

M e m o r a n d u m**495.0671**

To : Mr. Vic Anderson, Supervisor
Audit Evaluation, Planning & Settlement Section

Date: March 16, 1998

From : Warren L. Astleford
Senior Tax Counsel

Subject: *C--- C---, Inc.*

This is in response to your February 24, 1998 memorandum to Mr. Gary Jugum asking us to review a proposed memorandum to the Culver City District Office regarding the above-referenced taxpayer. A copy of this memorandum containing my proposed changes is attached for your review. You also ask when a sale is deemed to occur if Company A makes a year-end book entry to transfer ownership in tangible personal property to a related Company B, and Company B claims depreciation for that equipment for the entire preceding year.

The attached memorandum correctly notes that inter-company debits and credits are sufficient evidence to support a finding that assets were transferred for consideration. (See BTLG Annot. 395.1258 (4/28/93).) This is consistent with Revenue and Taxation Code section 6006(a) which provides that the transfer of title or possession of tangible personal property for consideration by any means is a sale. The existence of these elements creates a specific sales transaction which occurs no later than the time the seller completes its responsibilities with respect to physical delivery of the property. (See Cal. U. Com Code § 2401.) The time at which a sale takes place is important for many reasons including the determination of where that sale takes place. (See Rev. & Tax. Code § 6010.5.)

Depreciation on the other hand is an income tax principle. It provides for a reasonable reduction in the basis of property used for the production of income based on exhaustion, wear and tear, and obsolescence. (See IRC § 167(a); Rev. & Tax. Code §§ 17250, 24349.) It may be computed using different methods and is applied pursuant to various conventions adopted by a taxpayer. (*Id.*) It is not, however, determinative as to when a sale of tangible personal property takes place. This Agency has generally looked to a taxpayer's depreciation of assets to show that those assets are not held for resale (see, e.g., BTLG Annot. 570.0150 (9/19/94), or as evidence of an exercise of ownership (see, e.g., BTLG Annot. 495.0240 (3/17/70)). However, depreciation alone is not always sufficient to show when a sale necessarily took place. *McConville v. State Board of Equalization* (1978) 85 Cal.App.3d 156,

161 describes depreciation as “an *indication* of intent to use [property] . . . other than for retention, demonstration, or display, since inventory or property held for sale in the ordinary course of business is *not* subject o a depreciation allowance as a capital asset. . .” (Emphasis in original.)

Your hypothetical shows a transfer of tangible personal property for consideration at year-end based on the inter-company journal entries. The fact that Company B claimed depreciation for the entire year only evidences that Company B is exercising an ownership interest in the property, or that it does not hold that property for resale. It does not evidence when the sale to Company B took place. I further note that Company B may (or may not) be exercising a depreciation schedule or methodology that is acceptable to the IRS or FTB. It is not necessary for us to reach that determination, however, since we regard the sale to have occurred when there was a transfer of title or possession for consideration and Company A completed its responsibilities with respect to physical delivery. We assume from your hypothetical that this occurred at year-end and not some time prior to that date.

Please let me know if you have any questions regarding this issue or the enclosed memorandum.

WLA:cl
Attachment

cc: Mr. Dennis Fox
Mr. Rudy Zaragosa
Ms. Lynda Cardwell