed property, to the persons owning, claiming, possessing, or controlling it on the lien date. . . .
- (b) The assessor may assess all the taxable property in his county on the unsecured roll jointly to both the lessee and lessor or such property.

Absent an applicable exemption, leased personal property is assessed to both the lessee and lessor, which are jointly liable for the taxes thereon. Where the lessee is immune from state and local property taxation, the lessor thereby becomes the sole assessee and the person solely responsible for applicable property taxes.

**2. What additional requirements (if any) would we need to provide or meet in order to not be taxed for the units that are tax exempt?**

Because personal property leased to the government is assessable to the lessor, in general, there exist no legal provisions under which such property may receive an exemption. The single exception to the general rule is set forth in section 202 of the Revenue and Taxation Code which provides for exemption for

leased property used for libraries and museums that are free and open to the public, leased property used exclusively for public schools, community colleges, state colleges, or state universities, including the University of California, or leased property used exclusively for educational purposes by a nonprofit institution of higher education and granted the exemption set forth in subdivision (d) or (e) of Section 3 of Article XIII of the California Constitution . . .

Exemption is available only if the property is leased to one of the enumerated institutions and the financial benefit of the exemption must inure to the institution. See section 202.2 of the Revenue and Taxation Code, copy enclosed.

**3. In most cases Trust is the legal owner of the vehicles/equipment and the lessees say they are tax exempt. Do you honor them being tax exempt if the vehicles/equipment is titled in our name?**

With regard to equipment, as indicated above, title has no effect on the exempt status of the lessee; if the property is owned by the lessor, then the lessor would be solely liable for applicable property taxes. For licensed vehicles, California assesses a vehicle license fee in lieu of a property tax and, therefore, we have referred this question and the other questions concerning exemptions for vehicles to the California Department of Motor Vehicles which administers that fee.

**6. When the lessee is tax exempt, would we need to provide the taxing jurisdiction with the exemption certificate or maintain it in our files?**

As indicated, property tax exemption for a government agency lessee, arises solely from the lessee's immunity from state and local taxation pursuant to federal law; and personal property leased to the government will be exempt only to the extent that section 202 is applicable. See again section 202.2. The "Exemption Certificate" to which you refer pertains, presumably, to exemption from sales and use taxes, not property taxes.

**7. Is the type of lease a factor in determining whether they are exempt or not? (e.g. - operating vs. direct finance)**

As explained above, the immunity from property taxes for a governmental entity depends primarily on ownership of the property by the entity. If the terms of a "lease agreement" establish ownership of the "leased" property in the government entity, then the property would not be taxable. An ordinary operating lease typically secures to the lessee the temporary use and control of the property, and at the end of the lease term the property reverts to the lessor. Under those terms, the lessor retains ownership of the property and, therefore, has a taxable interest in the property.

By contrast, a direct financing lease that provides for the transfer of complete ownership of the "leased" property to the lessee at some future point in time may be equivalent to a conditional sales contract. In case of either such a direct finance lease or a conditional sales agreement, the "true owner" is considered to be the lessee or purchaser, and legal title to the property remains in the lessor or seller only for purposes of security.

Board staff have taken the position that for purposes of determining whether a particular lease agreement, such as a direct finance lease, is equivalent to a conditional sales contract, the parties' intent is controlling. The parties' intent may be ascertained by the specific terms of the agreement. The following terms are indicative of a direct finance lease under which the "lessee" could be considered the owner of the property.

1. The lease period approximates the anticipated life of the property and at the end of the period the property will be transferred to the lessee for no additional payment or a small optional payment.
2. The total of the lease payments are equal to or greater than the property's current purchase price.
3. The lessor treats the lease payments as an account receivable rather than treating the property as a depreciable asset.
4. The agreement does not specify that the lessor is to retain ownership.

If a particular agreement is ambiguous, it has been our view that an assessor should make the determination based on a preponderance of the terms.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

*/s/ Louis Ambrose*

Louis Ambrose  
Tax Counsel

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Enclosure (Rev. & Tax. Code § 202.2)

cc: Mr. Richard C. Johnson (MIC:63)  
Mr. Rudy G. Bischof (MIC:64)  
Mr. David J. Gau (MIC:64)  
Ms. Jennifer L. Willis (MIC:70)