STATE BOARD OF EQUALIZATION

November 4, 1964

H--- and S---
Certified Public Accountants
XXX --- Street
--- ---, California XXXXX

- - XXXXXX
K--- S--- and E--- Co.

Gentlemen:

Last July 22, 1964, you requested us to render an opinion in connection with sales tax on certain charges which you described as in the nature of development and design of an invention, namely, an automatic packaging line.

We first express our regret for not earlier acknowledging your request but find upon reviewing the file of K--- S--- & E--- Company that an audit is in progress by our San Francisco district office. This audit has evidently not been completed as we have not received a report of the results of the audit in this office up to the present time. We shall not, however, delay longer in answering your letter, but our answer will be subject to any findings of the audit that might be contrary to the factual basis upon which our views in this letter are expressed.

K--- S--- & E--- Company holds seller's permit number - - XXXXXX and is engaged in business as a seller of tangible personal property. Upon the basis of your statement that the receipts in question are for design and engineering services in connection with the development and improvement of an invention, there being no actual end product of a tangible nature called for by the contract, we will express the opinion that these receipts do not constitute receipts from sales of tangible personal property and, therefore, would not be subject to the tax. This conclusion appears consistent with Article 7 of the Agreement as quoted in your letter.

We note, however, your statement that not only has not California sales tax been billed or collected on any of K---'s charges, but also, "nor has any tax been paid by K--- to the Sales Tax Division." You state, however, that "Outside purchases of the items subject to sales tax have been made under 'resale certificates'." We assume from this that no tax reimbursement was paid to the outside vendors. If this is the case, tax is clearly due from K--- with respect to these outside purchases of taxable items made under resale certificates.

We have been unable to locate the Sales Tax Counsel rulings cited by you on page 4 of your letter because you mention only the dates, and not the paragraph numbers of the services in which you found these rulings. We have, generally, ruled, however, and these Sales Tax Counsel rulings are probably in line with such a ruling, that the rendition of engineering and design services where no tangible product is required to be delivered, represent charges for services only and not sales of tangible personal property. The basic test is whether at the time of commencing the work required there is an obligation to deliver an end product. If so, the receipts are taxable, unless the sale of the end product is for some other reason exempt.

On the other hand, if the contract for design, engineering, etc., precedes any contract for the delivery of an end product, the amounts received prior to the contract for the end product are receipts from services but the party rendering the services is the consumer of all of the tangible personal property which he uses in the rendition of such services. Thus, the tax applies to the sale of such property to him.

When the audit of K--- S--- & E--- Company is received from the district office, we will review it in the light of the problem as set out in your letter.

Very truly yours,

E. H. Stetson
Tax Counsel

EHS:fb

cc: San Francisco – District Administrator