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STATE OF CALIFORNIA

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May 24, 1994

Ms. J--- M---
Accounting Manager
O--- S--- International
--- Center
--- --- Street, Suite XXXX
--- ---, CA XXXXX

Dear Ms. M---:

This is in response to your letter of April 5, 1994 in which you request advise as to the application of sales tax to the activities of O--- S--- International related to its leases of office space.

O--- S--- International leases office space and provides related services to tenants. Your first two questions relate to locks and keys to suites leased to tenants. You state that when a tenant first moves in, you provide the tenant with keys to the office and the mailbox. There are occasions where the tenant will lose the keys or request additional keys. When you provide the new or additional keys, you charge the tenant for the cost of the keys plus a mark-up. Similarly, when you change or re-key locks, you charge the tenant for the cost of the lock and a mark-up.

Discussion

The gross receipts from the retail sale or lease of tangible personal property are presumed taxable unless the person making the sale proves otherwise. (Rev. & Tax. Code § 6091.) Charges for the sale or lease of real property are not subject to the sales tax.

In the situation where you merely provide keys, we assume that the keys are returned to you at the end of the office lease term. Since the true purpose of the keys is to allow access to the leased real property, the providing of the keys is regarded as incidental to the lease of the real property. You are the consumer of the keys, and your charge for providing the keys is not subject to sales tax. However, you must pay sales tax on your purchase of the keys.

The application of tax to the changing or re-keying of the locks depends upon who performs the work. If you purchase the property installed and install it yourself, then you are the consumer of any such property, and tax applies to the sale to you or your use. Since the charge passed on to your lessee is for the lease of real property, your charge is not taxable. If you hire a contractor to perform the work and the contractor furnishes and installs property, the application of tax is set forth in Regulation 1521. The contractor will be the consumer of any materials (tax on the sale to the contractor or to the contractor's use) and the retailer of any fixtures (tax on the sale to you). In any event, the charge to the lessee will again be for the lease of real property and will not be taxable.

The other question posed in your letter related to the application of tax to leases of plants. You state that you lease plants for the reception and common areas from a vendor. Some of your tenants request that you also provide plants for their suites. Your vendor provides you the additional plants and you continue to pay for all of the plants. However, you charge your tenants for the additional plants for their suites at your cost plus a mark-up. You ask whether this transaction is subject to sales tax.

Except as discussed below, a lease of tangible personal property 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.

Whether you must collect sales or use tax on the receipts from your sublease of the plants depends upon whether you are paying use tax on your lease. The lease of the plants to you is subject to tax unless your vendor paid tax when acquiring the plants and is now leasing them to you in substantially the same form as acquired.

A plant or tree can only be regarded as remaining in substantially the same form as acquired until, by reason of its growth, its value has increased by more than 20 percent. (Sales and Use Tax Annotation 330.4060 (12/06/67).)

The value of the plants you lease most likely increases by more than 20 percent during the course of the lease. Thus, it is unlikely that the plants are leased to you in substantially the same form as acquired. We therefore assume that the lessor of the plants has been collecting use tax from you measured by the rentals payable from your leases of the plants.

Sales and Use Tax Regulation 1660 (c)(5) states the rule applicable to your sublease of the plants to your clients.

> "PROPERTY SUBLEASED. Tax does not apply to receipts from subleases of tangible personal property which is leased in substantially the same form as acquired by the primary lessor where the prime lessor has paid sales tax reimbursement or use tax measured by his purchase price. Also, tax does not apply to subleases of tangible personal property if the tax is paid on rental receipts derived under the prime lease, or any prior sublease."

If you are paying use tax to your lessor on the prime lease to you, then you are not required to collect and pay sales or use tax on the rental receipts from the sublease.

If you have any further questions, please do not hesitate to write again.

Sincerely,

Sukhwinder K. Dhanda
Staff Counsel

SKD:plh

cc: --- --- District Office - --