

**M e m o r a n d u m****195.1530**

To: Out-of-State – Auditing (DMA)

Date: March 28, 1969

From: Tax Counsel (JKM) - Headquarters

Subject: Application of Tax to Leases  
Of Returnable Containers

This is in reply to your memorandum dated September 16, 1968, concerning the application of tax to leases of returnable containers. Please excuse the delay in our response.

We understand that R--- A--- Company (R---) leases new tappers to the H--- B--- Co. (H---), and that tax must be reported on rental receipts because the tappers are not leased in substantially the same form as acquired. In regard to this leasing operation, you have asked for our opinion concerning the following situations.

1. Does the fact that leases are considered to be continuing sales mean that property is resold each time a rental payment is made, or is it one sale for the term of the lease?

Sales and Use Tax Law section 6006.1 provides that the granting of possession of tangible personal property by a lessor to a lessee is a continuing sale in this state by the lessor for the duration of the lease as respects any period of time the leased property is situated in this state. Pursuant to this section, the lease of the tappers would be regarded as one sale for the term of the lease.

2. If it is one sale for the term of the lease, if the lease is renewed, or if another lease is entered into, is this considered another sale or a continuation of the original sale?

Where a lease is renewed, or where another lease is entered into, we would regard such leases as separate sales.

3. If they are separate sales, you state that this would mean the tappers would be exempt from tax as being sold for refilling. If this is correct, R--- could enter into short-term contracts of new tappers and when new contracts were made, no tax liability would accrue.

Section 6364 exempts from the sales and use taxes returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for refilling. As used therein, "returnable containers" means containers for reuse. Where a purchaser purchases new returnable containers into which it inserts its contents prior to making its sales, it has been our position that section 6364 does not exempt such sales from tax (Anno. No. 1292.16). The purchaser-seller is regarded as the consumer of the new containers. Where a purchaser purchases used returnable containers into which it inserts its contents prior to making its sales, however, it has been our position that section 6364 does exempt such sales from tax (Anno. No. 1301.30). As leases are sales under the Law, leases of returnable containers should be treated the same as sales of returnable containers. Thus, section 6364 should not exempt leases of such new returnable containers but should exempt leases of such used returnable containers. As you have stated, this means that leases of used tappers would be exempt from tax as being resold for refilling.

We do not agree, however, that if R--- entered into short-term lease contracts of new tappers and then renewed the leases or entered into new leases, no tax liability would accrue on the rental receipts received from the renewed or new leases. Whether tax would apply would depend upon the circumstances surrounding the execution of the leases and the business reasons therefor, and a determination as to resultant tax liability would be made upon the basis of the facts in each case. Thus, if R--- entered into lease contracts of new tappers for three-month periods and then renewed or re-leased the tappers to the same parties for five-year periods, we would consider the transactions to be shams and we would assert tax on the rental receipts received during all or substantially all of both periods. On the other hand, if R--- entered into lease contracts of new tappers for five-year periods, and then renewed or re-leased the tappers, we would assert tax on the rental receipts received during the initial period only.

The above examples are extreme cases which offer little, if any, difficulty in determining the period or periods in which tax should apply. Other lease and renewal/re-lease combinations will provide closer questions. As previously stated, however, each case should be considered separately as it arises.

4. Does the exemption of the resale of returnable containers when resold for refilling mean that in the case of a lease of a new returnable container tax applies only to that portion of the rental receipts which relate to the first filling of the container?

As a lease is one sale for the term of the lease and as leases of new returnable containers are not exempt from tax under section 6364, tax would apply to all rental receipts which are received from the rentals of new returnable containers and which are attributable to California.

JKM:smb

cc: Chicago