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December 23, 2004

Re: Property Taxation of Personal Property Leased to Federal Government

Dear Mr. _____ :

This is in reply to your December 8, 2003 letter to the Property Taxes Department of the Board of Equalization that requests an administrative ruling about property taxation of personal property leased to the federal government under an agreement described in your letter as a "Lease to Ownership Plan" (LTOP). You ask whether the lessor or the federal government lessee under the provisions of the LTOP lease is considered the owner of the leased property for property tax purposes. And if the federal government is the owner, you ask whether the property is exempt from property taxation. You also ask whether the lessor under the LTOP lease is required to report the leased property to the assessor.

As set forth below, it is our opinion that under the LTOP lease the lessee is considered to be the owner of the leased property. Thus, upon execution of the lease the property is owned by the federal government and, therefore, becomes immune from property taxation. Although the property is immune, the private lessor is still responsible for filing business property statements for the leased property unless specifically exempted.

Facts Presented

(X _____) is a lessor of tangible personal property (i.e., computer equipment) situated in California. X _____ leases the personal property to the federal government (or an agency thereof) under a "Federal Lease/Finance Agreement" ("Agreement"). The Agreement specifies that under a LTOP lease

Title remains with X _____ for the entire Lease Term unless an early purchase option is exercised by the government; Provided all lease obligations have been satisfied, title shall automatically transfer to the Government at the end of the Lease Term;

Among the provisions of the agreement, the federal government has “exclusive management, responsibility and control” over the selection, use and results of the property and may relocate equipment to another location with prior written notice to X . The government is responsible for making periodic lease payments and maintaining the equipment in good condition and working order. The government is obligated to reimburse X for applicable state and local sales, use and gross receipts taxes and personal property taxes, and if applicable, then are included in the lease payments.

Your letter also states that: 1. The lessor, X , classifies the lease agreements under Financial Accounting Standards Board (FASB) Statement No. 13 as operating, sales-type, or direct financing leases; 2. X records LTOP transactions as conditional sales for federal income tax purposes and that X does not depreciate the leased property for federal income tax purposes; and 3. The property is treated as having been sold to the federal government with the lease payments reported as interest income and return of principal.

Law and Analysis

Article XIII, section 1 of the California Constitution states that, unless otherwise exempt as provided by the state constitution or the laws of the United States, all property is taxable. Thus, the computer equipment leased by X to the government under the LTOP is subject to property taxation, unless specifically exempted by law. 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. (See *TRW Space & Defense Sector v. County of Los Angeles* (1996) 50 Cal.App.4th 1703, 1710.)

Under the facts presented, the lessor, X , holds title to the property under the terms of the lease until the government exercises the option to purchase or until the end of the lease term if all lease obligations have been met. However, a title clause does not establish conclusive ownership of property for tax purposes. (See *General Dynamics Corp. v. County of Los Angeles* (1958) 51 Cal.2d 59, 67.) Evidence Code section 662 provides that “[t]he owner of the legal title to property is presumed to be the owner of the full beneficial title. This presumption may be rebutted only by clear and convincing proof.” Thus, the federal government may have acquired ownership for property taxation purposes at the time that the parties entered into the lease agreement and the property is therefore exempt, if the provisions of the agreement rebut the presumption that X retained full legal and beneficial title.

In *Mayhew Tech Center, Phase II v. County of Sacramento* (1992) 4 Cal.App.4th 497, a case that involved a determination of ownership for property tax purposes under an agreement in which the State leased property from a private party, the court of appeal held that it was necessary to examine the terms of the agreement to determine which party holds “the essential indicia of ownership.” In that case, the State leased real property for a term of 23 years with rental payments due every six months. If the State failed to make payment, the lease would terminate and the State would have no further rights or title in the property under the lease. During the lease term, the State was responsible for all maintenance and repair, for utilities and

services provided; and any insurance proceeds would be made available to the State for those purposes. The State also agreed to pay any taxes and assessments levied on the property. If the State made all rental payments, title vested in the State at the end of the lease term. The State also held an option to purchase the property on or after 10 years after commencement of the lease term.

In our view, under the court's analysis in *Mayhew Tech Center* the federal government holds the "essential indicia of ownership" under the LTOP. If all lease obligations have been satisfied, title automatically transfers to the government at the end of the lease term unless the government exercises an early purchase option. The government has exclusive management, responsibility and control over the property including the right to relocate it to another location with prior written notice to X . The government is also responsible for maintaining the property in good condition and working order and for payment of any state and local taxes imposed on the property or the sale or use of the property.

In addition, X treats the leased property as a sale to the federal government by reporting the lease payments as interest income and return of principal. X also classifies the LTOPs for accounting purposes as operating, sales-type, or direct financing leases, records LTOP transactions as conditional sales for federal income tax purposes and does not depreciate the leased property for federal income tax purposes.

The above-listed factors support finding that the LTOP lease is a conditional sales contract or financing lease and the government as the lessee is properly considered the owner of the leased property during the lease term for property tax purposes. Thus, the property becomes immune from property taxation upon execution of the lease.

Your also ask "whether X Credit LLC as the lessor in a LTOP lease is exempt from filing required personal property tax returns." Section 442, subdivision (c) provides that for property that is the subject of a contract designated as a lease wherein the lessee has the option of acquiring the property at the end of the lease for nominal consideration, the lessor is required to report such property on the lessor's property statement. We conclude that because the LTOP lease described in your letter meets these criteria that X , as lessor, must report the leased property on personal property tax returns.

An exception to the reporting requirement occurs when the "property qualifies for the property tax exemption provided for by subdivision (d) or (e) of Section 3 of Article XIII of the California Constitution." Subdivision (d) exempts "property used for libraries and museums that are free and open to the public and property used exclusively for public schools, community colleges, state colleges, and state universities." Subdivision (e) exempts "buildings, land, equipment, and securities used exclusively for educational purposes by a nonprofit institution of higher education." However, neither of these exceptions apply to the property leased under the LTOP agreement. Therefore, X must report the property leased to the government pursuant to Revenue and Taxation Code 442, subdivision (c).

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

Sincerely,

/s/ Tim Treichelt

Tim Treichelt
Senior Tax Counsel

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