STATE OF CALIFORNIA

330.3629

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 322-2976

May 5, 1994

Mr. E--- T---
E--- T--- & A---
XXXX ---, Suite XXX
---, CA XXXXX

Re: **Application of Tax to Joint Marketing Agreement**

Dear Mr. T---:

This is in response to your letter of March 18, 1994 in which you request our opinion as to the application of tax to a computer manufacturer's loan of computer equipment to a software developer for “promotional and demonstration purposes”.

You state that the manufacturer and developer enter into a joint marketing agreement, referred to as the S--- A--- C--- P---, whereby the parties actively work to promote and sell each other's products. The manufacturer loans the computer equipment on a temporary, no-charge basis, for use by the developer at trade shows and at customer sites. These equipment loan agreements are usually for a period no longer than eighteen months. During the time that the equipment is on loan to the developer, the manufacturer accounts for the equipment on its books as inventory. No depreciation is taken on the equipment. When the developer returns the equipment, it is returned to inventory where it is held for sale.

You also attached excerpts from the joint marketing agreement and the equipment loan agreement. Exhibit H attached to your letter specifies the benefits of the joint marketing agreement to the manufacturer. Under the agreement, the developer provides the manufacturer a seat on the developer's Manufacturing Advisory Council; the developer allows the manufacturer to participate in the developer's Financials User group at no additional charge; the developer provides the manufacturer with a one full page advertisement in four quarterly editions of the developer's magazine at no additional charge to the manufacturer; manufacturer receives “reverse royalty program with 20 percent of assisted sales going to manufacturer”, and the agreement provides that there is no cap on the amount of revenue that the manufacturer can generate via the reverse royalty scheme.

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property. Revenue and Taxation Code section 6021 imposes an excise tax, commonly referred to as the use tax, on the storage, use or other consumption in this state of tangible personal property purchased from any retailer for storage, use, or other consumption in this state. The use tax complements the sales tax and is most frequently imposed upon in-state leases and out-of-state purchases of property for use in California.

Regulation 1660(a) (copy enclosed) states that a lease includes a contract under which a person secures for a consideration the temporary use of tangible personal property, which is operated by, or under the direction and control of, the person or his employees.

From the facts provided, it appears that the manufacturer is loaning the equipment to the developer for the developer to use in trade shows and at customer sites in exchange for the benefits described in Exhibit H. This transaction is therefore a lease of the equipment.

Except as explained below, a lease of tangible personal property in this state is a continuing sale and purchase, and the lessor must collect and pay use tax measured by the rental payments. (Rev. & Tax Code §§ 6006(g), 6010(e), 6006.1 and 6010.1.) However, certain types of leases are not treated as "sales". Revenue and Taxation Code sections 6006(g)(5) and 6010(e)(5) state that a "sale" and "purchase" do not include a lease of tangible personal property leased in substantially the same form as acquired by the lessor as to which the lessor has paid use tax or sales tax reimbursement measured by the purchase price of the property. As explained in Sales and Use Tax Regulation 1660(c)(2), no sales or use tax is due with respect to the rentals charged for such leases.

Since the manufacturer acquired the component parts of the equipment and then assembled them to make the equipment, the property is not being leased in substantially the same form as acquired. Therefore, the lease of the equipment in California is a continuing sale subject to use tax.

The use tax due on a lease of tangible personal property is measured by the rentals payable. In the agreement described, the rentals payable would include all amounts paid in exchange for the equipment. That is, the taxable rentals payable from the lease includes the value of all consideration paid to the manufacturer. (Rev. and Tax. Code § 6011(a).)

For any period of time that the equipment is used outside this state, the lease is not a continuing sale in this state. California use tax therefore does not apply to the rentals payable for any portion of the lease term where the developer uses the equipment outside California. If the developer uses the equipment both inside and outside California, use tax applies to the value of all consideration paid to the manufacturer, prorated for the time of use inside California compared to the total time of use.

Sincerely,

Sukhwinder K. Dhanda
Staff Counsel

SKD:plh

Enclosure - Regulation 1660

cc: --- District Administrator - --