



STATE BOARD OF EQUALIZATION

916-445-6493

September 27, 1989

Gross Receipts – cash discount in financing transaction

Dear:

In your August 2, 1989 letter to Mr. Les Sorensen, Senior Tax Counsel, you request an opinion of the Board's legal staff pursuant to Revenue and Taxation Code Section 6596 (taxpayer reliance on written advice) regarding the sales tax consequences of a certain transaction between --- and ---. Your position is that the transaction includes a cash discount under Revenue and Taxation Code Section 6012 (c) (1) which is not a part of the purchase price subject to sales tax.

You describe the transaction as follows:

“--- ('Taxpayer') entered into an agreement with --- ('Seller') to purchase a mainframe computer for a cash price of \$4,895,806 (a copy of the agreement marked Exhibit 1). As indicated in the Agreement, a \$100,000 reduction of the cash price (labeled 'credit') towards the 'first IPA ('Installment Payment Agreement') invoice was a part of the transaction. This reduction was an incentive for the taxpayer to use the seller's financing plan to fund this deal at a negotiated interest rate. (See seller's letter of June 12, 1989 marked Exhibit 2). The seller has taken the position that this is not a reduction of the purchase price in the form of a cash discount but instead a credit to the financing arrangement. The taxpayer finds the seller's interpretation to be an artificial distinction since the overall cash outlay has been reduced by \$100,000. In addition, the taxpayer has indicated to the seller that it believed the \$100,000 was a reduction of the purchase price (see taxpayer's letter of June 22, 1989 marked Exhibit 3). Since the seller is responsible for collection of the sales tax, it has requested assurance from the SBE that the taxpayer's position in this matter is correct; lest on a future audit, this transaction may be questioned as taxable and penalties be imposed.”

You enclosed with your letter an installment payment agreement which is part of the sales agreement between the parties (Reference Agreement No. ---. The installment payment agreement shows a finance charge (interest) of \$238,432 computed on the \$4.895 million cash price at an annual percentage rate of 10.52%, for a total price, including finance charges, of \$5.134 million. You also enclosed a June 12, 1989 letter

from Mr. --- Marketing Manager --- to Mr. --- Manager, Contracts and Leasing --- which states as follows:

“By choosing --- for the 1090-2005, an additional \$100,000 ‘Market Basket’ credit will be offered to ---. This credit will be applied to the first invoice, reducing the payment due by \$100,000.”

Finally, you enclosed Mr. ---’s June 22, 1989 letter to Mr. --- Southwest Marketing Division, --- in which Mr. --- contends the amount subject to California sales tax “should be \$4,795,806, which is net of the cash discount of \$100,000.”

Opinion

Under the Sales and use Tax Law, if a seller receives consideration from the purchaser in the form of “credits” in addition to cash or other consideration, the amount of the credit is included in the measure of the sales tax. (Rev. & Tax. Cods §6012 (b) (2) and (3)). By contrast, the measure of the sales tax does not include “cash discounts allowed and taken on sales,” under Revenue and Taxation Code Section 6012 (c) (1). Although --- refers to the \$100,000 as a “credit,” it is not the type of credit referred to in Section 6012 as part of the taxable measure, since --- did not receive additional consideration of \$100,000 from --- over and above the sales price for the property purchased. Instead, --- deducted the amount due on the first installment payment by \$100,000.

However, we also do not agree that the entire \$100,000 constitutes as a nontaxable cash discount allowed and taken on the sale. If the entire \$100,000 were deducted from the cash price of \$4.895 million, then the computation of interest at the agreed rate of 10.52% would necessarily be less than the \$238,432 agreed on between the parties. In that case, the reduction of the total contract price would not be exactly \$100,000, but would be an amount in excess of \$100,000. Since --- has not allocated the \$100,000 discount between the cash price and the interest charged in the total time sale price of \$5.134 million, but the installment payment agreement states an annual percentage rate of 10.52%, it is our opinion that --- must reduce the sales price subject to tax by an amount which, when added to a reduction in the interest (finance charge) computed at the 10.52% annual percentage rate, totals \$100,000. We leave the recomputation of this amount to the parties. Of course, neither the stated interest charge is subject to sales or use tax. (Reg. 1641 (a)).

I enclose Regulation 1641 for your information. Please feel free to contact me if you have any further questions or comments about this letter.

Sincerely,

John Abbott
Senior Tax Counsel