STATE OF CALIFORNIA **460.0144**

STATE BOARD OF EQUALIZATION
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March 14, 1995

Mr. D--- C---
--- & ---
--- ---, Suite XXX
--- ---, CA XXXXX-XXXX

Re: T--- Corporation
SY -- XX-XXXXXX

Dear Mr. C---:

This is in response to your letters dated November 3, 1994, January 26, 1995, and February 14, 1995 regarding the application of sales and use tax to the business of T---. I will respond to your first two letters first.

T--- provides a process it calls the [T] atmosphere service to aid in the preservation of fresh fruits and vegetables during transportation to market. The process involves enclosing the produce and adding carbon dioxide to that enclosure. The Board conducted an audit of T--- for the period January 1, 1988 through June 30, 1991. T--- had regarded itself as providing a service, but the Sales and Use Tax Department concluded that T--- was leasing equipment and selling other tangible personal property to its customers. Since the equipment regarded as leased was not leased in substantially the same form as acquired (T--- manufactured the equipment), a Notice of Determination was issued to T--- for tax measured by rentals payable from the leases (with appropriate offsetting credits for tax paid on the purchase price of the property incorporated into the equipment).

T--- filed a Petition for Redetermination. At the Board hearing, T--- argued that it was providing the service of protecting perishable products during shipment rather than leasing equipment and selling other property. One of the bases of T---'s argument was that its charge was based on the amount of produce shipped using the [T] process. The charge was not based on the amount of property provided by T--- which was used in its [T] activities nor on the type and

amount of T--- equipment used at any particular customer's site during the [T] process. For example, T--- noted that the equipment at the various customer sites varied considerably, but that its charge was wholly unrelated to such equipment, being based solely on the actual amount of produce shipped using its process. As explained in the Decision and Recommendation issued in connection with the petition filed by T---, "[T---] regarded itself as providing the service of protecting perishable products during shipment. It purchased all materials and equipment tax-paid and did not charge sales tax reimbursement to its customers or pay sales tax to the Board." The Board agreed with the arguments of T--- and ruled that T--- was providing a service.

Some of the aspects of T---'s business related solely to the acquisition of equipment used in the [T] process have changed. Previously, T--- self-manufactured the equipment used in the [T] process. Some of that equipment is now manufactured by others and leased to T---. T--- may purchase such equipment and then sell it to a third-party lessor. It would then lease the equipment from the third-party lessor. Other such equipment will be purchased by the third-party lessor directly from the manufacturer, and then leased to T---. When T--- purchases the equipment, it plans to pay sales tax reimbursement to the manufacturer and consummate the sale and leaseback within 90 days of its first functional use of the equipment. When the third-party lessor purchases the equipment directly from the manufacturer, it will pay sales tax reimbursement to the manufacturer when purchasing the equipment.

You ask about the sales and use tax implications of these changes in acquisition of equipment used in the [T] process. My understanding, however, is that the contracts between T--- and its customers remain identical to those ruled by the Board to be service contracts and not leases and sales of tangible personal property. For example, T--- continues to bill its customers based on a per pallet basis, unrelated to the value of equipment and other tangible personal property consumed at that customer site. Notwithstanding the Board's specific ruling upholding the position of T--- upon the identical facts, your questions are based on the assumption that T--- is selling materials and leasing equipment to its customers. You state:

> "In order to avoid a dispute with the Board concerning whether the facts and circumstances associated with the T--- service activities have changed since June 30, 1991, T--- will assume for the purposes of this ... request that its business activities involve the sale of materials and the lease of equipment.
>
> "Nonetheless, T--- believes that the Board's determination for the period commencing January 1, 1988 through and including June 30, 1991 is still applicable with respect to the period covered by this ... request, and T--- reserves the right to continue to treat its business activities as a service enterprise."

I am unable to answer your questions based on the assumption that you propose we accept because the facts in your letter and the Board's previous ruling on identical facts with respect to this taxpayer direct a contrary result. The manner of acquisition of equipment by T--- does not alter its contractual relationship with its customers, nor does its subjective decision that it is selling tangible personal property and not providing a service (or the reverse). Rather, the contract between T--- and its customers is the basis for determination of whether T--- is selling tangible personal property or is instead providing a service. This determination is unaffected by the change in facts and contracts regarding T---'s acquisition of property. Based on the understanding that the contractual relationship between T--- and its customers remains identical to that existing for periods with respect to which the Board ruled that T--- was providing a service, we conclude that T--- continues to provide a service, and does not sell (and lease) tangible personal property to its customers. Thus, this conclusion forms the basis for our answers to your questions, except as specifically noted below. You ask us to respond to requests 1 and 5 from your first letter, and 1 through 6 from your second letter.

First letter, request 1

You ask for confirmation that all gross receipts attributable to the sale to customers, or use by customers, of carbon dioxide and nonreturnable materials that contain the carbon dioxide are exempt from sales and use tax. You ask us to further confirm that the exempt gross receipts attributable to the sale or use of these materials will include various costs including proprietary know-how relating to their use, delivery and inventory stocking, monitoring services, and a return on the investment in these materials.

We agree that, under Revenue and Taxation Code section 6359.8, the sale to and use by the consumer of the carbon dioxide used in packing and transporting fruits and vegetables for human consumption are exempt from sales and use taxes, provided the fruits and vegetables are not sold to the ultimate consumer in a package that contains the carbon dioxide. We further agree that the sale and use of nonreturnable materials containing such qualifying carbon dioxide are also exempt from sales and use taxes under section 6359.8. However, as noted above, we disagree that the exempt transaction is a sale to the customers of T---. Rather, we conclude that the exempt retail transaction is the sale to, and use by, T--- of the carbon dioxide and nonreturnable materials since T--- is consuming such property in the providing of a service and is not regarded as selling any of such property to its customers.[1/]

[1/]If T--- were to alter its business practices such that it was regarded as selling this property to its customers, we agree that the sale to or use by the customers would be exempt from sales and use taxes if satisfying the requirements of section 6359.8. However, I note that one of the factors leading the Board to conclude that T--- was a consumer and providing service and not a seller of tangible personal property is that its charges did not relate directly to the amount of tangible personal property consumed when providing its services to any particular customer. Rather, T--- made a set charge per pallet without regard to the ease or difficulty of such service, and without regard to the tangible personal property it used to provide that service. Your current question continues to be in the context of T---'s making a set charge per pallet, and then making an allocation from that charge for its "sales" of tangible personal property. While a person can be regarded, under certain circumstances, as making a

First letter, request 5

You ask us to confirm that T--- may properly provide resale certificates to vendors selling it materials such as carbon dioxide, pallet bags, etc. If T--- were regarded as selling such property to its customers, then it would of course be entitled to purchase such property extax by issuing its vendors resale certificates provided it were to make no use of such property prior to resale. However, as discussed above, based on the facts before us, T--- is not selling such property to its customers. Therefore, it may not purchase such property extax for resale. It may, however, issue exemption certificates with respect to property whose sale and use satisfies the requirements of the exemption provided by section 6359.8. (See Reg. 1667.)

Second letter, requests 1 and 2

You ask us to confirm that, under the facts stated above, the sale by T--- of equipment to the third-party lessor and the leaseback to T--- is not subject to sales or use tax under Revenue and Taxation Code section 6010.65. That section states that neither the transfer of title nor the lease of tangible personal property pursuant to an acquisition sale and leaseback constitutes a "sale" or "purchase" under the Sales and Use Tax Law. An acquisition sale and leaseback is one where the seller/lessee has paid sales tax reimbursement or use tax with respect to the purchase of the property and the sale and leaseback is consummated within 90 days of the seller/lessee's first functional use of the property. You state that the seller/lessee, T---, will pay sales tax reimbursement when purchasing the property and will consummate the sale and leaseback within 90 days of its first functional use. As such, both conditions of section 6010.65 will be satisfied, and we therefore agree that neither the sale to the third-party lessor nor the leaseback to T--- constitutes a "sale" or "purchase" subject to sales or use tax.

Second letter, request 3

You ask us to confirm that use tax does not apply to the leases of equipment that the third-party lessor purchases directly from the manufacturer. Leases of tangible personal property in California are continuing sales and purchases subject to use tax measured by rentals payable unless the lessor has timely paid sales tax reimbursement or use tax measured by purchase price and leases the property in substantially the same form as acquired. (Rev. & Tax. Code §§ 6006(g)(5), 6006.1, 6010(e)(5), 6010.1, Reg. 1660.) You state that the third-party

(continued)

sale of tangible personal property when making such a set charge without making a separate charge for the property sold (which was the basis of the Department's prior assessment against T--- which was overruled by the Board), we conclude that T--- is not doing so under the currently stated facts. If T--- did somehow change its business practices so that it were regarded as selling the tangible personal property without making a separate charge for that property, the proper allocation would be a question best directed to the Board's audit staff. In any event, we do not believe that it would be appropriate, in such circumstances, to include all the components that you propose to be included in any such exempt gross receipts.

lessor will pay sales tax reimbursement to the manufacturer when purchasing the equipment and will lease it in substantially the same form as acquired. Thus, we agree that such leases to T--- are not sales or purchases of tangible personal property subject to sales or use tax.

Second letter, requests 4 and 5

You ask us to confirm that amounts paid by customers of T--- attributable the use of the equipment discussed in the previous two paragraphs are not subject to sales or use tax. As discussed previously, based on the Board's decision in connection with the audit period January 1, 1988 through June 30, 1991 and the fact that the contracts between T--- and its customers remain the same as during that period, T--- is not selling or leasing tangible personal property to its customers but instead is providing a service. It is therefore the consumer of any property used in the course of providing such services. For this reason, tax does not apply to the amounts about which you inquire.

If T--- were regarded as leasing such equipment to the customers, the rentals payable from such leases would be taxable unless the property were leased in substantially the same form as acquired and sales tax reimbursement or use tax had been paid on purchase price or on the rentals payable under the prime lease. (Reg. 1660(c).) Since the property would be leased in substantially the same form as acquired and sales tax reimbursement would have been paid when purchasing the property, a lease or sublease of the property would not be a "sale" or "purchase" subject to sales or use tax.

Second letter, request 6

You ask us to confirm that amounts received by T--- which are attributable to the use of equipment manufactured by T--- are subject to use tax. Since T--- is using such equipment in the performance of a service rather than leasing the equipment, tax is due with respect to the sale to T--- of property it incorporates into such equipment. T--- may not purchase such property extax under resale certificates. It must report use tax with respect to its purchase price of any such property acquired extax for resale. If, however, T--- were regarded as leasing such equipment to its customers, we agree that the rentals payable from such leases would be subject to use tax since the equipment would not be leased in substantially the same form as acquired.

Third letter, dated February 14, 1995

I was familiar with the facts and history of this case because I had represented the Sales and Use Tax Department at the Board hearing on T---'s petition for redetermination. Thus, in order to maximize our efficiency in serving the public, I am responding to the letters discussed above. Your letter dated February 14, 1995 is actually a follow up to a previous letter written to us dated December 8, 1994. Again, since I am familiar with the facts and history of this case, I would have generally also responded to that letter in order to maximize our efficiency in serving the public. Nevertheless, I did not do so because we were not provided with the taxpayer's

identity, nor any facts that would indicate that we were dealing with two different letters for the same taxpayer under the same facts. Since the December 8 letter did not disclose its connection to T---'s other pending opinion request, it was assigned to Staff Counsel Warren Astleford for response.

I note that Mr. Astleford and I spent time trying to figure out what were the actual facts involved in the December 8, 1994 letter, and it never occurred to me that the facts involved were those of T---. Thus, Mr. Astleford and I spent considerable time trying to figure out what, as it turns out, I already knew (and if I had not been responding to T---'s other opinion request, whichever attorney assigned to respond to it would have known such facts). This resulted in an unnecessary and unproductive use of the State's limited time, materials, and resources. In the future, if one of your clients has an opinion request pending before us and another different, but related, issue arises for which you or your client wishes our opinion, it is necessary for you to disclose the existence of that other opinion request. This is true whether the client is identified in the first request is not.[2/]

You should also note that each time a person writes us to ask a question, we consider the question and provide the necessary analysis. Even if we had just written to the person as an unidentified taxpayer and then the identical request comes in identifying the taxpayer, that second request must be processed as a new opinion request. Thus, when the sole purpose of a second letter is to identify the taxpayer for purposes of coming within section 6596, the additional workload of answering two letters when one response would have been sufficient greatly affects our efficiency. Another aspect to this approach is the time it takes to receive a response coming within section 6596. Letters coming within section 6596 are never "retroactive" to the date of any other correspondence. Thus, if you are going to seek a section 6596 letter, please do so in your first letter to us. This will assist us in better serving you and other taxpayers and representatives in the most timely and cost efficient manner.

In your February 14, 1995 letter, you state:

> "Commencing in 1988, the SBE, pursuant to an audit, informed T--- that the [T] process constituted a taxable sale of materials and a taxable lease of equipment. T--- had believed that any such transactions were incidental to the performance of a service.
>
> "While filing a protest against the SBE's characterization of the [T] process, T--- acted in accordance with the SBE's characterization. Accordingly, T--- delivered a resale certificate to the vendors who sold the materials in question to T---, and

[2/] Although this problem is more like to arise when the client is identified in one letter and you wish that the client be unidentified in the other letter, we ask that you notify us of the existence of the previous opinion request whether the client is unidentified in both, identified in both, or identified in one and not the other, and without regard to whom in the agency the opinions are addressed.

> T--- did not pay sales tax reimbursement on its purchases of the materials from its vendors. T--- charged its customers the appropriate rate of tax based on the entire value of the transaction. T--- then remitted the full amount of the tax to the SBE...."

You ask whether, for the period through November 30, 1994 when it was notified of the Board's decision that it was providing a service, T--- may offset the excess tax reimbursement it collected from its customers against its use tax liability arising from its use of property purchased under resale certificates.[3/]

In light of the Board's decision with respect to the previous audit period and as discussed above, we agree that T--- was providing a service with respect to its [T] service performed under identical contracts as those involved in the audit period. As such, its charges for that service were not subject to tax. Since T--- collected an amount designated as "sales tax reimbursement" on a charge that was not subject to sales tax, it collected excess tax reimbursement. T--- is required to refund such excess tax reimbursement to its customers or remit it to the Board. (Rev. & Tax. Code § 6901.5.) However, certain amounts of such excess tax reimbursement may be credited against the liability of T--- for use tax on its use of certain property. (Reg. 1700.)

You state that T--- was notified in 1988 in connection with the previous audit that the Sales and Use Tax Department considered it to be selling and leasing tangible personal property rather than merely providing a nontaxable service. You indicate further that T--- therefore acted in accordance with that characterization (even though administratively appealing that determination) by purchasing property extax for resale, collecting sales tax reimbursement on its charges, and remitting sales tax to the Board. My review of the record indicates that T--- was not notified in 1988 in connection with the audit since the audit was not conducted until 1991. The date of the audit report was November 21, 1991. An office discussion was held on May 14, 1992, and the audit report has an approval date of August 28, 1992. Therefore, it appears that your questions must relate to periods occurring sometime after January 1, 1992. Furthermore, as noted above, T--- regarded itself as providing a service through at least June 30, 1991, and did not charge sales tax reimbursement to its customers.

Since T--- paid sales tax on an amount not subject to sales tax, it is entitled to a refund of such amounts. However, since it collected an amount of "sales tax reimbursement" (in the same amount as the sales tax it paid to the Board) on charges not subject to sales tax, it collected excess tax reimbursement. Since T--- has already remitted such amounts to the Board, except as discussed below, no refund of such amounts will be refunded to T--- unless T--- refunds such amounts of excess tax reimbursement to its customers. (See Reg. 1700(b)(3).) Without regard to the discussion immediately above, T--- owes use tax on the purchase price of the property it

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[3/]Mr. Astleford's February 6, 1995 was in response to such generally stated facts that it cannot be much assistance with respect to the specialized facts that we have now been advised actually apply here.

had purchased extax for resale that it actually consumed. However, except as noted below, the Board will apply as a credit against such use tax due the amount of excess tax reimbursement T--- has remitted to the Board with respect to the same transaction for which T--- has incurred use tax liability. (See Rev. & Tax. Code § 6901.5.)

As you know, such a credit or offset can be made against a person's own tax liability only with respect to transactions in which possession of the property upon which the taxpayer's tax liability is based is transferred, either permanently or temporarily, to the customer. (Reg. 1700(b)(4).) In this case, T--- collected an amount as sales tax reimbursement in connection with charges in some way related to the use of certain materials and machinery. Prior to the Board's audit, T--- did not regard itself as transferring such property to its customers, but instead regarded itself as consuming the property. Generally, if this were true, T--- would not be entitled to a credit or offset with respect to any excess tax reimbursement because it would not be regarded as transferring property within the meaning of section 6901.5 and Regulation 1700. However, under the circumstances of the present case, T--- collected the amount we now know was excess tax reimbursement with respect to transactions the Sales and Use Tax Department had taken the position constituted sales and leases of tangible personal property.

Although we now know, based on the Board's decision, that T--- did not sell or lease property to its customers (i.e., it did not actually transfer the leased property to its customers), during the period in issue, the Board's position was that T--- was selling and leasing property to its customers (i.e., T--- knew that the Board believed that it was transferring property to its customers). We therefore conclude that the Board should offset the amount of excess tax reimbursement collected by T---, based on the Department's assessment, and remitted by T--- to the Board (presumably beginning sometime after January 1, 1992) through November 30, 1994 against the use tax liability incurred by T--- on the same transactions as discussed above.

No offset or credit is applicable to any periods after November 30, 1994. As you note, T--- was notified on November 30, 1994 that its contracts to provide the [T] service were not taxable sales of tangible personal property. Therefore, as of that date no further offsets or credits are available.

I note that my response to your February 14, 1995 letter is not a written response coming within the provisions of Revenue and Taxation Code section 6596. That section allows the Board to relieve a taxpayer of liability for certain taxes when that person has reasonably relied on certain incorrect written advice from the Board in response to a written request for such advice that discloses all relevant information. As provided in subdivision (b)(3) of section 6596, its provisions apply only when:

> "In reasonable reliance on the board's written advice, the person did not do either of the following:

> "(A) Charge or collect from his or her customers amounts designated as sales tax reimbursement or use tax for the described activity or transaction.
>
> "(B) Pay a use tax on the storage, use, or other consumption in this state of tangible personal property."

The tax liability of T--- in question here is its use tax liability incurred beginning no sooner than January 1992 and ending November 1994 for having used property purchased extax for resale. Since T--- obviously did not rely on this letter when failing to pay such tax liability, this letter does not come within the provisions of section 6596 with respect to such transactions and the offsets discussed herein.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Supervising Staff Counsel

DHL:cl

cc: Mr. Glenn A. Bystrom
Principal Tax Auditor
--- District Administrator