



STATE BOARD OF EQUALIZATION

January 22, 1958

G--- T---, D--- and S--- W---
XXXX --- Street
--- --- X, California

Attention: Mr. W--- E. W--- - - XXXX

Gentlemen:

We have read the letter of December 20 from W--- E--- C--- to you enclosed with your letter of December 28, in which W--- contends that sales tax should not apply to a purchase pursuant to a purchase order covering "all necessary engineering, design and drawings" necessary to manufacture a specific piece of equipment. The tax was determined against you as part of our determination dated July 16, 1957. The audit report upon which the determination is based merely states that the engineering services were "determined to be part of the cost of manufacturing equipment". From this we conclude that you were given a contract by W--- for the manufacture of certain equipment but that two purchase orders were actually furnished at approximately the same time, one for the equipment and the other for the design and drawings necessary to manufacture the equipment.

Under the Sales and Use Tax Law, if a person contracts to sell tangible personal property, his gross receipts which are subject to tax include, under the express provisions of section 6012, "any services that are a part of the sale", and there cannot be deducted therefrom "the cost of materials used, labor or service cost, interest paid, losses or any other expense." Therefore, if a manufacturer undertakes to manufacture and sell a given article of personal property, he cannot deduct any of the costs of manufacturing the article even though there may be a separate purchase order for such as engineering and design work.

If, on the other hand, a person enters into a contract to perform engineering and design work in the nature of experimentation or for the purpose of determining whether the customer might wish later to purchase an end product, we are able to regard such a contract as separable from a contract for the sale of merchandise.

The test is basically whether at the time of performing the engineering and design the person doing the work is not under any obligation to deliver an end product. If he is, then we do not believe the test of the engineering and design is deductible from his gross receipts. If he has no contract for an end product but is simply performing an engineering service not involving the production of any tangible personal property which is desired by the customer, then such charges can be regarded as service charges and not subject to the tax.

G--- T---, D--- and S--- W---
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From W---'s letter, it would appear to us that the engineering and design charges would not be deductible as apparently they were a part of fulfilling a contract to deliver an end product. If we are in error, than upon proper proof being submitted, we will be glad to review the matter and if it appears the tax does not apply, to certify a refund of that portion of your payment of July 31, 1957 found to have been in error.

As the six months limitation period for refund claims will run out January 31, it is suggested that if you wish to pursue this matter further, you should immediately write us requesting a refund of the amount in question.

Very truly yours,

E. H. Stetson
Tax Counsel

EHS:ds

cc: San Francisco - Administrator