

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

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

The Appeals conference in the above-referenced matter was held by Staff Counsel Michele F. Hicks on September 23, 1992 in Van Nuys, California.

Appearing for Petitioner:

Mr. R. J--- O---
Vice President
Finance & Treasurer

Mr. D--- L---
Tax Manager

Mr. M--- J. O---
Director
O---Programs

Appearing for the
Sales and Use Tax Department:

Mr. William J. Faiola
Supervising Tax Auditor

Mr. Luis Torres
Tax Auditor

Protested Item

The protested tax liability for the period July 1, 1985 through March 31, 1989 is measured by:

| <u>Item</u> | <u>State, Local and County</u> |
|---|------------------------------------|
| E. Claimed exempt validation testing charges. | \$409,170 |

Petitioner's Contention

Validation testing is exempt because the validation work is performed on the wheels which are resold rather than on the tooling/mold.

Summary

Petitioner is a manufacturer of automotive products. A large part of petitioner's business involves the manufacture and sale of cast aluminum road wheels to [car manufacturers]. The sales of wheels to [car manufacturers] are not subject to sales tax because [car manufacturers] purchase these wheels for resale.

In order for the Company to produce wheels for [car manufacturers], certain molds and support tooling are required. Therefore, prior to the initiation of wheel production, petitioner receives a purchase order from [car manufacturers] to produce all necessary tooling to support the volume of wheels which the Company is expected to produce. Although the tooling remains at all times at the Company's manufacturing facility, title to the tooling is transferred to [car manufacturers] prior to initiation of production. Because these tooling sales are not made for resale and the tooling is used exclusively in California, such sales are subject to sales tax. Petitioner recognizes this tax liability.

The issue in this appeal concerns the amounts petitioner charges [car manufacturers] for validation testing. Petitioner contends that the testing is done to prove the design intent of each individual wheel style and thus the testing is done on the wheels. Since the wheels are sold for resale, no tax is due on these charges.

The audit staff contends that the testing is done to validate the molds. The validation charges are always on tooling invoices and purchase orders. The staff presumes that [car manufacturers] will not take title to the molds until [car manufacturers] is satisfied that the molds produce unblemished wheels. Therefore, the staff contends that the validation testing is a service that is part of the sale of the molds and is taxable.

Petitioner has submitted a copy of [car manufacturers]'s engineering specification for the validation testing. The specification is for the cast aluminum wheel. The specification provides that "[t]he engineering tests, sample sizes, and test frequencies contained within the engineering specification reflect the minimum requirements established to provide a regular evaluation of conformance to design intent."

There are three test phases: (1) Production Validation; (2) In-Process Tests Phase 1; (3) In-Process Tests Phase 2. The first phase calls for tests to be completed with parts from production tooling. The second phase calls for tests to demonstrate manufacturing process capability and must be completed using production tooling and manufacturing processes. The third phase consists of tests completed with production parts (wheels) on a continuing basis. Sample wheels for these tests are selected on a random basis to represent the entire production population.

Analysis and Conclusions

Sales and Use Tax Regulation 1525(a) provides:

“(a) Tax applies to the sale of tangible personal property to persons who purchase it for the purpose of use in manufacturing, producing or processing tangible personal property and not for the purpose of physically incorporating it into the manufactured article to be sold. Examples of such property are machinery, tools, furniture, office equipment, and chemicals used as catalysts or otherwise to produce a chemical or physical reaction such as the production of heat or the removal of impurities.”

The factual question here is what is being tested? The wheels produced by the molds or the molds that produce the wheels. This question is rather like asking whether the chicken or the egg came first.

While the testing does serve to validate the molds, we believe that the primary purpose is to test the wheels. The engineering specifications which have been submitted outline a comprehensive wheel testing program from pre-production through production. The goal is repeatedly described as providing an evaluation of “design intent” of the wheel. If any requirements of the tests are not met, the result could be changes in tool design, or changes in material composition, or changes in manufacturing process. Thus the mold is incidentally being tested, along with the manufacturing process and the material composition, but the ultimate goal of the testing is to validate the wheel.

This conclusion is supported by the fact that the wheel validation tests which petitioner performs for [car manufacturers 1] are not required by [car manufacturers 2] even though the tooling for each is the same. This fact indicates that the validation tests are not required for the tooling itself.

S--- I---
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-4-

August 5, 1993
295.0728

Recommendation

Cancel the \$409,170 measure of tax attributable to wheel validation testing. Otherwise, redetermine in accordance with the revised audit dated December 3, 1990.

MICHELE F. HICKS, STAFF COUNSEL

8/5/93

DATE