

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 04-001

This document may not be used or cited as precedent. Ala. Code § 40-2A-5(a) (1993 Replacement Volume).

TO:

FROM: Commissioner of Revenue
Alabama Department of Revenue

DATE: September 1, 2004

RE: Applicability of Alabama sales, use or lease tax to sales/leaseback transactions involving a leasing company licensed under Article 4, Chapter 12, Title 40 of the Code of Alabama (1975), and engaging in the business of leasing or renting tangible personal property to others.

ISSUES AND FACTS

The facts as represented by the Requestor are as follows:

Corporation "A" took an assignment of a real estate lease on property adjacent to Airport from Corporation "B". The real estate ("Facility") is owned by the Airport Authority.

Corporation "A" later assigned its leasehold interest in the Facility to Corporation "C". Corporation "A" is the sole member of Corporation "C".

Pursuant to the Tax Incentives Reform Act of 1992 ("TIRA"), Corporation "A" and the Airport Authority entered into a Tax Abatement Agreement ("Abatement Agreement"), whereby the Airport Authority granted Corporation "A" an abatement for non-educational ad valorem taxes, construction-related transaction taxes, and mortgage and recording taxes. Under the abatement agreement Corporation "A"/Corporation "C" paid the non-abatement educational sales and use taxes on the equipment and fixtures ("Equipment").

Corporation "A" entered into a sales/lease back transaction with a finance company, Corporation "D".

Step 1: Corporation "A" sold Equipment to Corporation "D" pursuant to a sales/leaseback transaction.

Step 2: Corporation "D" leased the Equipment back to Corporation "A" under a "true lease" or operating lease before or shortly after the Equipment was placed in service. Corporation "D" is the owner of the equipment for GAAP and federal income tax purposes.

At the end of a lease, Corporation "A" would either renew the lease, exercise an option to buy back the Equipment at fair market value, or return the Equipment to Corporation "D". At one or more points prior to the expiration of a lease, Corporation "A" would have the option to buy the Equipment for its fair market value as estimated at the commencement of the lease. Corporation "A" obtained a license under Article 4, Chapter 12 Title 40 as a leasing company.

Step 3: Simultaneous with the lease of the Equipment by Corporation "D" to Corporation "A", Corporation "A" subleased the Equipment to Corporation "C", the ultimate user and possessor of the Facility and the Equipment. Due to Corporation "A"'s size and creditworthiness, Corporation "D" required Corporation "A" to be the primary lessee. Corporation "D" leased the Equipment to Corporation "A" with the understanding that it would be immediately subleased to Corporation "C".

Prior to the sublease, Corporation "C" elected, under the IRS "check the box" regulations, to be taxed as an association taxable as a corporation (i.e., a C corporation) instead of a disregarded entity for federal and Alabama state tax purposes.

The transaction was structured for legitimate business purposes, independent of tax consequences, as follows:

The sale/leaseback structure was adopted to remove the Equipment from the balance sheet of Corporation "A" in order to satisfy its lenders and for it to remain in compliance with its debt covenants.

Corporation "D" insisted that Corporation "A" be the immediate lessee because Corporation "A", and not Corporation "C", has the financial strength to assure Corporation "D" of payment of its lease.

Corporation "A" chose to place Corporation "C" in a LLC for operational and liability reasons.

Corporation "D" has decided to divest from its leasing portfolio all of its non-core assets (i.e., non-commercial aircraft). As part of the planned divesture, Corporation "D" intends to sell to another purchaser/new lessor ("Purchaser") the Equipment and accompanying leases currently leased to Corporation "A". The Purchaser will continue to lease the Equipment in the same manner and on the same terms as Corporation "D" did.

ISSUES

I. Whether the sale of Equipment by Corporation "A" to Corporation "D" is subject to Alabama sales or lease tax?

II. Whether the leasing by Purchaser, as replacement of Corporation "D", is subject to Alabama lease tax?

III. Whether the leasing by Corporation "A" to its wholly owned subsidiary, Corporation "C", which has elected to be taxed as a corporation, is subject to Alabama lease tax?

LAW AND ANALYSIS

The first step is the sale of the Equipment from Corporation "A", which has already paid sales and use tax on the Equipment, to Corporation "D", a leasing company licensed to engage in leasing transactions in Alabama. Under Sales and Use Tax Regulation 810-6-1-.33, this sale is exempted from sales and use tax as a "casual or isolated [sale] by persons not engaged in the business of selling". Moreover, if Corporation "D" is licensed under Article 4, Chapter 12, Title 40, and is indeed engaged in the business of leasing or renting tangible personal property to others, the sale to Corporation "D" is exempt from sales and use tax under Ala. Code §§40-23-1(a)(9)(j) & 40-23-60(4)(i) as a tax-exempt wholesale sale. Corporation "D"'s possible replacement, Purchaser, would also be exempt from sales and use tax if Purchaser meets the above criteria.

Step 2 is the lease of the Equipment by Corporation "D" back to Corporation "A". Ala. Code §40-12-223 exempts from the lease tax the gross proceeds from the leasing of tangible property to a lessee "who acquires possession of the said property for the purposes of leasing or renting to another the same property under a leasing or rental transaction subject to the provisions of this article". In order to qualify for this exemption, a lessee must obtain the license required under Article 4, Chapter 12, Title 40, found at Ala. Code §40-12-221, and must also be engaged in the business of leasing or renting tangible personal property to others. See Ala. Code §40-23-1(a)(9)(j). See also State v. GM&O Land Company, 275 So.2d 687(Ala. Civ. App. 1973) ("engaging in the business of leasing tangible personal property" implies a continuous and regular course of dealing, rather than an irregular isolated transaction). Therefore, the acquiring of a license alone simply is not enough to turn an entity into a leasing company. From the facts supplied by the Requestor, it does not appear that Corporation "A" is engaged in the business of leasing tangible personal property as a continuous and regular course of dealing, and is therefore not a leasing company. Corporation "D", therefore, owes lease tax on the amount charged to Corporation "A". However, if Corporation "A" does not simply hold a license, but is indeed engaged in the business of leasing or renting tangible property as a regular course of dealing, the lease between Purchaser, stepping into the shoes of Corporation "D", and Corporation "A" would be exempted from sales tax under Ala. Code §40-12-223(4). Again, from the facts presented, it does not appear that the transaction between Corporation "D", or its replacement, and Corporation "A" would qualify for this exemption.

The third and final step is the sublease between Corporation "A" and Corporation "C", wholly owned by Corporation "A" and electing to be treated as a corporation under "check the box" regulations. Pursuant to Ala. Code §40-12-223(11), a lease between a parent and its wholly owned subsidiary corporation is exempted from the lease tax "provided, that the appropriate sales or use tax, if any was due, has been paid on such items of personal property". Again, in order to qualify for this exemption, Corporation

“A” must be engaged in the business of leasing or renting as a regular course of dealing, not as an irregular, isolated transaction. As noted above, it does not appear from the facts supplied by the Requestor that this is the case. However, in any event, the sublease between Corporation “A” and Corporation “C” is a casual event and would not be subject lease tax.

HOLDING

Based on the particular facts of this case, the sale of Equipment by Corporation “A” to Corporation “D” is exempt from sales and use tax as a casual or isolated sale. If Purchaser is licensed under Article 4, Chapter 12, Title 40, and is engaged in the business of leasing or renting tangible personal property to others, Purchaser, Corporation “D”’s replacement, would also be exempt from sales and use tax.

The lease of the Equipment back to Corporation “A” by Corporation “D”, or its replacement, is taxable, and Corporation “D” owes lease tax on the amount charged to Corporation “A”, unless Corporation “A” obtains the license required by Article 4, Chapter 12, Title 40, and can show that it is engaged in the business of leasing or renting tangible personal property to others.

The sublease between Corporation “A” and Corporation “C” is exempt from lease tax.

G. THOMAS SURTEES, Commissioner
Alabama Department of Revenue

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