

M e m o r a n d u m**210.0560**

To: San Jose - Auditing

Date: July 21, 1967

From: Tax Counsel (GAT) Headquarters

Subject: B--- I---, Inc.
S--- Division
XXXX --- Avenue
--- ---, California

SR -- XX-XXXXXX

This is in reply to your request for rulings concerning the application of use tax with respect to machines manufactured by B--- which are withdrawn from its finished goods inventories and charged to its Training, Application Research, and Quality Assurance Departments.

It is our understanding that these departments use the machines in the following ways:

(1) Training Department

Machines charged to the training department are used in classes for training employees in servicing the machines. The machines are also used in other classes for training customers in their use. Machines may be used in classes for as long as 14 months. In the employee training classes, the machines may be completely torn down and reassembled. In the customer training classes, the trainees are instructed in the uses and possible applications of the machines. Customer trainees may be owners of machines or prospective buyers.

In our opinion, the use of machines for training service employees is subject to tax measured by the cost thereof. On the other hand, it is our opinion that the use of machines to train owners of similar machines or prospective buyers constitutes demonstration and display. Accordingly, no tax is incurred with respect to such use.

(2) Application Research Department

New and standard models of machines are assigned to the Application Research Department for study to determine how they can be improved and whether they can be applied to uses other than those for which they were constructed. These machines are also used to test other instruments and accessories.

In our opinion, the use of new and standard model machines by the Application Research Department to find new applications and to determine whether they can be improved and the use of the machines to test other machines are taxable uses. Therefore, the cost of such machines is subject to tax.

(3) Quality Assurance Department

Machines are assigned to the Quality Assurance Department to determine whether they meet the qualify and standards required by the manufacturer. In determining whether they meet such standards, other machines are used to test them. Machines are also used to check out problems which customers have complained of in their own machines.

In our opinion, the testing of machines withdrawn from inventory to determine whether they meet company standards does not subject such machines to tax. On the other hand, it is our opinion that the use of machines to test other machines is subject to tax, and that the use of machines to check customer's problems is likewise subject tot tax.

We have examined the copy of the lease which you submitted. The lease is for a term of two years, renewable monthly thereafter. The lessee has the option to purchase the leased machine. If he then exercises the option within the first 60 days of the lease, he will be given credit for 100% of the rentals which he has paid toward the purchase price. If he exercises the option after 60 days, he will be given credit toward the purchase price for 75% of the rentals paid. In our opinion, this lease is not in lieu of sale. Accordingly, tax applies to the monthly rental payments.

GAT:ph