

**STATE BOARD OF EQUALIZATION**

LEGAL DIVISION - MIC 82  
450 N STREET, SACRAMENTO, CALIFORNIA  
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)  
Tele: (916) 324-2637  
FAX: (916) 323-3387

JOHAN KLEHS  
First District, Hayward

DEAN ANDAL  
Second District, Stockton

ERNEST J. DRONENBURG, JR.  
Third District, San Diego

BRAD SHERMAN  
Fourth District, Los Angeles

KATHLEEN CONNELL  
*Controller, Sacramento*

---

BURTON W. OLIVER  
*Executive Director*

February 15, 1995

---

Re: Unidentified Taxpayer;  
Intercompany Purchases

Dear Mr. ---:

Your letter dated October 21, 1994 was received by us on November 21, 1994. You ask what is the measure of use tax on intercompany purchases of uniforms which will be leased to customers on an extax basis. I note that since you did not identify the taxpayer, this letter does not come within the provisions of Revenue and Taxation Code section 6596.

You state that your client is a national company that manufactures, distributes and rents company identity uniforms to its customers. These uniforms are purchased by the company's rental operations from the company's manufacturing/distribution center. We understand that your client now wishes to expand its rental operations to California but does not wish to collect tax from its customers on the rentals payable for the uniforms. As such, you ask whether the use tax reported by your client should be measured by the total materials cost of the manufacturing/distribution center (i.e., raw materials excluding labor and overhead) or the total manufacturing cost (i.e., raw materials plus labor and overhead) of the uniforms by the manufacturing/distribution center. You also ask whether the measure of tax would be different if the manufacturing/distribution center is a different legal entity than the rental operation that ordered the garments.

Discussion

A 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.) Thus, if property is not leased in substantially the same form as acquired, the lease will be a continuing sale. If property is leased in the same form as acquired, the lessor may elect to pay tax or tax reimbursement on purchase price. If the lessor fails to make a timely election to do so, the lease will be a continuing sale. 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 your client's rental operation will purchase uniforms from the manufacturing/distribution center for leasing to customers in California. My understanding is that the rental operation and the manufacturing/distribution center are part of the same company (i.e., corporation, partnership, etc.). Under the California Sales and Use Tax Law, a "person" includes, among other entities, any individual, firm, copartnership, joint venture, association or corporation. (Rev. & Tax. Code § 6005.) A "person" cannot make a sale, as defined in Revenue and Taxation Code section 6006, to itself. This means that a transfer of tangible personal property between different divisions of the same person (e.g., corporation) is not a sale for sales and use tax purposes. Thus, if the rental operation and manufacturing/distribution center are part of the same "person," your client is both the manufacturer and the lessor of the uniforms it leases to its customers. Under this scenario, your client is not leasing the uniforms in substantially the same form as acquired since your client would acquire component parts of the uniforms (i.e., cloth, buttons, thread, etc.), but actually lease finished uniforms to its customers. This means that the lease would be a continuing sale and tax would apply on your client's lease of uniforms to its customers measured by the rentals payable. (Rev. & Tax. Code §§ 6006(g)(5), 6010(e)(5); Reg. 1660(c).) The lessees would owe the tax and your client would be required to collect it from the lessees and pay it to this Board. (Rev. & Tax. Code §§ 6202, 6203, 6204; Reg. 1660.)

You also ask if the measure of tax would be different if the manufacturing/distribution center is a different legal entity than the rental operation. Under this scenario, we assume that the manufacturing/distribution center and rental operation are related, but separate entities (e.g., corporate subsidiaries of the same parent corporation) and thereby qualify as different "persons" within the meaning of Revenue and Taxation Code section 6005. This means that if the transfer from the manufacturing/distribution center to the rental operation is recognized as a sale under the Sales and Use Tax Law, the rental operation would be regarded as leasing the uniforms in substantially the same form as acquired if it purchases finished uniforms and leases them with nothing more than minor "fitting" alterations. Since the rental operation would be leasing the uniforms in substantially the same form as acquired, it would be entitled to make a timely election to pay California tax or tax reimbursement measured by the purchase price of the

uniforms (discussed below).<sup>1</sup> Thus, the remaining issue is whether we would recognize the transaction between the manufacturing/distribution center and rental operation so that the rental operation could elect to pay California tax or tax reimbursement measured by the purchase price of the uniforms.

Transfers between related parties under these circumstances are disregarded for sales and use tax purposes if they are not as if at arms length, and instead are solely for the purpose of avoiding or altering California sales or use tax liabilities. Generally, we regard a transaction between related parties as if at arms length when the sales price of property includes all costs of the seller, including the costs of the property and any overhead properly allocated to the cost of that property. For example, if a person sells property to a related party who will thereafter lease the property, the transfer to the related party will be disregarded for sales and use tax purposes if the sales price does not include all costs of the seller, including the costs of the property and any overhead properly allocated to the cost of that property (including cost of acquisition, manufacture, storage, transfer, etc.).

In this case, we would disregard the transfer of uniforms by the manufacturing/distribution center to the rental operation if the purchase price of the uniforms did not include the manufacturing/distribution center's entire cost of acquiring, manufacturing, storage, and selling the uniforms. Where the transfer of uniforms is disregarded, the lease of the uniforms to the rental operation's customers would constitute taxable continuing sales without regard to any payment of use tax on the purported purchase price of the uniforms. (Reg. 1660(c)(1).)

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford  
Staff Counsel

WLA:plh

cc: Out-of-State Sacramento District Administrator - OH

---

<sup>1</sup> If the rental operation does not purchase the uniforms for use in California (see Reg. 1620) and then brings them into California, the lease of uniforms in California would constitute continuing sales subject to tax on the rentals payable. There is no election available under such circumstances to pay tax or tax reimbursement on the purchase price of the uniforms whether the uniforms are leased in substantially the same form as acquired or not. (See Business Taxes Law Guide Annot. 330.2290 (4/28/75, 11/26/71).) We assume from your letter, however, that the rental operation will purchase the uniforms in question and immediately place them into rental inventory for lease in California.