State of California

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M e m o r a n d u m

To: Ms. Susanne Buehler
Chief
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Date: July 20, 2015

From: Robert Tucker
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Tax and Fee Programs Division (MIC:82)

Subject: **Alternating Proprietors Arrangement Leases**
Assignment No. 15-173

This is in response to your question regarding the application of tax to leases of tangible personal property by alternating proprietorship wineries and breweries. You have asked for guidance that staff might follow when staff is reviewing leases of tangible personal property by such businesses.

In order to establish some background, an alternating proprietorship is an arrangement that allows either wineries or breweries to share premises. For a winery, an alternating proprietor arrangement consists of two or more persons or entities taking turns using the same space and equipment to produce wine. An alternating brewery proprietorship is a term that is used to describe an arrangement in which two or more people take turns using the physical premises of a brewery. Generally, an existing proprietor-owner of a bonded wine premises or beer premises agrees to rent space and equipment to a new proprietor.[1] The existing proprietors are sometimes referred to as "hosts" and the new proprietors are sometimes referred to as "tenants." In general, such an agreement allows existing wineries to use excess capacity and gives new entrants to the wine or beer business an opportunity to begin on a small scale without investing in equipment.

In order for a winery to qualify as an alternating proprietor arrangement, the arrangement must be formally approved by the Alcohol and Tobacco Tax and Trade Bureau ("TTB") through an application and approval process. Likewise, the TTB must approve the brewers' qualifying documents and any necessary applications for alternate methods or procedures from existing regulatory requirements in order to establish the alternating arrangement. These requirements are discussed in detail in TTB industry circulars. Industry Circular Number 2008-4 ("Industry Circular 2008-4"), dated August 18, 2008, explains and addresses Alternating Proprietors at Bonded Wine Premises, and it was issued to wine premises proprietors and other concerned parties. Industry Circular Number 2005-2 ("Industry Circular 2005-2"), dated August 12, 2005, explains and addresses Alternating Proprietors at Brewery Premises, and it was addressed to brewers and others concerned.

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[1] This memo discusses the application of the sales and use tax law to leases of tangible personal property solely. It is not intended to address leases of real property such as storage space to house wine barrels during the aging process.

For purposes of illustration, Industry Circular 2008-4 explains in pertinent part:

> **1. Alternating Proprietor Arrangements**
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> An alternating proprietor arrangement consists of two or more persons or entities taking turns using the same space and equipment to produce wine. In almost all situations, an existing proprietor-owner of a bonded wine premises agrees to rent space and equipment to a new proprietor.

It further states:

> **2. "Custom Crush" Arrangements**
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> A "custom crush" arrangement involves an agreement or formal contract under which a customer pays a wine producer to produce wine to order, after which the customer markets the wine. It is not an alternating proprietor arrangement. In a custom crush arrangement, the wine producer is authorized by TTB to make wine and is entirely responsible for producing the wine and for all related processing steps and regulatory requirements, which may include tax payment (unless the wine it transferred in bond to other bonded wine premises for these activities).
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> **[6.] c. Employing the services of another proprietor's staff:**
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> The agreement or contract between the alternating proprietors may include the option to hire the services of another proprietor's production and office employees. We will look to factors of authority and control to make a determination whether the proprietor is running an independent bonded wine premises operation. *The proprietor employing the services of another proprietor's workers must direct and be fully responsible for those things that are usual and customary for the production, bottling, and storage of wine (as applicable) and the managing of the business.* The producing alternating proprietor must provide its contract employees with written direction in the form of work orders or similar documentation.

(Emphasis in italics added.)

As you are aware, California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code, § 6051.) A sale includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code, § 6006, subd. (a).) The sales tax is imposed on the retailer who may collect reimbursement from its customer if the contract of sale so provides. (Civ. Code, § 1656.1; Cal. Code Regs., tit. 18, § 1700.) When sales tax does not apply, use tax is imposed measured by the sales price of property purchased from a retailer for storage, use or other consumption in California. (Rev. & Tax. Code, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (Rev. & Tax. Code, § 6202.) The use tax must be separately stated, and violation of this provision is a misdemeanor. (Rev. & Tax. Code §§ 6206, 6207.)

As relevant to your inquiry, 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. (§§ 6006, subd. (g)(5), 6006.1, 6010, subd. (e)(5), 6010.1; Reg. 1660, subd. (c)(2).) When the lease is a continuing sale and purchase because either or both of the foregoing conditions are not satisfied, the lease is subject to use tax measured by rentals payable. (Reg. 1660, subd. (c)(1).) The lessee owes the tax and the lessor is required to collect it from the lessee and pay it to the Board. (§§ 6202, 6203, 6204; Reg. 1660, subd. (c)(1).) Subdivision (c)(1) of Regulation 1660 explains, in relevant part, which "rentals" are subject to tax as follows:

> The "rentals" subject to the tax include any payments required by the lease, including amounts paid for personal property taxes on the leased property, whether assessed directly against the lessee or against the lessor, but does not include amounts paid to the lessor for:
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> **(A)** Collection costs, including attorney's fees, court costs, repossession charges, and storage fees; but tax does apply to any delinquent rental payments, including those collected by court action;
> **(B)** Insuring, repairing or refurbishing the leased property following a default;
> **(C)** Cost incurred in defending a court action or paying a tort judgment arising out of the lessee's operation of the leased property, or any premiums paid on insurance policies covering such court actions or tort judgments;
> **(D)** Cost incurred in disposing of the leased property at expiration or earlier termination of the lease;
> **(E)** Late charges and interest thereon for failing to pay the rentals timely;
> **(F)** Separately stated optional insurance charges, maintenance or warranty contracts;
> **(G)** Personal property taxes assessed against personal property where a bank or financial corporation is the lessor.
> **(H)** "Customer facility fees" collected pursuant to Civil Code section 1936, or any other law whereby a local agency operating an airport requires a rental car company to collect a facility financing fee from its customers.

When the lessor is using property that has been purchased solely and strictly for the purpose of leasing, and:

1. the lessor makes no other use of that property,
2. the property is ultimately leased in substantially the same form as acquired,
3. and the lessor has not paid tax or tax reimbursement at the time property is acquired nor has the lessor paid tax timely with the return for the period during which the property is first placed in rental service, then the lease of that property is subject to use tax for the use of that property in this state. In

general, as explained above, that means that the tax is measured by rentals payable.

When a lessor is leasing equipment to tenants and the lessor elects to report use tax on the fair rental value, the lessor should be able to establish the following:

1. The lessor has made no use of the equipment other than leasing it;
2. There must be an approved Alternating Proprietor Agreement by the TTB;
3. The charge for the lease of the equipment must be representative of the use of the equipment. The charges must equate to the diminution of the life of the equipment and accounts for the following:
    a. Cost
    b. Useful life, and
    c. Profit;
4. The tenant must direct the contract staff in the operating of any equipment as described in the Industry Circulars; and
5. The use tax must be separately stated on the invoice.

Accordingly, when a winery or brewer is operating pursuant to a TTB approved Alternating Proprietor Agreement, then, pursuant to that agreement, the winery or brewer is leasing the equipment from the host facility. In the event the host elects to collect tax on the rental receipts, then, as required by statute, the host must separately state the amount of use tax to the winery or brewer and the charge for the lease of the equipment must be representative of the use of the equipment.

I hope this information is helpful, and please don't hesitate to contact me if you have additional questions or concerns.

RDT/yg

cc: Mr. Kevin Hanks (MIC:49)
Mr. Jason Parker (MIC:44)