

**M e m o r a n d u m****295.1380**

To: San Francisco – Tax Administrator (OSS:REP)

June 26, 1953

From: Headquarters – Sales Tax Counsel (WWM)

Subject: W--- P--- R--- Company  
XXX --- Street  
--- ---, California

SS – XX XXXXXX

Please refer to your memorandum of August 26, 1952. You inquire whether the sales tax should apply to the following transactions.

In the first, the taxpayer makes necessary repairs to foreign line cars in order to maintain them in proper operating condition. These are foreign line cars used by W--- P--- as the operating line. The W--- P--- is apparently a bailee for hire or lessee of these foreign line cars. Charges to the foreign lines for labor and material for these repairs are taken from schedules of prices prepared by the Association of American Railroads and are identical with similar charges made by the foreign lines in repairing W--- P--- cars. Taxpayer is purchasing the parts used on a tax-paid basis. However, the A. A. R. scheduled prices involve an element of markup for purchasing and handling expenses. You inquire whether this markup should be subject to the tax.

In our opinion, the tax should apply to the element of markup since it is part of the price charged the foreign line. We believe that Mr. T. H. Mugford's letter of December 22, 1942 to Mr. H--- H. M---, Attorney for Southern Pacific, in which Mr. Mugford expressed the view that the tax should not apply to the markup, was based on the fact that, in most instances, there was no such markup, and on the fact that at that time, the price charged the foreign lines on an overall total average was not equal to the cost of the parts purchased by S--- P---. Apparently, this situation has been changed, or you would not have made the inquiry. If the situation has changed, Mr. Mugford's letter is not, of course, controlling. If, however, the facts are the same as those upon which his letter was based, we see no reason to adopt a different view now. The fact that W--- P--- has possession of the cars after repairing the same, would not, of course, affect the application of the tax since the cars are owned by the foreign line, W--- P--- merely having the right to possess them.

The second item involves sales by the W--- P--- R--- Company to what is apparently a partnership or joint venture consisting of W--- P--- R--- Company; The C---, B--- and Q--- R--- Company; and the D--- and R--- G--- W--- R--- Company, dba the C--- Z--- Trains (Permit No. --- - XXXXX). The Z--- Trains, all individually owned by the companies involved in the joint venture, are serviced at W--- P---'s --- terminal. The charge for the servicing is billed to the joint venture companies on the basis of track mileage owned by the three companies, approximately 41% to C.B.&Q., 37% to W.P., and 22% to D.&R.G.W. As we understand it, the same percentage charge is made irrespective of whose car is serviced.

In connection with the servicing operations, supplies furnished to the units of the Z--- Trains include such items as Dixie cups, brushes, seat covers, etc. The total charge for such items to the joint venture includes the tax-paid cost, foreign line freight, plus handling charges.

It is our opinion that the tax should again apply to the markup. In accordance with Section A-2-(b) of Ruling 55 we feel that the fact that the supplies will not be immediately consumed at the time of installation does not alter the application of the tax. In reaching our conclusion that the tax should apply to the markup we assume that Z--- actually constitutes a separate entity (a bona fide joint venture) for sales tax purposes. This assumption seems warranted by the reference in the preamble of the Agreement between the three lines to the "3 partnership lines", to "any one partner line", and to "all three partners". In the next paragraph reference is made to the "3 partner railroads". Based on that assumption, there is a sale from one entity to another and accordingly, the tax should apply to the markup. Furthermore, the tax should apply to the entire markup irrespective of the fact that approximately 37% of the markup is paid by W--- P---, and the tax would apply even where the supply is furnished for a W--- P--- car.

If the Z--- is not a bona fide separate entity but merely a jointly owned railroad operated by the separate entities in their individual capacities, the application of the tax, measure of tax, and other related problems are extremely complicated. Accordingly, if you have some doubts in this connection, we would appreciate your further comments together with any other factual information you may wish to present. We have examined the file of the the C--- Z--- Trains (--- - XXXXX) and it appears to us to be a separate entity for sales tax purposes.

We are sorry that we delayed in answering this.

WWM:ja