

Memorandum

120.0650

To : Mr. Romero Y. Celedon
Supervising Tax Auditor
San Jose District - Audit

Date: December 14, 1992

From : Ronald L. Dick
Senior Tax Counsel

Subject: V--- L--- S---, Inc.
SR -- XX-XXXXXX

This is in reply to your November 12, 1992 memorandum regarding the application of sales tax to trade-ins accepted by V--- L--- S---, Inc. (V--- L---), under the following facts you described:

"The trade-ins can be divided up into roughly 3 areas, area one is the 'M--- o--- U---' hardware upgrade promotion for S--- and PC users. Area two is the 'G--- t--- C---' promotion. Area three encompasses other miscellaneous trade-ins.

"Both the S--- and C--- promotions are aimed at a select group of customers. Both promotions were designed to encourage these customers to upgrade their current software and to discontinue the use of their old software.

"The terms of the agreements are as follows:

1. The old software can be exchanged for new new software at 80% of list price.
2. Customer must be a current S--- user or a G--- user.
3. Customer must purchase at least one year software maintenance at time of purchase."
4. Customers must currently be on maintenance to qualify for this program.
5. The old software will be removed at the time of the installation.
6. The discounts are based on a 'one for one trade-in basis' for existing valid licenses.
7. These are limited time offers of approximately 6 months.

"The third area of miscellaneous trade-ins does not appear to conform to the taxpayer's contentions. These items all appear to be routine trade-ins...."

"In regards to the promotional discount/trade-ins, a detail examination of all sales invoices, customer purchase orders, sales orders and quotations sent to the customers revealed that the majority of the transactions contained the word trade-in somewhere in the paperwork.

"The customer was forced to give up his current software in order to obtain the taxpayer's so called promotional discount. An agreed value between buyer and seller was reached on these transactions as to the value of the trade-in software...."

Given this information, you asked for our opinion as to whether you are correct in regarding the value of the trade-ins as includible in the gross receipts of the sale of the newer software.

We believe you are correct. As provided in Sales and Use Tax Regulation 1654, Barter, Exchange, 'Trade-ins' and Foreign Currency Transaction, subdivision (b), when a retailer accepts a trade-in, the retailer must include in the measure of tax the amount agreed upon between the retailer and the buyer as the allowance for the merchandise traded in. Subdivision (b)(2) of the regulation provides:

"Although discounts allowed and taken by purchasers are not a part of taxable gross receipts, if there is a trade-in and also a discount, the contract between seller and buyer must make it clear that the parties contract for both a trade-in allowance and for a discount. Otherwise, the amount of the claimed discount will be considered to be an overallowance, and the total sales price will be subject to tax."

In Hawley v. Johnson (1943) 58 Cal.App.2d 232, the Court was faced with similar facts. The plaintiff was engaged in the retail sale of automobiles. When the plaintiff accepted a used car as a trade-in on a new automobile, the sales invoice showed the sale price of the new automobile, the amount of cash paid or to be paid, and the agreed value at which the used car was taken in. The agreed turn-in value was generally in excess of the appraised value of the used car. Plaintiff entered in its books the difference between the appraised value and the turn-in value as an "overallowance." Plaintiff made no such allowance on the sales slip or contract received or signed by the customer and set out as a single item the full turn-in price agreed upon. In upholding the Board's imposition of tax based on the total gross receipts including the trade-in value, the Court stated:

"Plaintiff argues that the so-called overallowance is no different than a cash discount. It is to be observed that our statute expressly excludes cash discounts

from the tax, but imposes the tax on payments in property 'valued in money.' The parties by bona fide agreement having valued the property in money, under the express terms of the statute have fixed the measure of the tax. To make market value rather than agreed value the measure would create almost insuperable administrative difficulties, since the taxing power would be compelled in every transaction to look behind the agreed value and ascertain the actual market value of the property traded in. In the give and take of the market place the value arrived at by the free negotiation of the parties may safely be relied upon to furnish a reasonable measure of the value in money of property traded in."

Based on the information you have provided, we believe the trade-in value of the software traded in should remain in the audit. The taxpayer may avail itself to the petition process.

RLD:sr