

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

In the Matter of the Petition for)	
Redetermination Under the Sales)	DECISION AND RECOMMENDATION
and Use Tax Law)	OF HEARING OFFICER
)	
REDACTED TEXT)	REDACTED TEXT
)	
<u>Petitioner</u>)	

This matter came on regularly for hearing in West Los Angeles, California on October 30, 1974.

REDACTED TEXT appeared for the taxpayer.

Protested Item

Use tax on purchase price of property used in development program.	\$64,662
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Contentions of Taxpayer

The use tax is not applicable because the property was acquired for incorporation in property to be resold.

Summary of Petition

The taxpayer is engaged in the business of selling equipment to the graphics industry.

Prior to the year 1966, the taxpayer had participated with REDACTED TEXT in a joint program to develop the REDACTED TEXT System for use in the printing industry. The program was successful, and in 1969 the parties entered into a second agreement providing for the marketing of the process by the taxpayer. However, REDACTED TEXT retained ownership of the underlying patents.

In 1970 the taxpayer and a customer, the REDACTED TEXT entered into a cooperative development program to demonstrate the feasibility of REDACTED TEXT system in the customer's newspaper operation (per Exhibit A, attached hereto).

If the program proved to be successful the customer was to pay the taxpayer the sum of \$167,000 for the system, and the parties were to share profits from additional sales of the system as specified in Exhibit A.

The program was unsuccessful and the property used in the system was ultimately returned to the taxpayer. The customer was not required to pay for the system, as agreed, and the components parts thereof were scrapped. Subsequently, the taxpayer wrote off the development costs it had expended in the program.

The staff asserted use tax on the purchase price of the material acquired without tax under resale certificates and used in producing the system in California.

The taxpayer's representative contends that no tax is applicable because the property was purchased for the purpose of incorporation in a manufactured article to be sold. Its representative concedes that tax is due on the tooling cost included in the purchase price of the material upon which tax was asserted. This tooling cost is estimated at 10 percent of the total cost.

Analysis and Conclusions

It is our conclusion that the California use tax applies to the material utilized in the development program. The statute generally requires the imposition of the tax to material purchased from a retailer under a resale certificate (or out of state) and stored, used or otherwise consumed in this state (see Revenue and Taxation Code Section 6001, 6202, 6094". Revenue and Taxation Code section 6009 defines "use" as follows:

“Use’ includes the exercise of any right or power over tangible personal property incident to the ownership of that property, and also includes the possession of, or the exercise of any right or power over, tangible personal property by a lessee under a lease, except that it does not include the sale of that property in the regular course of business.”

In the instant matter, the property was not utilized solely for incorporation in property to be sold in the regular course of business. The property was, in fact, used experimentally to determine the feasibility of the system. The use tax is applicable to such use even though the property may subsequently be sold. (See extensive discussion in California Attorney General Opinion No. 46-381 (11 Ops. Cal. Atty. Gen. 266).)

Recommendation

It is recommended that the taxes be redetermined without adjustment.

W. E. Burkett, Hearing Officer

1-17-75
Date