

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

295.0462
10/29/75

In the Matter of the Petition)
for Redetermination Under the)
Sales and Use Tax Laws:)
)
)
)
Petitioner)

DECISION AND RECOMMENDATION
No. ----

The above entitled matter came on regularly for hearing in Pasadena, California on September 30, 1975 before W. E. Burkett, Hearing Officer.

Appearing for Taxpayer:

Appearing for the Board: Mr. Hodder, Supervising Auditor

Protested Item
(Period 4/1/71 to 12/31/74)

- | | |
|--|----------|
| 1. Royalty payments subject to use tax not reported (audit item D) | \$18,854 |
| 2. Materials withdrawn from tax-paid inventory claimed exempt (audit item E) | 20,391 |

Taxpayer's Contentions

1. The royalty payments were made to secure the services of the seller's expert equipment operator.
2. The material was actually used in the performance of a contract to improve realty at an out-of-state location.

Summary of Petition

The taxpayer is a specialty contractor performing highway construction and fence installation contracts.

The first protested item is made up of a \$1.00 per linear foot royalty payment paid pursuant to the letter agreement attached hereto as Exhibit A.

The audit staff determined that the royalty payment represented a part of the purchase price of the concrete barrier machine.

The taxpayer's representative explained that the machine was purchased for use in the performance of a previously awarded highway construction contract. The seller's operator was secured because the operation of the machine requires very precise skills. The hearing officer has confirmed this by discussions with a recognized expert in the highway construction field.

The purchase price of the machine exclusive of the royalty payment is alleged to approximate the cash price of a new machine of the same type and size.

The second protested item consists of a disallowed deduction for material withdrawn from the taxpayer's tax-paid yard inventory and utilized in the performance of a construction contract at an out-of-state site. While the taxpayer held a seller's permit, it concededly did not certify to its vendor that the particular materials were acquired for use in the manner indicated (per Revenue and Taxation Code Section 6386).

Analysis and Conclusions

It is our conclusion that the royalty payments are not a part of the sales price of the machine. Royalty payments made for the right to use the property or to acquire any other right incident to the ownership of property are properly a part of the sales price. However, in this instance it is quite apparent that the payments were made to secure the skilled performance of the seller's skilled workmen and not for the right of use or any other incident of ownership of the property.

Contrawise, we conclude that the taxpayer is not entitled to any exemption for the material withdrawn from its merchandise inventory and used at an out-of-state location. This utilization of property would customarily result in the application of the sales or use tax. Accordingly, any exemption or exclusion must be strictly construed and limited to its precise terms (see Santa Fe Transportation Co. v. State Board of Equalization, 51 Cal. 2d 531). Here the taxpayer failed to meet the requirement specified by the legislature in Section 6385 that the purchaser certify in writing to his vendor that the property was being specifically acquired for use in the performance of a contract to improve real property located outside of this state. Having failed to do so, the tax is applicable.

Recommendation

The district audit staff should conduct a reaudit deleting the royalty payments from the audited measure of tax deficiency.

W. E. Burkett, Hearing Officer

10/29/75

Date

REVIEWED FOR AUDIT:

Principal Tax Auditor

Date

Preliminary Hearing
Exhibit A

June 7, 1972

Attention:

Dear

This will confirm our agreement for the purchase of your --- Machine, as Modified to time 10 ft. width, with 5 ft. height capacity.

---	\$40,000.00
Shipping allowance to Los Angeles	2,500.00
One screed for --- to-your latest design	1,250.00
One variable screed, with each side varying automatically, at the estimated cost of \$5,000.00 to \$7,000.00, based on your actual cost of Fabrication.	

A payment of \$5,000.00 for you and --- to come to the job, to be sure of the complete satisfactory operation of all of the equipment, as well as such advice you may be able to give us, the air fare of one of your operators, and the loan of one of your top operators for the duration of the job.

We will pay the operator and also such of his expenses as we agree is fair. We will also pay you \$1.00 per lineal foot for every foot of barrier poured with the machine on the simi job. Other jobs, where variable heights are concerned we will negotiate as required.

All of the above equipment will become the property of ---.

We are enclosing an advance payment of \$5,000.00 as discussed with you. We wish to thank you for the help you have given, and if this agreement is per your understanding, would you kindly sign one copy and return it to us for our records.

Yours truly,
