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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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January 23, 1995

Ms. J--- A--- C--- A---
G. H. P--- CPA
XXXX --- Avenue, Suite XXX
--- ---, CA XXXXX-XXXX

Re: SR --- XX-XXXXXX

Dear Ms. A---:

Your letter dated October 24, 1994 to Theresa Blue of the Board's Return Review Section has been referred to the Legal Division for a response. You ask how tax applies when your client provides espresso coffee machines to its customers on a trial use basis. We initially note that your letter does not identify the taxpayer subject to this opinion. We understand, however, that the taxpayer is the S--- U--- Corporation ("S---") based on your November 2, 1994 telephone conversation with Ms. Blue.

You state that S--- imports espresso coffee machines from Europe for resale to its customers. No sales tax reimbursement or use tax is paid by S--- on its purchases of these machines. S--- thereafter sells or leases these machines to its customers located both inside and outside the state. We understand from your letter that S--- reports sales tax on the machines it sells at retail inside this state. As a sales incentive, S--- may offer a machine to a customer for a 2 to 8 week trial basis. During this test period, S--- collects a fee from the customer on a "per cup served" basis. To date, this per cup fee has been approximately $0.40 which includes a $0.15 charge for the coffee beans.

You ask a series of questions regarding the application of tax to the espresso machines provided by S--- during the test period. For purposes of clarity, we have responded to each of your questions separately.

"1. Is ... [the] trial basis use [by S---'s customers] subject to sales or use tax? Is this considered a form of demonstration or a rental?"

S--- is providing some of its customers with the use of an espresso machine for a trial period in exchange for a "per cup served" charge. We regard this type of transaction as a lease of tangible personal property (Rev. & Tax. Code § 6006.3) and assume that S---'s $0.25 per cup charge ($0.40 per cup charge less the $0.15 charge for coffee beans) approximates the fair rental value of the espresso machine. (If this assumption is incorrect, our opinion would be different.) This transaction does not qualify as demonstration or display within the meaning of Sales and Use Tax Regulation 1669 since S---'s customers are making payments for their use of the machines. As such, the key issue is how tax applies to S---'s lease of this equipment and what is the measure of tax.

The lease of tangible personal property in California is a continuing sale 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.) A lease that is a continuing sale 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.)

You state that S--- does not pay sales tax reimbursement or use tax on the purchase price of its espresso machines. This means that S---'s lease of the espresso machines on a trial basis constitutes a continuing sale to its customers. As such, S--- is required to collect, and remit to this Board, use tax from its customers measured by the rentals payable.

"2. If so, how is the tax calculated? Can it be based on the fee per cup as described or must it be based on the cost of the machine to the importer?"

The tax imposed on S---'s lessees is a use tax measured by rentals payable. (Reg. 1660(c)(1).) This means that S---'s lessees owe tax measured by the per cup served charge for use of the espresso machines. Our understanding is that $0.25 of the per cup charge is for use of the espresso machine and $0.15 is for S---'s sale of coffee beans to the customer. If so, S---'s sale of the coffee beans is either a nontaxable sale for resale (Rev. & Tax. Code §§ 6007, 6051) or, if the customer consumes the coffee beans, an exempt sale of food products (Rev. & Tax. Code § 6359; Reg. 1602). Based on this understanding, $0.25 is the taxable rentals payable from S---'s lease of the espresso machine.

"3. Can these rental receipts be included in any offset against cost if lessor makes use of this equipment other than leasing or demonstration or display, as described in Page 12 of your Pamphlet No. 46?"

Sales and Use Tax Regulation 1660(c)(6) provides:

"If a lessor, after leasing property and collecting and paying use tax, or paying

> sales tax, measured by rental receipts, makes any use of the property in this state, other than incidental use, he or she is liable for use tax measured by the purchase price of the property. He or she may, however, apply as a credit against the tax so computed, the amount of tax previously paid to the board with respect to rentals of the property. If the credit is less than the tax, he or she must pay the difference with his return, but, may apply the amount of such payment against his or her liability for tax on subsequent rentals of the property...."

This means that S--- may apply the tax collected and paid on the rentals payable of an espresso machine against the tax it owes (use tax measured by the purchase price of the espresso machine) when it uses the machine, other than for incidental use, after leasing it to a customer. If S--- subsequently leases the machine again, the rentals payable from the machine are subject to tax as explained in the provision quoted above.

> "4. If lessor does not collect tax if due, can the lessee using the machine be responsible to report any pay such tax?"

The person actually owing the tax is the lessee. (Rev. & Tax. Code § 6202; Reg. 1660(c)(1).) Thus, if S--- fails to collect this tax, S---'s lessees are responsible to report and pay tax to the Board. Nevertheless, as the lessor, S--- is required to collect the applicable use tax from its lessees and pay it to this Board. (Rev. & Tax. Code §§ 6202, 6203, 6204; Reg. 1660.) S--- cannot delegate its duty to collect and remit this tax to its customers.

> "5. Does the time period involved or the lack of any written contract make any difference?"

Under the facts of your letter, the length of the trial use period or existence of a written contract between S--- and its customer(s) does not affect the application of tax as set forth above.

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Staff Counsel

WLA:plh

cc: --- District Administrator - --