STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

November 5, 1964

X----------------------

Attention: X-----------------------

Gentlemen:

This is to inform you of our conclusions with respect to the above named taxpayer's petition for redetermination of sales tax. We will recommend to the board that the item concerning pipe reconditioning and the item concerning handling-out charges be deleted from the audit and, with these adjustments, the tax be redetermined. This leaves in the audit two other protested items, namely use tax on horses and the disallowance of tax paid purchases resold deduction. This last item is disallowed only for the period of the audit and may properly be claimed in the first quarter 1963.

We believe that the letter to the taxpayer from the Los Angeles Administrator of the State Board of Equalization over the signature of Mr. Philip E. Rose, dated June 30, 1948, properly states the application of sales tax to the petitioner's business. The various operations performed on used pipe by the petitioner is for the purpose of restoring it to its previous condition and thus constitutes nontaxable repair labor. Included in these operations is roll welding, which when restoring pipe to its original length is a part of the repair. Of course, operations performed beyond mere restoration are taxable as fabrication labor. Such is the case where the taxpayer welds old 20-foot lengths to make new 40-foot lengths. This is also the position of the 1948 letter.

As concerns the handling-out charges, we believe the taxpayer's allocation between this nontaxable item and other taxable items was a reasonable division of his costs and should have been allowed by our auditors. Apparently the discrepancy was caused by using a fork lift rather than a crane in loading one customer's pipe. After a six-month test period the customer agreed to this procedure and appropriate changes were made in billing the customer.

At the hearing you stated that you would not present any evidenc3e rejecting the presumption of § 6246 of the Sales and Use Tax Law which presumes tangible personal property brought into the state was purchased from a retailer. Accordingly, there is no basis on which we can recommend any adjustment in this item.

The tax-paid purchases resold deduction is provided by § 6012(a). It provides that the measure of tax includes the cost of the property sold, except where the retailer has already paid tax on the cost and resold the property prior to making any use other than retention, demonstration or display. If it were not for this section, sales tax would apply to the receipts of the taxpayer from the sale of the material in question even though it had paid tax upon acquisition. It should be noted that the Legislature framed this as a deduction and not as a credit. The retailer is entitled to deduct the cost of the property provided the requirements are met from the gross receipts from the sale of the property. By the same token it did not frame it as credit to be given at the time the property is actually resold. Thus, no credit nor claim for credit or refund can be allowed merely from the fact of resale. There must be some taxable measure from which it can be deducted. Sales tax applies to receipts from sales in the quarter in which they are actually received and this is the proper time for the deduction to be taken. (See ruling 71, copy enclosed.) Thus, the deduction was properly disallowed by our auditors from the fourth quarter of 1962.

Neither is the taxpayer entitled to a claim for refund in the fourth quarter of 1962 for these amounts. The sales tax law gives the taxpayer an election for inventory items which may be either consumed or resold, between paying tax at the source or purchasing ex tax and paying tax upon use. The taxpayer made its election when it paid tax at the source. It is entitled to the benefit of the tax-paid purchases resold deduction, but it may not retroactively change from a tax paid to an ex tax basis by claiming a refund or credit.

The recommended adjustments will be made and presented to the board for action at its regularly scheduled meeting. You will receive official notice of its action in due course. We trust these adjustments meet your approval.

Very truly yours,

John H. Knowles
Associate Tax Counsel

JHK:cw
Enc.