

**STATE BOARD OF EQUALIZATION**

February 17, 1967

Gentlemen:

Your letter of February 15 evidently refers to the tax imposed on personal property leases by the amendments operative August 1, 1965 to a number of sections of the Sales and Use Tax Law.

Generally, these amendments define personal property leases to be sales with certain exceptions. One of the exceptions is a lease of personal property in substantially the same form in which it was purchased tax paid by the lessor. If property is leased in a substantially different form, as for example, by a manufacturer who purchases the raw materials then the lease becomes subject to tax. Similarly, a lease of property purchased without tax, as for example, a lease of property purchased under a resale certificate, would be taxable. The application of the tax under the law as amended is explained in the enclosed copy of sales and use tax ruling 70.

The question of whether property is leased in substantially the same form as acquired presents some difficult problems. The rental of plants which have been grown by a lessor presents one of these problems. Another situation is where a number of plants are placed in containers or otherwise assembled in a decorative or artistic display. Generally, if the value of the item leased is substantially in excess of the purchase price of the property leased or used in preparing the leased item, the article leased will be leased in substantially different form.

The question, however, must be resolved on an individual transaction basis because of the wide variations which exist. Whenever the lease is taxable, the amount of tax paid upon the purchase of the article constitutes a credit against the tax due on the lease provided no use of the property was made by the lessor other than leasing it after August 1, 1965, and provided the property is leased in a substantially different form. The amended law provides for a so-called grandfather clause under which leases entered into prior to August 1, 1965, continue to be governed by the previous law as respects tax liability until the leases are renewed or new leases are entered into.

Very truly yours,

E. H. Stetson  
Tax Counsel

EHS:fb [1b]

**M e m o r a n d u m****330.3900**

**To :** Mr. C. L. Thomas  
Return Review Section (MIC:35)

**Date:** May 2, 1994

**From :** Sharon Jarvis  
Staff Counsel

**Subject:** **SR -- XX-XXXXXX**  
**W--- - S--- B---, Inc.**

This is in response to your memorandum dated March 14, 1994. You ask whether --- - S--- B---, Inc. (W---) is leasing property in substantially the same form as acquired. W-- - leases beverage dispensing equipment.

In a letter dated October 31, 1988, the taxpayer's president describes the different kinds of beverage dispensing equipment leased by W---, and how W--- computes the tax which it pays on the equipment:

"When we lease our beverage dispensing equipment, we pay sales tax on the value of the equipment, in the quarter in which the lease is started. In the case of wine, beer and soda equipment, we pay tax based upon our purchasing costs. For spirits liquor dispensing equipment, which we manufacture (assemble), we pay tax on the cost of materials and labor (which is less than 10% of the total cost) involved in assembling our product."

In later correspondence W--- indicates it pays tax based upon what it variously describes as the "manufactured value" (5/29/90), the "value of the equipment" (3/24/93), and the "manufacturing cost" (7/27/93) when the equipment is first leased. Thereafter, W--- does not collect or pay tax on the rentals payable.

You note that in a telephone conversation on November 4, 1993 the taxpayer explained that sometimes the equipment is put together using a screwdriver to make a completed unit.

Discussion

The lease of tangible personal property is a continuing sale with use tax due on rentals payable unless two conditions are met: (1) the lessor timely elects to pay sales tax reimbursement or use tax measured by the purchase price, and (2) the property is leased in substantially the same form as acquired. (Rev. & Tax. Code § 6006(g)(5); Reg. 1660(c)(2).) Therefore, whether or not W--- has timely elected to pay tax on the purchase price of the equipment, if its beverage dispensing equipment is not leased in substantially the same form as acquired, its leases of that equipment are continuing sales and W--- must collect and remit use tax measured by the rentals payable. (Rev. & Tax. Code § 6203.)

If W--- is not leasing the equipment in substantially the same form as acquired, it is irrelevant that W--- paid tax on the purchase price, "cost", or "value" of the equipment. We note, however, that if W--- did pay tax on the purchase price of equipment which, prior to any use, it then leased in a substantially different form, W--- may take a tax-paid purchases resold deduction for those taxes. (Reg. 1701.)

You refer to Business Taxes Law Guide Annotation 330.3900 (2/17/67). Annotation 330.3900 states that for purposes of determining whether property is leased in substantially the same form as acquired, the general rule is that if the value of the property is substantially in excess of the purchase price of the property leased or used in preparing the leased item, the item is not leased in substantially the same form as acquired.

This annotation is based upon a paragraph in a 1967 Tax Counsel letter which discusses whether the rentals of plants grown by the lessor or the placing of a number of plants in containers or otherwise assembling them in a decorative or artistic display are leases of property in substantially the same form as acquired. Where the property involves plants which continue to grow, whether the value of the leased property is substantially in excess of the purchase price is a helpful tool in determining if the property is leased in substantially the same form as acquired. It is a factor which may be used in determining whether there has been a substantial change in form of the property. If the value of the leased property is substantially in excess of the purchase price, the general rule is that the property is not leased in the same form as acquired.

The annotation pertains only to those situations where there has been a substantial increase in the value of the property. In those situations the general rule is that the substantial increase in value alone is enough to show that the property is not leased in the same form as acquired. However, other situations exist where there is a change in form, but no substantial increase in value. In such instances, the fact that there is no substantial increase in value is irrelevant if there is a substantial change in form between what the lessor acquired and what the lessor leased.

For example, Mr. X buys a chest of drawers in an unassembled form. Mr. X now owns a cardboard box containing a stack of different sized pieces of chipboard, and a bag of screws and other hardware. The pieces are easily assembled using a screw driver. After an hour of simple assembly, the form has changed from a stack of chipboard pieces to a chest with five drawers. There is a substantial change in form, even if there is only a small increase in value. Therefore, if Mr. X now leases the chest of drawers, the lease is a taxable continuing sale, without regard to whether Mr. X paid tax on the purchase price or on the purchase price plus the value of the assembly labor. (See generally BTLG Annot. 330.3970 (9/26/86).)

In order to determine whether W--- leases property in substantially the same form as acquired, you need more information from the taxpayer. W---'s October 31, 1988 correspondence indicates that it leases two types of equipment: (1) equipment for dispensing spirits liquor, and (2) equipment for dispensing wine, beer and soda. W--- indicates that the spirits liquor dispensing equipment is assembled with a screwdriver, and in its October 31, 1988 letter uses the terms "manufacture (assemble)" to describe what W--- does to that equipment. This suggests that there is a substantial change in form from the time of purchase to the time of leasing, but it is not enough information to be certain. If, in fact, the spirits liquor dispensing equipment is in pieces which must be put together when purchased by W---, as in the example of the chest of drawers, above, then it is not being leased in the same form as acquired, and the rentals payable are taxable.

As to the wine, beer and soda dispensing equipment, W---'s correspondence implies that nothing is done to this equipment before it is leased. We advise you to confirm with W--- that there is no change in form to this equipment before it is leased. If that is so, W--- may timely elect to pay tax on the purchase price of the equipment, rather than collect tax on the rentals payable.

In conclusion, there is not enough information available in your memo and in the central file to determine whether W--- is leasing its beverage dispensing equipment in substantially the same form as acquired. We suggest that you find out exactly what form the different types of equipment are in at the time of W---'s purchase, what is done to each type of equipment after purchase, and how the form of each type of equipment differs between what is purchased and what is leased. After further investigation, if you determine that the equipment was not leased in substantially the same form as acquired, then tax is due on the rentals payable. Under those circumstances, if W--- paid tax on its purchase price of the equipment, W--- is entitled to a tax-paid purchases deduction if it made no use of the equipment prior to leasing it.

If you have further questions, please feel free to write again.

SJ:es

w---

Mr. --- L. T---

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May 2, 1994  
330.3900

cc: -- - District Administrator