

**STATE BOARD OF EQUALIZATION**

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March 12, 1992

Mr. C--- F. L---, Jr.  
L---, R---, M---, M---  
C--- & T---  
XXXX --- Avenue, Suite XXX  
---, California XXXXX

RE: S--- S--- Farms  
SR -- XX-XXXXXXX

Dear Mr. L---:

This is in response to your letter dated January 27, 1992. You ask our opinion with respect to the application of sales tax to the sale of pallets to your client, S--- S--- Farms.

S--- sells ---, which is loaded onto pallets used to deliver the ---. S--- makes no separate charge for deposit for the pallets. You explain further:

- “4. Although the taxpayer’s invoice used to contain the verbiage: ‘PALLETS REMAIN THE PROPERTY OF S--- S--- FARMS,’ it no longer contains said verbiage. At all times, third party independent contractors have picked up the pallets at customers’ places of business. A list of delivery addresses is provided daily to the contractors by the taxpayer. The contractors, in fact, sell these pallets back to the taxpayer.
- “5. These contractors also work for other --- farms or have other businesses.
- “6. Based on an analysis by the taxpayer, less than fifty (50%) percent of the pallets have been ‘returned’ to the taxpayer by the contractors in the past. Taxpayer expects to exceed fifty (50%) percent in the future.
- “ . . .
- “9. In summary, the following are the facts with respect to the pallets that the taxpayer uses in its business:

- a. The pallets that the taxpayer uses in its business are all purchased by the taxpayer. Some are purchased as new pallets, and some are purchased as used pallets.
- b. The used pallets that taxpayer uses are purchased from independent contractors and are comprised of pallets that taxpayer had previously used in the sale of ---, and in some cases, includes pallets that belong to taxpayer's competitors.
- c. The used pallets may comprise more than fifty (50%) percent of the pallets that were originally used in the delivery of the --- - depending on whether the original guidelines apply, or more efficient salvaging develops.
- d. No deposit is charged for pallets.
- e. No separate charge is made for pallets."

Initially, I note that we do not necessarily agree with your characterization that the third party contractors "sell" pallets to S---. S--- instructs the contractors where to pick up pallets and pays the contractors for that service. You recognize that the Board may consider the pallets to be "returnable containers" if more than fifty percent of the pallets used by S--- to deliver the --- are returned to S---. S--- disagrees for the following reasons:

- "1. Taxpayer makes no separate charge and receives no deposit for the pallets.
- "2. Taxpayer's cost of the new and used pallets is actually a part of the price of the --- that is sold to the customer, regardless of whether the portion of used pallets exceeds fifty (50%) percent. The sales tax is collected upon such sale and the Board thus appropriately gets its sales tax at that time.
- "3. Because of the foregoing, the issue of whether used pallets originally purchased by taxpayer are 'returnable containers' and thus, taxable at acquisition should be irrelevant. The costs of all containers, whether used or new, are part of the cost of the --- that is sold by taxpayer to its customers. A sales tax, measured by S--- cost is collected upon said event. Thus, the Board has fully collected the sales tax that is payable in the described stream of commerce."

Revenue and Taxation Code section 6364 provides an exemption for certain nonreturnable containers when sold without contents for resale with contents and for certain returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for filling. That is, the sale of a returnable container to a retailer who will use the container in selling or delivering his or her product is the retail sale subject to sales or use tax. (Associated Beverage Co. v. Board of Equalization (1990) 224 Cal.App.3d 192.) Section 6364

defines "returnable containers" to be containers of a kind customarily returned by the buyer of the contents for reuse. If the pallets in question here are of a kind customarily returned by the buyer for reuse, then they are returnable containers.

Regulation 1589 provides further explanations of what constitutes a returnable container. Subdivision (a) explains that containers constitute returnable containers if title to those containers is retained by the seller of the contents or the seller takes a deposit for those containers. When the seller of the contents retains title to the container or collects a deposit for return of the container, then no further analysis is necessary: the container is a returnable container. However, even if there is no specific retention of title or collection of deposit, the analysis is not complete. Rather, we must still ascertain whether the container is a type that is customarily returned to the seller of the contents. We have long recognized pallets to be the type of containers that are customarily returned to the seller of the contents. (See, e.g., Business Taxes Law Guide Annotations 195.0720 (6/27/56), 195.1560 (12/7/55).) As you note, we generally apply a fifty percent return rule to ascertain whether, in a particular instance, a retainer will be regarded as a returnable container within the provisions of section 6364. Therefore, even if the seller does not specifically retain title to the containers and does not take a deposit for their return, if more than fifty percent of the containers are returned to the sellers of the contents, we regard those containers as returnable containers.

With respect to your second and third arguments against these containers being regarded as returnable, a seller's overhead expenses are invariably included in the calculation of that seller's sales price. Nevertheless, sales of tangible personal property to that seller for use in the seller's business are not sales for resale or tax exempt because they are an overhead expense that will be added to the seller's calculation of sales price, even when that sale price will be fully taxable. When S--- purchases gardening equipment it uses in growing the ---, the amount paid for that equipment is factored into S---'s cost of doing business and is presumably included in the sales price of the ---. Nevertheless, the sale of that equipment to S--- is a sale at retail and is subject to sales or use tax. The pallets in question are simply another type of property used by S--- in its business operations. If qualifying as returnable containers, the fact that S---'s cost of those containers will be used to calculate its sales price of --- has no bearing on taxability of the pallets when sold to S---. Even if S--- does not specifically retain title to the pallets and does not collect deposit for those pallets, if more than fifty percent are returned to S---, they are returnable containers and subject to sales tax on their sale to S---.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine  
Senior Tax Counsel

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