M e m o r a n d u m

210.0085

To: Mr. C. Wayne Philpot
Appeals Unit – Room 450

Date: February 5, 1990

From: Gary J. Jugum
Assistant Chief Counsel

Subject: H--- P--- Company
Account No. SY – XX-XXXXXX-020

This is to confirm our oral advice to you of February 1, 1990 in regard to correspondence received concerning the referenced taxpayer's pending petition for redetermination of tax. The hearing occurred on January 9, 1990. The correspondence in question is dated January 15, January 22 and January 25, 1990.

Taxpayer has an admitted ulterior motive in this case. In conjunction with the California Manufacturer's Association and Cal-Tax, taxpayer is trying to introduce a new exemption into the law.

I say that because taxpayer is aware that the bulk of the items in dispute would be treated as nontaxable under our normal demonstration and display interpretations. Taxpayer is interested, however, in establishing a new principle for sales tax interpretation. Taxpayer wants the Board to conclude that an intervening use can be made of property purchased for resale without use tax applying, if the property will be sold as new in a reasonable period of time.

Under Revenue and Taxation Code section 6094, any use of inventory, other than for demonstration and display, is taxable. There is no 30-day, 60-day, or 90-day permitted use. In fact, the statute itself does recognize two cases where use may be made of the property before resale with tax applying only on a fair rental value basis. Under section 6094(b) and (c), if there is an accommodation loan while the customer awaits delivery of property or the return of repaired property, the loaner is taxed at fair rental value. Likewise, if property is frequently used for demonstration and display and partly for other purposes, tax also applies on the fair rental value basis. Taxpayer would engraff a 30-day exception where property could be used tax free for any purpose, so long as it was resold. This approach is inconsistent with the holding of the Court in the Kaiser, Burroughs, NCR and Lockheed litigation.

As I told you yesterday, the Business Taxes Department agrees that the first 16 items listed on the attachment to the January 15, 1990 letter should be deleted from the audit. This is what I said at the hearing. These cases involve demonstration to sales or service persons (although the list is wrongfully captioned). The demonstration to service personnel does not involve tearing the machine down, but only demonstrating the

features. Compatability testing, where the object is to test whether the product in question is compatible with other equipment, is likewise permissible demonstration and display within prior interpretations as taxpayer is well aware.

We believe that loan numbers G9 and J5 are taxable as not involving mere demonstration and display. The Business Taxes Department also thinks that loan number G3 is taxable. There is no credible evidence to support the attorney and tax manager's statements. The O--- Committee would not have accepted a casual undocumented loan of technical equipment. Absent contemporary written documentation of the event, we believe the transaction is taxable.

In this case, taxpayer's agent testified under oath that taxpayer sold used equipment as new equipment. The Board should not participate in this questionable activity by subsidizing it with public funds.

GJJ:sr