



## STATE BOARD OF EQUALIZATION

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June 19, 1996

Mr. M--- M---, Tax Manager  
I--- Corporation  
XXXX --- --- Boulevard, --X-XXX  
--- ---, CA XXXXX

**Re: I--- Corporation  
SY -- XX-XXXXXX**

Dear Mr. M---y:

Your letter to our --- --- District Office, dated December 20, 1995, has been referred to the Legal Division for response. You state:

“I--- purchases component parts from a foreign manufacturer’s sales office in California. The California sales office accepts the order, arranges for delivery from the foreign plant and handles processing through customs. The foreign manufacturer is responsible for risk of loss during shipment and title passes at the sales office in California. I---’s purchase price includes delivery charges & custom fees. The California sales office does not maintain an inventory of I---’s component parts. At I---’s direction, the California sales office drop ships these component parts to a manufacturer in California. I--- furnishes these component parts at no cost to the California manufacturer. The California manufacturer incorporates these component parts into equipment. The California manufacturer then ships the equipment to I--- locations outside of California, for use outside of California. The equipment does not return to California. These component parts are purchased directly by I---, vs. purchased by the California manufacturer, for a variety of reasons, including the protection of competitive, sensitive information associated with the component parts.”

It is unclear why you state that I--- furnishes the component parts “at no cost” to the California manufacturer. It appears from the facts you have provided that I---, rather than the manufacturer, purchases the parts. As long as the manufacturer is not purchasing the parts, you would have no reason to charge the manufacturer; rather, it appears that the manufacturer would instead charge you for incorporating the parts into the equipment.

You ask a number of questions concerning the scenario above. First, you ask:

“1. Because these component parts are incorporated into manufactured products which are shipped to locations outside of California, are these component parts exempt from California tax under section 6009.1 of the California Sales & Use Tax Law?”

In answering your questions, it is best for me to begin with a general discussion of California Sales and Use Tax Law. Retail sales of tangible personal property in California are subject to sales tax, measured by gross receipts, unless specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) A retail sale is a sale for any purpose other than resale in the regular course of business. (Rev. & Tax. Code § 6007.) A retailer may collect reimbursement from the purchaser for its sales tax liability if the contract of sale provides for such reimbursement. (Civ. Code § 1656.1.)

When sales tax does not apply, such as when sales take place outside of California, the use tax, measured by the sales price of the property sold, applies to the use of property purchased from a retailer for storage, use, or other consumption in California unless the use is specifically exempt from taxation by statute. (Rev. & Tax. Code §§ 6201, 6401, Reg. 1620.) Although the purchaser is liable for the use tax, a retailer engaged in business in this state is required to collect the use tax from the purchaser and to pay that tax to this state. (Rev. & Tax. Code §§ 6202, 6203, 6204.)

Under these facts, where the sale of the property is made through the foreign manufacturer’s California sales office and title passes (and thus the sale occurs) in California, the sales tax, rather than the use tax, applies. (Reg. 1620(a)(2)(A).) The storage and use exclusion provided in Revenue and Taxation Code section 6009.1 is an exclusion from the use tax, but not from the sales tax. Thus, under the facts you have provided, the sales of the component parts are not excluded from tax under section 6009.1. Rather, the foreign manufacturer’s sale to you in this state is subject to sales tax.

“2. Are these parts exempt under other California statutes or regulations?”

Based on the facts as you have described them above, the sales of the component parts are not exempt from tax under any California statutes or regulations.

“3. If taxable based on the current facts, what is the Board’s tax position under the following circumstances:

“A. The component parts are ordered from the California sales office, but title passes at the foreign location?”

If title to the property passes to the purchaser outside of California, the sales tax would not apply; rather, the use tax would be the applicable tax. (Reg. 1620(a)(1), (b)(1).)

You have asked about the section 6009.1 exclusion from use tax, which provides:

“‘Storage’ and ‘use’ do not include the keeping, retaining, or exercising any right or power over tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside the state, or for the purpose of being processed, fabricated, or manufactured into, attached to or incorporated into, other tangible personal property to be transported outside the state and thereafter used solely outside the state.”

You indicate that after the parts you purchase are incorporated into the equipment, the equipment is shipped to your out-of-state locations for your use outside of California, and that the equipment does not return to California. If such is the case, your storage or use of the parts in California for the purpose of incorporating them into equipment that will be transported outside this state for use solely outside this state comes within the section 6009.1 exclusion, and you will not owe California tax on such storage or use. However, you will owe use tax if you make any use of the property in California other than the storage or other exercise of a right or power over the property for the purpose of shipment outside this state for use thereafter solely outside this state.

“B. The component parts are ordered from the California sales office, title passes at the foreign location, I--- separately pays for shipment and I--- handles processing through customs?”

The answer to this question is the same as the answer to question 3A.

“C. The component parts are ordered directly from the foreign manufacturer, with no participation by their California sales office?”

The answer to this question is the same as the answer to question 3A, provided no location of the manufacturer in California participates in the sale in any way.

“D. The component parts are ordered from a sales office located outside of California and title passes outside of California?”

The answer to this question is the same as the answer to question 3A.

“E. The California sales office drop ships the component parts to the manufacturer’s plant located outside of California and the manufacturer returns the component parts to their California plant?”

As long as the contract of sale requires the foreign manufacturer to ship the property to a specific point outside this state, and the property is shipped outside this state, the sales tax will not apply. (Reg. 1620(a)(3)(B).) Instead, the use tax will apply. (Reg. 1620 (b)(1).) You state that the manufacturer will return the parts to California; therefore, the use of the parts will not come within the section 6009.1 exclusion from use tax.

“F. The California sales office ships the component parts to an I--- location outside of California and I--- ships the parts back to the California manufacturer?”

The answer to this question is the same as the answer to question 3E.

“G. The California manufacturer purchases the component parts for resale from I---, at a nominal value?”

“H. The California manufacturer purchases the component parts for resale from I---, at I---’s cost?”

“I. The California manufacturer purchases the component parts for resale from I---, at I---’s cost plus a profit?”

Your purpose for making a sale for resale for a nominal amount is unclear. Where a sale for a nominal amount is found not to be a bona fide business transaction, the person making the sale will be considered the consumer. (See Business Taxes Law Guide Annotations 295.0660(5/21/51); 295.0680 (4/9/51); 295.0700 (6/5/51).) This would mean that the sale to or use by I--- would be subject to tax, as discussed above.

On the other hand, if I---’s sales of the parts to the California manufacturer are considered to be true sales for resale, tax will not apply to I---’s sales of the parts, but tax will apply to the retail sale when the California manufacturer sells the parts unless otherwise exempt. Our understanding is that the amount you charge the manufacturer for the parts would be added to the manufacturer’s charge for the completed equipment (i.e., that you would effectively buy back the parts, as part of the completed equipment, for the same price as you charged the

manufacturer.) Under the specific facts discussed in this opinion, we would consider sales by I--  
- in which its sales prices included all of its costs to be bona fide business transactions.

I hope this has answered your questions. If you have further questions, please feel free to  
write again.

Sincerely,

Kelly W. Ching  
Tax Counsel

KWC:cl

cc: Mr. J. W. Cornelius, Supervisor  
Audit Evaluation and Planning Section (MIC:40)