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**STATE BOARD OF EQUALIZATION**

July 2, 1965

Gentlemen:

This is in reply to your inquiry of June 28, 1965. It is our understanding that two years ago you rented a piece of equipment to a customer with an option to purchase for \$30,000 plus sales tax. You collected and remitted use tax measured by rentals and when the option to purchase was exercised, you reported sales tax on the balance of the option price.

The equipment proved unsatisfactory in operation. The problem was finally resolved by your agreeing to take back the original machine and replacing it with a new machine. You issued the customer full credit for the original machine and replaced it with a new machine at the same price.

On the basis of the foregoing circumstances, it appears to us that you gave the customer full credit for the original machine when you replaced it with a new machine. In our opinion you are entitled to take the deduction for defective merchandise with respect to the selling price of the original machine when you report sales tax with respect to the new machine.

Very truly yours,

George A. Trigueros  
Associate Tax Counsel

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