

**STATE BOARD OF EQUALIZATION**

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May 10, 1995

BURTON W. OLIVER
Executive Director

Mr. D--- J. V---
Controller
The I--- R--- Corporation
XXXX --- Court
---, CA XXXXX

Re: The I--- R--- Corporation

Dear Mr. V---:

This is in response to your February 28, 1995 letter to Assistant Chief Counsel Gary Jugum regarding the application of tax on transfers of peptide libraries pursuant to a "Peptide Screening Collaboration Agreement" (hereafter "agreement").

You state:

"The I--- R--- Corporation (IRC) is a biotechnology company engaged in, among other research, the development of peptides. IRC has recently entered into a collaboration agreement ... with another biotechnology company, H--- P---, Inc. (HPI). The intent of the agreement is to share each party's existing technologies with the goal of developing new marketable products.

"Under the terms of the agreement, IRC receives the right to use HPI's existing products in IRC's research and development process. HPI's technology is transferred to IRC in tangible form (i.e., peptide libraries in vials) along with a written synopsis of each peptide's chemical structure. HPI retains the ownership rights to the peptides and IRC's use is restricted solely to research and development activities. Due to the physical characteristics of the technology, the peptides are destroyed during IRC's research activities.

"For each peptide library provided for screening, IRC pays HPI a fixed amount for each library delivered. If IRC's research efforts result in a 'marketable' product, the collaboration agreement requires milestone payments and royalties. The nature of the product developed governs which party must pay the milestone and royalty amounts. If IRC's research results in a therapeutic product, IRC must pay HPI, however, if a diagnostic product is developed, HPI must pay IRC."

We understand your letter to ask whether sales or use tax applies to the peptide libraries delivered by HPI to IRC pursuant to the agreement.

Discussion

California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for the storage, use or other consumption in California. (Rev. & Tax. Code § 6201.) A sale includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code § 6006(a).) A lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases it in substantially the same form as acquired and has made a timely election to pay California sales tax reimbursement or use tax measured by the lessor's purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1, Reg. 1660(c)(2).) When the lease is a continuing sale and purchase because either or both of the foregoing conditions are not satisfied, the lease is subject to use tax measured by rentals payable. (Reg. 1660(c)(1).) The lessee owes the tax and the lessor is required to collect it from the lessee and pay it to this Board. (Rev. & Tax. Code §§ 6202, 6203, 6204; Reg. 1660(c).)

You argue that the agreement between IRC and HPI creates "a joint venture to share research services" and is not a contract for the sale or lease of tangible personal property. Under the Sales and Use Tax Law, tax does not apply to a transfer of property to a commencing entity (e.g., a corporation or partnership) in exchange solely for an interest in that commencing entity. (See Reg. 1595(b)(4).) However, tax applies if the transferor receives consideration such as cash, notes, or an assumption of indebtedness, and the transfer does not otherwise qualify for an exemption. (Id.) Thus, tax would not apply if HPI is transferring the peptide libraries in exchange solely for an interest in a commencing joint venture between HPI and IRC. Tax would apply if HPI is regarded as transferring the libraries to either IRC or a joint venture for consideration.

In this case, HPI is receiving consideration in the form of cash based on the particular type of peptide library transferred. (See agreement ¶ 3.5.2.) This means that even if a joint venture between HPI and IRC exists and HPI is regarded as transferring the peptides to that entity, HPI would be making a sale of tangible personal property to that joint venture. If a joint

venture between the parties does not exist, HPI is selling the peptides to IRC. In either case, tax applies on HPI's gross receipts (if it is a sale as discussed below) or on its rental receipts (discussed below) for the peptide libraries since HPI is receiving consideration for its transfer of its libraries.

We further note that a joint venture between the parties does not appear to exist. Under the Sales and Use Tax Law, a "person" includes, among other entities, an individual, firm, copartnership, joint venture, limited liability company, association or corporation. (Rev. & Tax. Code § 6005.) The agreement provided to us for review does not indicate that a new person or entity was created by the collaboration of HPI and IRC.¹ We also note that paragraph 16.7 of the agreement specifies that HPI and IRC shall act as independent contractors and that "nothing contained in ... [the] [a]greement shall be construed or implied to create ... [a] partnership ... relationship between HPI and IRC." Since a joint venture is treated similar to that of a partnership (see Ballentine & Sterling, California Corporation Laws (1994) vol. 1A, § 22.05, p. 2-13; see also Business Taxes Law Guide Annot. 495.0780 (7/21/53)), we assume that HPI and IRC did not intend to form a joint venture. As such, HPI is either selling or leasing the peptide libraries to IRC. The next issue is whether this transaction is an outright sale or lease of tangible personal property.

A lease of tangible personal property contemplates a temporary transfer of possession and use of the property to another who agrees to return the property at a future time. (See Civ. Code § 1925; see also 42 Cal.Jur.3d, Leases of Personal Property, § 1, p. 510.) In this case, the transfer of the libraries is a sale and not a lease since the libraries are destroyed in the course of IRC's research and are not returned to HPI. The fact that the agreement characterizes the transfer of the libraries as a "license" does not alter the treatment of the transfers under the Sales and Use Tax Law since possession of the libraries is not returned to HPI. This means that tax applies on HPI's gross receipts from the sale of the peptide libraries to IRC. The remaining issue is what are the gross receipts from HPI's sale of the libraries to IRC.

Gross receipts include all amounts received with respect to the sale, with no deduction for the cost of the materials, service, or expense of the retailer passed on to the purchaser, unless there is a specific statutory exclusion. (Rev. & Tax. Code § 6012.) Royalty payments from the sale of tangible personal property are included in a retailer's gross receipts. (See Business Taxes Law Guide Annot. 295.4060 (7/8/55).) Under the agreement, IRC pays HPI various amounts for each particular type of library furnished to IRC for screening. (See agreement ¶ 3.5.2.) However, IRC does not always make royalty payments to HPI. Rather, where a "marketable" product is identified, HPI may pay IRC milestone and royalty fees, or IRC may pay HPI milestone and royalty fees, depending on whether the marketable product is therapeutic or

¹ Revenue and Taxation Code section 6452 requires that every "person" who owes sales or use tax file a quarterly sales and use tax return. (Rev. & Tax. Code § 6452.) This means that if a joint venture was created by HPI and IRC, that joint venture must file a quarterly sales and use tax return. Our review of the agreement does not indicate that such an entity was created by the collaboration of HPI and IRC.

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diagnostic. Under these facts and the terms of the agreement, we would not regard the milestone and royalty payments to be from HPI's sale of its peptide libraries. Thus, tax applies only to HPI's charges for the sale of its peptide libraries as set forth in paragraph 3.5.2 of the agreement.

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Staff Counsel

WLA:plh

cc: --- --- District Administrator - --