STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
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(916) 445-6557

December 31, 1990

R--- C. P---
Senior Tax Attorney
A---
P.O. Box XXXX
---, TX XXXXX

Dear Mr. P---:

Re: SS -- XX XXXXXX-010

Enclosed is a copy of the Decision and Recommendation pertaining to the petition for redetermination in the above-referenced matter.

I have recommended that the Board staff perform a reaudit in accordance with the views expressed in the Decision and Recommendation. No action is required of you at this time, except that you are requested to cooperate with the audit staff during the course of the reaudit.

The audit staff will provide you with a copy of the reaudit report. A copy of that report will also be sent to me. At that time, I will write to you informing you of your options for appeal in the event that you disagree with the reaudit results.

Very truly yours,

James E. Mahler
Hearing Officer

JEM:ct
Enc.

cc: D--- G. N---, Senior Consultant
D---, M--- & A---.
XXX --- Avenue, Ste. XX
---, CA XXXXX (w/enclosure)

Ms. Janice Masterton
Assistant to the Executive Director (w/enclosure)
Mr. Glenn Bystrom
Principal Tax Auditor (file attached)
Hollywood/Out-of-State/Fresno (Bakersfield) – District Administrator (w/enclosure)

STATE OF CALIFORNIA

700.0190

BOARD OF EQUALIZATION

APPEALS DIVISION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: A--- R--- C--- A--- O--- & G--- Petitioner	))))))))	HEARING DECISION AND RECOMMENDATION No. SS -- XX XXXXXX-010

The above-referenced matter came on regularly for hearing before Hearing Officer James E. Mahler on March 27, 1990 in Hollywood, California.

Appearing for Petitioner:

R--- C. P---
Senior Tax Attorney

B--- C. T---
Senior Technical Consultant

J--- D---
Senior Tax Audit Analyst

D--- G N---
Consultant

J--- M. C---
Consultant

Appearing for the Department of Business Taxes

Kenji Miyamoto
Senior Tax Auditor

Protested Items

The protested tax liability for the period January 1, 1983, through September 30, 1986 is measured by:

	Item	State, Local and County	LACT
A.	Actual purchases, $5,000 and greater, subject to the use tax from out-of-state vendors	$2,729,309	$ 213,500
B.	Purchases less than $5,000 subject to the use tax –statistical sample	1,035,807	32,034
D.	Disallowed tax adjustments for Material shipped out-of-state	1,205,533	-0-
F.	Taxable material transfers not reported	2,239,245	124,117
G.	Unreported seismic cost subject to the use tax	2,160,787	1,891,746
		$9,370,680	$2,261,397

Introduction

Petitioner A--- R--- C--- is a diversified corporation. This audit concerns one division of the business, called A--- O--- & G--- Company, which is engaged in the exploration for and production of crude oil at numerous facilities within California and off the California coast. The last prior audit of this account was through the fourth quarter of 1982.

Petitioner submitted additional evidence after completion of the audit, and the audit staff agrees that a reaudit will be necessary to evaluate that evidence. The appeal hearing was scheduled and held for the purpose of resolving as many issues as possible before initiation of the reaudit.

AUDIT ITEMS A AND B

Petitioner's Contentions

1. The applicable tax on numerous audit transactions is a sales tax on the vendor, not a use tax on petitioner.

2. California does not have "nexus" to tax certain transactions.

3. Some property was purchased for use and used on drilling rigs located outside California in federal waters.

4. Tax has been asserted on transactions where petitioner did not pay for the merchandise.

5. Tax has been asserted on service charges.

6. Tax has already been paid on some of the audit purchases.

7. Exemption should be allowed for separately stated freight charges.

8. The audit measure of tax on some transactions is incorrect.

9. Some items were purchased for resale and resold prior to use.

10. No vendor invoice is available for some of the audit transactions.

11. The audit workpapers identify the wrong vendor on some transactions.

12. Local tax does not apply to property used offshore in California waters.

13. Transit tax was erroneously assessed on some transactions.

14. Credit should be allowed for numerous transactions where petitioner overpaid tax.

Summary

The audit found that petitioner is liable for use tax on purchases of equipment and supplies from out-of-state vendors. Purchases of $5,000 and more were scheduled on an actual basis (item A) and purchases of less than $5,000 were tested on a statistical sampling basis (item B).

Analysis and Conclusions

1. According to petitioner, many of the vendors from which it made these purchases held California seller's permits or permits to collect California use tax. Petitioner contends that any applicable tax on these transactions should be assessed against the vendors, not against petitioner.

Resolution of this issue depends on whether the applicable tax is a sales tax or a use tax. If use tax applies, petitioner is liable for the tax and remains liable until the tax is paid to the state, or until petitioner produces a receipt from an authorized retailer showing that petitioner paid the tax to the retailer. (Rev. & Tax. Code § 6202.) A retailer's failure to collect the tax from petitioner does not relieve petitioner from liability.

If sales tax applies, however, petitioner is entitled to an exemption from the use tax. To qualify for this exemption, petitioner must establish, to the satisfaction of the Board, that the gross receipts from the transaction were included in the measure of the sales tax. (Rev. & Tax. Code § 6401.)

The general rules for determining when sales tax applies are described in subdivision (a) of Sales and Use Tax Regulation 1620. When the retailer ships the property into California from a point outside this state, sales tax applies only if two requirements are satisfied: there must be "local participation" in the transaction by an office or other place of business of the retailer in California; and the sale must occur in this state.

The sale occurs in California when title passes to the purchaser here. (Rev. & Tax. Code §§ 6010.5 and 6006.) When shipment is by carrier, title passes to the purchaser at the time and place of shipment, unless the seller and purchaser have explicitly agreed otherwise. (Cal. UCC § 2401(2)(a).)

With these principals in mind, we turn to the specific transactions at issue. Each transaction is recorded in a separate "voucher" in petitioner's records, and the purchases in question are listed by their voucher numbers (VNs) in the audit workpapers. We follow that system herein.

VNs 2837 and 3176. The vendor's invoice in each of these transactions indicates that the property was shipped to petitioner in California from a place of business of the vendor in this state. The applicable tax is therefore the sales tax and petitioner is not liable for use tax.

VN 1327. The vendor in this transaction was engaged in business in Texas. However, the vendor's invoice states that the property was shipped to petitioner from ---, California. Accordingly, sales tax applies and petitioner is not liable for use tax.

VN 201. Petitioner claims that this property was also purchased from a vendor in California. However, no invoice or other supporting documentation has been presented. Petitioner has failed to prove its right to exemption and we therefore conclude that use tax was properly asserted in the audit.

VN 234, 238, 726 and 3289. Petitioner rented equipment from a lessor engaged in business in Los Angeles. Absent unusual circumstances not present here, the applicable tax on leases is a use tax on the lessee, not a sales tax on the lessor. (Sales and Use Tax Reg. 1660(c)(1).) Petitioner is therefore liable for use tax even though the sale (lease) occurred in California.

VN 1969. Petitioner purchased this equipment from a vendor engaged in business in ---, Illinois. The vendor's invoice states that the equipment was shipped via common carrier from Nebraska to petitioner at an address in ---, California. The listed address is in fact the address of S--- O--- S--- (S---), an independent retailer. According to petitioner, S--- is the vendor's authorized distributor in California and was responsible for installing the equipment at petitioner's offices in ---.

Although S--- may be the vendor's authorized representative, it does not appear that there was any participation in this transaction by an office or other place of business of the vendor in California. Furthermore, since the sale contract apparently required the vendor only to ship the equipment to petitioner at S---'s offices, title passed to petitioner upon shipment in Nebraska. Sales tax therefore does not apply and petitioner is liable for use tax.

VN 3800. Petitioner purchased this property from a Texas vendor. The invoice and delivery ticket indicate that the property was shipped to petitioner in California from Texas via the vendor's own truck. Accordingly, we conclude that title did pass to petitioner in California upon the completion of the delivery. (Cal. UCC § 2401(2)(b).) However, there is no evidence of any participation in the transaction by an office or other place of business of the vendor in California. Under Sales and Use Tax Regulation 1620, therefore, the use tax is the applicable tax.

Other VNs. In each of the remaining transactions listed by petitioner under this contention, the vendor shipped the property via common carrier from a point outside California to petitioner in this state. Sales tax does not apply because title passed to petitioner at the out-of-state shipping point, and because there is no evidence of local participation by any of the vendors. The audit properly asserted use tax against petitioner.

2. Petitioner next contends that California does not have "nexus" to impose use tax on two other transactions, VNs 3451 and 4330. We construe this as an allegation that the property was not purchased for use or used in California.

VN 3451 reflects a purchase of drilling equipment from an Oklahoma vendor. The vendor's invoice states that the property was shipped to petitioner in ---, California, in care of W--- T--- of ---, Texas. The invoice also states that the equipment was "shipped from California" via "D--- T---". A delivery ticket from D--- - L---, Inc., is attached to the invoice and indicates that the equipment was delivered to petitioner's pipe yard in ---, Texas.

The invoice and delivery ticket both state that the invoice reference to shipment in --- is erroneous, and that vendor in fact shipped the equipment to petitioner in Texas. Based on the approval stamps, we further conclude that petitioner then brought the equipment into California for use at a drilling site here. Accordingly, petitioner is liable for use tax. (Rev. & Tax. Code § 6246.)

VN 4330 records a purchase of eight voice security systems from a Texas company, seven for delivery in California via air freight, and one for delivery in Colorado. The audit asserted use tax only on the seven units delivered in California. We find no error.

3. Use tax applies when tangible personal property is purchased for use and used in California. (Rev. & Tax. Code § 6201.) Section 6009 of the Revenue and Taxation Code provides, with an exception not relevant here, that "use" includes the exercise of any right or power over tangible personal property incident to the ownership of the property. Section 6009.1 of the Code nevertheless provides that "use" does not include the storage of property for the purpose of subsequently transporting it outside the state for use thereafter solely outside the state.

For four transactions (VNs 826, 2487, 4197 and 4330), petitioner contends that the property was purchased for use and used on offshore drilling platforms outside the territorial waters of California. According to petitioner, each out-of-state vendor shipped the property to a storage facility operated by an independent company in California, and the property was later transshipped to the drilling platforms. Petitioner also alleges that it did not pay for these items until they were received at the drilling platforms.

Petitioner believes it did not acquire title to or ownership in this property until it obtained "dominion and control" of the property, and alleges that it did not have dominion and control until the property was transshipped to the offshore locations and the vendors were paid. Petitioner concludes that it could not have exercised any right or power over the property in California incident to "ownership", so that use tax cannot apply.

We disagree. As explained above, "ownership" or title in the property passes to the buyer when the seller completes its performance with respect to the physical delivery of the goods, unless the parties have otherwise agreed. Petitioner therefore acquired title to this property upon shipment by the vendor or, at the latest, upon delivery to the storage facility in California, without regard to when or even if petitioner paid for the property, and without regard to when or even if petitioner acquired physical possession.

Petitioner also contends that the temporary storage of these items in California is excluded from "use" under Section 6009.1 of the Code. We agree that if any of this property was in fact transshipped solely outside the state, petitioner would not be liable for use tax. (Sales and Use Tax Annot. 570.1160 [6/18/68].) The reaudit should examine petitioner's records to verify the out-of-state shipment and use of this property and, upon verification, these transactions should be deleted from the measure of tax.

4. Petitioner contends that it is not liable for use tax on three transactions (VNs 2816, 2817 and 2950) because it never paid the vendors. As previously explained, however, nonpayment by petitioner would not in itself be sufficient to relieve petitioner of liability for use tax. If the goods were actually delivered, title passed to petitioner upon shipment from the out-of-state vendor or, at the very latest, upon delivery of the goods in this state. (Cal. UCC § 2401.) The tax would be measured by the agreed price for the property without regard to the amount actually paid. (Southern California Edison Co. v. State Board of Equalization, 7 Cal.3d 652.)

It is possible, however, that the reason petitioner did not pay these invoices is that the goods were never delivered. In that case, we would agree that there was no sale or purchase and thus no use tax liability. These transactions should be deleted from the audit measure of tax upon verification that petitioner did not receive the property.

5. Although use tax applies only to "purchases" of tangible personal property, the measure of tax includes not only charges for the property itself, but also charges for any "services that are a part of the sale". (Rev. & Tax. Code § 6011(b)(1).) In addition, Section 6010(b) of the Revenue and Taxation Code defines "purchase" to include:

> "When performed outside this state…the producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting."

On the other hand, tax does not apply if the true object of the transaction is the performance of services. (Sales and Use Tax Reg. 1501.) Tax also does not apply to "the repair or reconditioning of tangible personal property to refit it for the use for which it was originally produced." Sales and Use Tax Reg. 1526.)

Several VNs record payments to A--- T--- (A---) of ---, Texas. Petitioner contends that these were payments for some unidentified services, not for property. A---'s invoices, work orders and inspection reports contain terms such as "new casing" including "inspection"; "new casing inspection" including "replacement of bands & stencils"; "new casing spray stencil or steel dye stamping for identification"; "new tubing"; "thread evaluation service"; "thread inspection"; and "new tubing: clean and visual thread inspection plus API drifting full length."

We are unfamiliar with the jargon of this industry and therefore uncertain exactly what these documents describe. It appears, however, that petitioner purchased casing and pipes from A---, together with associated services such as cleaning, inspecting and threading the pipes. Absent further evidence and explanation, we conclude that these transactions were purchases of property and services that were part of the sales of the property. Accordingly, we conclude that tax applies as found in the audit.

VN 3798 reflects the acquisition of 296 "jt" of "7, 20#, J-55, STC, Range III, N/C". The price was $17.00 per "jt" further broken down as $12.54 for "critical end area" and $4.46 for drift full length". The Texas vendor's invoice also included separately stated charges for cleaning solution and thread compound.

According to petitioner, the Texas vendor performed some sort of unidentified services and did not sell property to petitioner. We find no support for this contention in the language of the invoice, and no further evidence or explanation has been offered. Accordingly, we conclude that tax was properly asserted.

6. Petitioner next contends that it has already paid tax reimbursement or use tax, either to California or to some other state, on five transactions included in the audit.

For VNs 1232 and 4067, petitioner has submitted copies of the vendor invoices and its own vouchers. Neither invoice charges tax or tax reimbursement. VN 4067 has an "X" in the column labeled "sales tax ind.", but petitioner does not explain what that means, and VN 1232 does not have an "X" in that column. We find the evidence insufficient to show that tax or tax reimbursement was paid on either purchase.

For the other three transactions (VNs 2664, 2706 and 3104), no evidence whatsoever has been submitted and we therefore find no basis for adjustment.

7. A retailer's charges for transporting the property sold are subject to tax unless certain requirements are satisfied. (Rev. & Tax. Code § 6011(a)(3).) If delivery is by carrier, reasonable charges for transportation directly to the purchaser from the retailer's place of business qualify for exemption if they are separately stated. When delivery is by the retailer's own facilities, such separately stated transportation charges qualify for exemption only if the transportation occurs after the purchase, that is, after title has passed to the customer. (Rev & Tax. Code § 6011(c)(7); Sales and Use Tax Reg. 1628.) Absent a contrary agreement, title passes to the buyer and the sale occurs when the retailer completes its performance with respect to the physical delivery of the goods. (Cal. UCC § 2401.)

Petitioner seeks exemption for a freight charge on the invoice recorded as VN 3800. This transaction was a purchase of a drill bit from D--- B--- U--- for $21,940, plus a separately stated transportation charge of $558.11, for a total of $22,498.11. The vendor's invoice states that the property was shipped to petitioner via "DB delivery".

Judging from the language of the invoice, it appears that the drill bit was shipped to petitioner via the retailer's own facilities. There is no evidence of an agreement between petitioner and the retailer regarding title in the drill bit, and title therefore did not pass to petitioner until the delivery was completed. (Cal. UCC § 2401(2)(b).) Since the transportation occurred before the purchase (passage of title), the transportation charges are subject to tax.

8. VN 536 reflects a purchase of casing for $34,069.79. The original vendor invoice did not mention any freight charges. Petitioner has now submitted a credit memo from the vendor for this transaction which shows a freight charge of $1,965.12, minus a credit for "equalized freight" of $3,136, for a net credit of $1,170.88 applied to petitioner's account. The credit memo appears to be in the nature of a rebate or adjustment to the purchase price. Accordingly, we recommend that the measure of tax on this transaction be reduced by $1,170.88 to $32,898.91. (Sales and Use Tax Annot. 295.0020 [10/11/67].) Petitioner argues that the reduction should be $1,120.81, but we cannot tell how petitioner arrived at that figure.

VN 589 is a purchase for $6,958. However, a subsequent credit memo reduced the charge by $1,063. The reaudit should therefore reduce the measure of tax on this transaction to $5,895.

In VN 4351, the vendor's invoice charged $16,800 for a boom hoist, plus $2,000 for "core charge on old boom hoist (credit to be issued upon receipt of old boom hoist)"; plus $240 for crating' plus separately stated transportation charges. The audit asserted tax measured by $19,040, that is, the sum of the charge for the boom hoist, the core charge and the crating. Petitioner seeks a reduction of $2,000 on the apparent ground that it received a credit when it delivered the old boom hoist to the vendor, but no supporting evidence has been presented, and we therefore recommend no adjustment.

Petitioner also contends that the audit measure of tax is overstated on the purchase reflected by VN 1253. However, no voucher, invoice or other evidence has been presented , so we conclude not adjustment is warranted.

9. Petitioner claims that use tax has been asserted on chemicals which petitioner purchased for resale and resold prior to use. No specific purchase has been identified and no evidence has been presented. We find no basis for adjustment.

10. Petitioner next contends that it should not be liable for tax on purchases which were recorded in its books, but for which a vendor invoice is not now available. (VNs 1554, 2823, 2841 and 5301). We disagree. Petitioner does not deny that these purchases occurred. Petitioner bears the burden of proving its right to exemption from use tax and since no evidence is available, tax was properly asserted in the audit.

11. VN 1118 records a rental of equipment from T---, a Los Angeles company. The rental price is $130.20 plus separately stated tax, installation and freight. In the audit workpapers, however, VN 1118 is listed as a purchase from S--- C---, Inc., in the amount of $452.48, and tax is asserted on that amount. The auditor comments: "This voucher is for a different invoice and company. Correct invoice is [illegible] (inclusive of sales tax)."

Petitioner does not deny that it made the purchase from S--- C--- in the amount of $453.48, and no evidence has been presented to suggest that the purchase would be nontaxable. We therefore conclude that tax was properly asserted in the audit. For clarity's sake, however, the reaudit should attempt to find the correct VN for the purchase from S---.

VN 1319 is a purchase of washers from A--- A--- for $72. Petitioner contends that the "wrong vendor" is listed in the audit workpapers. However, the workpapers list this transaction as a $72 purchase from A--- A---. We find no error.

VN 908 is listed in the audit workpapers as a $6,520 purchase from E---, Inc. Petitioner has presented evidence that this transaction was in fact recorded under VN 904. However, since the evidence does not reveal any potential basis for exemption, we recommend no adjustment.

12. According to petitioner, many of the items upon which the audit asserts use tax were purchased for use and first used on offshore drilling platforms within the territorial waters of California. In one case (VN 3800), it appears that the property may have been shipped to petitioner directly at the offshore platform. In all other cases, the property was shipped to petitioner at a warehouse or other receiving point on land in California, and petitioner alleges that it thereafter transshipped the property to the offshore platform. Assuming that state tax properly applies, petitioner contends that the 1.25 percent Bradley-Burns tax does not apply on the ground that the property was not used within any jurisdiction imposing the tax.

Petitioner asserts that "settled law of the sea" prohibits political subdivisions of California from levying taxes "outside the defined mean low water line". Petitioner cites no authority in support of this assertion and our research has revealed none.

Petitioner's argument confuses the concepts of "use" and "functional use". The term "functional use" refers to the use for which the property is designed or intended. (See Sales and Use Tax Reg 1620(b)(3).) the term "use" is much broader and includes storage, transportation, and the exercise of any other right or power incident to the ownership of property. (Rev. & Tax. Code § 6009.) It follows that petitioner's first "use" of each item in question here, with the possible exception of the property in VN 3800, occurred at the warehouse or other receiving point on land in California, even if the first "functional use" occurred at the offshore drilling platform.

More importantly, petitioner's argument assumes that the borders of California counties stop at the shoreline, and this assumption is simply wrong. The borders of all 15 coastal counties in California extend outward to the three-mile limit. (Gov. Code §§ 23100 et seq.; In re Humboldt Lumber Manuf'rs' Ass'n., 60 F. 428 at 432.) Each of these counties (as well as every other county in the state) imposes the Bradley-Burns tax. Each item in question was therefore purchased for use and used in a county imposing the Bradley-Burns tax, and petitioner is liable for the tax.

13. Petitioner next contends that property purchased for use and used on offshore drilling platforms is not subject to the .5 percent transit district use tax. We agree that the district tax does not apply to the storage of property within a transit district for subsequent transportation and use thereafter solely outside any district imposing a district use tax. (Trans. and Use Tax Reg. 1823(b)(2)(A).) If evidence is available to show that district use tax was asserted on any item functionally used solely outside a transit district, petitioner should present it to the audit staff during the course of the reaudit.

VN 2905 reflects a purchase of property delivered to petitioner in Goleta, California, in June 1986. As petitioner points out, Goleta was not within a transit district at that time. Accordingly, this transaction should be deleted from the measure of transit district use tax.

14. Finally, petitioner contends that the audit overlooked numerous transactions where petitioner overpaid use tax. Since the audit staff has not as yet had an opportunity to review petitioner's evidence on this point, we decline to reach a decision at this time. The reaudit should examine petitioner's evidence and allow credits as appropriate. If petitioner believes that appropriate credits are not allowed in the reaudit, the matter can be referred back to this Hearing Officer by means of a request for reconsideration.

AUDIT ITEM D

Petitioner's Contentions

1. Two of the debit entries were later reversed and tax was paid to the state.

2. One debit entry reflects a reduction in the purchase price of the property.

3. One debit entry reflects a payment of tax to the state, not a deaccrual of tax liability.

Summary

In its 942-0550-4XX series of accounts, petitioner accrues use tax on property purchased outside California and brought into the state. The audit reviewed these accounts and noted several debit entries where tax on certain purchases was "deaccrued". The debit entries were disallowed and use tax was asserted.

VMs M7729 and M7230. According to the audit verification comments, petitioner accrued use tax on these two purchases when the property was delivered to a well site in California as "Code A" (new) property. Later, the property was shipped back to a warehouse or other location outside California while still classified as "Code A" property. Petitioner deaccrued tax at that time, apparently on the ground that the property had not been used in California. (See Sales and Use Tax Annot. 570.1165 [8/24/70].) The audit concluded that the property had in fact been used in this state for "stand-by" purposes, so that use tax applies. (See Sales and Use Tax Annot. 570.0830 [11/7/66].)

Petitioner agrees that use tax applies and that the debit entries were therefore improper. Petitioner has therefore presented no evidence to contradict the auditor's finding of "stand-by" use in California. However, petitioner contends that the tax on these two purchases was "reaccrued" and paid to the state with its October 1987 prepayment.

VN N7802. This is a debit entry in the amount of $14,461.13. According to petitioner, the deaccrual was proper because it received a price reduction from the vendor which reduced its tax liability on the purchase to $14,355.88. Petitioner contends that the $14,355.88 liability was accrued and tax was reported on its third quarter 1985 return.

VN 0718U. According to petitioner, this debit entry reflects a payment of tax to the state, not a deaccrual of tax on any purchase.

Analysis and Conclusions

Petitioner has submitted accounting records to support its contentions under this audit item. The reaudit should review the records and allow credits as appropriate.

AUDIT ITEM F

Petitioner's Contentions

1. Tax does not apply to sales to customers holding seller's permits.

2. Tax does not apply to "intra-company" transfers.

3. The audit failed to allow sufficient credits for tax-paid purchases resold.

4. The audit failed to allow credits for taxes paid to other jurisdictions.

5. The audit measure of tax on certain transactions is incorrect.

6. Tax does not apply to property delivered to customers outside California, including deliveries to offshore sites outside California's territorial waters.

7. Tax has erroneously been asserted on transactions which were not "sales".

8. Tax has erroneously been asserted on transactions where documentary evidence is not available.

9. The Bradley-Burns tax does not apply to property delivered to offshore wells within California's territorial waters.

Summary

Petitioner maintains warehouses both inside and outside California. From these warehouses, it supplies materials and equipment to oil well drilling operations on land in California and off the California shore. Property at a well site may occasionally be transferred to another well site or back to a warehouse. Petitioner also sometimes sells surplus items from its warehouses or well sites to third parties.

Analysis and Conclusions

1. Petitioner's first contention deals with sales of surplus items to third parties. Petitioner contends that if the customer held a California seller's permit, the sale must be deemed a sale for resale. Petitioner did not receive a resale certificate for any of the protested transactions, but the customer's permit numbers are listed on vouchers or sale documents for some transactions.

Revenue and Taxation Code Section 6091 provides that the seller bears the burden of proving that a sales is not a taxable retail sale, unless the seller takes a resale certificate from the customer. Subdivision (c) of Sales and Use Tax Regulation 1668 provides that, absent a timely resale certificate taken in good faith, the seller can meet this burden only by submitting evidence that the property: was resold by the customer prior to use; is still being held by the customer for resale prior to use; or that the customer has paid the applicable tax directly to the state. The mere fact that a customer holds a seller's permit is therefore insufficient to prove that a sale is a nontaxable sale for resale.

Petitioner suggests that the auditor should have sent inquiries to customers (XYZ letters) to determine whether these sales were sales for resale. However, petitioner bears the burden of proof because it failed to obtain timely resale certificates, and it is therefor petitioner who should have sent the inquiries.

Petitioner recently did send out XYZ letters and received responses from some customers. For the transaction reflected in VN N8720 (listed in petitioner's brief as VN N8723), the XYZ response states that the property was purchased for use, not for resale. Tax was therefore properly asserted against petitioner.

VN 8719 reflects a sale of office equipment to R---'s P--- R--- S---, Inc., in November 1983. The XYZ response dated May 7, 1990, states that the property was purchased for resale and is still being held in resale inventory without use. We simply do not believe that a piston ring company would purchase used office equipment for resale and hold it in resale inventory for over six years. Absent further verification, therefore, we find the evidence insufficient to show that this was a nontaxable sale for resale.

The XYZ responses for four transactions (VNs N8290, M8200, N8080 and N8963) appear regular. Unless the reaudit discovers reason to question the validity of these XYZ responses, the transactions should be deleted from the measure of tax.

The XYZ response for VN N8750 is discussed below.

As for the remaining transactions claimed to be sales for resale (VNs M8042, M8043, N8517, M8441 and M8472), petitioner has submitted vouchers, sale contracts and other documents, but none of these documents prove that the property was sold for resale. No adjustment is recommended.

2. Petitioner's second contention deals with property delivered from one of petitioner's warehouses to a well site, or sometimes from one well site to another. In each case, petitioner charged the well site for the property. The charge was either petitioner's cost plus a markup, or a "standard cost" equal to fair market value determined by reference to manufacturer's price lists and other data. The question is whether these transactions were "sales" for sales and use tax purposes, or more specifically, whether there was any transfer of title.

Petitioner was the "operator" of each well site, that is, the person responsible for supervising the drilling operations. In a few cases, it appears that the well site was owned or was being leased by a person or persons other than petitioner; in most cases, however, petitioner itself held a fractional ownership or leasehold interest in the well site. Petitioner had been nominated to act as operator under "operating agreements" with the other fractional owners or leaseholders (hereinafter "co-owners"). Petitioner and the audit staff agree that the operating agreements did not create separate "persons" within the meaning of Revenue and Taxation Code Section 6005.

According to the audit staff, when petitioner delivered materials and equipment to the well sites, it transferred title or fractional title in the property to the other co-owners. For example, if petitioner owned a 25 percent interest in the well site, a 75 percent interest in the property was transferred to the other co-owners, so that tax is due on 75 percent of the price charged. If the well site was owned 100 percent by another person, then 100 percent of the title transferred and tax is due on 100 percent of the price charged.

Prior audits of petitioner also held petitioner liable for sales tax on sales of fractional interests to will sites it operated. During the current audit period, it was petitioner's policy to report and pay tax on such transactions in accordance with the findings of the prior audits. Petitioner failed to report or pay tax on some transactions, apparently through bookkeeper error, and the current audit also includes transactions where petitioner did report and pay tax, but the audit found that the measure of the reported tax was insufficient.

In its original petition for redetermination, petitioner contended that the current audit's method of computing tax on these transactions is different than the method used in prior audits. This contention has now apparently been abandoned. Instead, petitioner contends that no tax at all should be due on the ground that these transactions are not "sales".

Petitioner argues that since it was the operator of each well site, it always retained all "incidents of care, custody, and control of the property, and the risk of loss inclusive of insurance risk. Petitioner alleges that it reatined the "absolute right to convert, sale [sell]. destroy or alter any piece of production equipment" at a well site "without consulting" the co-owners. Petitioner concludes that it "never los[t] title" in the property and thus did not sell the property.

As evidence in support of these arguments, petitioner has presented pages 3 through 15 of a 1982 "model form" agreement apparently prepared by the Council of Petroleum Accountants Societies of North America. We assume that the model agreement is typical of the actual agreements at issue.

Articles I through IV(A) are on pages 1 and 2 of the model agreement, which have not been presented in evidence. The remaining articles of the model agreement include the following relevant provisions.

Article V explains the procedures for nominating one party to act as operator. Article VI(B) discusses "subsequent operations", that is, deepening a well or drilling new wells at the site. The parties to the agreement need not participate in such subsequent operations. Under certain circumstances, a party which does not participate "shall own the same interest in…the material and equipment" at the well site as such party "would have been entitled to had it participated…." (Page 7, lines 3-4.)

Article VII(B) provides that each party (other than the operator) grants the operator "a security interest in …its interest in all equipment…." (Page 9, lines 32-33.) The operator may demand payment in advance from the other parties for their shares of expenses by submitting an itemized statement and invoice. (Page 9, lines 55-62.) Article VII(G) requires the operator to "carry or provide insurance for the benefit of the joint account of the parties…." (Page 11, lines 5-6.)

Under Article VIII(A), if any party assigns its interest in the well site to another, "the assigning party shall have no further interest in the assigned or leased premises and its equipment…." (Page 11, lines 27-29.) Article VIII(D) states that, in order to maintain "uniformity of ownership" in the well site, no party shall sell, encumber, transfer or make other disposition of its interest in…equipment" unless certain requirements are satisfied. (Page 12, lines 11-13.) Article VIII(F) requires any party desiring to sell any part of its interest under the agreement to give written notice to the other parties and to grant the other parties a preferential right to purchase. (Page 12, lines 37-45.)

Petitioner has also submitted two exhibits to the model agreement, both entitled Accounting Procedure Joint Operations". It appears that one of these exhibits was drafted in 1974 and the other is a 1984 revision. Section I(l) of both exhibits defines "joint property" to mean "the real and personal property subject to the agreement" and "material" to mean "personal property, equipment or supplies acquired or held for use on the joint property."

Section II of each exhibit describes the items for which the operator may charge the "joint account". Paragraph 4 authorizes billing for "material purchased or furnished by operator for use on the joint property…." Paragraph 8 allows the operator to bill for all costs and expenses necessary to repair or replace joint property which result from losses by any cause except the operator's gross negligence or willful misconduct. Paragraph 11 provides that insurance premiums can be passed on to the parties.

Section IV requires the operator to make a timely disposition of all idle or surplus material. Such disposition is to be made either through sale to the operator, sale to a non-operator, division in kind or sale to outsiders.

Petitioner has also submitted copies of its vouchers and various other documents with respect to some of these transactions. In many cases, a memo attached to the voucher states: "Sufficient partner approval has been received to proceed with transfer of following equipment…." (See, e.g., VN N8809.)

* * *

We find that petitioner's contentions are meritless. Petitioner contends that it retained the "incidents of ownership" of the property, including the risk of loss and insurance risk; but the model agreement shows that the risk of loss was borne by the co-owners proportionately (except in the case of gross negligence or willful misconduct) and the insurance

premiums were also shared proportionately. Petitioner alleges that it had complete custody and control of the property, including an "absolute right" to sell it; but the model agreement in fact prohibited petitioner from selling, encumbering, transferring or otherwise disposing of the property, in order to maintain "uniformity of ownership", and petitioner had to obtain "sufficient partner approval" for many if not all of the transfers at issue.

Petitioner has not submitted pages 1 and 2 of the model agreement, wherein the ownership of materials and equipment is apparently expressly defined. The portions which petitioner has submitted nevertheless reflect a clear intent that title in such property would be held jointly by the co-owners. For example, a co-owner not participating in subsequent operations could nevertheless retain its "same interest" in materials and equipment. A co-owner which assigned its interests in the well site would have "no further interests" in equipment. A co-owner wishing to sell its interests could do so upon written notice granting the other co-owners a preferential right to purchase.

Even more telling, the co-owners granted to petitioner, as operator, a security interest in their interests in equipment. Petitioner, as operator, had a right to dispose of surplus materials and equipment by, inter alia, sale to itself. These two provisions would be completely meaningless if petitioner, as operator, was already the owner of materials and equipment.

For these reasons, we agree with the audit that petitioner transferred title or fractional title in the materials and equipment to the other co-owners. These transactions were therefore sales and, unless otherwise exempt, are taxable to the extent of the fractional interest transferred.

3. Petitioner generally paid sales tax reimbursement or use tax with respect to its acquisitions of materials and equipment for transfer to the well sites, except for pipes or "tubing" which were purchased ex-tax. The property could thereafter be sold several times. For example, a piece of equipment might be purchased for delivery to a warehouse, then sold to a well site, then back to petitioner, then sold to another well site and finally sold to still another well site. Petitioner contends that it is entitled to a tax-paid purchases resold deduction on all such sales.

Subdivision (a)(1) of Revenue and Taxation Code Section 6012 provides that a tax-paid purchases resold deduction is allowable:

> "…if the retailer has purchased property for some other purpose than resale, has reimbursed his vendor for tax which the vendor is required to pay to the state or has paid the use tax with respect to the property, and has <u>resold the property prior to making any use of the property</u> other than retention, demonstration, or display while holding it for sale in the regular course of business." (Emphasis added.)

With respect to new equipment ("Code A" property) on which California tax was paid, the audit asserted tax on petitioner's sale of the property measured only by the markup or profit over cost. In effect, therefore, a tax-paid purchases resold deduction was allowed. The deduction was not allowed for subsequent sales (when the property was classified as "Code B" [used], "Code C" [used and needing repairs] or "Code E" [junk]). Deduction was disallowed based on a finding that the property had been used, at least for stand-by purposes, prior to each subsequent resale. (Sales and Use Tax Reg. 1701(c).) The deduction was also not allowed for property transferred from a well site back into a warehouse, then resold to another well site, since petitioner could not show that tax had been paid on any sales back into the warehouse.

Petitioner has not identified any particular transaction for which it believes the deduction should have been allowed. More importantly, it has presented no evidence to indicate that any specific item upon which the audit asserts tax was resold prior to use. Resale prior to use is a statutory prerequisite to the deduction and, absent specific evidence, we find no basis for adjustment.

4. On a related issue, petitioner claims that it is entitled to a credit under Revenue and Taxation Code Section 6406 on 24 specific transactions. Section 6406 authorizes a credit against California use tax when tax or tax reimbursement has been paid to certain other jurisdictions upon acquisition of the property.

No voucher or other evidence has been presented for four of the 24 transactions. (VNs N5555, N9657, N9075 and N9096). The vouchers for four other transactions suggest that a four percent tax was paid to Texas. (VNs N8809 through N8812.) The vouchers for the remaining transactions are ambiguous.

The tax which has been asserted on all 24 transactions is a California sales tax on the sale of the property by petitioner. Section 6406 authorizes a credit only against California use tax, not against California sales tax, and petitioner is therefore not entitled to the credit on these transactions. If petitioner in fact paid another jurisdiction's tax or tax reimbursement with respect to any of this property, petitioner's remedy is to seek a tax-paid purchases resold deduction from that jurisdiction.

5. Petitioner next contends that when it bills the co-owners for the "standard cost" or fair market value of the property, any applicable tax should be measured by petitioner's original cost of the property. However, Revenue and Taxation Code Section 6051 provides sales tax applies to the "gross receipts" from the sale. Section 6012 defines "gross receipts" to mean the total amount of the sale price without regard to the vendor's acquisition cost. Accordingly, the tax on these transactions is properly measured by the amount petitioner bills the co-owners for the property sold.

Petitioner also argues that the audited tax measure is incorrect on the following specific transactions.

VN M7056 is a sale of new casing for $230,601.57, plus an inspection charge of $10,603.20 and a handling charge of $3,976.20, for a total of $245,180.97. The voucher also reflects "sales tax" of $13,836.90, computed on a measure of $230,601.57.

The audit found that, although tax was recorded on the voucher, petitioner had not in fact paid tax to the state. The audit also found that the total price was $245,181, with a 62.5 percent change in title, so tax was asserted on $153,238. We note that the audit did not assess any excess tax reimbursement. We assume this is because only 62.5 percent of the $13,836.90 "sales tax" on the voucher was actually billed out to the purchasers.

Petitioner alleges that the audit selling price is not correct, but does not offer any explanation. Presumably, petitioner believes that the inspection and handling charges should not have been included. If that is the contention, we disagree. The inspection and handling were services that were part of the sale, and the charges for those services were therefore part of the gross receipts from the sale. (Rev. & Tax. Code § 6012(b)(1).)

VN M7197 reflects a sale of tubing for $8,319.15 (with a 12.2 percent change of title for a tax measure of $1015). An attachment to the voucher indicates that freight charges may have been included in that amount, and petitioner appears to argue that the freight charges are not taxable. However, there is nothing to suggest that the freight charges were separately stated on the invoice to the purchasers, and the freight charges are therefore taxable. (Rev. & Tax. Code § 6012(a)(3) and (c)(7).)

VN M7058 shows a sale for $180,554.78. For reasons not explained in the record, the audit found that the price was actually $170,522 (with a 55 percent change in title, for a tax measure of $93,787). Petitioner alleges that the audit measure of tax is overstated but does not offer any evidence or arguments and we see not basis for adjustment.

Petitioner also alleges that the audit measure of tax is overstated for the transactions recorded on VNs M1916 and M7114. These vouchers have not been submitted for our review and we see no apparent error.

6. Revenue and Taxation Code Section 6396 authorizes a sales tax exemption when, pursuant to the contract of sale, the property is required to be shipped and is in fact shipped by the retailer to a point outside California. Subdivision (a)(3)(D) of Sales and Use Tax Regulation 1620 requires bills of lading or other documentary evidence to prove out-of-state shipment in support of this exemption.

Petitioner contends that the sale reflected in VN N9359 was a sale of property shipped to an out-of-state point. No copy of the voucher or other evidence has been presented. Since the alleged out-of-state shipment has not been documented, petitioner is not entitled to the exemption.

Petitioner also claims that sales tax has been asserted on property shipped from warehouses to drilling platforms outside California territorial waters. No specific transaction has been identified and no evidence has been presented, so no deduction is allowable.

7. VN N8155,dated November 27, 1985, records a sale of new steel tubing from petitioner's Monte Bello warehouse to an oil will. The "material movement date" was October 14, 1985. The voucher states "priced per attachment", but the attachment has not been presented in evidence. The audit found that the price was $34,926, with a 55 percent change in ownership, so tax was asserted on $19,209.

Petitioner alleges that this sale never in fact occurred. There is no evidence to support this allegation, so we find no basis for adjustment.

VN N8750 records a transfer of "build to remove" to J. R. S--- Co. for $8,500. Petitioner has presented an XYZ letter from the customer stating that the property acquired was "butler building" and explaining: "S--- purchased the building as real estate, then hired a contractor to remove it." We conclude that this was transfer of real property, not a sale of tangible personal property, so sales tax is not due. (Sales & Use Tax Annot. 150.0060 [9/12/68].)

Petitioner also alleges that tax has been asserted on transfers of property to California retailers for the purpose of being incorporated into or installed on equipment which the retailer were selling to petitioner. No specific transactions have been identified and no evidence has been presented, so no adjustment to the audit is warranted.

8. According to petitioner, tax has been asserted on transactions where no documentary evidence is available. However, every transaction in this audit item is listed by voucher number in the audit workpapers. If petitioner failed to retain documentary evidence of exemption, we fail to see how that would entitle petitioner to any exemption.

9. Finally, petitioner contends that the Bradley-Burns tax does not apply when property is shipped to an offshore drilling rig within California's territorial waters. As previously explained, this argument is based on the fallacious assumption that the taxing authority of California's coastal counties stops at the water's edge. It does not, and the Bradley-Burns tax therefore applies to these transactions.

10. Petitioner has also submitted VNs 9652 and N9714 for our review. However, these transactions are not listed in petitioner's brief and we do not know why these vouchers were submitted.

AUDIT ITEM G

Petitioner's Contentions

1. The first functional use of property installed aboard the vessel outside California occurred outside this state.

2. The actual time the vessel spent in California waters was substantially less than that scheduled by the auditor.

SUMMARY

Petitioner operated an ocean-going seismic research vessel called A--- R---. The vessel was often at sea during the audit period, but was sometimes docked in California or at out-of-state ports. This audit item concerns property which petitioner purchased for use aboard the vessel, including ship components and supplies as well as scientific research equipment.

The audit found that some of the property was purchased from California vendors for delivery in this state. The auditor commented that the applicable tax would be a sales tax on the vendor, not a use tax on petitioner. These transactions were not listed in the audit workpapers.

The auditor found that other property was purchased from out-of-state vendors for delivery outside the state, usually in Texas, Alaska or Oregon. These transactions were listed in the audit workpapers, but use tax was not asserted. The auditor commented that the first use of such property occurred outside California. According to the verification comments on Schedule 12, page 9, use tax did not apply even if the property was brought into California within 90 days of purchase, since the property in each case was used outside California more than one-half the time during the first six-months after entering the state. (See Sales and Use Tax Reg. 1620(b)(3).)

Use tax was asserted, however, on property purchased from out-of-state vendors and shipped to petitioner in California or at an unknown point presumed to be in California. In the verification comments, the auditor indicated that use tax would not apply if the property left California aboard the vessel before use, and thereafter did not return to California for at least six months (citing Rev. & Tax. Code § 6009.1), but apparently no purchases were found to qualify.

Use tax was also asserted in a few cases where the vendor was located outside the state and the property was delivered to petitioner at: "TX/CAL?", TX/?", "TX/CAL", "A--- R---" or "M---". We are uncertain exactly what these notations mean. However, in view of the verification comments on Schedule 12, page 9, we assume they mean delivery in California or at an unknown point presumed to be in California.

Analysis and Conclusions

1. Petitioner contends that when it accepted delivery of property and installed it aboard the vessel outside California, the first functional use of the property occurred at the out-of-state point. Petitioner cites Sales and Use Tax Annotation 570.1320 (10/25/69). We agree with this contention, but no adjustment to the audit appears necessary. In those cases where the auditor found that the property was delivered to petitioner at an out-of-state point, the auditor commented that the "first use" occurred outside the state and did not assert use tax.

2. The application of use tax on this property depends in part on when the property entered California and how long it remained in this state. In making findings on these points, the auditor relied on a summary or extract of the vessel's log provided by petitioner. Petitioner now contends that the summary or extract was incorrect. In support, petitioner has submitted a complete set of the vessel's location log, downtime log and cable log.

We have briefly reviewed these logs and noted some differences between them and the summary log used by the auditor. For example, the location and downtime logs indicate that the vessel was in California waters or at a California port from May 11, 1983, through May 14, 1983, while the summary indicates that the vessel was in federal waters on those days. Accordingly, the reaudit should review the transactions in this audit item in light of the new information.

Recommendation

Reaudit in accordance with the views expressed herein.

12/6/90

James E. Mahler, Hearing Officer — Date