

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

440.1230

In The Matter of the Petition)
For Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law) OF HEARING OFFICER
)
K--- G--- M--- CORP.)
)
) Account No. SY -- XX XXXXXX-010
)
Petitioner)

This matter came on regularly for hearing in Los Angeles, California, on August 12, 1976, before W. E. Burkett, Hearing Officer.

Appearances

For the Taxpayer: Mr. R--- T---, Tax Manager
Mr. R--- F. S---, Vice President
Manufacturing

For the Board: Mr. Forrest M. Paisley
Supervising Auditor

Mr. William Kozovsky
Tax Auditor III

Protested Items

(Period 7-1-72 to 6-30-75)

- | | |
|--|----------|
| 1. Purchases of salt cake and gypsum audited subject to use tax. | \$66,667 |
| 2. Royalty payment made in conjunction with license to use specially designed equipment. | \$ 1,500 |

Contentions of Taxpayer

1. The property in question was purchased for the purpose of incorporation as a component part of a finished article produced for purposes of resale.
2. The payment was made for separate intangible rights.

Summary of Petition

The taxpayer is a corporation engaged in the business of manufacturing and selling glassware. It is a leading manufacturer of containers for the home canning consumer.

The first protested item consists of purchases of salt cake and gypsum classified as manufacturing aids used in the manufacture of glass and therefore subject to use tax. Substantial quantities of each item were purchased for resale during the audit period.

We have heretofore ruled that salt cake is purchased for the purpose of incorporation as a component part of the glass and may be purchased for resale (see Annotated Letter Ruling No. 440.2150). This ruling was annotated after the current deficiency determination was issued to this taxpayer.

In our prior ruling we concluded that the salt cake aided in the manufacture of the glass but also contributed substantial physical properties which were essential to the finished article. Approximately 61 percent of the salt cake remained as a component of the glass.

A similar contention is made for the gypsum. It is contended that the product breaks down in the course of manufacture to form calcium oxide (CaO) and that its physical properties contribute materially to the hardening and chemical durability of the glass. A very substantial portion of the property remains as a part of the end product.

The second protested item consists of annual royalty payments of \$500 made to B--- B--- S--- Corporation, for a nonexclusive revocable, indivisible license and right to use an "AP-5 Vapor Coater" in the taxpayer's manufacturing plant.

The audit included the royalty payments in the measure of tax on the basis that the payments were made for the right to obtain the use of the property. The taxpayer contends that the payments should be exempted on the basis that the payments were made to acquire the use of the patented process and "know-how". Paragraph 1(b) of the parties' agreement defines "know-how" as follows:

“LICENSOR’S know-how’ shall mean operating and maintaining instructions for LICENSOR’S AP-5 Vapor Coater as used by LICENSOR on April 1, 1968.”

Analysis and Conclusions

For the reason noted in the summary, the salt cake purchases should be deleted from the measure of tax. It is also our conclusion that the gypsum should be deleted as property acquired for purposes of resale. The auditor's notes from "Glass Blowing" by Frank Kulaseviz, 1974, indicates that the gypsum does provide some aid in the manufacture of the glass. However, our review also confirms that certain components of the gypsum (CaO) are essential ingredients of the end product. This is indicated by the following excerpt from "Properties of Glass", page 79, et seq.:

“Sodium silicate glass, of about the composition of the lowest-melting composition between sodium disilicate and quartz, is made in large quantity in the soluble silicate industry. It is readily dissolved by water, and some other oxide must be added to give it better chemical durability if a permanent glass is to be obtained. The oxide commonly added is lime, CaO, because it is cheap and efficacious. If too little lime is added, the glass, although easy to melt, has poor chemical durability. Much of the ancient Egyptian glass which has survived probably represents their best product, yet their best was of so poor a quality as to be rejected by discriminating users today, because of its high content of sodium oxide.” (Emphasis added.)

A supporting reference is also found in “Glass: The Miracle Maker”, by C. J. Phillips (see particularly Chapter 3, The Chemistry of Glass, at page 32.

While it is apparent that the product in question yields oxides that aid in the manufacturing, it is also clear that its physical properties are essential components of the end product. The property is, in fact, incorporated in the end product in substantial part.

Property is not denied exemption as a sale for resale by reason of its use as an aid while it is being incorporated or attached in the manufacturing process, so long as the property was acquired for the purpose of incorporation in the finished article. This follows, even though some portion of the property is dissipated or is “wasted” in the course of manufacture. (Annotated Letter Ruling No. 440.1880, Cal. Tax Service 3666).

It is our conclusion that the royalty payments were properly included in the measure of tax. The amounts were paid for rights that can only be exercised by use of the physical property and were without independent value (see Annotated Letter Ruling No. 295.2480). The service of instructing in the use of a given property is includible as a service that is a part of the sale (see Revenue and Taxation Code section 6012).

Recommendation

It is recommended that the salt cake and gypsum purchases be removed from the measure of tax proposed for redetermination.

Reaudit adjustment to be initiated by _____.

W. E. BURKETT, HEARING OFFICER

11-18-76

Date