STATE BOARD OF EQUALIZATION
916-324-3828

September 19, 1985

[X]

Dear [X]:

This is in response to your letter of August 29, 1985, in which you request our opinion as to the application of the Sales and Use Tax Law to the following transaction.

Your client is in the business of buying, breeding, and selling Arabian horses. Specifically, your client is in the business of selling breeding mares. Normal practice would be to purchase breeding mares for resale and breed each mare prior to sale. Any mare not bred at the time of sale would be sold with breeding rights to a specific stud. Sale of the mare would normally take place within six months to one year of the breeding although, occasionally, a mare would be held longer if no buyer could be found. Any foals born prior to the date of sale that are six months of age or older would be sold separately from their mothers. Any foals less than six months of age prior to the date of sale of the foal's mother would be sold with her.

Specifically, on these facts, your client would like to know if the Board staff will treat the mares as held for use rather than held for sale.

Revenue and Taxation Code section 6094 provides that if a purchaser who gives a resale certificate makes any use of the property other than retention, demonstration or display while holding it for sale in the regular course of business, the use shall be taxable to the purchaser.

We agree with you when you state in your letter that a brood mare is more valuable upon resale if its fertility can be proven. In reaching this conclusion we note that the purpose of a brood mare is to give birth and, if the retailer can demonstrate to the buyer the mare's breeding ability, the mare is more likely to be sold, and sold at a higher price. However, a line needs to be drawn somewhere so a conclusion, or at least a presumption, can be established that the breeding of the mare was for the purpose of demonstrating the mare's fertility and not a taxable use of the mare. To this end, Board staff has in the past applied the following guidelines: If a brood mare held for resale has had two or more foals as a result of having been bred while owned by the person holding the mare for resale, then the owner has made a taxable use of the horse as a brood mare since this is substantial evidence that the breeding was not a utilization either incidental or necessary to effect a sale. A taxable use will also be found if a brood mare, held for resale, has been capitalized and treated as a depreciable asset for federal and state income tax purposes. In addition, if a retailer of horses retains a brood mare for resale over two full years, regardless of whether it has ever foaled, the individual case would be suspect and a taxable use presumed. However, a mare having been bred in two successive breeding seasons or sold with a single foal

at her side or sold while in foal and with a single foal at her side will not dictate a finding that there is a taxable use inconsistent with that of holding the brood mares for resale.

Applying the foregoing criteria to the "proposed transaction" in your letter, we are of the opinion that a taxable use of the mares has not occurred since it is not indicated that the mares have had two or more foals, nor is it indicated that the mares have been retained for resale over two full years. Your letter indicates, however, that in some instances a mare may be held longer than one year if no buyer can be found. You should note that a taxable use could result if a mare, under these circumstances, were retained for over two full years. You should also note that a taxable use will result if a mare has had two or more foals as the result of having been bred while owned by your client. We assume that in the proposed transaction the mares have not been capitalized and depreciated for income tax purposes.

The Board staff does not believe that the McConville case cited in your letter (McConville v. State Board of Equalization, 85 Cal. App.3d 159) requires a finding that all breeding of brood mares constitutes nontaxable demonstration and display. In the McConville case the court found that the plaintiff, who was engaged in the business of buying, breeding and selling horses, had made a taxable use of the horses purchased for resale since the horses had been capitalized and treated as depreciable assets for federal and state income tax purposes (Ibid 159, 161). In reaching this decision, the court noted that a reasonable construction of the term ''use...other than retention, demonstration or display" must be determined by a logical relationship to sales and business custom and usage. The court then found that in the circumstances particular to the McConville case, the plaintiffs breeding of the mares was a reasonable incident to the sale and not a use incompatible with the requirement that mares held for resale be used only for demonstration and display (Ibid 160-161). This finding by the court did not require the Board staff to change its rule which is a reasonable method to differentiate between a taxable use and a use for demonstration and display purposes only.

Finally, as you note in your letter, the "primary purpose" test has been developed by the California courts to decide the application of sales and use tax when tangible personal property is both used and resold by a retailer (Burroughs Corp. v. State Board of Equalization, 153 Cal.App.3d 1160). The California courts have consistently looked to the primary intent of the purchaser or the primary purpose of the purchase. The above stated guidelines with regard to brood mares is a method, which we believe is compatible with the primary purpose test, that is used to ascertain the primary intent of the purchaser.

We hope this answers your question; however, if you need further information, feel free to write again.

Very truly yours,

Robert J. Stipe
Tax Counsel

RJS:sr