

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

395.0074.175  
11/6/87

In the Matter of the Petition )  
for Redetermination Under the )  
Sales and Use Tax Laws: )  
)  
)  
)  
)  
Petitioner )

DECISION AND RECOMMENDATION  
No. ----

The preliminary hearing on the above taxpayer's petition for redetermination was held on October 20, 1987, in Culver City, California.

Hearing Officer: H. L. Cohen

Appearing for Petitioner ---

Appearing for the Board: ---

Protested Items

A petition for redetermination was filed by letter dated August 22, 1986. The protested tax liability for the period July 1, 1984, through November 30, 1985, is measured by:

<u>Item</u>	<u>State, Local and County</u>
B. Unreported sale of assets	\$1,739,000

Contention

Petitioner contends that the transaction in question was an exempt occasional sale.

Summary

Petitioner is a corporation which was engaged in providing oil field services and in making retail sales of nitrogen. It began in business in July 1984. This first audit was a close-out audit conducted because petitioner sold its assets to --- effective November 30, 1985.

Petitioner states that it provides certain services to oil exploration activities. None of its services are performed for production wells. During exploration activities, a well is drilled to evaluate a given zone. In many instances, oil does not flow to the surface because the internal pressure is too low or because the oil is too viscous. The exploration company will then hire petitioner. Petitioner inserts flexible metal tubing into the well and pumps nitrogen gas through the tubing into the well to force oil to the surface. The nitrogen is stored by petitioner in the liquid state. Ultimately, the nitrogen dissipates into the atmosphere. The tubing is pulled back up

and is reused. The equipment, consisting of tubing spools: pumps, nitrogen tanks, etc., is specially designed and is mounted on skids for ease in transportation. The majority of petitioner's jobs are aboard exploration ships or drilling platforms outside California waters. All equipment is operated by petitioner's skilled employees.

Petitioner made some retail sales of nitrogen gas inside California. For that reason, petitioner held a seller's permit and reported tax. During the seventeen months of the audit period, petitioner reported receipts of \$3,897,078.80 and taxable sales of \$210,052.58. Taxable sales were 5.4 percent of receipts.

Petitioner contends that it was engaged in a service business; any sales of tangible personal property were minor and only incidental to the rendition of services. The final sale of assets was therefore an exempt occasional sale.

### Analysis and Conclusions

Section 6367 of the Revenue and Taxation Code exempts occasional sales from tax. Section 6006.5 defines "occasional sale" to include a sale of property not held or used in the course of activities for which a seller's permit is required. If petitioner's activities require the holding of a seller's permit, the exemption does not apply.

Sales and Use Tax Regulation 1501 provides that the basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. We have previously concluded that the injection of nitrogen into oil wells for purposes of testing and processing is a service. See Business Taxes Law Guide, Annotation 515.1200 (August 4, 1964). Petitioner would not be required to hold a seller's permit if this were its only activity. In that case, the occasional sale exemption would apply.

Petitioner, however, also made retail sales of nitrogen. The question then is whether the sales of nitrogen result in making all or some part of the sale of equipment taxable. In Ontario Community Foundation, Inc. v. State Board of Equalization, 35 Cal.3d 811, the court held that where an entity which is primarily in the business of furnishing services makes a sale of assets, only receipts from the sale of assets used in making incidental retail sales of tangible personal property will be subject to tax. We think the situation here is similar. The primary business of petitioner is the rendition of services. The sales of nitrogen are incidental to this primary business and do nothing to enhance petitioner's primary activity. Applying Ontario, only the sale of the nitrogen storage tanks should be regarded as taxable.

### Recommendation

Reduce the amount subject to tax to the transfer price of the nitrogen tanks. ---District to calculate the reduction. Redetermine without other adjustment.

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H. L. Cohen, Hearing Officer

11/6/87  
Date