STATE OF CALIFORNIA

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
Begin deleted text REDACTED TEXT End deleted text CO.	)	Begin deleted text REDACTED TEXT End deleted text
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Elizabeth Abreu on December 1, 1993 in Sacramento, California.

Appearing for Petitioner: Begin deleted text REDACTED TEXT End deleted text
Tax Manager

Appearing for theSales and Use Tax Department: Bruce Morgan
Senior Tax Auditor

Protested Item

The protested tax liability for the period April 1, 1990 through June 30, 1990, is measured by:

Item	State, Local and County
Ex-tax purchase of truck and trailer	$ 48,000

Petitioner's Contention

Petitioner contends that it purchased a Kenworth truck and trailer for resale in connection with the cessation of its transportation division.

Summary

Petitioner is a California corporation currently engaged in business as a wholesale trader in petroleum terminating operations. Petitioner owns one tank farm in Contra Costa County and two tank farms in Los Angeles County where it stores its own petroleum products and petroleum products of lessees who lease tank space from petitioner. Petroleum is delivered to the tanks by pipelines and marine barges.

Lessees make their own arrangements for removing their petroleum products, either by truck or through pipelines. Lessees have tank cards which give them access to the tanks. The amount of petroleum removed by a lessee is electronically monitored by a computer.

Since June 1990, petitioner's sales of petroleum products have been mainly bulk sales, but on sporadic occasions petitioner has made nonbulk sales in which petroleum was delivered by trucks. For such nonbulk sales, either the purchaser provided the truck, or petitioner hired a common carrier.

Prior to 1988 petitioner owned Begin deleted text REDACTED TEXT End deleted text Gas Stations. Petitioner delivered petroleum products to its gas stations in trucks it owned or leased from third parties. Beginning in 1988, petitioner began selling all of its gas stations. Rather than selling its own trucks and assigning its truck leases, petitioner held itself out as a common carrier and continued using the trucks in its common carriage business. Petitioner also used its trucks to deliver its petroleum products to "mom and pop" gas stations. The transportation division of its business was known as the Delivered Products Unit.

Petitioner decided to terminate the Delivered Products Unit because this division was losing substantial amounts of money. By agreement dated May 15, 1990, petitioner transferred its Delivered Products Unit to Begin deleted text REDACTED TEXT End deleted text Oil Co., which agreed to assume responsibility for petitioner's leases but required petitioner to purchase from it two trucks and two trailers, including the Kenworth truck and trailer in issue. Petitioner also agreed to pay Ramos $70,000. Petitioner did not issue a resale certificate to Ramos for the truck and trailer in issue. The stated sales price in the agreement for the truck and trailer was $48,000.

According to Department of Motor Vehicle (DMV) records, petitioner purchased the Kenworth truck on June 19, 1990. Ramos, which is not a certificated dealer, filed a Notice of Release of Liability with the DMV, but petitioner did not register the truck and trailer. Petitioner sold the truck and trailer to Begin deleted text REDACTED TEXT End deleted textInc. on January 25, 1991 for $24,000.

The Department contends that petitioner has not met its burden to establish that the sale of the truck and trailer to petitioner was a sale for resale. It relies upon the following facts:

1. Petitioner did not issue a resale certificate to Begin deleted text REDACTED TEXT End deleted text;

2. Storage alone is sufficient use if property is not purchased with an intent to resell;

3. Petitioner was not a licensed dealer of trucks but was in the trucking business;

4. Petitioner produced copies of advertisements of sale for other trucks and trailers it owned but had no documentary proof showing that it advertised for sale the truck and trailer in issue;

5. Petitioner has no documentation to establish the odometer reading at the time it purchased the truck and trailer and at the time it sold them;

6. Petitioner capitalized the truck and trailer as fixed assets on its books and depreciated the truck and trailer on its income tax returns;

7. Petitioner did not maintain adequate records as required by law; and

8. The burden is on petitioner to establish that this was a sale for resale. Petitioner has not met that burden.

Petitioner contends that it did not issue a resale certificate because Ramos did not request one. Petitioner may have advertised this truck and trailer, but petitioner did not always keep copies of such advertisements. After the discontinuance of the transportation business, the paperwork for the truck and trailer sales were handled by secretaries who were inexperienced in such matters. They did not record the odometer readings; nor did Begin deleted text REDACTED TEXT End deleted text Inc. have any records of the odometer readings.

Petitioner further contends that the truck was in such disrepair that it was not road worthy for petroleum delivery purposes. The bolsters on the storage tank were in such poor condition that the truck would have been ticketed at the first inspection/weigh station that it entered.

Petitioner's representative stated that in June 1990, the operations of the transportation division terminated and that all but one of its drivers were laid off. The driver who

was not laid off was retained for a few months for pension purposes. This driver, however, did not drive any trucks after the operations of the transportation division were terminated. Petitioner submitted a computer run of employees who were terminated between March 1, 1990 and December 31, 1990. Twenty-two drivers and one dispatcher were laid off by June 15, 1990. Until petitioner sold them, the truck and trailer in issue were kept in storage at a facility leased from Begin deleted text REDACTED TEXT End deleted text in West Sacramento and later at petitioner's terminal facility in Contra Costa County.

Petitioner submitted a schedule from an accounting record which shows that after June 1990, there were no more rack sales, i.e., sales in which truck racks were used. Petitioner also submitted a document prepared by Begin deleted text REDACTED TEXT End deleted text showing the reserve required for the transportation business. At the bottom of this document is a handwritten notation which states that this represents a reserve for loss on discontinued operations of part of a segment of the oil business.

Petitioner contends that the classification of the truck and trailer on its books and on its income tax returns as fixed assets was an error. Petitioner's representative stated that she noted the error on the return before it was filed but concluded that reclassification was not necessary because the bottom line on the return would remain the same since the purchase and sale occurred in the same fiscal year.[1] Most of petitioner's inventory consisted of petroleum products, and it would have been a lot of work to set up an inventory account for the trucks and trailers.

Analysis and Conclusion

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property. Section 6201 of the Revenue and Taxation Code imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for the purpose of such storage, use, or other consumption.

Sales of motor vehicles between private parties, as opposed to sales by licensed or certificated dealers, are exempt from sales tax. Rev. & Tax. Code § 6282. However, the use of a vehicle purchased from a private party is subject to use tax unless an exemption applies. The purchaser must pay the use tax to the DMV at the time the purchaser makes an application for registration or identification. Rev. & Tax. Code §§ 6275, 6291, and 6292 and Sales and Use Tax Reg. 1610(c)(1).

Even though a purchaser of a vehicle is not licensed as a dealer, the purchaser may purchase a vehicle for resale and will incur no use tax liability if the purchaser does not make any taxable use of the vehicle before selling it. See Business Taxes Law Guide, Sales and Use Tax Annotation 585.0180.

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[1] Until 1992, petitioner filed returns on a fiscal year which ended February 28.

I find petitioner's explanation of the transactions in issue credible, and based upon the documentary evidence submitted by petitioner, I believe that petitioner had ceased its transportation operations in June of 1990, did not use the truck and trailer for transportation purposes, and had purchased the truck and trailer for resale. The remaining question is whether petitioner is liable for use tax because it capitalized and depreciated the truck and trailer on its books and income tax returns.

Regulation 1669.5(a)(7) reads:

> "Except for vehicles held for the purpose of leasing, vehicles which are capitalized in a fixed asset account and depreciated for income tax purposes are not held for sale in the regular course of business. Tax must be paid measured by the purchase price of such vehicles."

This regulation does not, however, address the issue of whether tax applies when property is depreciated in error and the taxpayer does not make any use of the property other than retention, demonstration, or display while holding it for sale.

In McConville v. State Board of Equalization 85 Cal.App.3d 156 (1978) the taxpayer argued that her accountant erroneously depreciated the horses in issue and that this tax treatment should not be binding on her. The Court of Appeal rejected her argument but stated that it was proper for the trial court, in reaching its conclusion that the animals were subject to use tax, to consider the taxpayer's treatment of the horses for purposes of state and federal income taxation.

In Sales and Use Tax Annotation 495.0240 of the Business Taxes Law Guide, the Board's staff concluded that when entries in a company's books erroneously transferred the company's equipment to another entity, resulting in a sale by mistake, sales tax was due on the transfer because the transferee claimed depreciation of the equipment on the transferee's state and federal income tax returns. The claim of depreciation constituted an exercise of ownership over the equipment. The annotation further provides, however, that the tax could be "canceled" if the transferee amended the returns to exclude the claim of ownership.

Annotation 110.0025 provides in pertinent part:

> "The breeding of the horses will not ordinarily be seen as exempt demonstration and display after the horses are capitalized on the purchaser's records. If a horse purchased ex-tax has been capitalized and bred but is resold prior to the purchaser's obtaining any depreciation or capital gains benefits, consideration shall be given to any evidence submitted by the purchaser that the breeding of the horse was only for purposes of demonstration and display." [7/10/74]

Neither the McConville case nor these annotations provide that depreciating property in error is always a taxable use of the property. Rather, tax does not apply if (1) the depreciation deductions were taken in error and the taxpayer did not realize a tax advantage from the depreciation deductions, (2) there is convincing evidence that the property was purchased for resale, and (3) the taxpayer made no taxable use of the property while holding it for resale.

In this case, petitioner did not obtain a tax advantage by capitalizing and depreciating the truck and trailer because they were purchased and sold in the same year.[2] If petitioner had treated these items as inventory, petitioner would have recognized a loss in that year. Since the depreciation was in error and petitioner did not realize a tax advantage from the depreciation, the capitalization and depreciation of these items are not by themselves a taxable use of the items. Therefore, petitioner is not liable for use tax on the truck and trailer.

Recommendation

It is recommended that the petition be granted.

Elizabeth I. Abreu, Staff Counsel Date

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[2] If the purchase and sale had occurred in different taxable years, there would have been a tax advantage. Petitioner would have realized a timing benefit by taking depreciation deductions during the earlier years.