

**M e m o r a n d u m****325.0612**

To: Mr. Howard Frohlich  
San Mateo Auditing

Date: January 26, 1987

From: David H. Levine  
Tax Counsel

Subject: I--- A--- S--- I---  
S- -- XX-XXXXXX

This is in response to your memorandum dated November 25, 1986. You set forth two sales of aircraft parts and ask if either is subject to sales tax.

I. X--- purchased a jet engine from I--- A--- S--- I--- ("I---"). A sales invoice dated January 3, 1984 and issued by I--- provides the following information: the order date was December 19, 1983; the engine was shipped FOB to [city], California on January 3, 1984 by C--- D---; the engine was to be shipped by X--- to [city], Germany on airfreight waybill #220-83431725; "payment due upon completion of test cell acceptance"; and payment of \$625,000 was to be made by bank to bank transfer (which was done on January 13, 1984).

A purchase order dated January 6, 1984 indicates FOB [city] for shipment by X--- to [city], Germany and states:

"Engine unused and in same condition since previously received from X---. Acceptance of engine after inspection and test cell run in accordance to the PWA overhaul manual at X--- [city]. In case test run negative X--- will pay for transportation cost back to owner. Payment terms: cash after successful inspection and test run."

**DISCUSSION**

I--- contends that the sale occurred in Germany after the tests performed by X---. We disagree. For purposes of the Sales and Use Tax Law, a sale is any transfer of title or possession, conditional or otherwise, for a consideration. (Rev. & Tax. Code § 6006(a).) The consideration I--- received for the transfer of possession was X---'s obligation to test the engine and pay I--- \$625,000 if the engine conformed to the contract. The only condition to that transfer was that X--- pay the sale price or return the engine if it did not conform to the contract. Therefore, I--- sold the engine in [city], California when it transferred possession to X---.

The provisions of the Uniform Commercial Code as adopted by California are consistent with this conclusion. Under Commercial Code section 2401(2), the contract of sale was consummated when I--- completed its performance with reference to the physical delivery of the engine at the FOB site, [city]. The purchase order and sales invoice do not provide for passage of title, but even if they did, a retention of title by I--- would be limited in effect to a security interest. (Comm. Code § 2401(1).)

For purposes of discussion, I note that a contract that could be confused with the one here is known as a “sale on approval.” If I---’s contract with X--- were a sale on approval, the sale might not be subject to tax depending on where the sale is determined to have occurred. However, I---’s contract with X--- is not a sale on approval.

Commercial Code section 2326 specifically states that “if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is [a] ‘sale on approval’ if the goods are delivered primarily for use...” (Emphasis added.) The contract here does not permit X--- to return the engine regardless of its conformance to the contract. Rather, a fair reading of the sales invoice and the purchase order discloses a good faith duty by X--- to test the engine and pay the sales price if the engine conforms to the contract. This is not a sale on approval.

Since the sale occurred in California, it is subject to sales tax unless it satisfies the requirements of Revenue and Taxation Code section 6385 as they existed at the time of the sale (all references to section 6385 are to that section as it existed on January 3, 1984). (Rev. & Tax. Code § 6051; regulation 1621.)

I assume that X--- is a foreign air carrier as that term was defined in Section 1301 of Title 49 of the United States Code on January 1, 1980. Based on this assumption, subdivision (b) of section 6385 sets forth the applicable exemption. (Regulation 1621(b)(2), (d)(2), and Certificate D.) “To qualify for this exemption, [X---] shall [have] timely furnish[ed] to [I---] a certificate in writing that the [engine] shall be transported and used in the manner described in this subdivision. Such certificate shall be substantially in the form prescribed by the board. Acceptance in good faith of such a certificate shall relieve [I---] from liability for the sales tax. [X---] shall maintain records in this state, such as a copy of a bill of lading, an air waybill or cargo manifest, documenting its transportation of the [engine] to a foreign destination.” (Rev. & Tax. Code § 6385(b).)

The requirements to qualify for the Section 6385 exemption are mandatory. If they are not satisfied the exemption does not apply. I--- must produce a certificate in substantially the same form as Certificate D of Regulation 1621 accepted in good faith and received before I--- billed X---, or within the I---’s normal billing and payment cycle, or no later than delivery of the engine to X---. (Reg. 1621(d)(2) and (e)(2).) If I--- received the required certificate within these time limits, it is relieved from liability for the sales tax. (X--- must, of course, have the required records in this state.) If not, I--- should be assessed the sales tax.

II. You ask whether the following transactions are subject to sales tax:

“I--- has claimed numerous sales to domestic air carriers as exempt. The merchandise, generally engine parts, was shipped to California aircraft maintenance shops (J--- at SFO and K--- in San Diego) where the parts were installed on the out-of-state airline engines. The engines were then shipped out-of-state.”

DISCUSSION

These facts do not bring the transactions within the interstate shipment exemption of Revenue and Taxation Code section 6396. The invoices you provided us as Exhibit C show that the out-of-state purchasers directed I--- to ship the parts to facilities within this state. The sale occurred when I--- completed its performance with reference to the physical delivery of the parts to the buyer’s representatives in California. (Comm. Code § 2401(2), Rev. & Tax. Code § 6006(a).) Sales tax applies, unless otherwise exempted, despite the sale having preceded the parts’ movement to a point outside this state. (Reg. 16209(a)(1).) Further, the tax applies even though, with better planning, the parties may have been able to structure the transaction in a manner that would have avoided taxation.

I--- also cannot prevail with an argument that the sale qualifies for the Section 6385 exemption, even if it otherwise satisfied the timely bill of lading and certificate requirements. (See Reg. 1621.) Installation of the parts sold by I--- is a use in this state and defeats a claim of Section 6385(a) exemption. (Reg. 1621(b)(1)(C); BTLG Anno. 570.1320 (10/15/69).) That is, “for the exemption to apply, the role of the purchaser-carrier inside the state must be limited solely to its capacity as a common carrier transporting the purchased property.” (Southern Pacific Equip. Co. v. State Bd. of Equalization (1971) 16 C.A.3d 302, 307.) The purchasers’ representatives in this state, the repair shops, did not act solely in this capacity. Therefore, tax should be assessed on I---’s sales structured as those represented by Exhibit C.

DHL:ss