

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

195.0548

APPEALS UNIT

In the Matter of the Petition)	HEARING
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
Y--- B---, INC.)	No. SR --- XX XXXXXX-010
)	
)	
<u>Petitioner</u>)	

The above-referenced matter came on regularly for hearing before Hearing Officer James E. Mahler on April 26, 1989, in Sacramento, California.

Appearing for Petitioner:

T--- H---
General Manager

Appearing for the Department
Of Business Taxes:

Phillip Bishop
Senior Tax Auditor

Protested Items

The protested tax liability for the period January 1, 1984, through December 31, 1986, is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Projected ex-tax consumable supply purchases (\$225,773 less unprotected amounts)	\$23,101
B. Ex-tax consumable supply purchases - actual (\$16,604 less unprotected amounts)	6,338
C. Ex-tax fixed asset purchases (\$39,763 less unprotected amounts)	<u>10,500</u>
	\$39,939

The determination includes a ten percent penalty in the amount of \$1,626.64 for negligence.

Petitioner's Contentions

1. The media mix is a shipping material and is sold with petitioner's products.
2. The truck was not functionally used in California.
3. The negligence penalty should be abated.

Summary

Petitioner is a corporation engaged in the business of growing and selling plants. Its main offices are in Ohio, but it maintains a growing facility and sales outlet near S---, California.

1. Insofar as concerns us here, petitioner grows all its plants from cuttings. Most of the cuttings are "stuck" into growing beds, which are benches containing a mixture of redwood sawdust, peat moss and perlite (referred to as "media" or "media mix"). Petitioner purchases the ingredients of the media ex-tax under resale certificates.

The media is necessary to provide support for the cuttings so that the roots will grow, that is, to provide something for the roots to grow into. It also promotes good drainage. It does not supply any nutrients or heat to the cuttings however. Petitioner adds all nutrients and heat separately to help control growth.

About 17 days or three weeks after sticking, when the cuttings are rooted, petitioner removes the plants from the growing beds and delivers them to its customers. We understand that most of the customers are engaged in the business of selling cut flowers. They keep the plants purchased from petitioner as a source for those flowers. Petitioner charges tax reimbursement to its customers and reports tax to the Board on its sales.

When petitioner removes the plants from the growing beds to prepare them for shipment, about one-third of the media mix remains attached to the roots of the plants. This media remains with the plants and serves to protect the roots during shipment.

Petitioner then mixes new media into the media remaining in the beds, to bring the beds back to their former level. The cycle then begins again by sticking new cuttings. This process has been going on since the beds were first filled between 17 and 25 years ago.

The cuttings for some types of plants are stuck in trays, rather than in the growing beds. These trays are filled with the same type of media as the growing beds. When the cuttings are rooted, the entire tray (including all the media) is shipped to the customer.

2. Petitioner was leasing a 1981 Iveco truck from R--- E--- Company for use at one of petitioner's operating divisions in A---, Ohio. The A--- facility was closed down around March 1, 1984, and petitioner purchased the truck from the lessor for \$10,500 on March 9 of that year. Petitioner did not pay any Ohio tax or tax reimbursement on this purchase.

Petitioner purchased the truck for use as a delivery vehicle at its S--- facility. Immediately after the purchase, one of petitioner's employees drove the truck from Ohio to S---. Petitioner registered the truck with the California Department of Motor Vehicles, but did not pay any use tax.

According to testimony at the appeals hearing, upon its arrival in California, petitioner discovered that the truck was not suitable for its intended purposes. The truck sat in petitioner's yard for about one year and was not driven during that period. Petitioner then resold the truck to an employee.

3. A prior audit of petitioner for the period January 1, 1978, through December 31, 1980, asserted sales tax on sales of cuttings, plus use tax on purchases of consumable supplies and fixed assets from out-of-state vendors totaling \$171,564. No penalty was asserted. The auditor's penalty comments state:

“Penalty: Not recommended. Carnation cutting sales represent 70 percent of the assessment. This is a new area of tax liability.”

Petitioner was next audited for the period January 1, 1981, through December 31, 1983. Use tax was asserted on purchases of fixed assets and supplies from out-of-state vendors totaling \$92,830. Again, no penalty was asserted. The auditor's penalty comments state:

“Penalty: None recommended. No negligence or intentional disregard of the Sales and Use Tax Law noted.”

During the current audit period, petitioner did not self-report use tax on any purchases of assets or supplies from out-of-state vendors. Petitioner explains that its policy was to wait until the next audit to “settle any tax due” on out-of-state purchases. Since interest but no penalties had been asserted in prior audits, petitioner believed that its policy was entirely proper.

Analysis and Conclusions

1. With certain exceptions not relevant here, Revenue and Taxation Code Sections 6094 and 6244 provide that use tax applies when tangible personal property is purchased under

resale certificates but used prior to resale. The auditor's position is that petitioner purchased the ingredients of the media under resale certificates, but then used the media in rooting cuttings and growing plants prior to resale. Accordingly, the auditor concludes that petitioner is liable for use tax.

Petitioner points out that the media, or at least a substantial portion thereof, is transferred to its customers along with the plants. Petitioner also contends that the media is used as a shipping container. Shipping containers may be exempt under subdivision (a) of Revenue and Taxation Code Section 6364, which provides that tax does not apply to:

“Nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents together with the container.”

The Board's legal staff has previously ruled on a similar issue. Sales and Use Tax Annotation 195.0860 (11/17/53) provides:

“Peat moss sold to growers of tomato plants for the sole use of keeping such plants moist in shipment, constitutes container material exempt from tax. [¶] Sale of peat moss to nurseries for use in growing beds is, however, subject to tax.” (Emphasis added.)

Petitioner uses the media mix as a growing or rooting media for cuttings and plants. This use occurs prior to any resale of the media as shipping material. Because of this use, petitioner is liable for use tax under Sections 6094 and 6244.

2. Section 6201 of the Revenue and Taxation Code imposes use tax when tangible personal property is purchased from a retailer for storage, use or other consumption in California, and is stored, used or otherwise consumed in this state.

The term “storage” is defined in Section 6008 of the code to include: “...any keeping or retention in this state for any purpose except sale in the regular course of business...” The term “use” is defined in Section 6009 to include:

“...the exercise of any right or power over tangible personal property incident to the ownership of that property...except that it does not include the sale of that property in the regular course of business.”

Petitioner used the truck in California by driving over California roads on the initial journey to S---. Furthermore, the retention of the truck in California prior to the time petitioner decided to sell it was a “storage” in this state. Since petitioner purchased the

truck for storage or use in California, and actually stored and used it here, petitioner is liable for tax as determined.

3. Revenue and Taxation Code Section 6453 provides that the sales and use tax return of a purchaser "shall show the total sales price of property purchased by him or her, the storage, use, or consumption of which became subject to the use tax during the preceding reporting period." (Emphasis added.) Petitioner's practice of waiting for audit to pay its use tax liability is therefore incorrect. Petitioner must report its use tax liability on its return for the reporting period in which the property is first stored or used in California.

However, we note that petitioner has been subjected to at least two prior audits. The second of those two audits expressly found that petitioner's failure to pay use tax timely was not due to negligence. Under these circumstances, we conclude that petitioner's failure to pay use tax in this audit period was also not due to negligence, but rather to a misunderstanding of the applicable law. Accordingly, we recommend that the penalty be deleted.

We make this recommendation with the understanding that petitioner is now aware of its responsibility to self-report use tax timely. Petitioner will be subject to penalties in future audits if it fails to correct its reporting procedures.

Recommendation

It is recommended that the account be redetermined without adjustment to the tax, deleting the negligence penalty.

James E. Mahler, Hearing Officer

6/12/89

Date