

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

**715.0490**

In the Matter of the Petition	)	
for Redetermination Under the	)	DECISION AND RECOMMENDATION
Sales and Use Tax Law:	)	
	)	
T---, INC.	)	No. SZ OHA XX XXXXXX-020
	)	
<u>Petitioner</u>	)	

This petition was heard on Wednesday, January 24, 1979, at 9:00 a.m. in Sacramento, California, by Hearing Officer Donald J. Hennessy.

Appearing for Petitioner:

W--- D---, Manager – State and Local  
Tax Research and Planning

B. G. C---, Assistant Controller  
Tax Administration

Appearing for the Board:

Jack E. Warner, District Principal Auditor

Protested Items  
(Audit Period 1/1/73 to 6/30/76)

Petitioner protests a Notice of Determination dated October 23, 1978, for tax and interest in the total amount of \$425,401.25. Petitioner herein seeks a decrease in tax of \$102,328.45 plus the interest attributable thereto. Specific protest is to the disallowance of a credit of \$3,057.60 for tax paid to other states, and to the entire measure of tax included in Items E and Q of the Report of Field Audit dated September 8, 1978, which read as follows:

- E. Sales of kennels, overnight bags understated.
  
- Q. Fuel purchases considered to be subject to local tax.

Contentions of Petitioner

1. A credit of \$3,057.60 is allowable for tax paid to other states pursuant to Section 6406 of the Revenue and Taxation Code. (All section references hereinafter are to such code.)

2. (Item E of audit report) A tax reduction of \$1,707.70 is due on the basis that Petitioner's selling price included tax.

3. (Item Q of audit report) A local and transit district tax reduction of \$97,563.78 is due with respect to purchases of jet fuel used or consumed by Petitioner in its operations as a certificated common carrier by air and not used principally within the county of sale.

#### Summary of Petition

Petitioner is a corporation engaged in business as an air common carrier with both domestic and international operations. There was a prior audit through December 31, 1972.

(1) (Section 6406 credit for tax paid to another state.) In a memo dated December 13, 1978, the Chicago audit staff states, "We agree that an additional credit of \$3,057.60 should be allowed. This was an oversight which was not caught by the auditor or taxpayer during the course of the audit."

As there is now agreement on this issue, we will not discuss it further herein. The additional credit should be allowed in the redetermination.

(2) (Item E of the audit report.) In connection with its common carrier services, Petitioner makes some sales of miscellaneous merchandise. The merchandise is generally limited to dog kennels, flight bags, and travel booklets, and is generally of a low price character. These sales are often made by ticket agents just prior to a flight and sales tax is not separately stated to the customer. Neither is there any sign or advertising stating that the sales are for a tax included price. Nevertheless, Petitioner computed the sales tax due as if the selling price were tax included. Petitioner believes this procedure was authorized by the last paragraph of Section 6012.

It was not Petitioner's intention to absorb the tax applicable to these sales but only to facilitate such sales without causing major disturbances to the ticket agents. Adequate provisions for making change (selling price was rounded off) and providing cash register receipts were not effectively accomplished because of the incidental and inconsequential nature of these sales. Nevertheless, Petitioner believes the tax has been properly collected and paid to the Board.

(3) (Item Q of the audit report.) This is the main issue here and involves purchases of jet fuel used or consumed by Petitioner in its operations as a certificated common carrier by air. Regarding jet fuel purchases, Petitioner quotes Section 7202(h) as follows:

A provision that there is exempted from the sales tax 80 percent of the gross receipts from the sale of tangible personal property to operators of aircraft to be used or consumed principally outside the county in which the sale is made and directly and exclusively in the use of such aircraft as common carriers of persons or property under the authority of the laws of this state, the United States, or any foreign government.\*

No longer applies to sales of fuel. SPJ 5/26/00. See R&T §7202.

Similar provisions are in the statute for local use tax and district transaction and use taxes. Any such tax applicable on 20 percent of the gross receipts from jet fuel sales has already been determined and paid and is not in issue here. Petitioner furnished the oil company which sold the jet fuel with an exemption certificate claiming all fuel was entirely exempt from local and district tax. The contracts for purchases of jet fuel were principally negotiated outside California.

The audit considered the county (Los Angeles and San Mateo) in which the jet fuel was delivered to be the place of sale. The amount of fuel to which state tax would not apply (Section 6385) was computed by the usual first-in first-out (FIFO) method. As state tax did not apply to such fuel, neither did any local or district tax. Such flights where no local or district tax applied because all fuel boarded was carried to an out-of-state destination under a bill of lading reduced the local tax base by 9 percent at San Francisco Airport (San Mateo County) and by 7.3 percent at Los Angeles Airport (LAX).

When the state tax applied to a portion of the fuel purchased, the auditor used percentages (5.6% at SFO); 8.1% at LAX) furnished by Petitioner to compute the amount of fuel consumed within Los Angeles or San Mateo County (counties of purchase). The local tax was applied to such amount (\$9,740,823) as not being within the exemption provided by Section 7202(h) as above quoted. The exemption was applied only to jet fuel consumed outside the county of sale. In addition, the small amount (\$31,109) of fuel consumed at the Oakland Airport (Alameda County) was considered subject to the district tax (BART).

Petitioner disagrees with the audit on the ground that Regulation 1805(d) (Title 18, Cal. Admin. Code; all regulation references hereinafter are to such code), which gives special treatment to fuel, conflicts with the statute. Petitioner presumes that the Board's position is based on the belief that not all such fuel is consumed principally outside the county of sale. The language giving special treatment to fuel was added to Regulation 1805 effective October 26, 1974, yet is applied to the entire audit period beginning January 1, 1973. Petitioner believes that fuel purchases must be viewed in bulk and, if they are, that the bulk amount purchased is principally consumed outside the county of purchase. Petitioner does not believe a single purchase can be divided into purchases of individual gallons. The Legislature's use of the word "principally" is seen as contemplating that there would be some consumption in the county of purchase without impairing the exemption.

In addition, Petitioner believes the FIFO method of computing the state tax on fuel purchases must also be applied to compute local tax, since Sections 7202, 7203 and 7261 make clear that no local tax can apply to purchases not subject to state tax. Petitioner believes that the Board abandons FIFO in favor of last in-first-out (LIFO) when computing local tax. Believing that in almost all cases an aircraft has enough fuel on board prior to refueling to get it outside California, and certainly outside the county of purchase, Petitioner contends that, on a FIFO basis, none of the purchased fuel is burned in the county of purchase.

Regulation 1805 no longer provides any fuel exemption. See current jet fuel place of sale rules at §§ 7204.03 and 7205.
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Lastly, Petitioner argues that the application of the place of sale rules here produces an arbitrary and unreasonable result, i.e., if a fuel supply contract is executed at an oil company office on Montgomery Street in San Francisco, no local use tax applies, if no fuel is consumed (used) in San Francisco County; whereas if an identical contract is executed in an oil company office in Houston, Texas (or at any other point outside California), the local use tax of the county in which the fuel is delivered applies. This is seen as artificial, arbitrary and clearly not the legislative intent.

### Analysis and Conclusions

(1) See above Summary.

(2) (Item E of the audit report; sales of dog kennels, flight bags, etc.) Regarding this tax included argument, the Chicago audit staff's memo of December 31, 1978 points out that, if Petitioner's arguments are accepted, the reaudit adjustment would be only \$482.71 rather than the claimed \$1,707.07. The difference of \$1,224.36 was caused by accruing tax of 4 percent during 5 percent periods and 5 percent during 6 percent periods.

To add to the difficulties, Petitioner was "rounding off" tax reimbursement. Such "rounding off" is specifically stated in Regulation 1700 to be a circumstance indicating knowingly computed excess tax reimbursement which must be returned to the customer (impractical here) or paid to the State. We have no idea of the amount of such excess reimbursement. We do know that excess collections cannot be offset against undercollections. (Reg. 1700.)

Given this mish-mash of reimbursement procedures and errors, we believe that the more stringent requirement of Section 6052.5 that a retailer "...post a notice in his premise stating that each posted or advertised price includes reimbursement so computed..." applies here, rather than the more liberal requirement of Section 6012 that tax-included be established "...to the satisfaction of the board..." A tax included price was properly disallowed in the audit.

(3) (Item Q of the audit report; local and BART tax.) the local and BART tax determined here is a sales tax due to Petitioner having issued exemption certificates on the purchase of the fuel. (See Section 6421.) Petitioner's objection is three-fold: (a) the word "principally" is misinterpreted; (b) the FIFO method used to apply Section 6385 should also be applied to local and district taxes; and (c) the place of sale should be considered outside California.

(a) Interpretation of Principally. Petitioner objects to the statement in Regulation 1850 (local tax) and 1825(d) (BART tax) that, "In the case of fuel which is consumed partly inside and partly outside the county of sale, the exemption applies only to the fuel consumed outside the county of sale." Our investigation reveals that the amendments to such regulations, effective October 26, 1974, were only a restatement of a longstanding Board interpretation of the exemption. Our research reveals that as early as 1957, Sales Tax General Bulletin (STGB) 57-28 stated:

Note changes to rules concerning place of sale for jet fuel at §§ 7204.03 and 7205 & deletion of partial exemption for fuel to be consumed outside county in which sale is made.
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Fuel oils used to propel motor vehicles, locomotives, waterborne vessels and airplanes are consumed at the time combustion occurs; hence, purchases of fuel oil for use in the operation of common carriers and water borne vessels are exempt from county sales tax only to the extent that the fuel is consumed outside the county of purchase. In this respect fuel oils differ from other types of tangible personally property, such as lubricating oils, trucks and tires, with a longer useful life.”

To the same effect is Business Taxes Law Guide (BTLG) Annotation 700.0140 (CCH State Tax Reporter, Calif., Vol. 3, 60-021.36) dated October 31, 1956, which distinguishes lubricating oils and greases from fuel oil on the grounds that “...they are not consumed by combustion as in the case of fuel. Their use is a continuing use of the total amount purchased. If the oil and grease is used in vehicles traveling a greater number of miles outside the county than inside the county, the sale of the oil and grease falls within the exemption.”

Petitioner therefore correctly perceived that the Board gives special treatment to fuel by looking on one portion of a bulk purchase of fuel as being entirely consumed on combustion within the county of purchase, while the remaining portion is entirely consumed outside the county. It is the difference between tangible personal property (lubricating oil), the whole of which is only gradually consumed, and tangible personal property (fuel), parts of which are entirely consumed on first use.

We are sure nothing further we might say will convince Petitioner that this is a proper interpretation of the word “principally” in the statute. Nevertheless, the Board’s position is of longstanding and, as embodied in a duly enacted regulation, will not be overturned unless arbitrary and capricious. (Mission Pak Co. v. State Board of Equalization, 23 Cal. App. #d 120, 125.) For periods before the distinction was embodied in the regulations, the Board’s contemporaneous interpretation of the statute (it goes back to the enactment of the Bradley Burns Uniform Local Sales and Use Tax Law in 1956) is entitled to great weight. (Culligan Water Conditioning v. State Board of Equalization, 17 Cal. 3d 86.) If reasonable minds may well be divided as to the wisdom of an administrative board’s action, its action is conclusive. (Rible v. Hughes, 24 Cal. 2d 437, 445 (Cited in Mission Pak case, supra.)) We must approve the audit position here.

(b) FIFO v. LIFO Method. Admittedly, the Board applies the FIFO method in deciding the amount of state tax, if any, due on sales of fuel under Section 6385. If a common carrier aircraft has enough fuel on board prior to California fueling to reach the first out-of-state landing point, all of the fuel purchased in California is exempt from state sales and use tax. But, contrary to our understanding at the hearing and to Petitioner’s contention, this application of the FIFO method to state tax was also followed as to local and district tax in the audit. On audit Schedule 10), pg. 3, the auditor states “Then short-range flights where no tax would apply had to be eliminated. These were calculated on the basis of B/L obtained for several days in December 1975 per 10)-1”. Read in conjunction with the computation of “burn-out” fuel in the audit, we read the auditor’s statement to mean that, if no state tax applied after a FIFO computation, then

no local or district tax could apply, which is correct. Therefore, FIFO was also applied to local and district taxes when its application resulted in no state tax.

If, however, only a portion of the sale was exempt from state tax (i.e., if less than the total amount purchased was covered by a billing of lading), the sale of the portion not so covered was subjected to state tax and the portion used within the county of purchase was subjected to local and district tax according to the percentages supplied by Petitioner. (5.6% at SFO; 8.1% at LAX.) In other words, when any tax applied, LIFO was used, rather than FIFO, for state, local, and district purposes.

Therefore, we do not find the inconsistency complained of; like accountancy treatment is afforded under each of the statutes. Granted, an application of FIFO to all situations would often avoid all tax, and we assume that is really the contention here, but we do not believe the State is required to use solely FIFO, and we believe petitioner's argument fails.

Granted, our above description of the audit method regarding FIFO and LIFO is taken solely from the audit work papers (Schedules P). We ask that the audit staff in particular compare the audit method to our description of it and inform us in writing of any material differences.

(c) The Place of Sale. Petitioner finds arbitrariness in local tax applying to a California delivery of fuel, if the contract was signed outside California, but no local tax applying if the contract was signed in a California county other than the county in which the fuel was delivered. The starting point for this strange state of affairs (the transaction having the most nexus with California is the one not taxed) is Section 7205 which states that, when a retailer has more than one place of business, the place of sale shall be determined by Board regulation. Regulation 1802(a)(2) states, "If a retailer has more than one place of business in this State which participates in the sale, the sale occurs at the place of business where the principal negotiations are carried on." (Underlining added.) Therefore, when two places of business in California are involved, but they are in different counties (contract signed in San Francisco County; fuel delivered at SFO in San Mateo County), San Francisco County is the place of sale and no tax applies if no fuel is consumed in San Francisco County.

When two places of business are involved in the sale, but only one of them is in California (contract signed in Houston, Texas; fuel delivered at SFO), the Board staff's position as stated in BTLG, Annotation 710,0030 is that the place of sale "...is the place where the order for delivery of the fuel was taken and the fuel was delivered to the airline common carrier." The annotation is based on Regulation 1802 stating that the place of principal negotiations is the place of sale only when more than one place of business in this State participates in the sale. The rule does not apply when one of the participating places of business is outside California. Then Annotation 710.0030, in effect, defines the one place of business in this State which participates as the place of sale.

We find nothing arbitrary about the conclusion that the place of sale is the place where the fuel is delivered. This logical and straightforward rule applies whenever only one place of business in California participates in the sale and that is the place where the fuel is delivered.

Granted, when two places of business in California participate in the sale, a rule is required to allocate tax between local jurisdictions, and whatever rule is adopted will probably be attacked as having an arbitrary element. The place of principal negotiations rule adopted by the Board, if arbitrary, is arbitrary in Petitioner's favor since negotiating a contract in a county with no large airport often results in no local tax. Petitioner now responds that the arbitrary rule be expanded at the expense of the straightforward and logical rule applied when only one place of business in California participates in the sale. This might be described as looking a gift horse in the mouth. If there is an arbitrary element to the principal negotiations rule, the remedy is not to expand the rule, and therefore expand the arbitrariness, but to limit such rule, or even abandon it in favor of a more logical rule. Petitioner is encouraging the Board to go in the wrong direction.

Recommendation

Increase Section 6406 credit by \$3,057.60 as recommended by Chicago audit staff's memo dated December 13, 1978. Redetermine without other change.

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Donald J. Hennessy, Hearing Officer

3-26-79

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Date