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June 10, 1994

Mr. R--- L---
Managing Director
S--- L--- O--- Association's
M--- C---
XXXX --- Street, Suite XXX
---, CA XXXXX

BURTON W. OLIVER
Executive Director

Re: **SR -- XX-XXXXXX**

Dear Mr. L---:

I am responding to your letter of April 4, 1994. You ask whether you must collect tax on costume rentals. Some are donated and you alter them before renting. Others are constructed entirely by you and then rented. You pay sales tax (reimbursement) on materials used to alter or construct the costumes.

Your letter does not indicate whether the lessee has an obligation or an option to purchase the costumes during or at the end of the lease period. For purposes of this opinion, we assume that your leases are true leases, that is, you retain title to the costumes and they are always returned to you after the lease period is over.

The lease (or rental) of tangible personal property in California is a continuing sale unless that property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, Reg. 1660.) If the lease is a continuing sale under this definition, that lease is subject to use tax measured by rentals payable. (Reg. 1660(c)(1).)

If the value of the property leased is substantially in excess of the purchase price, the property is not leased in substantially the same form as acquired. (Business Taxes Law Guide Annotation 330.3900 (2/17/67).) Property is also regarded as not leased in substantially the same form as acquired if there has been a substantial change in the form (such as fabrication). (See, e.g., BTLG Annot. 330.3980 (11/1/67, 8/21/90).) When property is not leased in

substantially the same form as acquired, the lease is a continuing sale subject to use tax measured by rentals payable without regard to whether the lessor reported tax on the purchase price of some or all of the property incorporated into the leased property.

You state that to be suitable for renting, your costumes are either altered or made from materials you purchase. The costumes you make are clearly not leased in substantially the same form as acquired. Although we have previously concluded that "minor temporary adjustments to rented tuxedos" do not substantially change the form of the tuxedos (BTLG Annot. 330.4180 (8/25/66)), it appears likely that your alterations of donated costumes substantially change the form. Additionally, although you have paid tax (reimbursement) on the property you purchased to make or alter the costumes, you did not pay tax on the purchase price of the donated costumes since they had been donated to you. Therefore, even if you have been renting the donated costumes in substantially the same form as acquired, you are obligated to collect use tax on the rentals payable on the costumes you altered or made. However, you may take a tax-paid purchases resold deduction for sales tax (reimbursement) paid on the purchase of materials incorporated into the costumes, provided you did not use the costumes prior to renting them. This is explained in Regulation 1701, a copy of which is enclosed.

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

Very truly yours,

Victor G. Matl
Tax Counsel

VGM:plh

Enclosure - Regulation 1701

cc: --- District Administrator - --