

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

570.0167

In the Matter of the Petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
B--- E. and J--- S.) No. SR -- XX XXXXXX-010
M---)
)
Petitioners)

The preliminary hearing on the above taxpayer's petition for redetermination was held on August 27, 1985, in Ventura, California.

Hearing Officer: John Adamo
Appearing for Petitioners: J--- S. M---
Appearing for the Board: Robert Kaudse
Senior Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1981 through March 31, 1983 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Horse purchased for resale - Capitalized as fixed asset	\$100,000

Contention of Petitioners

The horse in issue was properly purchased under issuance of a resale certificate.

Summary

Petitioners purchased the horse in issue, A--- C---, in March 1981 for \$100,000. At the time of the purchase, petitioner's were the holders of a seller's permit issued for the purpose of engaging in the sale of horses.

During the entire course of the audit period, petitioner's made no sales and reported as such on the sales and use tax returns which they filed. Petitioners were eventually contacted by the Board's staff and informed that their seller's permit would be revoked unless they could establish that they were engaged in the sale of tangible personal property. Petitioner's did not respond to this notice and their seller's permit was closed out effective March 31, 1983.

Upon audit, the audit staff discovered that petitioners had made the subject purchase under resale certificate in March 1981. The audit staff concluded that petitioners had not actually been engaged in the business of selling horses and that, accordingly, use tax was due as of the time of the purchase.

The audit staff's conclusion was based on the lack of evidence that petitioner's had actively attempted to sell A--- C--- and the fact that petitioners had depreciated the horse for income tax purposes. The audit staff believed that this depreciation had allowed petitioners to offset income from other sources.

The preliminary hearing on this matter was originally scheduled for May 21, 1985 in Santa Barbara, California. Mrs. M--- appeared at the time and place scheduled for the hearing and requested a postponement because her husband was unable to attend; the postponement was granted. Mrs. M--- then asked what evidence would be satisfactory to establish and intent to hold the horse for sale in the regular course of business. Mrs. M--- was informed as to the type of evidence normally submitted in cases of this sort and the preliminary hearing was rescheduled for August 27, 1985.

At the preliminary hearing conducted on this matter, petitioners submitted the evidence referred to in detail below. In addition, Mrs. M--- expressed her correct understanding that either use tax is due measured by the purchase price or that sales tax is due measured by the sales price. Mrs. M--- further stated that A--- C--- has already had two foals and is expected to have another foal in 1986. It was disclosed that the birth of one foal generally increases the sales price of a horse because it shows that the animal is capable of production. Generally, the birth of more than one foal is an indication that the horse is being held for breeding, rather than resale.

Analysis and Conclusions

In relevant part, Revenue and Taxation Code Section 6244 provides as follows:

“(a) If a purchaser who gives a resale certificate or purchases property for the purpose of reselling it makes any storage or use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the storage or use is taxable as of the time the property is first so stored or used.”

The term "use" is defined in Section 6009, in relevant part, as "the exercise of any right or power over tangible personal property incident to the ownership of that property,...except that it does not include the sale of that property in the regular course of business." The term "storage" includes any keeping or retention in this State for any purpose except sale in the regular course of business...." (Revenue and Taxation Code Section 6008.) The expression "holding for sale in the regular course of business" requires the making available of that property to customers or potential customers." (See Mercedes-Benz v. State Board of Equalization, 27 Cal.App.3d 871; Safeway Stores v. State Board of Equalization, 148 Cal.App.3d 299 (1957).)

As with all such exemptions, the taxpayer has the burden of establishing that he is entitled to the exemption from the use tax for "demonstration or display" of tangible personal property being held for sale in the regular course of business. (See Standard Oil Co. of California v. State Board of Equalization, 39 Cal.App.3d 765 (1974).) A taxpayer's general statements are insufficient, and are not a substitute for the required documentation. (People v. Schwartz, 31 Cal. 2d 59 (1947).)

After careful consideration of the record of this petition, it is our position that petitioners have established that A--- C--- was originally purchased for resale and was held for sale in the regular course of business until April 15, 1985, i.e., on or about the date the second foal was born. Use tax is due on the purchase price as of April 15, 1985.

Our conclusion that petitioners were holding A--- C--- for sale in the regular course of business is based upon a combination of factors. Specifically, petitioners have submitted evidence to demonstrate that: (i) the horse was consistently advertised for sale; (ii) that they maintained a separate bank account for their business which they called "T--- O--- A---;" (iii) the horse was shown at a number of horse shows for the purpose of finding a purchaser; and (iv) the fact that petitioners entered into an agreement with O--- A--- R--- for the purpose of, among other things, marketing the horse for sale.

The fact that the horse was depreciated for income tax purposes on petitioner's income tax returns for 1981, 1982, and 1983 is inconsistent with the holding of the animal for sale in the regular course of business. (See McConville v. State Board of Equalization, 85 Cal.App.3d 156.) Nevertheless, a review of petitioners' income tax returns for those years does reveal that they derived no tax advantage from the depreciation claimed since claimed deductions from other sources were more than sufficient to shelter their entire income. It is our conclusion that the fact that petitioners depreciated A--- C--- should not dictate the finding that the horse was not held for sale in the regular course of business given the factors cited above. Finally, the date as of which petitioners' seller's permit was closed out should not be used as the date as of which use tax is due. The factors cited above clearly demonstrate that petitioners were holding A--- C--- for sale in the regular course of business subsequent to March 31, 1983. At the preliminary hearing conducted on this matter, Mrs. M--- was questioned as to why she allowed the seller's permit to be revoked. She stated that she had consulted with her accountant and was informed

that, unless she made at least three sales a year, she was not entitled to hold a seller's permit. Mrs. M--- relied upon this advice and allowed the seller's permit to be revoked.]

The advice given to Mrs. M--- was incorrect. Petitioners were and, based upon the information presented at the preliminary hearing, still are engaged in the business of selling horses. They are therefore required to hold a seller's permit regardless of the number of sales transacted during any twelve-month period. (Revenue and Taxation Code Section 6066; compare with Section 6006.5(a) and Sales and Use Tax Regulation 1595(a)(1).) Petitioners should immediately consult with the Board's Santa Barbara District Office for the purpose of reinstating their seller's permit. Furthermore, it is evident that petitioners do not have a clear understanding as to their responsibilities under the Sales and Use Tax Law and that they should consult with the Board's staff to avoid future difficulties.

We have concluded that the birth of the second foal is the date at which use tax should be assessed in light of our determination that petitioners are now holding A--- C--- for breeding purposes, rather than resale. That conclusion is buttressed by the fact that the horse is now awaiting the birth of yet another foal in 1986. While petitioners may eventually sell A--- C---, the horse was "used," as that term is defined in Section 6244, as of the birth of the second foal. Under the unique circumstances presented by this case, it will not be necessary for petitioners to file amended income tax returns reversing the claimed depreciation. Petitioners are advised, however, that should they in the future claim such depreciation, such an election would constitute convincing evidence that the depreciated property was not held for sale in the regular course of business.

Recommendation

Reaudit in accordance with the views expressed above.

Redetermine without further adjustment. Petitioners should immediately contact the Santa Barbara District Office regarding reinstatement of their seller's permit as well as to consult with the Board's staff as to how to properly report their tax liability in the future. Reaudit to be conducted by Petition Unit. A use tax determination should be issued reflecting the above conclusions.

John B. Adamo, Hearing Officer

September 5, 1985
Date