MEMORANDUM - June 14, 1951
SALES TAX - Leases to be regarded in lieu of purchase

QUESTION: The question here involved is, What is meant by the language in Section 2 of the Sales Tax Act, under the definition of "sale", "but only when such leases and contracts are deemed to be in lieu of purchase by the state tax assessor."

This is a question on which no light can be obtained from the statutes or practices of other states. Rhode Island has something like this language but the definition of taxable transactions is much broader than ours. Furthermore, I do not find anything in the House or Senate debate in any way discussing this language.

The following are possible theories:

1. a lease is in lieu of purchase if, from the seller's point of view, the article leased is all used up in the process of leasing to one or more persons. Upon this theory we could tax the renting of tires, diaper service, towel service, etc.

2. a lease is in lieu of purchase when the article is all used up from the viewpoint of the purchaser. Under such theory we would tax a 10-year lease of an article with an expected life of 10 or fewer years.

3. we can deem the renting of articles which are not customarily sold to be in lieu of purchase. This would apply to I.B.M. machines, United Shoe machines, and a few other categories.

4. we may deem that the Legislature feared the outbreak of an epidemic of leases, by enactment of the Sales Tax Law, as a means of avoiding a sales tax and may use the language to prevent such avoidance. Upon this theory we would reach approximately the same transactions as by "2" above and perhaps other transactions.

Some states, such as Rhode Island, clearly include leases in the taxing language. The Albee Bill, LD 44, included leases.

Where a taxing statute is ambiguous, doubts must be resolved against the sovereign. Resolving doubts in this way, and in view of the general pattern of the statute which is to tax only sales, it would appear that the assessor should deem leases to be in lieu of sale only where the lease is spurious or where, by means of a lease, the lessor transfers to the lessee all incidents of ownership.

Mr. C. E. Lord, district manager of United Shoe Machinery Corp., 38 Minot Ave., Auburn, advises me that the typical lease of one of his machines is for 10 years with a 5 year renewal. The lease is assignable. Connecticut and California tax the use of the machines basing the tax upon the cost of the parts to United Shoe Machinery Corp. which processes and assembles the parts to make the machines. Rentals are determined on two bases: The rent may be so much a year or the rent may be so much for each unit of use. Thus, a stitching machine is priced at so much a stitch.

Some United Shoe machines are sold. All their machines may be rented. For Federal Income Tax purposes United Shoe Machinery takes depreciation. Connecticut charges replacement parts as a sale to the lessee. California taxes replacement parts in the same way as the machines.

The reason for the rental policy is that most shoe factories do not have enough money to buy the machines. Some 125 machines are needed to make a pair of shoes. United and its predecessor have been leasing machines since the time of the Civil War.

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