M e m o r a n d u m

295.0560

To: Santa Rosa – Auditing (ARD)   November 1, 1965

From: Tax Counsel (GAT)

It is our understanding that "S" was the inventor of a log peeling device. He apparently placed an order with "B" to fabricate a peeler which he purchased ex tax under a resale certificate.

"S" sold the peeler to "G" under a contract, pursuant to which "G" agreed to pay $46,000 plus a royalty of 20 cents per thousand board feet of logs peeled. The royalty was to be paid for a period of three years and, providing "S" received a patent on the device, the royalty was to be paid for the duration of the patent. "S" reported the $46,000 as taxable gross receipts, but did not report tax on the royalties.

"B" fabricated a second log peeler and, pursuant to permission granted by "S", sold it ex tax under a resale certificate to "O". "O" leased the peeler to a logging company for a stipulated rental. "S" then entered into an agreement with the lessee, pursuant to which the lessee agreed to pay "S" a royalty of 20 cents per thousand board feet of lumber peeled. "O" reported tax measured by its receipts from the rental of the peeler, but no tax was reported with respect to the royalties paid to "S".

Although both agreements, between "S" and "G" and "B" and "O", were in form absolute sales, "S" retained the absolute right to control the operational use of the peelers and the right to compensation for such use. In our opinion, this interest was an ownership interest in tangible personal property, identical to an ordinary lessor's interest in property which he leases.

In view of the foregoing, it is our opinion that "S" became liable for sales tax measured by the receipts from the sale of the first peeler to "G:, and also became liable for tax measured by the royalty payments.

It is further our opinion that "O" became liable for use tax measured by its receipts from the rental of the second peeler to its lessee, and that "S" likewise became liable for use tax measured by the royalties paid by lessees to "S".

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