2/23/04

CITICORP INTERNATIONAL COMMUNICATIONS, INC.	*	IN THE
	*	MARYLAND TAX COURT
V.	*	
COMPTROLLER OF THE TREASURY	*	NO. 02-SU-OO-0068

* * * * * * * * * * * *

MEMORANDUM OF GROUNDS FOR DECISION

Petitioner, Citicorp International Communications, Inc., appeals from a final determination of the Respondent, Comptroller of the Treasury, denying a claim for refund of sales taxes paid in the amount of $360,999. The issue to be resolved is whether the payment made pursuant to a Lease Termination Agreement between Petitioner and IBM Credit Corporation (hereinafter "IBM Credit") should be considered a transaction subject to the Maryland sales tax.

Stipulated Facts

The parties have provided a stipulation of facts, a portion of which states as follows:[1]

2. Petitioner is a Delaware Corporation with its principal place of business in New Jersey.

3. Petitioner and Citicorp North America, Inc. ("CNAI"), are wholly-owned subsidiaries of Citicorp, a leading financial services corporation.

[1] Paragraph numbers in this section reflect the number of the paragraph of the "Stipulation of Facts".

4. Petitioner liaisons with the technology and communications vendors, which provide equipment, supplies and services to Citicorp and its operating affiliates.

5. Petitioner maintains a data center in Silver Spring, Maryland.

6. CNAI provides administrative support, such as negotiating contracts, including leases, for Citicorp and its affiliates, including Petitioner.

7. For purposes of this proceeding, Petitioner and Comptroller stipulate that, as between Citicorp and CNAI, Petitioner is the real party in interest and shall be regarded to be the proper party to file this Petition appealing the Comptroller's Final Determination, finding that Petitioner is not due a refund.

8. CNAI entered into a Master Lease Agreement and certain amendments thereto (collectively "Master Lease") with IBM Credit Corporation ("IBM Credit"), dated as of May 30, 1990, under which Citicorp and affiliated corporations, including Petitioner, leased computer equipment from time to time.

9. The Master Lease, in Section 6.1, provided that "Lessee's obligation to pay all Rent and any and all amounts payable by Lessee under any Equipment Schedule shall be absolute and unconditional and shall not be subject to any abatement, reduction, setoff, defense, counterclaim, interruption, deferment or recoupment for any reason whatsoever, and that all such payments shall be and continue to be payable in all events".

10. The Master Lease, in Section 14.1, provided that "Neither this Master Lease nor any Equipment Schedule may be altered, modified, terminated or discharged except by a writing signed by the party against whom such alteration, modification, termination or discharge is sought."

11. Pursuant to the Master Lease, the Leased Equipment was leased from IBM Credit under a "true lease" (i.e., not a sale) and used by Petitioner at its facility in Silver Spring, Maryland.

12. IBM Credit invoiced and collected from Petitioner applicable Maryland sales taxes, along with the monthly payments.

13. A Term Lease Supplement prepared November 8, 1996 lists the Leased Equipment and the terms under which Petitioner and IBM Credit agreed to extend the lease of the Leased Equipment, commencing January, 1997.

14. In the Fall of 1998, CNAI advised IBM Credit that it wished to terminate the lease. IBM Credit and CNAI negotiated the terms of a lease termination, which resulted in execution of a Supplement for Termination of Lease/Prepayment of Financing ("Termination Agreement") bearing a date of October 15, 1998…under which CNAI released its interest in the Leased Equipment and was relieved of all obligations with respect to such property after November 1, 1998, in consideration for a Lease Termination Charge of $7,219,998 and an Associated Financing Prepayment Charge of $847,185.

15. …In this Lease Termination Agreement, because of the amount of business it received from Petitioner, IBM Credit did not insist on payment of all remaining lease payments. Rather, it: (a) agreed to accept approximately 90% of the remaining lease payments as calculated on a "present value" basis; (b) offered Petitioner a small Fair Market Value Credit in the purchase of new equipment: and (c) accepted the return of the Leased Equipment.

16. In accordance with the terms of the Termination Agreement, the Leased Equipment was required to be returned to IBM Credit by January 14, 1999.

17. On November 1, 1998, an invoice was issued to CNAI for the Lease Termination Charge, the Prepayment Charge and the Maryland sales tax applicable to the Lease Termination Charge.

18. On December 1, 1998, an invoice was issued to CNAI requesting payment of Maryland sales tax in the amount of $360,999.90 applicable to the Lease Termination Charge.

19. On April 1, 1999, a check was issued by CNAI to IBM Corporation in the requested amount of $360,999.90.

20. By letter dated April 24, 2000, Christine M. Oates, Manager KPMG LLP, requested a "no-names" ruling regarding the taxability of a lease termination charge, pursuant to Md. Code Ann., State Government, §10-305. James Dawson, Assistant Director of the Legal Division, declined to issue a formal ruling. However, he informally responded to Petitioner's representative, in a letter dated June 8, 2000, that the lease termination payment…was not subject to Maryland sales tax.

21. Petitioner filed an initial Sales and Use Tax Refund Application on September 5, 2000, seeking a refund of $360,999.90 in sales tax paid to IBM Credit on the payment for early termination of its lease obligations. Petitioner refilled its Refund Application on January 29, 2001 along with additional documentation requested by the Refund Supervisor.

22. Petitioner's refund claim was denied in a letter dated July 30, 2001.

Issues Involved

Maryland sales tax is imposed on "a retail sale in the State", §11-102 (a)(1).[2] A "retail sale" is a "sale of tangible personal property", §11-101(f)(1). Sale is defined in §11-101(g)(1) as:

> a transaction for a consideration whereby:
>
> (i) title or possession of property is transferred or is to be transferred absolutely or conditionally by any means, including by lease, rental, royalty agreement, or grant of a license for use: or
>
> (ii) a person performs a service for another person.

Respondent's regulation, COMAR[3] 03.06.01.28, further defines a "sale" as

> A. The transfer of possession, absolutely or conditionally by any means, of tangible personal property for a consideration, by way of lease, rental, royalty agreement, or grant of license for use, referred to in this regulation as a "lease", is included within the statutory definition of the term "sale" and is thus subject to the tax in the absence of a specific exemption or exclusion.
>
> E. The tax applies to the value of money of the consideration of any kind required to be paid to the lessor under the terms of the lease…

§11-104 sets forth the sales tax rates to be imposed based on the taxable price of the transaction. "Taxable price" is statutorily defined in §11-101(j)(1) as

> the value, in money, of the consideration of any kind that is paid, delivered, payable, or deliverable by a buyer to a vendor in the consummation and complete performance of a sale without deduction for any expense or cost,…

First, Petitioner asserts that the lease termination charge is not taxable because the payment was not part of the "taxable price", in that the charge was not "consideration…paid…to a vendor in the consummation and complete performance of a sale." Petitioner reasons that in executing the Termination Agreement, a separate agreement from the Master Lease, it relinquished any claim of right to either title or possession of the equipment that it had under the Master Lease. Since no transfer nor change in title occurred, then the tax

[2] All statutory references pertain to the Tax-General Article of the Annotated Code of Maryland.
[3] Code of Maryland Regulations

does not apply. Next, Petitioner contends that the transaction under the Termination Agreement was not a "sale" because the lease termination charge is not "consideration required to be paid under the terms of the lease", COMAR 03.06.01.28E, supra. Petitioner asserts that since the agreement to terminate it's obligations to pay rent under the Master Lease, permissible according to Paragraph 14.1 (see Stipulation Para. No. 10, supra), was a subsequent and separate agreement from the Master Lease, that any payment paid in accordance with that subsequent agreement was not "paid under the terms of the lease".

Respondent argues that the Termination Agreement was a part of the original lease and that the charge imposed a price "…in the consummation and complete performance of a sale." Respondent points to language in the Master Lease, Paragraph 6.1 (see Stipulation Para. No. 9, supra), wherein the Petitioner's obligation to make rental payments is "absolute and unconditional", in contending that the Petitioner is paying the termination fee to meet and complete its pre-existing obligations under the Lease. In addition, Respondent claims that the Termination Agreement was simply an amendment to the Master Lease reducing the lease payment periods from over three years to just one payment. The payment of that fee was pursuant to the lease and therefore a taxable sale according to the Respondent.

Conclusions of Law

The issue to be determined is whether the Termination Agreement is an amendment or supplement to the Master Lease. If the answer is in the affirmative, then any payment pursuant to the termination would be deemed consideration in the "consummation and complete performance of a sale" and therefore a part of the "taxable price".

We find that the Termination Agreement is a separate and distinct agreement from, and not an amendment to, the Master Lease. Respondent accurately directs the Court to Paragraph 6.1 of the Master Lease, noted above, which unequivocally states that the Petitioner's obligations to pay pursuant to the equipment schedule is unconditional. If the lease had remained in effect, then Petitioner would be obligated for the monthly rental payments and those payments would be made in the "consummation and complete performance of a sale.

However, Paragraph 14.1 of the Master Lease explicitly permitted the parties to agree to make any changes, including termination, to the Master Lease. Due to rapidly changing

technology and other business factors, Petitioner and IBM Credit did enter into an agreement, whereby Petitioner would return all leased equipment to IBM Credit, Petitioner would pay a lease termination charge to IBM and the Master Lease would be terminated. The termination charge imposed by IBM Credit on Petitioner relieved each of the parties from the requirements of the lease agreement. Rather than being a condition or requirement added to the Master Lease, the Termination Agreement effectively rendered the Master Lease void. Since the lease was no longer in effect, the termination charge is not consideration in the "consummation and complete performance of a sale" and not considered part of the "taxable price as provided in § 11-101(j).

Unlike the Master Lease payment obligations of Petitioner and contrary to Respondent's assertions, the negotiated termination fee was not consideration for the use and possession of the equipment because that equipment was to be returned to IBM Credit. Since title to the property subject to the original lease agreement did not vest to Petitioner, the charge was not made in consideration for the transfer of title or possession of property and therefore was not a "sale" as defined in § 11-101(g)(1).

While Respondent argues that "any change to the Petitioner's original lease obligations is in fulfillment of the original obligation that Petitioner unconditionally pay rent for the use of the computer equipment (Respondent's Supplemental Memorandum, p. 7), the fact is that Petitioner and IBM Credit were free to agree to any termination terms, including those requiring no fees being paid. In that scenario, just as in the present, Petitioner's original obligation would not be "fulfilled" by any reduction in term length or rent, but rather would be terminated.

Respondent submitted a Texas Court of Appeals decision, *Residential Information Services Limited Partnership v. Rylander*, 988 S.W. 2d 467, 1999, which involves similar facts and law. In finding for the taxing authority, however, the Court noted that the authority's own regulations specifically indicate that "all charges related to a lease agreement are taxable, including 'a charge imposed for the early termination of the lease' " and that "a charge imposed for the early termination of the lease is included in the lease price and is taxable", *RIS L.P.*, supra at p. 5. In addition, the Court gave deference to the long-standing administrative interpretation of the taxing authority in taxing early termination fees. While that ruling's analysis may warrant review, for purposes of the Maryland sales tax imposition, because there

are no Maryland statutes, regulations or prior administrative interpretation pertaining to "early termination fees", the Texas Court's ruling is not helpful.

Conclusion

The clear and unambiguous provisions of the Master Lease and the Lease Termination Agreement and the lack of any transfer of title of the leased property to the Petitioner establish that the lease termination payment was not made pursuant to a transaction that is a "sale" as defined by § 11-101(g). Accordingly, the Court shall pass an Order reversing the decision of the Respondent.