STATE BOARD OF EQUALIZATION

December 18, 1969

C---, Inc.
XX --- XX[nd] Street
--- ---, -- XXXXX

Attention: Mr. J--- L T---
Senior Tax Attorney

SU -- XX XXXXXX
C--- V--- C---
S---, Inc.

Gentlemen:

This is to advise you of our conclusions and recommendation for further action on the petition for redetermination filed on behalf of C--- V--- C--- S---, Inc.

We have given consideration to the able argument presented by you in lieu of appearing at a hearing on the matter and have based our conclusions upon your argument in conjunction with the facts and information previously available to us.

The facts are not in dispute and are as follows:

The petition concerns the assessment of use tax on the purchase of T.V. cable from an out-of-state vendor for use in California. The cable allegedly was found to be defective and destroyed prior to installation.

The cable was purchased from S--- C--- Corporation [S---] in ---, North Carolina. No use tax was collected by S--- and none was self-assessed. The cable was purchased for use by petitioner in the installation of T.V. cable systems. The audit working papers indicate that the purchases were made in the year 1965. Some of the cable purchased from S--- became defective after being installed and credit was allowed petitioner by S--- for the defective installed cable. The cable which is the subject of this protest was never installed but had been retained in inventory until late 1967 when it was determined by petitioner to be defective on the basis of the defects found to exist in the installed cable. Petitioner claims it was instructed by S--- to destroy the cable and did so in early 1968.

S--- disputed the claim that the cable was defective and that petitioner was instructed to destroy it and refused to allow credit since the cable was not returned by petitioner to S---. As a result of the dispute and differences which arose in regard to the matter, a "Settlement Agreement and Mutual Release" was entered into on March 4, 1969, whereby S--- remitted the sum of $6,250 to petitioner in release of petitioner's claim.

It is your contention that the use tax does not apply to the purchase price of the cable voluntarily destroyed by petitioner.

Further, you contend that in the event the use tax does apply by reason of the storage, use or other consumption of the property, the sales price of the cable for use tax purposes should be reduced to the extent of the amount paid by the seller to petitioner in settlement of petitioner's claim, as evidenced by the "Settlement Agreement and Mutual Release" entered into by seller and petitioner on March 4, 1969.

In support of the contentions that the use tax is inapplicable, you cite ruling 64 [(Admin. Code 2056) Defective Merchandise], Ruling 59 [(Admin. Code 2029) Goods Damaged in Transit], and ruling 71 [(Admin. Code 2071) Tax-Paid Purchases Resold]. In addition to the above rulings, certain letter ruling of sales tax counsel is cited.

It is our opinion that the transaction here involved is subject to the use tax and that under the facts and circumstances does not qualify either wholly or in part for exemption from the tax provided by the cited rulings.

The Revenue and Taxation Code expressly provides for the imposition of the use tax on the storage, use or other consumption of tangible personal property in this state (§6201). Any keeping or retention in this state for any purpose except sale in the regular course of business or subsequent use solely outside this state of tangible personal property, constitutes "storage" (§6008) to which the tax applies. Further, "use" includes the exercise of any right or power over tangible personal property incident to the ownership of that property (§6009).

The property was purchased by petitioner for purposes other than resale or subsequent use solely outside the state. The property was received and retained by petitioner in this state for two years or longer before destruction.

There is ample authority holding that the imposition of tax on the storage of tangible personal property purchased for use in the state is valid. Southern Pacific Company v. Gallagher, 306 U.S. 167, 177 [83 L.Ed. 586, 593], Nashville C & St. L. R. Co. v. Wallace, 288 U.S. 249 [77 L.Ed. 730].

Storage is but one of the bundle of rights incident to the ownership of the property. The withdrawal and voluntary destruction of the property are a further exercise of such rights.

The measure of the tax is the sales price of the property to the purchaser. The incidence of the tax has attached at the time of the original sale and can be removed only by an authorized deduction.

The California Sales and Use Tax Law provides no deduction from the tax for the voluntary destruction of goods subsequent to the incidence of the tax. The applicability of the above-cited rulings to transactions involving the imposition of use tax is governed by adherence to the requirements contained therein.

The deduction provided by ruling 64, Returned Merchandise, cannot be invoked without a return of the merchandise to the seller and a full refund of the applicable purchase price. None of the cable here in question has been returned to the seller. We cannot agree that the destruction of cable constituted a constructive return of the merchandise to the seller as advanced by your argument. The seller expressly denies conferring authority for the destruction.

Ruling 59, Goods Damaged in Transit, has no application under the circumstances. The portion of the ruling applicable to use tax reads as follows:

> "Use tax does not apply with respect to goods damaged before the purchaser makes any storage or use of the goods. If the goods are damaged but are nevertheless stored or used by the purchaser, tax applies to that portion of the total amount paid to the retailer representing the full retail value of the goods in their damaged condition."

There is no showing of damage to the goods prior to storage. Even if it were conceded that the goods were defective, the ruling would not apply since the exemption granted is for goods damaged, not goods damaged or defective. The exemption may not be so extended. Nor does "damage" include "defective." The words damage and defect are distinguishable within their common meaning. Webster's Unabridged Dictionary defines damage as "loss or harm resulting from injury" and defect as "a shortcoming or imperfection."

Ruling 71, Tax-Paid Purchases Resold, provides in pertinent part that, "a retailer who resells tangible personal property before making any use thereof (other than retention, demonstration or display while holding it for sale in the regular course of business) may take a deduction of the purchase price of the property if…he has reimbursed his vendor for the sales tax or has paid the use tax… ."

The requirements for exemption are clear and unambiguous. The transaction here involved meets none of these requirements.

Ruling 66, Defective Merchandise, provides that, "Amounts credited or refunded by sellers to consumers on account of defects in the merchandise sold may be excluded from the amounts on which tax is computed."

The claim for relief based on this ruling presents a closer question. Whether payment by the seller to petitioner of the $6,250 pursuant to the Settlement Agreement and Mutual Release constitutes a refund on account of defective merchandise is in controversy.

Petitioner contends the cable was defective because it contained no water block compound and consequently allowed moisture to build up on the cable after installation, which presented problems in the efficient use of the cable system.

In correspondence with petitioner, the seller has steadfastly denied that the cable was defective and intimates, in letter of July 31, 1968, to petitioner, that it was the manner of petitioner's installation which caused the unsatisfactory function of the cable. The language of that letter in pertinent part is as follows:

> "There is no doubt in my mind that you did indeed have difficulty with our product, particularly inasmuch as your original construction included a tap which allowed moisture to penetrate in the cable and in turn as the cable did not provide a waterblock you consequently suffered moisture problems."

Further, the Settlement Agreement expressly provides that the seller has specifically denied that said cable was in any way defective and has further specifically denied that authority was given by seller to petitioner to destroy the same. The agreement describes the cable as, "HB6030 coaxial cable, 'old type-without water block compound inserted', and "HB6020 coaxial cable, 'old type-without water block compound inserted.'"

While the unsuitability of the cable to petitioner's installation was occasioned by the absence of the water block compound, it cannot be said that the absence of such compound constituted a defect in the cable. From the description of the cable contained in the settlement agreement, the cable was purposely manufactured without water block compound inserted. It is difficult to believe that petitioner was not aware of the particular specifications of the cable purchased. There is no showing that the cable as purchased was to contain the water block compound, but failed to do so.

In view of the lack of proof or the seller's admission that the cable was in fact defective goods, we are of the opinion that the payment of $6,250 made by seller to the petitioner pursuant to the Settlement Agreement and Mutual Release did not constitute a refund on account of defects in the merchandise sold and may not be excluded from the computation of the use tax.

We cannot agree with your argument that the opinion cited as Sales Tax Counsel 4-1-54 [Anno 1914, Cal. Tax. Serv.] should apply with equal force to goods which are destroyed rather than resold. That opinion does not stand for the unqualified proposition that no taxable use can occur if the property is unsuitable for its intended use.

The rationale of that opinion is that retention of the property for the purpose of resale statutorily (§6008) does not constitute a use and where the property is resold in the regular course of business, unsuccessful efforts to repair the property to make it suitable for the seller's own use is not considered an event to which use tax applies.

The facts in the instant case can be distinguished from those in the cited opinion. Petitioner was not a retailer, no effort was made to repair the property and the property was destroyed rather than resold in the regular course of business.

Nor can we agree with your argument that there are ample precedents for holding that use tax must be based on the suitability of the property for its intended use, no matter the actual value of the property or its subsequent disposition. We are unable to find any precedent for such a holding.

It is well established that exemptions from tax are to be strictly construed (Good Humor Company v. State Board of Equalization, 152 Cal.App.2d 873), and are not to be expanded. Administrative construction of the requirements of exemption are entitled to great weight. (Union Oil Company v. State Board of Equalization, 60 Cal.2d 441.)+

We believe that allowance of an exemption in the instant matter under any of the above cited rulings or Sales Tax Counsel Opinion would constitute a strained interpretation of such rulings, entirely inconsistent and unsupportable.

We will recommend that the determination be redetermined without adjustment.

You will be notified of the official action taken.

Very truly yours,

T. P. Putnam
Tax Counsel

JM:smb