STATE OF CALIFORNIA

395.0518

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
J--- A. V--- dba J--- V--- F---	)	No. SN --- XX XXXXXX-010
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Cynthia Spencer-Ayres on June 23, 1992, in Bakersfield, California.

Appearing for Petitioner: S--- H. B---
Attorney at Law

J--- A. V---
Owner

Appearing for the
Sales and Use Tax Department: Norman Angelo
Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1982 through December 31, 1988 is measured by:

Item	State, Local and County
Taxable sales of horses not reported	$1,298,250
Reaudit adjustments	- 2,250
	$1,296,000

Petitioner's Contentions

1. Petitioner is not in the business of selling horses and, therefore, is not a retailer. His sales are exempt occasional sales.

2. Petitioner requests to delete the penalty because the failure to file returns or reports and pay sales or use taxes was absent willful neglect and was due to reasonable cause and occurred notwithstanding the exercise of ordinary care.

Summary

Petitioner is a sole proprietor who owns a horse ranch where he boards, breeds, trains and races thoroughbred horses. The business commenced in 1970 and there was no prior audit.

The audit period is January 1, 1982 through December 31, 1988 and nine taxable sales of horses were disclosed by the original audit dated July 26, 1990. No ex-tax purchases of horses were noted by the auditor and a majority of the horses were bred by petitioner. Other horse purchases were tax paid through auctions, claiming races or occasional purchases. Schedule 12, page 4, of the audit workpapers for the period 1982 through 1988 revealed that there were: four audited taxable sales and two sales in interstate commerce in 1983; three audited taxable sales in 1984; one sale in interstate commerce in 1985; one audited taxable sale in 1986; and one audited taxable sale in 1988. The horse known as "E--- T---" was deleted from the measure of tax in the January 24, 1991 reaudit because it constituted a sale in foreign commerce.

Petitioner states he is engaged in the business of training and racing horses. He purchases some of the horses he uses, and the remainder are horses which he breeds. He states he does not breed race horses for sale to others, but rather his breeding is solely limited to procuring horses for his own racing purposes. Therefore, petitioner states the purpose of his business operations is not to sell horses, but to race them.

Petitioner's primary contention is that he is not a retailer and except for an occasional sale, he is not in the business of selling his horses. Petitioner states that no seller's permit is required for the business of horse racing. Petitioner believes that as long as he restricts his activities to horse racing, he cannot be considered a retailer, and he is therefore not required to hold a seller's permit. Petitioner contends that most of his sales are exempt occasional sales because there is not a series of three sales in any 12-month period. In petitioner's pre-conference brief he states that in the present matter, there are no culling sales. If the petitioner owned a horse which was not suitable for either breeding or racing, he gave the horse for no consideration to third parties. Therefore, petitioner states that most of his horses are owned by him, were sold in exempt transactions or were given away to friends and acquaintances for no consideration.

Petitioner states in a document entitled "Arbitration Brief" and signed by petitioner's attorney that there is no dispute that in the years 1984, 1985, 1986, 1987 and 1988 he sold not more than two horses in any single year, although in his petition for redetermination, which was submitted earlier in time, petitioner conceded that there were more than three sales in 1983 and 1984, but in both years only two sales were made in California. During the calendar year 1983, petitioner states he was engaged in four transactions in which several of these transactions have

been mischaracterized by the Board staff; the horses involved are "M---", "B--- G---", and "I--- F---".

Petitioner states that the horse known as "M---" was purchased by petitioner in Argentina for a friend, A--- I---. Mr. I--- reimbursed petitioner for the purchase price of the horse, the traveling, shipping and other associated costs. Petitioner contends that the transaction does not constitute a sale because he acted as an agent for Mr. I---; he never used the horse for either breeding or racing; the horse was delivered to Mr. I--- upon arrival; and the only money received by the petitioner was reimbursement for his expenses.

Petitioner contends the transaction pertaining to "B--- G---" was not a sale. Petitioner states that the ownership of this horse remained with petitioner at all times and the transaction should not be confused with the sale of a breeding right. Furthermore, the petitioner contends the transaction pertaining to "I--- F---" was also not a sale or lease of tangible property because all ownership of the horse remained with the petitioner and the petitioner was solely responsible for all decisions regarding the training and racing of the horse. Petitioner states Mr. L---, a party to the agreement, neither possessed nor exercised any ownership rights over "I--- F---". Petitioner concludes that Mr. L--- only obtained an interest in the horse's future earnings, after all expenses for the years 1983 and 1984, which is an intangible asset. The petitioner concludes that the only transaction which could constitute a sale was the transfer of a one-half share of the horse "S--- F---" in November of 1983.

In an earlier document which requested a hearing with a hearing officer dated October 4, 1990, it was specifically stated that petitioner leased both horses ("B--- G---" and "I--- F---") for a short period of time, but the ownership of the horse remained with the petitioner. The document was submitted and signed by petitioner's attorney. More specifically, it was stated that "I--- F---" was leased to a friend of the petitioner, so that the friend could enjoy certain privileges at the racetrack. It was stated further that "B--- G---" was leased for one year to a third party for breeding purposes. Therefore, petitioner concludes that the inclusion of these horses as taxable sales in 1983 is improper.

The petitioner states that the horse known as "E--- T---" was sold and delivered to the buyer in Caliente, Mexico, and constituted a sale in foreign commerce and "P--- K---" was sold to a resident in Florida, and the agreement provided that the place of sale for tax purposes shall be Florida. Furthermore, the horse was delivered to a common carrier to be delivered to the buyer outside of the state; therefore, this sale constitutes a sale in interstate commerce. Petitioner cites Revenue and Taxation Code section 6396 which he states specifically exempts sales of personal property which, pursuant to the contract of sale, is required to be shipped and is shipped to a point outside the state by the retailer by means of "...(b) delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point".

The petitioner concedes that in the years 1983 and 1984, there were more than three sales; however, in both years only two sales were made in California. Petitioner argues the requirements for the imposition of the sales tax is that the alleged sale must occur within this state and no sales tax is due for transactions in interstate or foreign commerce. Therefore, sales in interstate and foreign commerce are not to be included when determining a series of three or more sales for sales tax purposes.

Petitioner requests relief from penalty for failure to make a timely return under Revenue and Taxation Code section 6592. Petitioner states that he had been advised by his attorney that sales of two or fewer horses per year were statutorily exempt as occasional sales.

The Board staff's position is that petitioner is engaged in the business of breeding, training, boarding and selling horses and as such, he is required to hold a seller's permit. Furthermore, for the years 1983 and 1984, petitioner sold three or more horses each year and in 1985, 1986 and 1988, petitioner sold one horse each year. Since petitioner's business is breeding, training and racing horses and since this activity results in sales of horses, the Board staff concludes that he is a retailer under Revenue and Taxation Code sections 6014 and 6015. Therefore, since petitioner is engaged in a business required to hold a permit, none of the sales in question qualify as exempt occasional sales, even if fewer than three sales were made per year.

The Board staff determined that "I--- F---" and "B--- G---" were leased and are properly included in the audit. The sale of "E--- T---" was deleted from the audited measure of tax because the documentation submitted by petitioner showed it was sold in foreign commerce. The agreement and bill of sale on "P--- K---" states F.O.B. point is at the present location and the footnotes on the agreement show the location to be the --- --- racetrack. Also, the April 9, 1988 copy of the Blood-Horse, a racing news sheet, states "P--- K---" was sold and would remain in V---'s barn until after the April 9, 1988 Santa Anita Derby. Therefore, the Board staff determined this was not a transaction in interstate commerce.

Analysis and Conclusions

Petitioner contends he is not in the business of selling horses; therefore, he is not a retailer. Petitioner concludes that since he did not have a series of sales in any 12-month period, the sales in question must qualify as exempt occasional sales.

Tax exemption statutes are to be strictly construed against the taxpayer. (Santa Fe Transp. v. State Bd. of Equalization (1959) 51 Cal.2d 531, 539; Framingham Acceptance Corp. v. State Bd. of Equalization (1987) 191 Cal.App.3d 461, 463.) The burden of proving entitlement to an exemption from the tax is upon the taxpayer and does not shift from the taxpayer to the Board since the taxpayer is in the best position to create and maintain records of his transactions. (H.J. Heinz Co. v. State Board of Equalization (1962) 209 Cal.App.2d 1, 4; Pope v. State Bd. of Equalization (1988) 202 Cal.App.3d 73, 84.) Therefore, we must determine whether petitioner met its burden of proving his entitlement to the occasional sales exemption.

There are two definitions of "retailer" in the Revenue and Taxation Code. Revenue and Taxation Code section 6019 provides that any person making more than two retail sales of tangible personal property during any 12-month period is a retailer. Revenue and Taxation Code section 6015 provides that every seller who makes any retail sale is a retailer. A "seller" is every person engaged in the business of selling taxable tangible personal property. (Revenue and Taxation Code section 6014.) If petitioner is considered a retailer, the number of sales in any 12-month period is of no importance.

The question raised is whether petitioner's activities qualify for exemption as occasional sales. Revenue and Taxation Code section 6367 authorizes an exemption for "occasional sales". Subdivision (a) of Revenue and Taxation Code section 6006.5 defines "occasional sale" to include a sale of property not held or used by a person in the course of activities which require the holding of a seller's permit. Under section 6006 of the Code, every person desiring to engage in business as a seller in California must hold a seller's permit. "Seller" is defined in section 6014 to include:

> "...every person engaged in the business of selling tangible personal property of a kind the gross receipts from the retail sale of which are required to be included in the measure of the sales tax."

Subdivision (a)(2) of Sales and Use Tax Regulation 1595 provides that "a person engaged in the business of selling tangible personal property" must hold a seller's permit. Subdivision (a)(1) of that regulation further provides:

> "Generally, a person who makes three or more sales for substantial amounts in a period of 12 months is required to hold a seller's permit."

Evidence in the file indicates that petitioner is in the business of breeding horses, as evidenced in a January 20, 1983 lease agreement which pertained to "B--- G---". Petitioner desired to lease the mare for approximately twelve (12) months for $4,000. Section 3, Terms of Agreement and Breeding of Mare, page 2, of the agreement states that the agreement shall be for the 1983 breeding season as it relates to the breeding and boarding of "B--- G---". The petitioner's 1983 California income tax statements clearly stated that "B--- G---" was acquired January 1, 1983 and sold March 9, 1983.

The second horse in question is "I--- F---". The same income tax statement where information on "B--- G---" appears also indicates that "I--- F---" was acquired on January 1, 1978 and sold April 25, 1983 for $10,000 and petitioner sold a one-half interest in the horse. In addition, a document dated April 1, 1983 on the V--- F--- Co.'s letterhead sets forth the agreement between petitioner and J--- L--- regarding the "I--- F---" transaction. The agreement provides:

"Dear J---,

"I will lease you half interest in the racehorse 'I--- F---', so you can have some fun and privileges at the track (receive passes, stickers, etc.).

"Half of her earnings will belong to you after all expenses have been deducted. This agreement is for the period of two years and the rental fee is $10,000.00.

"Agreed upon by J--- L---:" (Emphasis added.)

Furthermore, on page 3 of an October 4, 1990 document from S--- B---, petitioner's attorney, it was stated that petitioner leased "I--- F---" and "B--- G---". This evidence clearly supports petitioner's initial conclusion that these two horses were leased which has significant legal ramifications.

Regulation 1660(a)(1) defines "lease" in relevant part:

"The term 'lease' includes rental, hire and license. It includes a contract under which a person secures for a consideration the temporary use of tangible personal property which, although not on his premises, is operated by, or under the direction and control of, the person or his employees....

"(b) IN GENERAL. Any lease of tangible personal property in any manner whatsoever for a consideration is a 'sale' as defined in Section 6006, and a 'purchase' as defined in 6010, except a lease of:

"(A) Motion picture films and videotapes,... (Emphasis added.)

The transactions regarding "I--- F---" and "B--- G---" constitute leases because they were rented out for consideration. We, therefore, conclude that the petitioner's lease of each of the two horses constitutes a sale even though petitioner remained the owner of these horses.

There were inconsistencies noted in petitioner's evidence submitted on the issue regarding the leases. The agreement between petitioner and Mr. Lewin regarding "I--- F---" indicated petitioner was leasing a one-half interest in the horse. The October 4, 1990 document submitted by petitioner's attorney requesting a hearing stated that "I--- F---" and "B--- G---" were both leases. Petitioner's Arbitration Brief indicated these transactions were not leases, which was later in time. Inconsistencies impair the credibility of a witness and reduce the weight of his evidence presented. (31 Cal.Jur.3d section 695, p. 981.) In the sphere of evidence, the trier of a fact may disbelieve all or any part of the evidence of a party or witness if it is tainted with evasiveness, uncertainty, or contradictions, or may believe only such portion as seems credible in the light of other evidence. As a rule, an account of a transaction given in a

contemporaneous writing when no differences existed, outweighs subsequent oral explanations given after differences have arisen, and is at variance with the writing. In judging the weight of the evidence, one may properly find in favor of oral testimony that is contradictory to a writing when, in fact, such evidence is so strong that it cannot be disregarded. (31 Cal.Jur.3d section 691, pp. 976-977.) The evidence presented by petitioner is tainted with contradictions. In judging the weight of the evidence in this case, we give more weight to the petitioner's October 4, 1990 document submitted by petitioner, which stated the two transactions were leases, over his subsequent oral and written statements which were given after differences had arisen.

A third horse known as "M---" was purchased by petitioner in Argentina for a friend and was turned over to his friend in the USA. The audit staff concludes on Schedule 12-A2, p. 2, that petitioner sold "M---" on January 7, 1983 to his friend for $42,000. Petitioner's 1983 California income tax statement indicates that "M---" was acquired October 31, 1982 and sold January 7, 1982 for $42,000, which is consistent with the Board staff's conclusion.

The evidence supports the conclusion that the transactions regarding "I--- F---", "B--- G---", and "M---" constitute sales in 1983 and the horse "S--- F---" counts as the fourth sale in that year.

Petitioner contends it is engaged in the business of breeding and racing horses and that the business does not normally involve sales of horses. All sales in question are exempt occasional sales. Several horses have been sold which were owned, not only for racing purposes, but also for breeding purposes. Horses, including fractional interests in horses, are tangible personal property subject to tax when sold at retail. (See Sales and Use Tax Annots. 540.0280 [9/16/66] and 540.0300 [11/22/65].) Persons who are engaged in the business of selling horses are therefore required to hold permits even if none of the sales are at retail. (See Santa Fe Energy Co. v. State Board of Equalization, 160 Cal.App.3d 176.)

At the conference, petitioner stated that some thoroughbreds are not good for racing or for riding. Therefore, he takes approximately "one year to break the horses into another type of action" or activity. Petitioner specifically stated that training is necessary to make these horses into pleasure horses which are sold for "a couple of thousand dollars at best". Petitioner concludes these horses are "given away" at insubstantial prices because registered horses, unlike these horses, have value because the offspring can be registered. We conclude that these transactions would still constitute sales no matter how insubstantial the petitioner perceives the consideration. Horse breeding and racing activities necessarily involve the culling and sale of animals or interests in animals unfit for racing. We believe that petitioner did not give away, without consideration, all horses which were not fit for racing or breeding based upon petitioner's statements at the conference. Therefore, we believe there were some culling sales during the audit period. Those culling sales are to be counted to determine whether petitioner was a retailer in the years after 1984.

Although petitioner has made various sales throughout the audit period, we believe the facts weigh in favor of the conclusion that the primary purpose of the business is the breeding and racing of horses. We further believe the sales of horses are incidental to the primary purpose of racing and breeding horses. We are not convinced that the facts support the position that petitioner was a retailer on a continuous basis. We must look at the application of the three or more sales in a 12-month period rule to determine whether the sales that were made were occasional sales. Petitioner sold more than three horses in 1983, at least three in 1984, and one each in 1985, 1986 and 1988. More specifically, the transactions regarding "M---", "B--- G---", "I--- F---" and "S--- F---", and any transactions in interstate and foreign commerce in 1983 all constitute sales, although excluded from the measure of tax, for purposes of the three or more sales in a 12-month period in which petitioner is required to obtain a permit. Also, even though there were only two sales in 1984, for "M---" in January 1984 and "O---" in March 1984, there were more than two sales in a 12-month period because "I--- F---" was sold in April 1983 and "S--- F---" was sold in November 1983. (See Audit Manual 1001.35. The audit manual mandates that sales can be counted twice to determine the three-sale rule.) Therefore, petitioner still would not meet the occasional sale exemption for 1983 and 1984. We therefore conclude that the petitioner was a retailer for 1983 and 1984 and was therefore required to hold a seller's permit in those years. We also recommend that a reaudit be done on the issue of culling sales in order to determine if petitioner was a retailer in any other years in the audit period.

The audit assessed a 10 percent penalty for failure to file returns. Petitioner has submitted a request for relief in the form required by Revenue and Taxation Code section 6592. We recommend that relief be granted.

Recommendation

Grant the request for relief from the penalty. Reaudit with respect to culling sales. Delete the sale in 1986 and 1988 unless the culling sales are sufficient in 1986 and in 1988 to establish petitioner as a retailer.

Cynthia Spencer-Ayres, Staff Counsel — February 26, 1993 Date