STATE BOARD OF EQUALIZATION
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May 30, 1996

Mr. D--- B. F---, Manager
Multistate Tax Services
C--- & L--- L---.
XXX --- ---, Suite XXXX
---, CA XXXXX-XXXX

Re: H---H--- Corporation
SY --- XX-XXXXXX

Dear Mr. F---:

This is in response to your letter dated April 9, 1996 regarding the application of tax to a certain transaction involving your client. You state:

> "Our client, H--- H--- Corporation ('H&S'), has purchased all of the assets (inventory, machinery and equipment, delivery vehicles, furniture and fixtures etc.) from two corporations to which it was not related. The two selling corporations were engaged in the business of selling bottled water and related products to consumers in California as well as 12 other states. The two selling companies were related to each other as parent and subsidiary. To the best of our knowledge, the following are the facts and circumstances surrounding this transaction.
>
> "H&S, the buyer, acquired all of the assets of the two companies on March 29, 19XX for approximately $230 million. H&S plans to operate the acquired businesses in substantially the manner as previously conducted by the sellers. The two selling companies operated the business in California out of 14 locations. The sellers were principally engaged in the business of the production, marketing and distribution of non-carbonated bottled water. The two selling companies produced a broad range of water products including spring water, distilled water, natural artesian water, pure drinking water and premium mountain spring water. The two selling companies distributed their products primarily

through a route delivery system in 1/2 to 5 gallon containers. In certain markets, products are delivered through independent third party distributors. The two selling companies also sold branded and private label water in various container sizes through retail distribution channels.

"The two selling companies also rented water coolers to many of their residential and business customers. (Occasionally customers desired to purchase the water coolers and, in those situations, the companies would sell the coolers - - although the majority of the customers would rent.) The selling companies primarily used two types of cooler rental agreements with customers. The first type is for rental on a month-to-month basis under a written agreement which included a provision requiring 30 days notice in order to cancel. The other type of rental agreement specifies a minimum period of 12 months after which the rental converts to month-to-month with the same 30 day cancellation provision. All coolers were originally purchased by the selling companies with tax paid on cost, and tax was not charged on rental receipts. All coolers, with the exception of a minor amount held in inventory, are assumed to be under lease at the date of the transfer and sale of the business assets.

"Finally, other sources of revenue earned by the two selling companies included the rental of water filter and purification systems to customers; an Office Refreshment Program which offers customers a wide variety of coffee, juices, refreshments and snacks; and the sale of paper cups to water cooler rental customers.

"Both selling companies have California seller's permits as a result of their activities of selling taxable items under the Office Refreshment Program and sales of paper cups. Sales tax was collected and remitted on sales of paper cups and other taxable items, but the sales of bottled water were claimed as exempt."

You ask us to answer questions based on the above facts in two separate scenarios. In the first scenario, you ask us to assume that the selling companies have made fewer than two sales of water coolers or other similar equipment in the previous twelve months. In the second scenario, you ask that we assume the selling companies have made a substantial number of sales of water coolers or similar equipment in the previous twelve months. First, you ask whether the sale of water coolers to H&S qualifies as an occasional sale exempt from tax.

As you know, a retailer owes sales tax on its sales of tangible personal property in California, measured by gross receipts, unless the sales are specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) The retailer may collect reimbursement for its sales tax liability from the purchaser if the contract of sale provides for such reimbursement. (Civ. Code § 1656.1.) When sales tax does not apply, the use tax, measured by the sales price of the

property sold, applies to the use of property purchased from a retailer for storage, use, or other consumption in California, unless such use is specifically exempt from taxation by statute. (Rev. & Tax. Code §§ 6201, 6401; Reg. 1620.)

The applicable exemption is set forth in Revenue and Taxation Code section 6367, which provides an exemption for certain occasional sales as defined in subdivision (a) of Revenue and Taxation Code section 6006.5. Section 6367 provides an exemption from tax for an "occasional sale" of tangible personal property other than vehicles, vessels, and aircraft. You state that some of the assets purchased by H&S constitute delivery vehicles. With respect to the transfer of the vehicles, the exemption set forth in section 6367 does not apply.

Further, section 6006.5(a) defines "occasional sale" as a sale of property not held or used by a person in the course of activities for which the person is required to hold a seller's permit. You state that the two selling companies had California seller's permits for the purpose of selling paper cups, and for making sales of taxable items under the Office Refreshment Program. The sales under the Office Refreshment Program appear to be related to the selling companies' leases of water coolers and other related equipment. Their sales of the paper cups were clearly part of their businesses involving the leases of the water coolers. As a result of the activities in which the selling companies were involved, they were required to hold, and did in fact hold, seller's permits. Since it appears that the tangible personal property sold was used in the course of activities requiring the holding of those seller's permits, the section 6367 exemption does not apply, even with respect to property that does not constitute vehicles, without regard to the number of sales that took place within any twelve-month period.[1]

With respect to the leases, we assume that none of the property transferred constitutes mobile transportation equipment. As you know, a lease of tangible personal property in California is a continuing sale and purchase unless the lessor leases the property 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 a lease is a continuing sale and purchase because either or both of the foregoing conditions is not satisfied, the lease is subject to use tax measured by rentals payable. (Reg. 1660(c)(1).) The lessee owes the tax, which the lessor is required to collect from the lessee and pay to this Board. (Rev. & Tax. Code §§ 6202, 6203, 6204; Reg. 1660(c).)

You state that all coolers were purchased by the selling companies with tax paid on cost, and that tax was not charged on rental receipts. This means that H&S purchased the coolers subject to leases which are not continuing sales. The sale to H&S is therefore a taxable retail

[1] The number of sales taking place in a particular twelve-month period is relevant only where the property sold is not held or used by a seller in the course of activities for which he or she is otherwise required to hold a seller's permit or permits or would be required to hold a seller's permit or permits if the activities were conducted in this state.

sale, with tax measured by the sales price of the property to H&S. (Reg. 1660(c)(9)(A).) This conclusion is correct with respect to both scenarios 1 and 2.

In light of this conclusion, you ask whether the "tax-paid status" of the water coolers under lease carry over to the purchaser where the seller is required to pay sales tax on its sale of the water coolers but does not bill the tax to the purchaser.

The answer is no. The only way a H&S would acquire the tax-paid status of the seller is if the seller were a "transferor" within the meaning of subdivision (g)(5) of section 6006. As relevant here, "transferor" means a person from whom the lessor acquired the property in a transaction described in subdivision (b) of section 6006.5. (Rev. & Tax. Code § 6006(g)(5)(A).) None of the information provided to us indicates that H&S acquired the property in a section 6006.5(b) transaction. Thus, it appears that the sellers are not "transferors" as defined in subdivision (g)(5)(A) of section 6006, and that H&S does not acquire the tax-paid status of the sellers. (Cf. Rev. & Tax. Code § 6094.1.)

Next, you ask: "Must the purchaser make a timely election to pay tax on cost, or will it be required to pay tax on rental receipts with respect to the water coolers under lease at the time of the asset transfer?"

As discussed above, the sale to H&S is not an occasional sale. H&S purchased the property at retail. There is no election available; tax is due on the sales price to H&S. (Reg. 1660(c)(9)(A).)

Next, you ask: "Are the rental agreements described above sufficient to constitute leases in accordance with Regulation 1660 so that there is an assignment of leases of tax-paid property with a transfer of title as described in Regulation 1660(c)(9)?"

It is not clear exactly what you are asking in this question. It appears from the information you have provided that the rental agreements you have described constitute leases as that term is defined in subdivision (a)(1) of Regulation 1660, and that the assignment of the leases by the selling companies to H&S involved a transfer of title as discussed in Regulation 1660(c)(9)(A). As stated in that subdivision, if title is transferred, tax applies measured by the sales price.

You ask whether, if the purchaser pays no tax on the purchase of the leased water coolers, a new election to pay tax on the cost of the water coolers will be required when the current leases expire and the water coolers are leased to new lessees.

As explained above, H&S owes tax on cost. There is no election available. Neither the leases in effect at the time of the sale to H&S, nor any subsequent leases, will be continuing sales; therefore, the lease receipts will not be subject to tax.

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

Sincerely,

Kelly W. Ching
Staff Counsel

KWC:cl

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