

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

330.1874.100

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition
for Redetermination Under the
Sales and Use Tax Law of:

X-----

Petitioner

DECISION AND RECOMMENDATION

The Appeals conference in the above-referenced matter was held by Senior staff Counsel W. E. Burkett on June 2, 1992 in, --- California.

Appearing for Petitioner:

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Appearing for the
Sales and Use Tax Department:

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Protested Item

The protested tax liability for the period January 1, 1987 through December 31, 1989 is measured by:

| <u>Item</u> | <u>State, Local and County</u> |
|---|--------------------------------|
| E. Unreported cost of company vehicles purchased ex-tax. | \$10,515,836 |
| Undisputed "no employee charge" adjustment. | <u>\$ (214,653)</u> |
| Disputed measure of tax, net of reported amounts measured by 1.73% of vehicle cost per month. | \$10,301,183 |

Contentions of Petitioner

1. The use of the vehicles qualifies as exempt demonstration and display.
2. The transactions qualify as leasing sales.

Summary

The petitioner is a corporation engaged in the business of performing contracts for military hardware or surveillance equipment including satellite vehicles. It is a wholly owned subsidiary of --- --- ---. It is not directly involved in the manufacture of components for motor vehicles. It does, however, perform considerable research and development work which could lead to improvements in motor vehicle components.

Petitioner regularly purchases motor vehicles from the various --- --- manufacturing divisions for use in its motor pool. Tax is paid on the purchase price of the vehicles, and they are not an issue in this petition. The protest involves other vehicles assigned to level eight employees. These latter vehicles are acquired for resale without payment of sales tax reimbursement or use tax and are registered with the cooperation of local --- --- --- dealers.

The vehicles are assigned to level eight employees under the terms of --- Product Evaluation Vehicle Lease Agreement(s)". (Copy in file.) This allows the employee the use of the vehicle for personal purposes for the payment of a monthly amount equivalent to 1.73 percent of the vehicle cost. Use tax was declared and paid on these amounts. The petitioner pays for repairs and maintenance insurance and all licenses and taxes. The employees were required to return the vehicle after it was used for 10,000 miles and complete a product evaluation form. Under the terms of the agreement, the vehicle could be sold without notice to or consent by the employee.

The Sales and Use Tax Department (Department) concluded that these vehicles were not leased but were used as company cars, and determined a deficiency measured by the difference between the purchase price and the monthly amounts reported. Authorization to report under the 1/40th or 1/60th of cost provided by Regulation 1669 was denied on the basis that the petitioner was not a manufacturer or seller of motor vehicles. Actual resale of the vehicles after use is made through local --- --- ---dealers.

Petitioner contends that the use made of the vehicles should be regarded as exempt demonstration and display in view of the product evaluation, and the fact that the vehicles were customarily resold to retail customers at an amount in excess of the purchase price.

It is also submitted that the vehicles were leased to the employees.

Analysis & Conclusions

The petitioner is not entitled to report under the 1/40th and 1/60th provisions of Sales and Use Tax Regulation 1669.5 for two independent reasons.

1. Non taxable demonstration and display are limited to activities performed while the purchaser is holding the property for sale in the regular course of business. (See Regulation 1669.5(a) (3); also see Revenue and Taxation Code Section 6094(a).) In legal contemplation petitioner did not purchase and hold the vehicles for sale in the regular course of business even though a resale was to be made of each vehicle after it was used for 10,000 miles. (See E .. I. Kirk. et al v. Charles G. Johnson, 37 Cal.App.2d 224; Safeway Stores. Inc. v. State Board of Equalization [1957] 148 Cal.App.2d 299; Kaiser Steel Corporation v. State Board of Equalization [1979] 24 Cal.3d 188.)

2. The alternative reporting authorized by Sales and Use Tax Regulation 1669 is limited to manufacturers, distributors or dealers. Petitioner does not qualify under any of these categories.

It is also our conclusion that the transactions are not bona fide lease agreements. In tax matters the substance of the transaction governs.

The employees received the limited right of use of the vehicles for a monthly amount that was only approximately one-third of the market rental rate. While the preparation of a simple evaluation sheet has some value, it is not measured in terms of money and does not account for the great disparity. The amount of the monthly payment is not negotiated but is dictated by the petitioner. It is available only to a certain level of employees. The property may be sold by the petitioner without notice to the employee. Finally, the employee does not bear the ordinary expense relating to its use during the period it is driven as is currently required of a lessee. (See California civil Code section 1956.)

In substance, the possession and use were given to the employees primarily as a fringe benefit.

The petitioner's purchase of these vehicles "for resale" is contrary to law and should be discontinued. Property may be purchased for resale only if it is held for resale in the regular course of business. (See Revenue and Taxation Code Sections 6092, 6094 and 6244; also see Revenue and Taxation Code section 6094.5.)

Recommendation

It is recommended that the petition for redetermination be denied.

W. E. Burkett, Senior Staff Counsel

8/12/92
Date