

STATE OF CALIFORNIA
BOARD OF EQUALIZATION
APPEALS DIVISION

325.0104
6/14/91

In the Matter of the Petition)
for Redetermination Under the)
Sales and Use Tax Law of:)
)
)
Petitioner)

DECISION AND RECOMMENDATION

The above-referenced matter came on regularly for hearing before Hearing Officer Joyce L. Carrillo on April 16, 1991, in Hollywood, California.

Appearing for Petitioner:

Appearing for the
Sales and Use Tax Department:

Protested Item

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

Item	State, Local and Country
A. Underreported sales of used assets from California plants on actual basis.	\$1,105,040
C. Disallowed sales in interstate And foreign commerce of dye machines At the --- location	143,963

Petitioner's Contentions

1. The sales of assets from its --- plant qualifies as an occasional sale and should not be taxed since petitioner is not in the business of selling equipment or linens but rather linen services. (Item A)
2. A portion of the sale of the --- plant assets included "new case goods inventory" in the sum of \$345,745. This inventory had never been used. Therefore, petitioner should be entitled to a tax-paid purchases resold credit. (Item A)
3. Disallowed out-of-state sales of four new dye machines amounting to \$143,963 should be allowed and treated as exempt. (Item C)

Summary

Petitioner is a corporation doing business primarily as a laundry service to various medical providers, hospitals, clinics, etc. Petitioner has several locations in the state. Petitioner also sells new linens to customers on a convenience basis. During the audit period, petitioner was doing a sufficient amount of sales of new linens to generate an average of \$50 per month in sales tax liability. From time to time, petitioner also sells outdated or old equipment in its various plants either as used equipment or for junk value. However, the bulk of petitioner's gross receipts are generated from the laundry service. Petitioner has had a seller's permit since 1965.

During a routine audit, it was discovered that petitioner had sold the assets and business interests of its --- plant to --- for a sum in excess of \$3 million. The Agreement of Purchase and Sale was dated November 6, 1987, and closed December 3, 1987. As part of the assets valued, the parties agreed that \$800,000 represented the value of "Circulating Linen" and \$150,000 for "carts." The remaining amount included various vehicles, a covenant not to compete and goodwill. No sales tax was reported or paid by petitioner on this sale. The Sales and Use Tax Department (Department) auditor determined the linen and carts sold for a total of \$950,000 constituted tangible personal property, the sale of which was subject to tax. In addition to this sale, various other unreported sales of used assets were discovered and scheduled. (See 12A p.1, R12E p.1 & R12A.) Subsequently, petitioner provided documentation for various sales scheduled that indicated valid sales in interstate commerce. The revised audit indicates these sales were allowed and a total of four sales retained as unreported sales of used assets for a total of \$1,015,040 (Item A) {R12A}.*

* Note: The revised audit also allowed unclaimed tax-paid purchases resold on some items not credited in the original audit. There is no remaining dispute on these items.

In addition, four sales continued to be disallowed as interstate sales because petitioner did not provide the documentation necessary to show delivery by a common carrier to the out-of-state purchaser. These four sales total \$143,963. (Item B)

Petitioner contends that the sale of its --- plant assets to --- is exempt as an occasional sale. Petitioner argues it is in the business of providing linen services and not selling assets and that its sales constituted a liquidation of assets. This is distinguishable from the sales of used equipment it made a few times a year, since those were to update existing and continuing plants. The --- sale is also distinguishable from the sales of linens on a monthly basis since those were convenience sales to customers and were linked to the laundry service.

Petitioner also contends that out of the \$800,000 worth of linens which were part of the - sale \$345,745 were new linens purchased tax-paid. Petitioner contends it should be given a tax-paid purchase resold credit on this amount, and to do otherwise would constitute double taxation. The Department disputes this analysis and argues the linens were purchased and placed in "Standby Service" which constitutes a use and precludes a tax-paid purchase resold credit pursuant to Sales and Use Tax Regulation 1701(c).

Finally, at hearing, petitioner submitted documentation that the four disallowed interstate sales were delivered by common carrier from petitioner's plants directly to the out-of-state purchaser. The purchaser had contracted with --- to rewire the machines, but these repairs were done at petitioner's plants. The common carrier then picked up the machines from petitioner's

plants and shipped them out of state. Petitioner contends these constitute valid sales in interstate commerce and should be allowed.

Analysis and Conclusions

Section 6051 of the Revenue and Taxation (Rev. and Tax.) Code imposes the sales tax on retail sales of tangible personal property in California. The tax is imposed upon every retailer engaged in business in the State. Liability for the tax is not extinguished until the tax is paid or satisfactory proof of exemption is shown. (See generally, Rev. and Tax. Code, sections 6051 et. Seq.; Western L. Co. v. State Board of Equalization (1938) 11 Cal. 2d 156, 164.) The Revenue and Taxation Code further states the general presumption that all gross receipts from the sale of tangible personal property are subject to the tax until the contrary is established. The burden of proving a sale to be exempt from tax is upon the taxpayer. (Rev. and Tax. Code, section 6091; Hall v. Franchise Tax Board (1966) 244 Cal.App.2d. 843; Honeywell Inc. v. State Board of Equalization (1982) 128 Cal.ApP.3d 739, 744.).

Item A:

Petitioner argues its sale of the ---, plant assets are exempt as an occasional sale. Rev. and Tax. Code section 6006.5 defines occasional sale in relevant part as follows:

"6006.5 'Occasional sale.' 'Occasional sale' includes all of the following:

(a) A sale of property not held or used by a seller in the course of activities for which he or she is required to hold a seller's permit or permits if the activities were conducted in this state, provided the sale is not one of a series of sales sufficient in number, scope, and character to constitute an activity for which he or she is required to hold a seller's permit if the activity were conducted in this state."

(Sub-sections (b) and (c) of that statute involve transfers of ownership between essentially the same parties or sales of property by a producer of hay. Neither of these sections are applicable to the facts of this case.)

Petitioner argues that the sale of the --- plant assets is an occasional sale because petitioner is not in the business of selling plant assets but rather selling laundry services. The law does not contemplate that argument. Rev. & Tax. Code Section 6367 exempts an occasional sale only if it meets the definition cited above.

For the sale of the --- plant assets to qualify as an exempt occasional sale, the property sold would have to be property not held or used by petitioner in its activities for which it is required to hold a seller's permit.

Sales and Use Tax Regulation 1595 (Regulation) provides some assistance in defining what activities require a seller's permit as follows:

"(a) (1)... Generally, a person who makes three or more sales for substantial amounts in a period of 12 months is required to hold a seller's permit. A person who makes a substantial number of sales for relatively small amounts is also required to hold a seller's permit."

Petitioner meets both definitions. The four sales giving rise to the measure of tax are substantial and occurred over a twelve month period. These sales were part of the on-going sales of used or obsolete equipment petitioner had engaged in over various years.* Additionally, the small but frequent sales of linens to customers giving rise to an average of \$50 per month in tax liability required petitioner to have a seller's permit. The fact that the sale to --- essentially liquidated the business in --- is irrelevant. (Sutter Packing Co. v. State Board of Equalization (1956) 139 Cal.App.2d 889; Hotel Del Coronado Corp. v. State Board of Equalization (1971) 15 Cal.App.3d 612). Also, even if petitioner had not engaged in any activities for which a seller's permit was required, the four sales in question were sufficient in number, scope, and character to require the holding of a seller's permit. (See U.S. Industries. Inc. v. State Board of Equalization (1962) 198 Cal.App.2d 775.)

* Note: It is interesting to note that petitioner's application for seller's permit and registration as a retailer dated ---, describes the principal taxable sales as "used equipment."

Petitioner argues its principal business was selling linen services and not selling assets. "It is not required that the principal business activity of the taxpayer shall involve making retail sales of tangible personal property, if, in fact, the retail sales of tangible personal property made by the taxpayer are sufficient in number scope and character to make the taxpayer a retailer under the provisions of the Revenue and Taxation Code." Hotel Del Coronado Corp. v. State Business of Equalization (supra) at 619-620, and cases cited therein.

Clearly both the sales of used equipment and the "convenience" sales of linens to petitioner's customers were sufficient in number, scope, and character to require a seller's permit. This precludes petitioner's four sales giving rise to the measure of tax from qualifying for the occasional sale exemption.

Petitioner further contends that part of the sale of linens to --- for \$800,000 included \$345,745 worth of linens that had been purchased tax-paid and never used. Petitioner argues that since no use had been made of the linens prior to sale, it should be allowed a tax-paid purchases resold credit. Regulation 1701(a). That Regulation reads in relevant part:

"PARTICULAR APPLICATION. 'STANDBY SERVICE..'

Property purchased 'tax-paid' by a retailer and placed in 'Standby Service,' located at the place of intended use and committed to that use, is considered used sufficiently to preclude a tax-paid purchase deduction when sold, even though never physically used there and ultimately removed and sold."

We note it appears that tax-paid purchases resold credit (*deduction) pursuant to Regulation 1701(a) was allowed for the "convenience" sales of linens to petitioner's customers. It is unclear from the audit workpapers why this was done. However, in regard to the new linens sold as part of the sale of assets to --- these were clearly in "Standby Service" and precluded from the allowance. The linens were located at the plant, in inventory and committed to use in the laundry service. Pursuant to Regulation 1701(c), this constitutes sufficient use to preclude the tax-paid purchases resold credit (*deduction).

Item C: During the original audit, many sales of used equipment to out-of- state purchasers were questioned and scheduled. (Schedule 12B). Apparently, petitioner provided sufficient documentation on many of these sales to carry its burden of proving valid sales in interstate commerce; and these were allowed by the Department. However, the Department contends that the sales to on November 23, 1988 and October 31, 1988 (RI2B) are not valid sales in interstate commerce because the equipment was shipped to --- agent, ---, in California and therefore, delivery took place in this state. Testimony at hearing indicated that --- did some re-wiring on the equipment and then shipped the equipment to out-of-state locations. At hearing, petitioner testified that --- was contracted by the purchaser to perform the re-wiring services and that the work was done on petitioner's premises. Documentation was submitted to show shipment from petitioner's locations by common carrier directly out of state.

Regulation 1620(a) governs the applicability of tax to sales in interstate commerce. That regulation reads in relevant part as follows:

"(3) SALES PRECEDING MOVEMENT OF GOODS FROM WITHIN STATE TO POINTS OUTSIDE STATE.

(A) **To Other States--When Sales Tax Applies.** Except as otherwise provided in (B) below, sales tax applies when the property is delivered to the purchaser or the purchaser's representative in this state, whether or not the disclosed or undisclosed intention of the purchaser is to transport the property to a point outside" this state, and whether or not the property is actually so transported...

* * *

(B) **Shipments outside the State--When Tax Does Not Apply.** Sales tax does not apply when the property pursuant to the contract of sale, is required to be shipped and is shipped to a point outside this state by the retailer, by means of:

1. Facilities operated by the retailer, or
2. Delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point."

Petitioner submitted three sets of documents. One concerned a shipment that took place on March 28, 1989. This is not relevant to the sales at issue since the sales occurred on October 31 and November 23, 1988.

Another set of documents dated October 6, 1988, while some days earlier than the October 31, 1988, sale at issue appears to be the same piece of Machinery, i.e., --- for \$38,963 (Schedule 12B-2a p.2). Those documents indicate a pickup by a common carrier. ---, from petitioner's plant on --- California. (See Exhibit A)

The third set of documents correspond to the November 23, 1988, sale of three ---, The documents indicate pick up in three different plants owned by petitioner by a common carrier to three different out-of-state locations (see Exhibit B). Each machine was sold for \$35,000 for a total of \$105,000.

It is clear from the documentation provided by petitioner that the used equipment sales disallowed by the Department were shipped directly from petitioner's locations to out-of-state locations by common carrier. Thus, 'petitioner has satisfactorily rebutted the Department's basis for disallowance. i.e., that the purchaser shipped the machines to --- for repair, who then, as --- agent, shipped them out of state.

As stated above, the burden of proving the exemption is on the taxpayer. While petitioner has satisfactorily rebutted the basis the Department denied the exemption; it still has not met its burden in proving it is entitled to the exemption. As mentioned above, --- purchaser of the machines, contracted with --- to perform rewiring services on the machines prior to shipment out of state. Once --- entered petitioner's premises for the purpose of performing this work, it took delivery of the machines as an agent for --- and tax applies. Delivery was completed as evidenced by the use made of the machines by virtue of the rewiring services performed.

Rev. and Tax. Code section 6009 defines "use" in relevant part as follows:

"'Use' includes the exercise of any right or power over tangible personal property incident to the ownership of the property..."

An exception to this definition is contained in Rev. and Tax. Code section 6009.1 which states:

"'Storage' and 'use' do not include the keeping, retaining or exercising any right or power over tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside the state..."

The rewiring done by --- was not for the purpose of transporting the machines out of state and, thus, this exception does not apply. Apparently the purpose of the work done on the machines was to change the electrical "... from 120 to 220..." (testimony at hearing). This constitutes the exercise of right or power over the machines which was incident to ownership.* Petitioner is therefore not entitled to claim these sales as exempt sales in interstate commerce. Statutes granting exemption from tax must be reasonably but strictly construed against the taxpayer (Fellowship of Humanity v. County of Alameda (1945) 153 Cal.App.2d 673).

*it is interesting to note that the shipping documents indicate the shipper is --- further evidencing --- control over the property as --- agent.

Recommendation

Redetermine without adjustment.

Joyce L. Carrillo, Hearing Officer

May 24, 1991
Date

(W/Exhibits A and B)