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**STATE BOARD OF EQUALIZATION**

(916) 445-5550

July 9, 1990

Re:

Dear

This is in response to your letter dated May 25, 1990 regarding the application of tax to charges for rentals of video cassettes. You explain:

“ --- is machine based video library program implemented at large residential apartment complexes. Residents pay our client \$14.95 per month to be a member of the library. For this monthly membership fee they receive unlimited borrowing privileges from the --- library. Irrespective of whether they borrow 1, 10, or 15 movies in a month, they pay the same flat charge. There is no limit on the number of movies they may borrow. To prevent hoarding of cassettes, there is a penalty fee imposed on overdue items.”

You ask whether the membership fees or the penalty fees are taxable.

I assume that the customer joins this program on a month-to-month basis and may become a member for one month without being required to be a member for additional months. Whenever a member acquires a video cassette from the machine, the member is leasing that video cassette. That is, this program is an arrangement to lease video cassettes. The lease of video cassettes under these circumstances is a sale and purchase under the Sales and Use Tax Law. (Rev. & Tax. Code §§ 6006(g) (7), 6010(e) (7).) The rentals payable from that lease are subject to use tax on the lessee which the lessor must collect and pay to this state. (Subdv. (c) of Reg. 1660, a copy of which is enclosed.) The membership fees are rentals payable from the lease of the video cassettes. Therefore, the membership fees are subject to use tax. The only exception to this is when a member actually borrows no cassettes for the month to which the membership fee relates. The reason for this is that there was actually no lease of tangible personal property during that month since, although the member had a right to borrow the video cassettes, the member never actually did so. Penalty fees are amounts required to be paid by the lease agreement

and directly relate to the lease of the video cassettes. Those penalty fees are rentals payable and are subject to use tax.

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

Sincerely yours,

David H. Levine  
Tax Counsel

DHL:wak 2297C

Enclosure

bc: Oakland District Administrator