

205.0066 **Linen Rentals.** Fungible linens furnished pursuant to “requirements clause contracts” are eligible for the business inventory exemption while they are on the lessor’s premises, even if they are bundled and scheduled for delivery. The lessor’s premises includes its delivery vehicles if the contract requires the lessor to deliver linen supplies to the lessee’s premises. C 10/23/97. (M99-1)



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 Executive Director

October 23, 1997

Re: Application of Business Inventory Exemption to Linen Service and Rental Agreements

Dear Mr. 1.

You have requested a supplementary opinion to our letter of September 5, 1995; in response to your letter of November 19, 1996, after some discussion and a letter to you of January 7, 1997, we informed you that because of other matters, there would be a delay in our response. Mr. Larry Hafetz of the Los Angeles County Counsel's Office was sent a copy of your November 19, 1996 letter; he did not respond in writing but we spoke briefly on the telephone. We understand that this matter has been considered by the Los Angeles County Assessment Appeals Board and in court proceedings; we are informed that a substantial amount of hours have been spent in attempts to resolve this issue. This letter will clarify the position of the Board's legal staff; we apologize for the delay in response and appreciate your patience.

Our letter of September 5, 1995 addressed the application of the business inventory exemption to linen service and rental agreements. That letter is attached and incorporated herein. In that letter, we considered the subject linens to be either on the premises of the lessee or on the premises of the lessor; we concluded that business inventories include linens on the premises of the lessor on the lien date if those linens are not subject to contractual obligations, and that those linens are eligible for the business inventory exemption (provided all requirements other than location were met).

Your concern is that our letter of September 5, 1995 left open a question as to those linens on the lessor's premises on the day prior to the lien date and scheduled for delivery on the lien date or soon thereafter. It is our opinion that fungible linens furnished pursuant to "requirements clause contracts" are eligible for the business inventory exemption while they are on the lessor's premises (which would include the lessor's delivery vehicle if the contract requires the lessor to deliver), even if they are bundled and scheduled for delivery.

We remind you that the State Board of Equalization does not have the authority to make a determination as to whether particular property falls within the business inventory exemption; such determination will be made by the local county assessor, the county appeals board or the court. Please note that our opinion is advisory only.

10/28/97 - Sorenson, Siv, Palmer, Nisson, Schultz

DISCUSSION

The question of assessing linen supply rental companies using "requirements clause contracts" and circulating inventories as used herein is surprisingly difficult; a point in time must be fixed and the business inventory exemption applied as of that moment. We assume for purposes of this letter that the items under discussion are on the premises of the lessor at 12:01 a.m. of January 1 and scheduled for delivery on January 1 or very soon thereafter. By "scheduled for delivery" we mean that the lessor is planning to deliver a specified number of linens to a particular lessee; that those linens are set aside, shelved, assembled, bundled or otherwise designated by the lessor as the linens to be delivered; and that except for the scheduling designation, the linens are fungible. Fungible goods are those "of which any unit is, by nature or usage of trade, the equivalent of any other like unit." See California Commercial Code section 1201, subdivision (17).

The Los Angeles County Assessor's Office maintains that the linens scheduled for delivery are "committed" to lease, are not available to a lessee other than the lessee to whom they are scheduled for delivery (i.e., not "openly offered for lease") and thus not eligible for the business inventory exemption.

You describe the procedures for specifying quantities to be delivered as follows:

On the afternoon prior to each day's delivery, the lessee calls the lessor and informs it of the quantity of linens needed for the next day. The linens are then assembled and scheduled for delivery. Except for emergencies or other extraordinary circumstances, the linens designated for delivery are actually delivered. In those extraordinary circumstances, the lessor will prioritize the needs of its customers and may vary the delivery amounts and designated linens.

We note that the linens referred to herein are fungible linens and are distinguished from "specific linens". The term "specific linens" refers to those linens with a company logo or with particular characteristics such that they are not interchangeable with linens supplied to other companies. Typically, lessees of specific linens have contractual rights to those linens and specific linens are not eligible for the business inventory exemption.¹ See paragraph 3 on page 2 of Letter to Assessors (LTA) No. 91/68, attached hereto.

Revenue & Taxation Code section 219 provides that business inventories are exempt from taxation. Revenue and Taxation Code section 129 defines business inventories and provides:

"Business inventories" shall include goods intended for sale or lease in the ordinary course of business and shall include raw materials and work in process with respect to such goods. . . .

¹ Specific linens are not available to potential lessees and thus do not meet that requirement of Rule 133, subdivision (a)(3).

"Business inventories" shall not include any goods actually leased or rented on the lien date. . . . (Emphasis added.)

Title 18, California Code of Regulations, section 133 (Rule 133) addresses the business inventory exemption. Excluded from the exemption pursuant to Rule 133, subdivisions (b)(2) and (3), respectively, are property being used by its owner and property actually leased or rented on the lien date. Fungible linen supplies do not fall within these or any other regulatory exclusion from the exemption while on the lessor's premises.

Assessment on the lien date requires that the stream of circulating inventory be stopped, classified and valued at a moment in time. This raises the question as to when does an item change from inventory to "actually leased." Consideration of the Commercial Code is helpful; that code has addressed in detail the question of when a sale occurs and provides a useful analogy. A sale occurs when title is passed from buyer to seller; if the contract requires delivery by the seller to the buyer's destination, title passes and the sale occurs at the time of delivery. See Commercial Code sections 2106, subdivision (1) and 2401, subdivision (2). By analogy, fungible linen supplies scheduled for delivery and in the possession of the lessor on the lien date are not out on a lease. Those undelivered linens in the control of the lessor are "intended for lease" and the business inventories exemption should apply pursuant to section 129 and Rule 133.

The views expressed in this letter are only advisory in nature; they represent the analysis of the legal staff of the Board based on present law and the facts set forth herein, and are not binding on any person or public entity.

Very truly yours,

Janet Saunders
Janet Saunders
Tax Counsel

JS:jd
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Enclosures: Letter of September 5, 1995
LTA No. 91/68

cc: Honorable Kenneth P. Hahn (w/attachments)
Los Angeles County Assessor

Mr. Larry Hafetz (w/attachments)
Deputy County Counsel
Los Angeles County Counsel

Mr. Richard Johnson, (w/o attachments) MIC:63
Ms. Jennifer Willis, (w/o attachments) MIC:70

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OCT 27 1997

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