

**STATE BOARD OF EQUALIZATION**

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June 24, 1991

Mr. P--- B---
[X] Corporation
Western Operations
P.O. Box XXXXX
--- ---, California XXXXX-XXXX

Re: Federal Government Contractors
SY -- XX-XXXXXX

Dear Mr. B---:

This is in response to your letter dated May 10, 1991 regarding the application of sales or use tax to your sales to United States government contractors. You ask what documentation is required to support your claim that certain sales are not subject to tax. You also ask: "Should we require the federal government contract number be on the exemption certificate? Would specific exemption verbiage on the purchase order be sufficient? If the purchase order is the only reference, what words are required?"

You have included a copy of a document which you refer to as a resale exemption certificate and which is captioned California Exemption Certificate. In California, only retail sales are subject to sales or use tax, that is, sales which are for any purpose other than resale in the regular course of business prior to any use by the purchaser. (Rev. & Tax. Code §§ 6007, 6051, 6201.) Thus, a sale for resale is not subject to sales or use tax while a retail sale is subject to sales or use tax unless that sale is specifically exempt by statute.

Exemption certificates are discussed in Regulation 1667, a copy of which is enclosed. Resale certificates are discussed in Regulation 1668, a copy of which is also enclosed. Your questions relate entirely to whether or not a sale is a nontaxable sale for resale. The documentation required to establish that a sale is for resale is a resale certificate and not an exemption certificate. Since the example you have provided us relates solely to sales for resale and not to retail sales entitled to an exemption, the caption on the document should be changed to California Resale Certificate.

A retailer's sale of tangible personal property in California is presumed to be at retail and subject to sales or use tax. (Rev. & Tax. Code §§ 6091, 6241.) The retailer may overcome this presumption by accepting a timely and valid resale certificate in good faith. (Reg. 1668(a).) As explained in subdivision (b) of Regulation 1668, there are five essential elements to a valid resale certificate. The certificate you have provided us includes all these elements. Therefore, when that certificate is fully completed, it will be regarded as a valid resale certificate. For purposes of this opinion, I assume that a valid certificate will be accepted by [X] in a timely manner as specified in Regulation 1668. Therefore, the remaining question is whether the certificate is accepted by [X] in good faith.

Obviously, if [X] knows that a purchaser will not resell purchased property prior to using it, then [X] would not be regarded as accepting in good faith any resale certificate for that purchase. The harder question, and the one that appears to be critical here, is whether [X] will be regarded as accepting the certificate in good faith if it has reason to believe that the purchased property will not be resold prior to use. Under such circumstances, [X] may not be regarded as accepting a resale certificate in good faith and should therefore take precautions when it has reason to believe the property it sells will not be resold prior to use.

When [X] sells machines to a [X] dealer, that purchaser is in the business of reselling the property which [X] sells to it. Therefore, unless [X] had specific knowledge that such purchaser was not reselling property purchased from [X], [X] would be regarded as accepting resale certificates from that purchaser in good faith. On the other hand, when [X] sells property to a person who is not in the business of reselling that property, the presumption is that such purchaser is not reselling the property and a resale certificate accepted from that purchaser may be subject to some doubt. I note that in the certificate you have provided us, there is a statement for the purchaser to check if it is purchasing the equipment in order to sell it to a financial intermediary and lease it back. I assume that the reason for this statement is to overcome the presumption mentioned immediately above. Although the regulation does not require such a statement in a resale certificate, it is certainly worthwhile as evidence of the good faith of [X] in accepting the certificate.

In the case of a United States government contractor who does not regularly sell [X] equipment, the same presumption arises that such purchaser is not reselling the property purchased from [X] prior to using it, but rather simply using the property to perform the contract. The circumstances under which such purchaser does resell the property to the United States prior to using it are often that there is a title passage clause in that purchaser's contract with the United States providing that title to certain property purchased by the contractor for use in performing the contract will pass to the United States prior to the contractor's using it. Such a title passage clause would be controlling, and we would regard such property as sold to the United States prior to use. (See Aerospace Corporation v. State Board of Equalization (1990) 218 Cal.App.3d 1300.)

When the contract with the United States has this title passage clause, the contractor would be regarded as making a nontaxable purchase of the property for resale to the United States. Nevertheless, unless [X] has specific knowledge of that contract, the problem remains as to whether [X] may accept a resale certificate in good faith from a person not in the business of reselling the

purchased property. A statement on the resale certificate similar to the one you include for property purchased for resale and lease back would be helpful to resolve the question of good faith. That statement could be something to the effect that the purchaser will be reselling the purchased property to the United States prior to using it pursuant to Government Contract No. ____, which contract provides that title to such property passes to the United States prior to the purchaser's use. Please note that this statement is not required in order to validate the resale certificate but goes only to the question of whether the certificate is accepted by [X] in good faith. A similar signed statement on the purchase order rather than the resale certificate would also help evidence the good faith of [X] in accepting the resale certificate. If [X] does not accept the certificate in good faith, it will have the burden of establishing that the property was actually resold to the United States prior to use.

You also note that some federal contractors state that all their transactions should be tax free since they self assess and pay sales tax directly to the state. As you note, there has been no direct pay authorizations granted this year. Direct pay permits are discussed in Regulation 1699.5, a copy of which is enclosed. As provided in that regulation, the holder of a direct pay permit would issue the seller a direct payment exemption certificate. Obviously, if the purchaser cannot issue you such a certificate, your sale will be regarded as subject to sales or use tax unless [X] establishes the sale is for resale or is an exempt sale. If a purchaser does provide you with such a direct payment exemption certificate, it will include a direct payment permit number. We recommend that you contract us for confirmation that the permit is valid.

Finally, you note that [X] sometimes offers a lease with a buyout at \$0 or a minimal amount. You ask whether these types of lease are actually viewed as sales. As explained in subdivision (a)(2) of Regulation 1660, a copy of which is enclosed, if the lease binds the "lessee" for a fixed term and the "lessee" is to obtain title at the end of the term upon completion of the required payments or has the option to purchase the property for an option price not exceeding \$100 or one percent of the total contract price, whichever is less, that "lease" is regarded as a sale at inception under a security agreement.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:cl
Enclosures