

M e m o r a n d u m**420.0686**

To: Mr. Mike Hilbert
Audit Review and Refunds

Date: June 24, 1991

From: Elizabeth Abreu
Tax Counsel

ATTS 454-8208
916-324-8208

Subject: X-----

By memorandum dated May 9, 1991, you requested our advice concerning the claim for refund X----- filed for sales tax paid on its sales of X-ray film to X----- . The basis of the claim is that X-----'s sales to X----- are sales for resales.

X----- is a service company which performs non-destructive resting for customers who are manufacturers of parts and components that are subsequently sold by the customers to other companies, primarily companies in the aerospace industry. In each contract with X----- the customer specifies the type of testing to be performed.

Some testing contracts require X----- to X-ray parts and components to detect defects and to insure that the parts and components meet X-----'s customer's specifications. X-----'s own employees examine the exposed film to determine if there are any defects in the items tested. The controller of X----- asserts that after testing is completed, the exposed x-ray film becomes the property of the customer. All of X-----'s customers except X----- receive the film with the tested parts and components. X----- retains X-----'s X-rays at its request but alleges that X----- is the owner of the X-rays. X-----'s contracts do not include a specific provision for the sale or passage of title of the X-ray film to its customers. Nor do the contracts separately state the charges for the X-ray film. X----- contends that its charges for the X-rays are included in the testing charges and that each contract has an implied agreement that title passes to the customer.

X----- purchases the unexposed X-ray film from X----- . On March 23, 1990 it issued a resale certificate to X----- for chemicals and X-ray film. X----- states that the exposed x-ray film is subsequently resold by its customers with the tested parts and components. Therefore, neither its purchases of X-ray film nor its sales of the exposed X-ray film to its customers are taxable because these transactions are sales for resales.

After reviewing the refund file, Regulation 1528(c), Annotations 420.0700 and 420.0720, Glenn Bystrom's letter dated April 5, 1985 concerning X-----, and Hearing Officer Robert Anderson's Decision and Recommendation issued December 5, 1986 in the X----- case X----- and X-----, we conclude that the facts in this case are distinguishable from those in the X----- case and that X-----'s sales of X-ray film to X----- are taxable.

Regulation 1528© provides that producers of X-ray film for purposes such as use for inspection of metals are retailers of the films and that tax applies to the gross receipts from the retail sale thereof. If, however, an X-ray laboratory contracts to furnish an X-ray inspection service, retaining title to and possession of the X-ray produced, charges for the performance of such an inspection service are not subject to tax. Annotation 420.0720 contains a similar provision for radiographs. But neither the regulation nor the annotation addresses the issue of the proper tax treatment where a producer of X-ray film makes a taxable use of the film prior to its sale to the customer.

Only retail sales of tangible personal property are subject to sales and use tax. Rev. & Tax. Code §§ 6051 and 6201. A retail sale occurs when a purchaser who has purchased property for resale makes a taxable use of the property. Rev. & Tax. Code § 6094 and *Safeway Stores v. State Board of Equalization* (1957) 148 Cal.App.2d 299. In his letter to the attorney for X-----, Glenn Bystrom notes that an X-ray laboratory which sold X-rays of its customers' products could not properly accept a resale certificate from the customer if the customer intended to make a taxable use of the X-ray before reselling it.

In the present case, X----- is making a taxable use of the X-ray film it purchases prior to selling the exposed X-ray film to its customers. X----- contracts with its customers to provide a full-blown inspection service, not just to sell X-rays of its customers' products. X----- inspects and tests its customers' products, X-rays them, examines the X-rays for defects in the products, and, we assume, prepares reports for its customers based on the results of its tests and its examination of the exposed X-ray film. X-----'s primary purpose for purchasing the X-ray film is to use the film as a tool for inspecting its customers' products. Transferring the exposed X-ray film to its customers appears to be an afterthought. Its contracts do not even state that the X-rays are to be transferred and sold to its customers and do not contain separate charges for the X-rays.

The facts in X----- made it a close case, but the hearing officer accepted X-----'s explanation that it only took X-rays at its customer's specific request and not for the purpose of inspecting the parts and components X----- was manufacturing. Here, X----- is taking X-rays where requested by a customer as part of X-----'s testing and inspection procedure.

Note also that X-----'s sales of X-ray film to its customers may not be sales for resales. If a customer intends to perform its own examination of the X-ray film to look for defects in its products or to determine if its products meet specifications, the customer is making a taxable use of the film prior to sale. In such cases, X-----'s sales are taxable.

Based on the above, it is our opinion that X-----'s sales of X-ray film are taxable. Therefore, we recommend that the claim for refund be denied. If you have any further questions, please do not hesitate to call me at 324-8208.

Bc: Mr. Donald J. Hennessy