M e m o r a n d u m

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To: E. L. Sorensen, Jr. Date: June 20, 1989

From: David H. Levine (916) 445-5550
ATSS 485-5550

Subject: A--- C--- M---, Inc.
SR -- XX-XXXXXX

Taxpayer wrote a letter dated March 28, 1989 to Hollywood District Principal Tax Auditor Joseph Cohen. Mr. Cohen responded in a letter dated April 17, 1989. These have been referred to us for our opinion as to whether Mr. Cohen's advice is correct.

As paraphrased in Mr. Cohen's letter, taxpayer asked how sales tax applies in the following circumstances:

1. "Sample Sales – We bill our customers for sample sets including sales tax when a resale certificate is not applicable. We have an incentive program that once our customer reaches a certain sales quota we refund the amount charged for the sample. Should we refund the sales tax charged on the sample, and if so, may we deduct the amount of the sample sale on our sales tax return?

2. "Showroom/Store Use Sales – We have another program where we bill our customers for showroom/store use carpet and charge sales tax. We have an incentive program where within one-year, if our customer reaches a certain sales quota, we refund the amount billed for showroom/store use carpet. Should we refund the sales tax charged on the showroom/store use carpet and if so, may we deduct the amount of the showroom/store use sale on our sales tax return?"

Mr. Cohen concluded that the taxpayer should not refund the amount of tax charged on the sales of samples or showroom/store use carpet and may not take a deduction on the sales tax returns with respect to those refunds. Initially, I note that when the original sales remain subject to tax, whether the taxpayer refunds the sales tax reimbursement is governed by the contract and by business practices of the taxpayer and not by the Sales Tax Law. The Sales Tax Law would only be relevant on this point when the taxpayer is entitled to a refund of such sales tax, since the taxpayer would then be required to refund any sales tax reimbursement it had collected.

Neither of the taxpayer's transactions qualify for the returned merchandise deduction of Regulation 1655 since no merchandise is being returned. This means that the amounts at issue are included in the measure of taxpayer's tax liability unless those amounts never become gross receipts. That is, an amount that never becomes part of the consideration for the purchase of tangible personal property does not become part of the taxable measure, whether the seller merely charges a certain amount or, for example, the seller makes a deduction from the "usual" charge. Thus, an amount deducted from an initial computation to reach the agreed price is not part of the taxable measure when there was never an obligation to pay that deducted amount.

Both of taxpayer's examples can be restated as follows. Taxpayer sells certain items at retail and sells other items for resale. It collects sales tax reimbursement on its retail sales and reports the sales tax to us. When taxpayer's purchasers purchase sufficient quantities of the items for resale, taxpayer refunds the amounts the purchasers paid for the items sold to them at retail. An example of this might be that the purchaser purchases $100 worth of property at retail. If, over the course of the next year, the purchaser makes $1,000 worth of purchases for resale, the taxpayer would have collected $100 (plus sales tax reimbursement) for the retail sale and $1,000 for the sales for resale, and then would refund to the purchaser $100. The $100 of gross receipts from the retail sale remain subject to sales tax and no deduction is permitted by virtue of the refund to the purchaser. The reason for this is that the purchaser had been obligated to pay, and presumably paid, the $100 eventually refunded.

The following is an example of a transaction where taxpayer would be entitled to a deduction from its taxable gross receipts; however, it appears unlikely that this scenario occurred. Taxpayer sells property at retail for $100 and in the same transaction sells property for resale for $1,000. As part of that single contract of sale, taxpayer deducts $100 with reference to the retail sale so that the total sales price for the items is $1,000, all for the items for resale. Taxpayer does not owe sales tax on the $100 charge since, as part of a single contract, the purchaser was never obligated to pay that amount. However, taxpayer should be regarded as the consumer of those items and would owe use tax on its use of the items by giving them to the purchaser.

In summary, I believe that it is possible, but unlikely, that taxpayer could have had a transaction where the sales price for the samples and store use carpets would not have been subject to sales tax because the purchaser would never have been obligated to pay the sales price. However, even if this occurred, taxpayer would owe use tax with respect to those transfers. I believe that Mr. Cohen's letter would have been more accurate by stating that the sales price for the samples and store use carpets is subject to sales tax except when the purchaser is never obligated to pay the sales price, and that under the facts presented, it appears that all such sales are subject to sales tax. I also believe that Mr. Cohen's statement that taxpayer should not refund the amount of tax charged on the sales of samples or store use carpet is not an accurate statement since taxpayer may, if it wishes, refund such sales tax reimbursement.

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