

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 323-7977

April 9, 1991

Mr. J--- -, H---
Tax and International Accounting Manager
S--- Company
E--- & W---
---, Illinois XXXXX

Dear Mr. J---:

Re: SR --- XX-XXXXXX-010

Enclosed is a copy of the Decision and Recommendation pertaining to the petition for redetermination in the above-referenced matter.

I have recommended that the taxes be redetermined in accordance with the reaudit dated December 21, 1988 as explained in the Decision and Recommendation.

There are three options available to you at this point.

1. If, after reading the Decision and Recommendation, you believe that you have new evidence and/or contentions, you should file a Request for Reconsideration. No special form is required to file the Request for Reconsideration, but it must be filed within 30 days from the date of this letter and clearly set forth any new contentions. If new evidence is the basis for filing the request, the evidence must be included. Direct any such request directly to me, with a copy sent to the State Board of Equalization, Post Office Box 942879, Sacramento, California 94279-0001, Attn: Principal Tax Auditor. I will subsequently notify you whether the request has been taken under review or whether the request is insufficient to warrant an adjustment. If I conclude that no adjustment is warranted, I will then notify you of the procedure you can follow to request an oral hearing before the Board.

2. If, after reading the Hearing Decision and Recommendation, you find that there is no basis for filing a Request for Reconsideration, but nevertheless desire to have an oral hearing before the Board, a written request must be filed within 30 days with Ms. Janice

Mr. --- -. ---
S--- Company – SR --- XX-XXXXXXX-010

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Masterton, Assistant to the Executive Director, Board of Equalization, Post Office Box 942879,
Sacramento, California 94279-0001.

3. If neither a request for Board hearing nor a Request for Reconsideration is received within thirty (30) days from the date of this letter, the Hearing Decision and Recommendation will be presented to the Board for final consideration and action.

Very truly yours,

W. E. Burkett
Hearing Officer

WEB:af
Enc.

cc: Ms. Janice Masterton
Assistant to the Executive Director (w/enclosure)

Mr. Glenn Bystrom
Principal Tax Auditor (file attached)

--- – District Administrator (w/enclosure)

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

295.0713

APPEALS DIVISION

In the Matter of the Petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
S--- COMPANY) No. SR --- XX-XXXXXX-010
)
)
Petitioner)

The above-referenced matter came on regularly for hearing before Hearing Officer W. E. Burkett on September 10, 1990 in Chicago, Illinois.

Appearing for Petitioner:

Mr. J--- -, H---
Tax and International
Accounting Manager

Mr. G--- P---
Staff Tax Account

Appearing for the
Department of Business Taxes

Mr. Terrence Dudek
Supervising Tax Auditor

Mr. Gary Wolferman
Senior Tax Auditor

Protested Item

The protested tax liability for the period October 1, 1983 through September 30, 1986 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Additional taxable sales to U--- O--- Company	\$1,221,854

Contentions of Petitioner

1. Blending is an exempt service.
2. Storage charges are not taxable because they were incurred after title passed to U--- O--- Company.
3. The transportation charges are exempt because the terms of sales were "F.O.B. ---, Illinois".
4. The charges for the letter of credit are not gross receipts from sales of tangible personal property.

Summary

The petitioner is a corporation engaged in the business of manufacturing and selling chemical products. A prior audit of petitioner was conducted through March 31, 1980.

This protest relates to certain charges made to U--- O--- C--- of California (U--- O---) pursuant to a contract entered into with U--- O--- to produce and deliver a petroleum sulfonate mix for use by U--- O---. This contract, a copy of which has been made a part of the petition file, generally required petitioner to provide the raw material to mix the product, to store it for use, and to ship to U--- O--- according to its scheduled needs. A separate provision was made in the contract for the raw material, storage, transportation, and for the cost of letters of credit which served in lieu of a performance bond.

For unrelated business reasons U--- O--- prepaid the entire amount anticipated as the price for the product and related services. A reaudit adjustment has been made for the portion of this advance payment that involved compensation for amounts not delivered as a result of an agreed reduction of U--- O---'s requirements.

The parties' contract was amended in 1983 to provide for additional delays in the shipment of the goods and for additional intervening storage at Richmond, California.

The petitioner only paid tax on the material portion of the charges rendered.

It is contended that the charge for blending is an exempt service because title passed to the purchaser prior to the time the service was performed.

It is contended that the charge for storage in Illinois and also at Richmond, California are exempt because they occurred after title passed to U--- O---. Its representative cites the claim that title to the property had passed to U--- O--- as the basis for exemption.

The claim for exemption of the transportation charges is based upon the provision in the contract provided for F.O.B. ---, Illinois.

The Department of Business Taxes (Department) contends that the charges for blending were properly subject to the tax because this service was a process required for the production of the end product.

The storage charges are subject to the tax because this service was an integral part of the sale of the property.

The Department contends that the delivery charges were subject to the tax because the transshipment to Richmond, California did not constitute a shipment directly to the purchaser as required by the statute granting an exemption for the transportation services.

Analysis and Conclusions

It is our conclusion that the petitioner's protest is without merit. Our analyses for each of the protested charges are as follows:

Blending Charges

Under the provision of the Uniform Commercial Code, an "F.O.B." designation is considered to be a term defining the seller's obligation with respect to delivery unless otherwise agreed by the parties. (See California Commercial Code Section 2319.) In this case it is clear that the parties had agreed that the F.O.B. designation was merely a pricing and not a delivery term because other provisions of the contract otherwise provided for delivery of the product to another location. (See particularly, paragraph 47 of the original contract.)

In any event, the result would not be different even if we were to assume that title to the property passed to U--- O--- prior to the blending. Under the provision of Revenue and Taxation Code Section 6006(b) a statutory sale is defined to include:

"the producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting."

This statute is implemented by the provisions of Regulation 1526(b) which reads in pertinent part as follows:

"Producing, fabricating, and processing include any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property...."

It is thus apparent that the blending activity, a step in the process of producing petroleum sulfonate, would have been classified as a statutory sale even if title to the raw materials had passed to U--- O--- prior to the time the blending was performed.

Storage Charges:

It is our conclusion that the storage charges are includable in gross receipts as services that were “a part of the sale” as provided in Revenue and Taxation Code Section 6012(b)(1). These are not independent services, but rather, services that were provided in connection with the performance of the sales contract. All services were in fact performed prior to the delivery and passage of title to the goods.

Delivery Charges:

The provisions of Revenue and Taxation Code Section 6012(c)(7) provided a limited exemption for “Separately stated charges for transportation from the retailer’s place of business or other point from which shipment is made directly to the purchaser.” (Emphasis added.) In order to obtain the exemption, there must be strict compliance with all of its requirements.

In this petitioned matter the property was transshipped from ---, Illinois, to Richmond, California, and the property was consigned to petitioner at this destination. It was stored at this location and the charges for the storage were billed by the petitioner to U--- O---. Accordingly, it is quite clear that the shipment was not directly to the purchaser as required by the terms of the exemption statute. The property was in fact transshipped by petitioner from Richmond, California, to U--- O---’s business location and an exemption was granted for this shipment.

Letter of Credit Charges:

The extraordinary charges for the letters of credit were includable in gross receipts from sales under the provisions of Revenue and Taxation Code Section 6012 defines “Gross Receipts” to mean the total amount of the sale without any deduction on account of the following:....”

“(a)(2) The cost of the materials used, labor or service cost, interest paid, losses, or any other expense.”

The mere separate statement of reimbursement for an item of expense incurred under the terms of the sales contract does not provide grounds for exemption.

Recommendation

It is recommended that the taxes be redetermined in accordance with the reaudit dated December 21, 1988.

W. E. BURKETT, HEARING OFFICER

3-15-91
Date