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June 19, 1995

BURTON W. OLIVER
Executive Director

Mr. J--- A. H---
Corporate Tax Manager
H--- - P--- Company
XXXX --- Street, MS XX--
--- ---, CA XXXXX

Re: SY -- XX-XXXXXX

Dear Mr. H---:

This is in response to your letter dated March 21, 1995, in which you requested tax advice regarding components manufactured or sold by California companies which are acquired by an out-of-state H--- - P--- factory for use outside of the state.

You describe the transaction as follows:

"Vendor A and vendor B are both located in California. An H--- factory located outside of California places a separate purchase order with each of these vendors. Each purchase order requires the vendor to ship the property to H--- located outside of California. H--- will furnish the common carrier for each out of state shipment.

"Vendor A's product must be used with Vendor B's product. Vendor B's product must be integrated and tested with Vendor A's product at Vendor B's site. Vendor A, being required to ship the property to H--- outside California is also required to ship the property to Vendor B with final shipment to follow after Vendor B has completed its integration and testing.

"Upon completion of Vendor B's work, Vendor A will go to Vendor B's site and prepare Vendor A's product for shipment. Vendor A's product requires special packaging and handling which Vendor B does not want to be responsible. The common carrier arranged for A and B but at H---'s expense picks up both vendor's products at Vendor B's site and delivers the property outside California. There will be two separate shipments with separate shipping documents, however both shipments may go out on the same truck at the same time."

You state that the shipping terms are F.O.B. origin with title to pass to H--- upon delivery of the property to the common carrier. A final 10 percent payment will be made to Vendor A upon final acceptance at H---'s site outside of California. It is your position that Vendor A's sale qualifies as an exempt interstate sale despite the fact that it was first delivered in California to Vendor B.

Retail sales of tangible personal property in California are subject to sales tax, measured by gross receipts, unless specifically exempted by statute. (Rev. & Tax. Code § 6051.) Revenue and Taxation Code section 6396, provides an exemption for sales in interstate commerce. This exemption is explained in subdivision (a)(3)(B) of Sales and Use Tax Regulation 1620 (copy enclosed):

"Shipments Outside the State--When Sales Tax Does Not Apply. Sales tax does not apply when the property pursuant to a 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. As used herein the term `carrier' means a person or firm regularly engaged in the business of transporting for compensation tangible personal property owned by other persons, and includes both common and contract carriers. The term 'forwarding agent' means a person or firm regularly engaged in the business of preparing property for shipment or arranging for its shipment. An individual or firm not otherwise so engaged does not become a `carrier' or `forwarding agent' within the meaning of this regulation simply by being designated by a purchaser to receive and ship goods to a point outside this state."

Regulation 1620(a)(3)(A) provides the caveat that regardless of the intent to deliver the property outside of this state "tax will apply if the property is diverted in transit to the purchaser or his representative in this state or for any other reason is not delivered outside this state."

As explained in your letter the goods are required to be shipped to a point outside of California by a common carrier. The question here is whether the delivery of Vendor A's product to Vendor B's premises constitutes a delivery to H--- or H---'s representative within this state. California Business Taxes Law Guide (BTLG) Annotation 325.0920 (11/16/64) provides:

"Inspection by Purchaser. If the contract of sale requires the seller to ship the goods sold to an out-of-state point and in fulfillment of the contract the seller, in fact, so ships the property, a prior temporary transfer of possession to the buyer for visual inspection or testing will not deprive the seller of the interstate commerce exemption, provided the property is returned to the seller for out-of-state shipment in accordance with the contract of sale."

If the transferred possession to Vendor B is a temporary transfer for the limited purpose of visual inspection or testing, then it appears that the interstate exemption may apply. However, you state: "Vendor A's product must be used with Vendor B's product. Vendor B's product must be integrated and tested with Vendor A's product at Vendor B's site." This statement connotes that more than "visual inspection or testing" will occur at Vendor B's premises. If more than testing occurs at Vendor B's premises then the nature of H---'s possession is more than the limited and temporary possession contemplated by the annotation. Rather, H--- would be regarded as taking delivery of Vendor A's product in California and sales tax would apply. This is explained in BTLG Annotation 570.0410 (8/23/93) which provides:

"Testing and Training. Machinery is purchased from a California retailer or an out-of-state vendor, delivered to a California location, and set up alongside a counterpart for:

- "1. Testing to insure it performs as required.
- "2. Training key employees from the out-of-state facility.
- "3. `Burning-in.'

"Upon completion of these functions, the machinery will be shipped to the out-of-state facility. If the machinery is purchased from California vendors, delivered in this state, and later shipped out-of-state, the transaction is subject to sales tax."

From the limited facts you have provided it appears that the use of Vendor A's product at Vendor B's California facilities constitutes more than just a test for product defects. If this is the case, the sales tax exemption for purchases in interstate commerce will not apply.

Mr. J--- A. H---

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August 2, 2006
325.1075

If you have any further questions please feel free to write again.

Sincerely

Patricia Hart Jorgensen
Senior Staff Counsel

PHJ:cl

Enclosure

cc: --- --- District Administrator