

490.0477

Memorandum

To: Mr. Glenn Bystrom

Date: July 10, 1996

From: Gary Jugum

Subject: Non-Attorney Opinions

I have reviewed Bob Nunes' memorandum of August 5, 1988 to REDACTED TEXT.

We are in agreement with his conclusion, as follows:

Optional Service Contract - Replacement Units. Under an optional service contract, a firm provides next day delivery of a replacement unit for any failed equipment. The replacement unit becomes the customer's property and the customer's unit becomes the firm's property. The unit which is replaced is repaired and becomes part of the replacement inventory. If the unit replaced is found not to be defective, the customer is charged. The division providing the replacements is located outside California. The contract falls within the purview of regulation 1546(b)(3)(C). The firm is the consumer of property used to fulfill its obligations under the contract. Since the firm completes its obligation under the contract when the replacement unit is delivered to the carrier the "use" occurs outside of California. Since no use occurs in California, no use tax is due.

If the unit is not defective and a charge is made, the firm must collect use tax on exchange units shipped to California. 8/5/88



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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

916-445-1441

August 5, 1988

Mr. REDACTED TEXT
Manager
State Sales/Excise Taxes
REDACTED TEXT

Dear Mr. REDACTED TEXT:

The contents of your letter of July 6 together with the related contracts have been discussed with the legal staff.

You indicated that REDACTED TEXT enters into optional service contracts on portable low-end workstation products. The contract provides for a replacement of any failed equipment through next day delivery. This is accomplished by furnishing the customer with a replacement unit which becomes his or her property. In turn, the defective unit becomes the property of REDACTED TEXT. The unit which is replaced is repaired and subsequently becomes a part of the replacement unit inventory. Initially, the replacement inventory will be stocked with new units in order to start the program.

The replacement units are expensed at the time they are made available for replacement purposes. They are not carried as a "book inventory". On the other hand, the parts used to repair the units are carried as a part of a book inventory. I assume that, at the time parts are withdrawn from inventory to repair units, the parts are expensed.

You also indicated that on occasion the returned unit will be found to not be defective. In these cases, a charge is made to the customer.

You believe Regulation 1546 (b)(3) (C) is applicable to the replacement of defective units and REDACTED TEXT is the consumer of the parts and materials used in fulfillment of the optional service contract.

You ask the following questions:

1. Assuming REDACTED TEXT is the consumer, would the "taxable moment" occur when the property is withdrawn from resale inventory in fulfillment of the warranty or contract obligation, in this case, REDACTED TEXT Oregon.
2. If the customer is located in California and the equipment is shipped to California, would REDACTED TEXT be the consumer of the exchange unit in California?

3. To further complicate the situation and assuming that REDACTED TEXT is the consumer of the exchange unit, at material cost, what would be the basis for tax liability if the unit had already been in California as a replacement unit (and tax paid)?
4. Under the present program, the service center is located in REDACTED TEXT, Oregon, but “what if” the service center was located in California. What would be the basis for our tax liability?

We agree that the service contract between REDACTED TEXT and its customer falls within the purview of Regulation 1546 (b)(3)(C). Accordingly, REDACTED TEXT is the consumer of property used to fulfill its obligations under the contract.

I do not believe the “taxable moment” theory has application to this situation. Generally, that approach is used to determine if there is any incident within the taxing state which provides a basis for taxation. In this particular instance, I believe the appropriate issue is whether the property was purchased for “use” in California. The fact that there may have been some “use” or “taxable moment” outside the State would not necessarily resolve the issue.

With this thought in mind, we believe that the person “using” the property in these transactions is REDACTED TEXT. As the consumer under Regulation 1546, it is responsible for any tax due on the transaction.

The “use” of the property first occurs when it is committed to meeting the requirements of the optional service contract. Since some of the replacement units may be “sold” to customers because the unit was not defective, we believe that the replacement unit “inventory” and the repair part inventory is not committed to performance under the contract until such time as the replacement unit is removed from inventory for shipment to the customer.

Under the contract, REDACTED TEXT is obligated to “ship, freight prepaid, replacement products with the next day delivery by a premium air freight carrier”. Under the Uniform Commercial Code, REDACTED TEXT completes its obligation under the contract upon delivery to the carrier. Accordingly, its “use” occurs completely outside of the State. Since no “use”, occurs in California, no use tax is due.

On the other hand, if the unit is not defective and a charge is made to the customer, REDACTED TEXT must collect use tax from its customer on exchange units shipped into California.

With respect to your question concerning whether REDACTED TEXT would be the consumer of the exchange units, we believe that it is. However, the issue as to whether this would result in a use tax would depend on whether the customer transferring the unit was a “retailer. If the person was a retailer, any use tax due would include the “sales price” of the exchange unit. Obviously, determining such a “sales price” would be difficult since the “consideration” paid for the exchange unit is unspecified in the contract. In the absence of information to the contrary, we would accept evidence as to the value of like property in similar condition as a reasonable determination of the sales price.

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Finally, with respect to REDACTED TEXT's tax liability. If the service center were located in California, it would be our position that the "use" of the units occurred in California and tax would apply to all parts and materials used in performance under the contracts; notwithstanding that some units are subsequently shipped out-of-state. The measure of tax would include the "sales price" of the exchange units acquired from "retailer" customers and subsequently repaired for use under the service contract.

If you need additional information, please let me know.

Sincerely,

Robert Nunes
Chief of Field Operations

RN:ls

bc: Mr. Gary Jugum
Mr. Don Hennessey
Mr. Glenn Bystrom – w/incoming correspondence