STATE OF CALIFORNIA

570.0230

BOARD OF EQUALIZATION

APPEALS DIVISION

In the Matter of the Petition for Redetermination and Claim for Refund Under the Sales and Use Tax Law of:	)	HEARING DECISION AND RECOMMENDATION
G---, ET AL.	)	Nos. SN -- XX XXXXXX-010 SN -- XX XXXXXX-001
Petitioner/Claimant	)	

The above-referenced matters came on regularly for hearing before Hearing Officer James E. Mahler on July 18, 1990, in Hollywood, California.

Appearing for G---
Company:

T--- E. E---
Senior Tax Attorney
T---, Inc.

A--- J. N---
Senior Tax Supervisor
T---, Inc.

R--- B. B---
Tax Analyst
T---, Inc.

Appearing for the Department
of Business Taxes

Joseph J. Cohen
District Principal Auditor

Kenji Miyamoto
Senior Tax Auditor

Duane Kaifer
Senior Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1981, through December 31, 1983, is measure by:

Item	State, Local and County
Ex-tax purchases of casings	$1,066,667

A ten percent penalty in the amount of $6,400, for failure to file returns, is also protested.

Unresolved Issues

1. Whether the participants in the P--- Project formed a single "person" liable for sales or use tax.

2. Whether the assessment of tax is barred by the statute of limitations or in conflict with previous Board policy.

3. Whether the penalty for failure to file returns should be relieved.

Summary

G--- Company (G---) was a corporation engaged in the business of exploring and drilling for oil in California and other places. It held California seller's permit number SZ -- XX XXXXXX and filed California sales and use tax returns for the first and second quarters of 1981. It was previously audited for periods including those two quarters.

R--- D--- and E--- (aka P--- Ltd., hereinafter "R---") was also engaged in the business of exploring and drilling for oil. It had offices in [city], Colorado, and [city], Wisconsin. It did not hold a California seller's permit during the periods in question.

On or about July 15, 1980, G---, R--- and several other companies executed a document called P--- P--- F--- Agreement. The purpose of the P--- Project was to search for oil at a location in Kings County, California. G--- and R--- each owned a 25 percent share in the project. R--- acted as the manager or operator during pre-drilling phases up to April 1, 1981, and G--- was substituted as operator as of that date.

Drilling pipe and associated supplies for the project were purchased from two out-of-state vendors, S--- S--- Company (S---) of [city], Louisiana and T--- S--- Supply, Inc. (T---) of [city], Colorado. The purchase orders are not now available, but some of the vendor invoices are included in the audit workpapers.

The available invoices from T--- are addressed to R--- at its [Colorado] office, but indicate that the property was shipped to R--- in Bakersfield, California, by common carrier. However, other documents in the file show that the property was in fact shipped to a storage yard of A--- T--- Company (A---) in Bakersfield. A--- sent billing invoices to R--- charging for unloading the property at its storage yard, for monthly storage fees, and for subsequent transportation to the P--- jobsite.

The available invoices from S--- indicate shipment to R--- via S---'s own trucks. The invoices are addressed to R--- in Denver and state that the property was shipped to: "Same: Ultimate destination, Kings County, California" or "Same: c/o Kings County, California" or "Same: Kings County, California". No bills of lading or other documents are available to show the exact point of delivery.

Some of the invoices from R--- to T---, S--- and A--- are dated in the first quarter of 1981, when R--- was operator of the P--- Project, and some are dated in the second quarter after G--- became operator. In both quarters, R--- periodically sent its own invoices to G---. These invoices list the amounts billed to R--- by the suppliers, add a five percent "overhead and supervision" fee, and charge G--- 25 percent of the total as its "owner portion". G--- paid these amounts to R--- by check.

The prior audit of G--- questioned the billings from R---, but the auditor ultimately decided that G--- owed no tax on those billings. According to the Department of Business Taxes (DBT), the auditor's decision was based on "material misstatements" by G---'s employees. Apparently, G---'s employees told the auditor that R--- was the operator of the P--- Project and, as such, was the party responsible for any tax on equipment purchases.

We note that DBT has not assessed penalties for fraud or intentional disregard of the Sales and Use Tax Law. We view this as an implied finding that any misstatements made by G---'s employees, while perhaps material, were made by mistake with no intent to deceive the prior auditor.

After the prior audit of G--- was completed, DBT continued to investigate and ultimately concluded that G---, R--- and the other parties had formed a joint venture for the P--- Project. DBT concluded that the joint venture was itself a "person" distinct from any of the participants, and further, that R--- had acted as an agent of the joint venture when it purchased supplies from T--- and S---. A notice of determination assessing tax on the purchases was issued to the alleged joint venture on June 10, 1988, with a copy to each of the participants in the project, including G---.

G--- filed a petition for redetermination, then paid the determination under protest and filed a claim for refund. Among other things, G--- denied the existence of a joint venture and contended that any California tax on the purchases from T--- and S--- would be due from R---. In the meantime, G--- had become a subsidiary of T-2, Inc. (T-2) and T-2 is prosecuting the petition and refund claim on behalf of G---.

Regarding the measure of tax, the prior audit of G--- found that the purchases from T--- and S--- totaled $513,831, of which $328,215 was in the first quarter of 1981 and $185,616 in the second quarter. However, a subsequent audit of G--- for periods beginning July 1981 found a $64,000 entry in G---'s tax accrual account for that month. DBT concluded that this entry reflected tax on purchases for the P--- Project in the first and second quarters of 1981, which had been accrued by G--- with the expectation that G--- would pay it, but that G--- had not in fact paid it to the Board.

A $64,000 tax liability represents purchases of $1,066,667 ($64,000 divided by .06, rounded off) and the determination issued against the asserted joint venture was therefore measured by that amount. For reasons not clearly explained in the record, $680,831 of the total was allocated to the first quarter of 1981 and $385,836 was allocated to the second quarter.

Discussion at the appeal hearing focused on the question of whether the P--- Project was a joint venture. We suggested that resolution of this issue would depend on the terms of the parties agreement. T-2's representatives informed us that the agreement could not be presented in evidence because the parties are involved in litigation and the judge has issued a gag order. DBT's representatives stated, however, that an auditor had previously reviewed the agreement in connection with another matter and had made notes regarding some of its terms.

We understand that the auditor reviewed the P--- agreement in connection with another claim for refund filed by G---. It appears that some equipment purchased tax-paid for use on the P--- Project was stored in warehouses, then sold to third parties prior to any use. G---, in its capacity as operator of the project after April 1, 1981, filed a claim for refund on the ground that a tax-paid purchases resold credit was due. Based on the auditor's review of the P--- agreement, however, DBT found that the project was "not a person" for sales and use tax purposes, in part because all property purchased for use on the project was "owned separately and not jointly." DBT therefore concluded that G--- would be entitled to a tax-paid purchases resold credit only to the extent of its ownership interest in the property (25 percent), and the other participants in the project would have to file separate claims for their respective shares of the credit. (See the letter from the Hollywood District office to T-2 dated May 31, 1990, copy in petition file.)

According to the notes taken by the auditor in that review, the P--- agreement provided that the relationship among the parties would be a partnership for federal income tax purposes, but not a partnership for any other purpose. All liabilities to third parties would be several, not joint. The auditor also commented that the wording of the agreement was similar to other joint operating agreements examined by the staff in audits of other taxpayers. (The notes are attached to a memo from the auditor to the Hollywood District reviewer dated May 17, 1990, copy in petition file.

In concluding that the P--- Project was not a "person" for purposes of the tax-paid purchases resold credit, DBT apparently relied on a memo dated January 6, 1984, written by the Board's Principal Tax Auditor. The subject of the memo is "a specific joint operating agreement between co-owners of oil and gas leaseholds" in Alaska. The Principal Tax Auditor determined that the type of operating agreement described is not a 'person'" for sales and use tax purposes provided that "the parties are truly co-owners and not members of a true joint venture."

In the instant matter, on the other hand, DBT argues that the P--- Project was a "person". DBT relies on a letter written by the Board's tax counsel to another taxpayer on February 5, 1969. The subject of that letter is "jointly operated oil and gas fields" where "the equipment used in the enterprise is commonly owned by the participants…." The author notes that "differences between partnership property and property which is merely commonly owned result in different sales and use tax consequences." More specifically, the author agrees with the following statement regarding the operator's purchase of equipment and materials from a vendor for use in the operations:

> "The operator is considered purchasing on behalf of the participants. Thus, there is a taxable sale made by the vendor to each of the participants of the fractional interest acquired by each, to be collected by the vendor from the operator as the agent of the participants."

The author finds that such commonly owned enterprises are "persons" for sales and use tax purposes, but concludes:

> "…if the taxes of the jointly operated oil and gas field enterprises here in question are reported and paid by the operators under their permits, we will not require the enterprises to hold permits. We reserve the right, however, to require the enterprises to hold permits if it becomes necessary for proper administration of the law."

The P--- Project itself did not hold a seller's permit or file returns for the first and second quarters of 1981. In accordance with tax counsel's 1969 letter, DBT initially acquiesced in the enterprises's operating without a permit. DBT points out, however, that as a condition for operating without a permit, R--- and G--- (as operators) were required to file returns reporting all sales and use tax liabilities of the enterprise.

R--- did not file a return for the first quarter of 1981, when it was the operator of the enterprise. G--- did file a return for the second quarter, when it was operator, but did not report tax on the purchases from T--- and S---. DBT argues that the conditional authority to operate without a permit was therefore automatically revoked, and that the P--- Project itself should have held a permit and filed returns reporting tax on these purchases. Since it did not, DBT concludes that the statute of limitations for issuing a deficiency determination to the P--- Project was extended to eight years. (Citing Rev. & Tax. Code § 6487.)

Analysis and Conclusions

Revenue and Taxation Code Section 6005 defines "person" to include not only partnerships, joint ventures and other types of formal associations, but also to include "any group or combination acting as a unit." The parties who formed the P--- Project associated together at least as a group or combination acting as a unit, if not as a formal joint venture or partnership, and the association was therefore a person for sales and use tax purposes.

The important question, however, is not whether the association was a person, but whether it was the person which incurred a tax liability on the purchases from T--- and S---. For the following reasons, we conclude that it was not.

Section 6202 of the Code imposes use tax liability on the person who stores, uses or otherwise consumes in this state tangible personal property purchased from a retailer. Section 6009 defines "use" to include the exercise of any right or power over tangible personal property incident to the ownership of that property…."

The audit staff reviewed the P--- agreement and found that the property used in the enterprise was owned separately by the participants, not jointly by the association itself. This finding is consistent with similar agreements reviewed in audits of other taxpayers. If follows that the association was not the person which used the property in California and was therefore not the person which incurred a use tax liability.

The evidence before us would support alternative findings as to how the property came to be used on the P--- Project. The language of the billing invoices suggests that R--- purchased the property for resale to the participants. In that event, the applicable tax would have been a sales tax on R--- or a use tax on the participants, depending on whether R---'s sale to the participants occurred in interstate commerce. Alternatively, as recognized in tax counsel's 1969 letter, R--- may have been acting as an agent on behalf of the participants. In that event, the applicable tax was either a sales tax on T--- and S--- or a use tax on the participants, again depending on whether the sales were in interstate commerce. Under either scenario, however, the association itself did not purchase anything from anyone. Accordingly, the association did not incur a use tax liability.

Recommendation

It is recommended that the determination be cancelled and the claim for refund be granted.

1/17/91

James E. Mahler, Hearing Officer Date

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G--- O--- C---.	)	Nos. SZ -- XX XXXXXX-010
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Appearing for petitioner:

T--- E. E---
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District Principal Auditor

Kenji Miyamoto
Senior Tax Auditor

Duane Kaifer
Senior Tax Auditor

Protested Items

The protested tax liability for the period July 1, 1982, through June 30, 1985, is measured by:

	Item	State, Local and County
B.	Ex-tax purchases of capital assets and supply items ($3,946,763 minus unprotected amounts)	$ 8,913
D.	Ex-tax purchases of soda ash	$1,308,400

Petitioner's Contentions

Audit Item B. The applicable tax on the purchases of pipe was a sales tax on the vendor, not a use tax on petitioner.

Audit Item D. The applicable tax on the purchases of soda ash was also a sales tax on the vendor. Furthermore, the soda ash was purchased for a tax-included price.

Summary

G--- O--- Company, petitioner herein, is engaged in the business of exploring and drilling for oil. It was previously audited through June 30, 1981. It was an independent corporation at that time but became a subsidiary of T---, Inc. during this period.

Audit Item B. Petitioner purchased pipes for use in its California oil wells from E--- F--- Corporation (EFC) of [city], Oklahoma. EFC was not engaged in business in California and did not hold a California seller's permit.

EFC's invoice to petitioner states that the pipes were shipped from [city] aboard EFC's own truck, "FOB ["city"], and delivered to petitioner in Bakersfield, California. The invoice does not explicitly mention title in the pipes. Petitioner did not pay tax or tax reimbursement to EFC, nor did it report use tax to the Board. Use tax was asserted in the audit. Petitioner contends that the applicable tax should be a sales tax on EFC.

Audit Item D. Petitioner uses soda ash to clean its oil wells. Sometime prior to May 17, 1984, petitioner sent a bid specification sheet for soda ash to "T--- M--- Co." The bid sheet requested a price quote per ton "delivered to jobsite (including tax and freight)…."

A price quotation request was also sent out along with the bid sheet, addressed to "T--- M--- Co." at an address in [city], Texas. The request stated that bids should be "quoted on a delivered price to our field location, Bakersfield, California" with "FOB destination", but did not specifically mention tax. It also provided that:

> "Buyer's objective is to obtain competitive and firm pricing throughout the total contract period…. Any bids that do not meet outlined specifications, or include firm pricing for the [contract] period will not be considered."

In reply, petitioner received a letter on the letterhead of "T--- M--- - a T--- company" of that same [city] address. A copy of petitioner's bid request was attached to the letter with blanks filled in stating that the price would be $96 per ton, and that delivery would be from ["city'], Wyoming with truck delivery from Bakersfield, California."

Petitioner accepted the bid and sent a blanket purchase order to "T--- M--- Co." at the same [city] address. The purchase order identifies "T--- M--- Division" as the seller of the soda ash at the agreed price of $96 per ton, but does not expressly refer to the bid quotation and does not mention tax.

For each delivery of soda ash, petitioner received a billing invoice from "T--- M--- - a T--- Company" with an address in [city], Wyoming. The invoices charged the agreed price of $96 per ton, with no explicit mention of tax. Payment was to be sent to "T--- M--- Company – Soda Ash Account" at an address in [city], North Carolina. Petitioner did not request or receive a receipt for any taxes included in the price, nor did it report tax to the Board.

The invoices state that the soda ash was delivered to petitioner by independent trucking companies at "--- River field area as directed." However, according to testimony at the appeal hearing (with which the audit staff apparently agrees), the soda ash was in fact transported by train to a terminal in Bakersfield, California. The terminal was owned by I--- F--- & F--- Company. The trucking companies picked up the soda ash at this terminal and transported it to the jobsite.

The initial shipments of soda ash all originated from [city], Wyoming. However, by letter dated September 28, 1984, from T--- M--- - a T--- Company", petitioner was informed:

> "Per our phone conversation on September 26th, T--- M--- will begin to service a portion of G---'s soda ash requirement with soda ash from K--- M---. Under a swap arrangement, K--- M--- will furnish regular dense soda ash in rail cars to T---'s [---] River steam generator leases. T--- will continue to provide soda ash from our [Wyoming] facility in conjunction with K--- M---.

* * *

> "Pricing, quality, and service will be unaffected. T-1's commitment, as always, is to maintain high service standards and fast response to G---'s needs from our local terminal.

Thereafter, some soda ash continued to be shipped to the Bakersfield facility from Wyoming, but other soda ash was transported to Bakersfield from a plant owned by K--- M---. The location of this plant is not revealed in the record. The record also does not disclose the percentage of soda ash shipped from K--- M---.

The auditor investigated and determined that T--- M--- Company (hereinafter TM) is a corporation and is a subsidiary of T---, Inc. (hereinafter T-1). T-1 is engaged in business in California and holds a California seller's permit. TM is not engaged in business in this state and does not hold a permit.

Petitioner does not dispute the findings that TM and T-1 are separate corporations, and that TM itself has no place of business in this state. According to petitioner, however, when it issued its purchase order for soda ash, it believed in good faith that TM was merely a division of T-1, not a separate corporation, and that it was dealing with a California seller required to pay sales tax on sales of soda ash. In support, petitioner points out that it used the term "T--- M--- Division" in its purchase order; that TM referred to "T-1's commitment to insure delivery from "our local terminal" in its September 28, 1984 letter; and that the bid sheets requested a tax-included price. Petitioner also points out that any soda ash received from K--- M--- may have been shipped from a California location. Petitioner concludes that any applicable tax is due from TM, T-1 or K--- M---, and that the $96-per-ton price it paid included tax reimbursement.

Analysis and Conclusions

Revenue and Taxation Code Section 6201 imposes use tax when tangible personal property is purchased from a retailer for use in this state and is used here. Petitioner purchased the property in question from retailers for use in this state and used it here. Petitioner is therefore liable for use tax, unless there is some statutory basis for exemption.

Petitioner seeks exemption under Revenue and Taxation Code Section 6401, which provides:

> "The storage, use, or other consumption in this state of property, the gross receipts from the sale of which the purchaser establishes to the satisfaction of the board were included in the measure of the sales tax, is exempted from the use tax…."

DBT contends that petitioner is not entitled to a use tax exemption under Section 6401 on the ground that none of the transactions was subject to sales tax. DBT relies on subdivision (a)(2) of Sales and Use Tax Regulation 1620. Under this regulation, when the property is transported into California from a point outside this state, sales tax applies only if two requirements are satisfied. First, there must be "local participation" in the transaction by or

through a California place of business of the seller. Second, the sale must occur in this state. If either of these requirements is missing, the vendor is not liable for sales tax.

As a general rule, the sale occurs at the time and place where the property is physically located when title passes to the customer. (Rev. & Tax. Code §§ 6010.5 and 6006.) the law governing passage of title is set out in California Commercial Code Section 2401, subdivision (2) of which provides:

> "Unless otherwise explicitly agreed title passes to the buyer as the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading.
>
> (a) If the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but
>
> (b) If the contract requires delivery at destination, title passes on tender there."

With respect to the purchase from EFC, DBT argues that title passed in Oklahoma because the billing invoice stated "FOB [city]". In our view, however, an FOB clause is not an explicit agreement for the passage of title. The sale contract (as reflected in the billing invoice) required EFC to deliver at destination in California via its own trucks. The contract was therefore a destination contract and, under California Commercial Code Section 2401(2)(b), title passed to petitioner upon delivery in California.

Nevertheless, we agree with DBT that EFC was not liable for sales tax. Under Regulation 1620, when the property is brought into California from a point outside this state, sales tax does not apply unless there is "local participation" in the transaction by a California place of business of the seller. EFC had no place of business in California, so there obviously was no "local participation". Since the gross receipts from the sale were not included in the measure of sales tax, petitioner is not entitled to a use tax exemption under Section 6401.

We reach the same conclusion with respect to the purchases of soda ash delivered to petitioner from a location or locations outside California. The audit found that any place of business of T-1 in California was not a place of business of TM, since TM and T-1 were separate corporations, and petitioner has failed to present any contrary evidence. More importantly, even if TM did have a place of business in California, it did not participate in any way in these transactions. Lacking "local participation", sales tax does not apply, and petitioner is liable for use tax.

As petitioner points out, it is possible that some of the soda ash may have been delivered to Bakersfield from California by K--- M---. If that occurred, there was no interstate shipment, and the provisions of Regulation 1620 would not govern this case. TM would therefore be liable for sales tax, even if there was no "local participation". (Indeed, K--- M--- might also be liable for sales tax under the second paragraph of Revenue and Taxation Code Section 6007.) Again, however, petitioner has failed to present evidence that any of the soda ash was in fact delivered from a point in California.

Section 6401 expressly provides that the exemption from use tax is available only to persons who prove "to the satisfaction of the Board" that the gross receipts from the sale were included in the measure of sales tax. Since Petitioner has failed to prove that these were sales tax transactions, petitioner is not entitled to the use tax exemption.

Finally, petitioner contends that the amount it paid to TM included tax and that its liability to the state has therefore been satisfied. We agree that the $96-per-ton contract price included use tax, but conclude that petitioner remains liable to pay to the state. However, we also find that an adjustment to the measure of tax is warranted.

The bid specifications and request which petitioner sent to TM asked that the quoted price include tax. TM was expressly advised that nonconforming bids would not be accepted. Therefore, the $96-per-ton contract price ultimately accepted by petitioner included California tax, even though tax was not expressly mentioned in the purchase order or billing invoices. (See Cal. Comm. Code § 2007(1); see also Steiner v. Mobil Oil Corp., 20 Cal.3d 90, and Lockheed Electronics Co. v. Keronix, 114 Cal.App.3d 304.)

Revenue and Taxation Code Section 6226 requires all retailers selling tangible personal property for use in this state to register with the Board. Section 6206 of the Code provides that any use tax required to be collected from the customer must be separately stated. TM violated these statutes when it quoted a tax-included price to petitioner. The fact remains, however, that it did quote a tax-included price.

Section 6010 of the Code defines "sales price", which is the measure of use tax, to mean the total amount for which tangible personal property is sold. There is no express provision in this statute which allows use tax collected by the vendor to be deducted from the measure of tax. Such a deduction is required, however, since a contrary construction of the statute would lead to absurd results. For example, a $100 charge for property would require tax of $6, for a total of $106; which in turn would require tax of $6.36, for a total of $112.36; and so on ad infinitum. Accordingly, the measure of use tax does not include the tax collected by TM.

A tax-included price of $96 per ton translates to $90.57 for soda ash and taxable transportation, plus tax of $5.43. We therefore recommend a reaudit to reduce the measure of tax to $90.57 per ton.

Although petitioner has already paid tax to TM, it nevertheless remains liable to pay tax to the Board. Revenue and Taxation Code Section 6202 provides that a person's liability for use tax:

> "…is not extinguished until the tax has been paid to this State except that a receipt from a retailer engaged in business in this State or from a retailer who is authorized by the board, under such rules and regulations as it may prescribe, to collect the tax and who is, for the purposes of this part relating to the use tax, regarded as a retailer engaged in business in this State, given to the purchaser pursuant to Section 6203, is sufficient to relieve the purchaser from further liability for the tax to which the receipt refers."

TM was not authorized by the Board to collect use tax and has not paid the use tax to the state. Petitioner neither requested nor received a receipt for use tax from TM. Therefore, petitioner's liability for the tax is not extinguished. Petitioner finds itself in this predicament because it paid tax to TM without verifying that TM was an authorized retailer. Petitioner's remedy is to seek redress from TM.

Recommendation

Reaudit to reduce the measure of tax on soda ash purchases from $96 per ton to $90.57 per ton. Redetermine without other adjustment to the tax.

_____	1/17/91
James E. Mahler, Hearing Officer	Date