

**STATE BOARD OF EQUALIZATION**

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February 8, 1996

Ms. J--- L. P---, Senior Manager
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XXXXX --- --- Avenue, Suite XXX
---, CA XXXXX-XXXX

Re: Modifications to Leased Property

Dear Ms. P---:

This is in response to your letter of January 2, 1996, in which you inquired about the application of California sales and use tax on leases of tangible personal property which require adjustments after the property is in place.

Your client, who you refer to as "The Company," leases fiberglass tanks which are filled with chemically charged resin for use as water purification systems. These tanks are attached to the customer's water supply whereby the water passes through the resins which filter the impurities from the water before the water continues through the customer's plumbing system. The leased "tank" package is comprised of a shell, a boot, connectors, a head, a cap, a collector and resin. The shell and boot are purchased pre-assembled and the remaining components, except the resin, are purchased pre-threaded. You explain that it takes approximately 10 to 12 minutes for a technician to install the components together and fill the tank with resin which results, according to your estimation, in approximately \$2.00 in additional labor costs. You state that your client's average cost in acquiring the tank and the necessary components for the water purification system is \$150.00.

In California, the general rule is that a lease of tangible personal property is a continuing sale and purchase. For most leases that are continuing sales, the applicable tax is the use tax which is measured by the rentals payable and which must be collected by the lessor from the lessee at the time the rentals are paid. (Rev. & Tax. Code §§ 6006(g), 6006.1, 6010(e), 6010.1, & Reg. 1660(c)(1).)

However, a lessor leasing tangible personal property in “substantially the same form as acquired” may elect to pay California tax or tax reimbursement measured by its purchase price. (Reg. 1660(c)(3).) A lease of such California tax-paid property is not a taxable continuing sale. The lessor may make this election by paying California sales tax reimbursement or use tax to its vendor when purchasing the property or by paying use tax, measured by the purchase price, directly to the Board with its timely return for the reporting period in which the property is first placed into rental service. When a lessor makes an election to pay tax on the purchase price it is making an election to be treated as the consumer of the property rather than the reseller to the lessee.

Your question is whether the components that The Company purchases for the water purification systems it leases are considered to be leased in “substantially the same form as acquired.” Business Taxes Law Guide (BTLG) Annotation 330.3980 (11/1/67; 8/21/90), which discusses two separate leases of irrigation pipe and fittings, provides relevant examples for determining when property has been substantially changed from the form in which it was originally acquired. The first situation addressed by this annotation involves the lease of pipes and fittings in which a sprinkler head has been attached, a coupler has been welded to one end, and a latch has been attached to the other end. Under these circumstances it was concluded that the property was leased in substantially the same form in which it had been acquired. The second situation addressed by this annotation involves the lease of irrigation pipes and couplings in which the pipe has been altered by expanding one end and welding a coupling thereon and by drilling nine holes into the pipe with gate valves screwed into each of the holes. Under these circumstances, it was concluded that the property had been substantially changed from the form in which it was originally acquired.

From the information you have provided it appears that the adjustments made by your client are analogous to the first circumstance addressed by Annotation 330.3980, that is, the adjustments made by your client were to connect the components together to enable them to operate as a water purification system. Thus, so long as the components are not altered prior to attaching them together, the components are leased in substantially the same form as acquired. Accordingly, under these circumstances, your client may elect to pay California sales tax reimbursement or use tax to its vendor when purchasing the components (except for the resin) that comprise the water purification systems or by paying use tax, measured by the purchase price, directly to the Board with its timely return for the reporting period in which the property is first placed into rental service. If your client does not make this election, use tax, measured by the rentals payable must be collected by your client from the lessee at the time the rentals are paid.

This foregoing analysis only applies to your client’s purchase of the shells, boots, connectors, heads, caps, and collectors. The resin, we assume, is periodically replaced with new resin to filter out the impurities of the water. This being the case, the resin, which has a limited useful life and is not capable of being reused, is not leased but rather is consumed in the process of purifying the water for your client’s customers. Thus, your client’s purchase of the resin is for

the purpose of reselling this product to its customers. Accordingly, the transfers of resin by your client to its customers are not leases but sales which are subject to sales tax. However, your client may purchase the resin ex-tax if it timely submits a resale certificate to its resin supplier.

As I have previously explained, Revenue and Taxation Code section 6596 provides the only basis for relief from tax when a taxpayer reasonably relies on written advice from the board. The primary conditions to qualify are that the request for opinion must be in writing and must disclose all relevant facts, including the identity of the taxpayer. Since you have not identified your client, this opinion does not come within the provisions of section 6596.

If you have any further questions, please feel free to contact us again.

Sincerely,

Patricia Hart Jorgensen
Senior Staff Counsel

PHJ:cl

cc: --- --- District Administrator